Monday, October 19
9:00 am–10:30 am

1001 Real Estate Due Diligence for Property Acquisitions

Philip Brody
General Counsel
Time Equities, Inc.

Jason P. Maxwell
Corporate Counsel
Hines Advisors

Douglas A. Olson
Principal
The IVI Companies

Charles Tiedemann
Partner
Holland & Knight

Gregory J. Walsh
President
Potomac Capital Advisors

Faculty Biographies

Philip Brody

Philip S. Brody is general counsel of Time Equities, Inc. and also maintains a private law practice focusing on real estate matters. Mr. Brody has been general counsel for Time Equities, Inc. for the past 26 years and has been practicing real estate law for the past 29 years. Mr. Brody is also a vice president of Time Equities Securities LLC, a registered broker dealer, which is a member of the National Association of Securities Dealers.

Mr. Brody is currently the chairman of the Real Estate Acquisition and Finance Subcommittee for the Real Estate Committee of ACC. Mr. Brody was the chairman of the Real Estate Committee and treasurer of the Greater New York Chapter of the ACC. Mr. Brody is also a member of the Real Estate Finance, Coop and Condo, Title and Transfer and Leasing Committees of the New York State Bar Association. Mr. Brody was a member of the Village of Ridgewood, New Jersey Zoning Board of Adjustment and the president of the Parent's Association Advisory Council of George Washington University.

Mr. Brody received his BA from George Washington University, a Masters from Rutgers University and a law degree from Southwestern University School of Law.

Jason P. Maxwell

Jason Maxwell is the corporate counsel for the international real estate firm, Hines, headquartered in Houston, Texas. He is the sole in-house attorney at the firm, and most of his time is devoted to the legal activities of the firm's larger private and public funds: the Hines US Core Office Fund, Hines REIT and Hines Global REIT. Since his arrival at Hines, he has been involved in the acquisition of 28 Class A office and other assets with an aggregate purchase price of approximately $4.8 billion. Hines is a privately owned real estate firm involved in real estate investment, development and property management worldwide, with over 50 years experience in a variety of real estate types.

Prior to joining Hines, Mr. Maxwell was a corporate and securities partner in the Dallas office of Locke Liddell & Sapp LLP (n/k/a Locke Lord Bissell & Liddell), and a member of that firm's national REIT practice.

Mr. Maxwell is a graduate of the Georgetown University Law Center in Washington, DC.

Douglas A. Olson

Douglas Olson is a principal with IVI Companies. Headquartered in White Plains, New York, IVI provides an array of nationwide services to include property condition and environmental site assessments, real estate workouts, construction consulting, cost segregation, zoning compliance and environmental remediation services.

Over his career with the IVI Companies, Mr. Olson has completed over 1,000 property condition and environmental site assessments on all asset classes of real estate. More recently, as a manager with IVI's due-diligence group, Mr. Olson has overseen the production and quality control of thousands of due-diligence assessments on behalf of institutional investors, lenders, legal counsel and developers. Prior to re-locating to New York, Mr. Olson managed IVI's Washington, DC regional office in Bethesda, Maryland.

Mr. Olson holds a BS from the Virginia Military Institute and is a Licensed Professional Engineer.

Charles Tiedemann
Partner
Holland & Knight

Gregory J. Walsh

Gregory J. Walsh is the president and manager of Potomac Capital Advisors, Inc. in Boston, MA. In this capacity he is responsible for the management and operation of this real estate investment, development and consulting firm providing real estate advisory services to third party clients. He is actively involved in the work of the firm and is committed to principal involvement in each of the company's assignments.

Mr. Walsh brings years of real estate and capital markets experience and specializes in development, project management, due diligence and value creation. During his career he has assisted clients with the acquisition, permitting and entitlements, financing and delivery of complex projects and investments in Boston, New York, Chicago and Washington, DC. Prior to forming his own firm, Mr. Walsh was director of real estate at The Massachusetts General Hospital where he was responsible for leasing, lease negotiations and administration, site selection, acquisitions, disposition, permitting, financial analysis, development analysis, utilization analysis, property valuation and tax abatement. Mr. Walsh also worked at Cabot, Cabot & Forbes a national real estate development firm where he was a project manager responsible for the development of Fox Hill Village.

In addition to his direct experience in the areas of investment and development, he has been acknowledged as an expert witness at the Appellate Tax Board of the Commonwealth of Massachusetts where he has provided testimony regarding real estate valuation.

Mr. Walsh holds a BA from Boston College and has taken continuing educational courses at Harvard University.

COURSE MATERIALS FOR DUE DILIGENCE FOR REAL ESTATE ACQUISITION OCTOBER 19, 2009

1) Due Diligence Document to include as an Exhibit to the Contract of Sale
2) Due Diligence Checklist for the Due Diligence Period
3) Form of Tenant Estoppel Certificate to include in the Contract of Sale
4) Acquisition Risk Management; A Due Diligence Guide for Conducting Research and Obtaining Operational Information when Purchasing New Buildings
5) Environmental Site Assessment and Compliance Audits
6) All Appropriate Inquiries in Commercial Real Estate Due Diligence: What Inquiring Minds Need to Know
7) Requirements for Qualification of Innocent Landowner Defense under All Appropriate Inquiries Rule
8) Value Provided to Owners and Lenders by the New 2006 ALTA Policy Forms
9) Understanding Creditors' Rights Title Insurance
10) The ALTA Commercial Endorsements
11) 2005 Minimum Standard Detail Requirements for ALTA/ASCM Land Title Surveys
12) Lender Requirements for Land Surveys
13) Fannie Mae Requirements and Certification for ALTA Surveys

DUE DILIGENCE DOCUMENTS
(to include as an exhibit to the Contract of Sale)

The following items shall be provided by the Seller, to the extent available and in the Seller's or its agent's possession, within _____ business days after the Effective Date for the Contract of Sale:

(a) the last available title policy or commitment for the Property;
(b) copy of the latest available survey of the Property;
(c) copy of the rent roll for the Leases, which includes the name of each of the tenants, suite or store number or location, expiration date, current monthly base rent and additional rent and options to renew;
(d) copies of all leases, accepted offers to lease, subleases or assignments of leases, if any, currently in force, affecting the Property, together with all amendments, guarantees and indemnities, or other documents or agreements relating to, elaborating upon or affecting the rights and obligations of the parties thereunder (the "Leases"); copies of any current written request by a tenant to sublet all or a part of their leased premises or to assign their Lease; copies of any current offers to lease space from prospective tenants;
(e) a copy of a current accounts receivable or arrears report for rent and other payments due under the Leases;
(f) a schedule showing CAM Charges currently payable by each Tenant (to the extent not reflected in the rent roll);
(g) schedule of rent and operating expense recoveries bills for each Tenant for calendar years _____, and _____;
(h) documentation as to reconciliations for CAM charges for calendar year _____;
(i) security deposit schedule for the Tenants which indicates the amount of any such security deposits and those which are held in the form of a letter of credit and expiration date of any such letter of credit;
(j) a list of any current brokerage commissions which remain outstanding as to any of the Leases;
(k) list of any tenant improvements and/or allowances which have not yet been completed and/or paid by Seller;
(l) listing of any pending litigation with the Tenants;
(m) list and copies of any letters received from any of the Tenants requesting a reduction in rent which is not already reflected in amendment to their Lease;
(n) list of any tenants who are subject to any bankruptcy proceedings;
(o) list of any pending disputes as to overpayment of CAM charges;
(p) name, address and telephone number for the contact person for each Tenant;
(q) copies of any existing environmental assessments, tests or surveys relating to the Property;

(r) copies of any engineering and/or physical inspection reports for the Property;
(s) copies of all structural, mechanical, electrical and other plans relating to the construction or renovation of the Property;
(t) a list of any capital improvements completed in calendar years _____, _____ and _____;
(u) a copy of the operating statement for the Property from January 1, _____ to the end of the month immediately prior to the month of the Effective Date, detailing all income and expenses of the Property and copies of operating statements for the Property for calendar years _____ and _____;
(v) real estate tax bills for the last two (2) years;
(w) copies of Certificates of Occupancy for the Property and/or tenant spaces (to the extent applicable);
(x) last twelve (12) months of common utility bills;
(y) copies of any service contracts;
(z) list of any employees, their job descriptions, current salary and fringe benefits as to any employees for the Property;
(aa) copies of insurance certificates for the insurance coverage maintained by the Seller for the Property; and
(bb) contact information for Seller's insurance agent

DUE DILIGENCE CHECK LIST

DUE DILIGENCE EXIRATION DATE: _____

ITEM	DESCRIPTION	RECEIVED	PERSON PERFORMING TASK	COMMENT
1.	Latest available Title Report, including copies of underlying recorded title exceptions (easements, restrictive covenants & encumbrances)			
2.	New title commitment			
3.	Existing survey			
4.	Updated ALTA survey (2005 standards)			
5.	Survey readings as part of title commitment			
6.	Copies of any existing zoning letter or zoning reports			
7.	Subdivision and parcel maps			
8.	Flood plain/seismic zone location			
9.	Schedule of pending litigation, governmental proceedings, notices of legal violations or enforcement actions;- list of any open building applications; search web site of municipality for violations and open applications			
10.	Special assessment districts and assessment amounts			
11.	If an assumption - copy of loan documents and current bill from lender (or its servicer)			
12.	Consent decrees/orders to which seller is a party.			
13.	Current Rent Roll • base rent and additional rent • lease expiration dates • free rent periods • option periods • unpaid tenant improvement allowances			
14.	Historical occupancy rate (by month for the last 3 years)			
15.	Most recent monthly rental delinquency report and Accounts Receivable aging report			
16.	List of any unpaid brokerage commissions and copies of brokerage agreements			
17.	Copies of existing leases (including all amendments and guarantees)			
18.	Copies of existing lease abstracts from Seller			

ITEM	DESCRIPTION	RECEIVED	PERSON PERFORMING TASK	COMMENT
19.	Tenant financials & lease abstracts (if not already completed)			
20.	Tenant credit reports			
21.	Lease guarantor financials/credit reports			
22.	Summary and copies of pending leases and offers to lease			
23.	Tenant estoppel certificates			
24.	Standard form lease utilized by Seller			
25.	Schedule of unpaid or remaining tenant allowances or rebates; Schedule of any tenant improvements to be completed by the Seller			
26.	Tenant escalation billings for current calendar year; Reconciliations for 2008 CAM charges			
27.	Schedule of Security Deposits (including listing of letter of credit security deposits); copies of letter of credits			
28.	Letters from tenants who requested rent reductions			
29.	List of tenants who received rent reductions in 2008 and/or 2009			
30.	Information on any tenants that filed for bankruptcy			
31.	List of tenants who pay percentage rent and list of percentage rent payments made in 2008 and 2009 (including calculations for such payments)			
32.	List of any legal actions against tenants			
33.	Contractor's waiver of liens, permits and approvals for completion of tenant improvement work by within last year			
34.	Pending Tenant audits as to CAM charges			
35.	Lender's opinion of anchor tenants			
36.	Interviews of real estate directors for anchor tenants (If applicable)			
37.	Year-end financial statements, including balance sheets and monthly operating statements (P & L's) for the property for the past 3 years			
38.	Real estate and personal property tax bills, notices of changes in assessment, information regarding tax protests, refunds, and real estate tax appeals etc. for the past 2 years; appraisals for real estate tax reductions (if any)			
39.	Utility bills (electric, water, gas) for prior 12 months			

ITEM	DESCRIPTION	RECEIVED	PERSON PERFORMING TASK	COMMENT
40.	Copy of current year operating budget.			
41.	Copy of current capital improvement budget (next 24 months); list of capital improvements completed during last 3 years			
42.	Maintenance work orders for preceding 24 months			
43.	Copies of contractor, vendor and manufacturer warranties			
44.	Copies of existing construction contracts			
45.	Certificates of occupancy, licenses, operating permits and approvals			
46.	Compliance with ADA requirements			
47.	Copies of as-built drawings and specifications			
48.	Copy of recent appraisal for the Property (if any)			
49.	Copies of bank statements for operating and reserve accounts (for the last 12 months)			
50.	Copy of any equipment or personal property leases			
51.	Personal property inventory (to be included as part of sale)			
52.	Copies of service contracts			
53.	Insurance certificates for current insurance coverage			
54.	Copy of insurance bill			
55.	Contact information for Seller's insurance agent or broker			
56.	List of any pending insurance claims			
57.	Copies of tenant insurance certificates			
58.	Insurance loss reports for most recent 3 years			
59.	Schedule of all employees employed by Seller or the management company, including salary and benefits, tenure, union affiliation.			
60.	Environmental impact reports, studies, including asbestos and lead paint reports			
61.	Updated Environment Assessment			
62.	Copy of existing engineering and physical inspection reports (roofing, HVAC, seismic)			

ITEM	DESCRIPTION	RECEIVED	PERSON PERFORMING TASK	COMMENT
63.	Parking Plan and space count, schedule of assigned parking spaces and storage areas			
64.	Copy of any roof consulting report			
65.	Update for physical inspection report			
66.	Site plans, leasing brochures, maps and photos			
67.	Sales/Lease Comps			
68.	Contact information for Seller's asset manager and/or representative from managing agent			

FORM OF TENANT ESTOPPEL CERTIFICATE

_____, 200___

Re: Lease dated _____
[IF APPLICABLE: as amended by amendment dated _____, 20___] between ...]

consisting of approximately _____ rentable square feet located at _____ (the "Property")

Ladies and Gentlemen:

The undersigned, as tenant, has been advised that a contract of sale has been entered into with respect to the Property and that, in connection with the sale contemplated by such contract, the Lease (as hereinafter defined) has been or will be assigned to the purchaser named therein or its designee or assignee (the "Purchaser"). Tenant has been further advised that the Purchaser may finance its acquisition of the Property. The lender who provides such financing for the acquisition of the Property is herein referred to as the "Lender". As an inducement for the purchase of the Property and the financing that may be provided by the Lender, Tenant hereby certifies to Purchaser and Lender the following:

1. Lease. Attached hereto is a true and complete copy of the lease [IF APPLICABLE: and amendments thereto] referenced above (the "Lease"), which constitutes our entire agreement with respect to the Property. To the extent applicable, attached hereto is a true and complete copy of any Guaranty of the Lease (the "Guaranty"). The Tenant has taken possession of and is in occupancy of the premises demised under the Lease.

2. Full Force and Effect. The Lease is in full force and effect, and to our knowledge, no default on the part of the landlord under the Lease (the "Landlord") exists and, to our knowledge, as of the date hereof, no circumstances or state of facts exist which for any reason would give Tenant the right to terminate the Lease or pursue any other recourse or remedy against Landlord provided under the Lease, at law or in equity.

3. Completion of Improvements. The improvements and space required to be furnished according to the Lease, including any construction required to be made by the Landlord under the Lease, have been satisfactorily completed by the Landlord in all respects, duly delivered by the Landlord and accepted by the Tenant.

4. Base Rent. The base rental currently payable under the Lease is as follows:

Period	Monthly	Annual

Payments of additional rent on account of common area maintenance, real estate taxes and insurance (collectively, "CAM Charges") are currently payable monthly in the amount of $_____. The Tenant's proportionate share for such CAM Charges is ___%.

Except as set forth below, if any, there are no payments due to the Landlord based on Tenant's gross sales at the Property: _____

There has been no advance payment of rent and additional rent payable under the Lease other than for the balance of the month in which this Estoppel Certificate is executed.

5. Security Deposit. The amount of the security deposit and all other deposits paid to Landlord is $_____. {insert if security deposit in held in form of letter of credit]

6. Rent. Base Rent has been paid through _____. CAM Charges have been paid through _____. Tenant is not disputing the computation of any, Base Rent or additional rent for CAM Charges payable pursuant to the Lease.

7. Tenant Setoffs, Claims and/or Defenses. As of the date hereof, the Tenant has no setoffs, claims and/or defenses to the payment of Base Rent and/or CAM Charges under the Lease, the enforcement of the Lease or which otherwise would give rise to any legal action against the Landlord.

8. Free Rent; Landlord Contributions. Landlord has not agreed to grant Tenant any free rent or rent rebate or to make any contribution to the Tenant for tenant improvements. Landlord has not agreed to reimburse Tenant for or to pay Tenant's rent obligation under any other lease.

9. Offsets. Tenant has not advanced any funds for or on behalf of Landlord for which Tenant has a right to deduct from or offset against future rent and additional rent payments.

10. Term Commencement. The lease term commenced on _____. The lease term expires on _____ [IF APPLICABLE: unless extended pursuant to _____ option(s) to renew for _____ years each, _____ of which have been exercised as of the date hereof].

11. Assignments; Subletting. Tenant has not executed or otherwise agreed to any sublease, assignment or other rental occupancy agreement with respect to the Property.

12. Insolvency. Tenant does not have pending against it any insolvency, bankruptcy or other creditor protection actions and has not made an assignment for the benefit of creditors.

13. Disputes and Defaults. To the best of Tenant's knowledge, neither Tenant nor Landlord are in default of any provisions under the Lease and there are not currently any disputes between Landlord and Tenant regarding any payments of Base Rent, CAM Charges or any other amounts. All reconciliations as to CAM Charges for calendar year 200___ and all prior years and any other additional rent during the term of the Lease have been completed and adjusted between Landlord and Tenant.

14. Right to Purchase and Lease. The Tenant has no right to purchase the Property or any part or interest thereof by right of refusal, rights of first offer or option or similar right to purchase. The Tenant has no right to lease other space in the Property.

15. [IF APPLICABLE: Guarantor. The undersigned Guarantor of the Lease hereby confirms and certifies to Purchaser and the Lender that the guaranty of the Lease is in full force and effect and that there are no defenses to and/or offsets against the enforcement of such guaranty of the Lease or any provision of the Lease.]

16. Reliance. This certificate may be relied upon by the Purchaser in connection with its acquisition of the Property and by the Lender in connection with its financing of the Property. This certificate shall inure to the benefit of the Purchaser and the Lender and its respective successors and assigns and shall be binding upon Tenant and Tenant's heirs, personal representatives, successors and assigns.

17. This Certificate has been duly authorized, executed and delivered by the Tenant [insert if applicable – and by the guarantor of the Lease].

Very truly yours,

TENANT:

_____

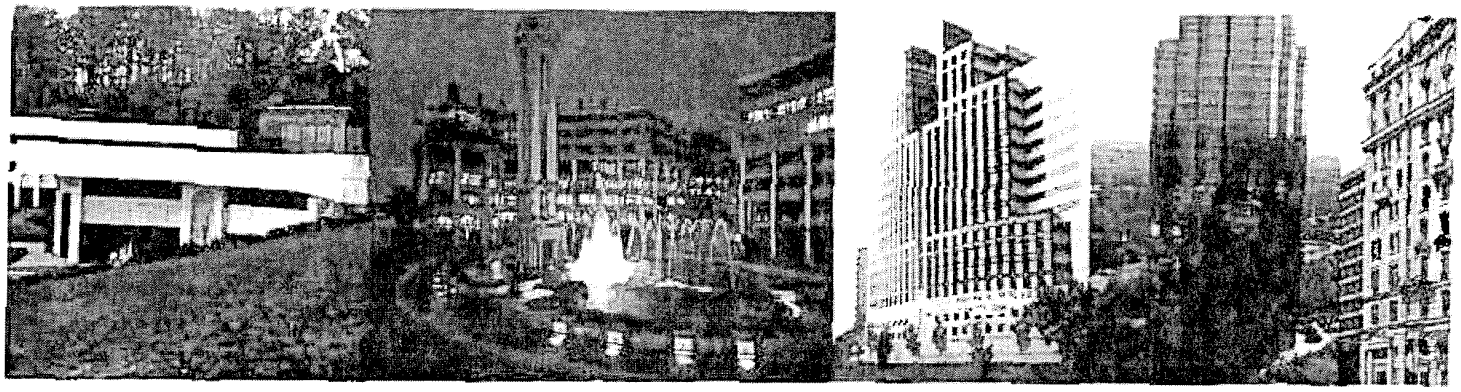
By:_____
Name:_____
Title:_____

GUARANTOR:

_____

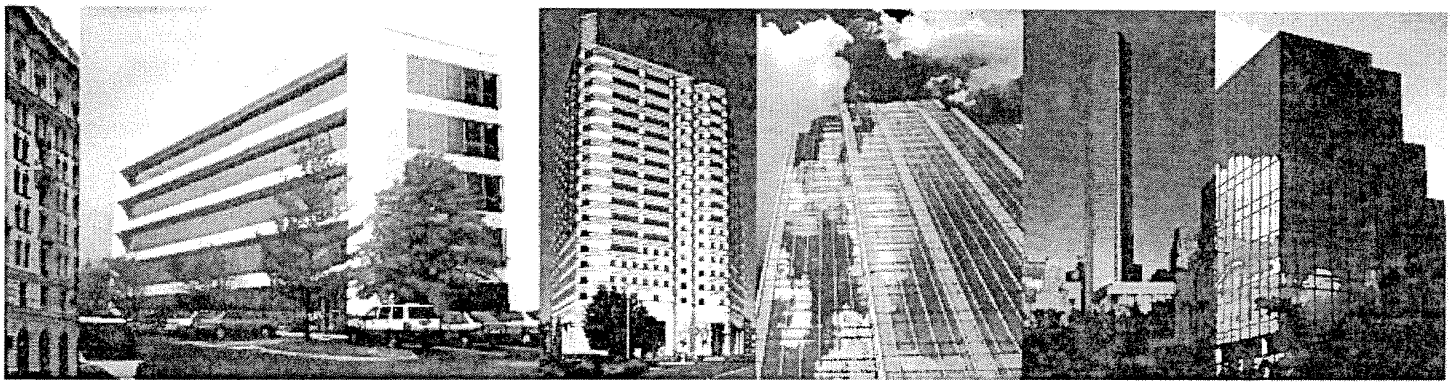
_____

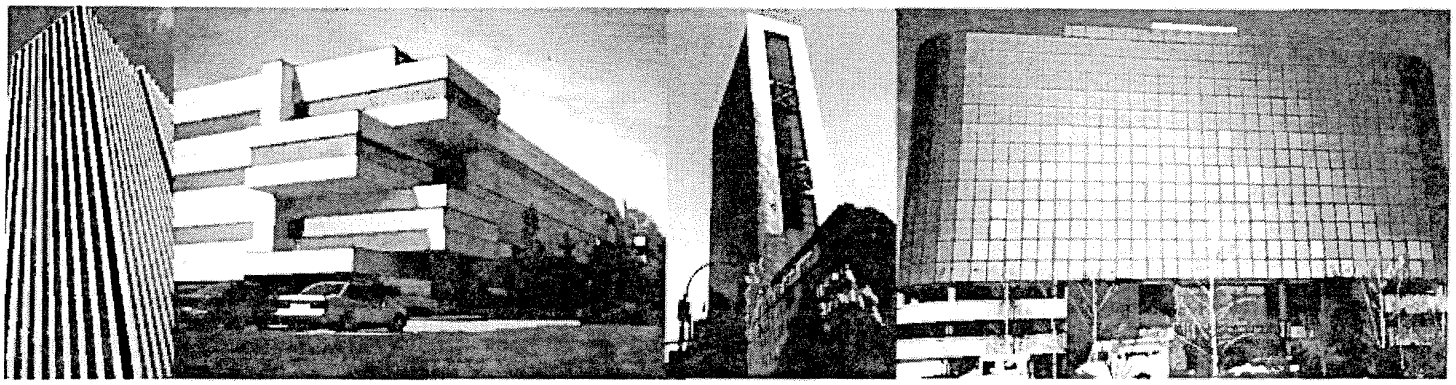
COPY OF LEASE ATTACHED



ACQUISITION RISK MANAGEMENT

A Due Diligence Guide
For Conducting Research and Obtaining Operational Information
When Purchasing New Buildings



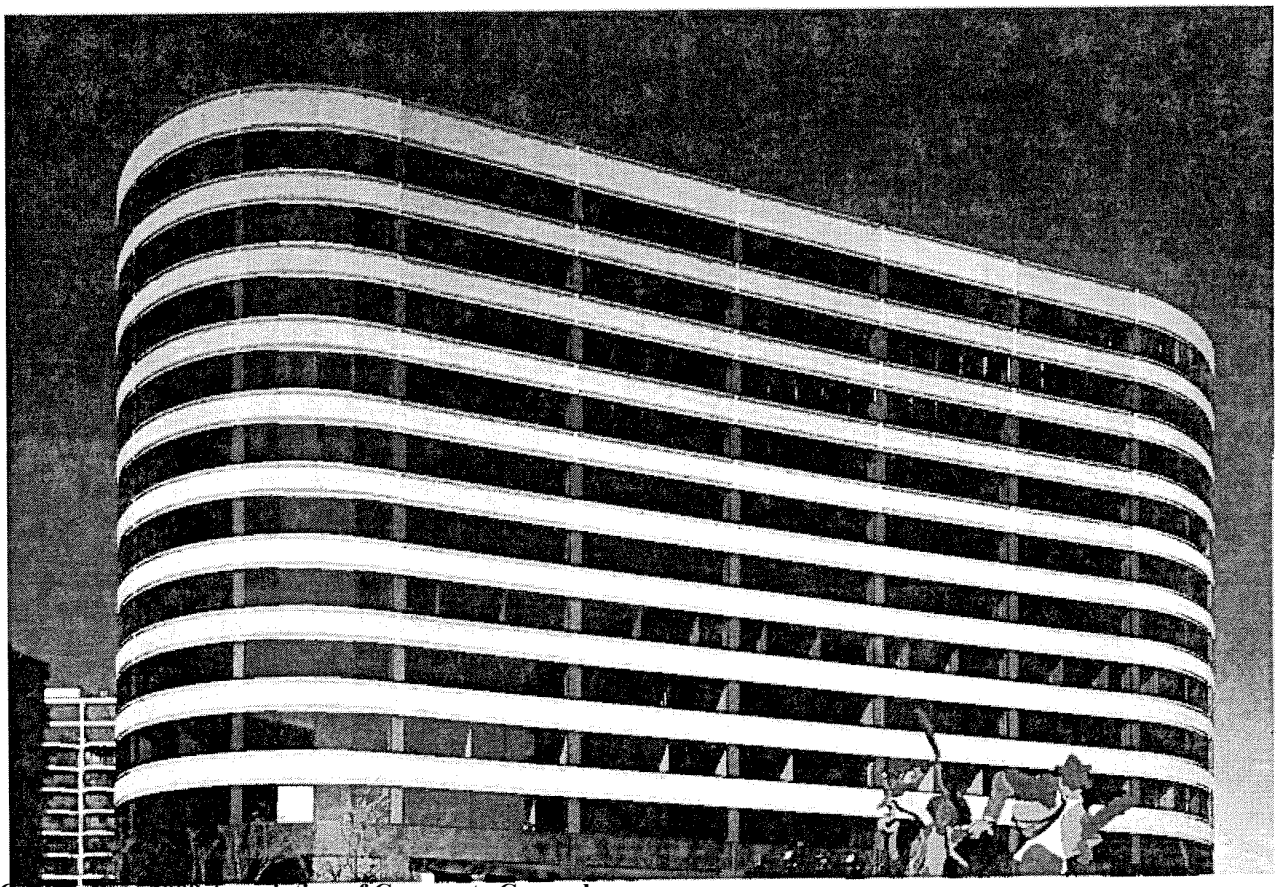


Many buyers think that purchasing a *new* building poses no significant risk with respect to construction defects. This is not the case. Further research should be conducted to augment the property walk-through condition assessment.

New buildings are defined, for purposes of this guide, as either newly constructed, or those that have undergone substantial core, shell, and MEP (mechanical, electrical, and plumbing) system renovation within the past two years. However, most of the due diligence techniques discussed herein apply to all buildings regardless of whether they are new or not.

New buildings usually have not been thoroughly "road-tested" under full-load occupancy. Or, they may not have experienced extended usage or the stress and strain associated with repeated cycles of seasonal climatic changes. They also lack a sufficient period of elapsed time, which typically exposes latent defects that generally become apparent with extended use, operation, settlement, and shrinkage.

Based upon IVI International, Inc.'s experience in conducting thousands of property condition assessments on behalf of purchasers, the following issues warrant consideration by the acquisition due diligence team.



Identify the Project Development Team

Have the seller provide contact information for the designer-of-record, construction manager/general contractor (CM/GC), and owner's rep, if any. This should be followed by interviewing these key construction team members to discuss any pertinent design or construction phase issues. Further research of individual team member experience with the particular asset type, type of construction, and project's scope also provides insight into understanding the team member's strengths and weaknesses with respect to the asset.

Development Strategy and Building Delivery Method

Often, a significant indicator of design and construction quality is the development strategy. Was the building constructed to be flipped upon completion, was it intended to be a long-term hold, or was the building a build-to-suit? Was the building delivery method a design-build, GMP, lump sum, or cost plus? Was there an "arms-length" relationship between the developer and CM/GC — or did the developer construct the building without a third-party CM/GC? Did either the developer or GC self-perform any of the trades and therefore had unfettered control?

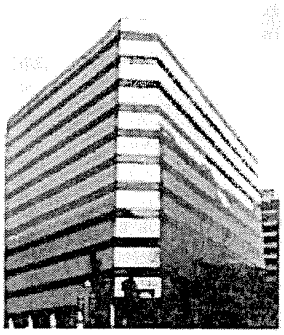
The development strategy may provide insight into the developer's motivation to implement certain value engineering/cost reduction opportunities. For instance, if the strategy was to build "spec" and flip the building, there may have been a tendency to use lower first-cost components, equipment, and systems. This could result in an increase in future operating, maintenance, and capital expenditure costs. If the building was a build-to-suit, consideration needs to be given to possible adaptive re-use should the original tenant no longer occupy the building.

Also, the building delivery method often impacts construction quality and workmanship, with respect to the quality control exercised during the construction, and the propensity of the developer to initiate unilaterally approved changes to the drawings and specifications.

Design Agreements, Construction Agreements, Change Orders, and Waivers of Lien

An effort should be made to obtain copies of the design and construction agreements. The design agreement will define the designer's role, if any, during the construction phase. If the designers provided traditional contract administration services complete with site visits, obtain copies of all site visit reports and progress photos.

Determine if certain traditional design agreements are missing or if designs of certain systems are "carved-out." This may flag vendor-designed systems. Systems that commonly fall into this category include HVAC, control systems, sprinklers, energy management, and smoke and fire alarm systems. If vendor-designed, the design professional responsible should be clearly identified. Often, vendor-designed systems provide substantial leeway with respect to material and equipment selections, execution of details, etc. Sometimes, there is a tendency to incorporate materials and equipment that are readily available but considered "secondary market." Incorporation of such components or systems should be a "red flag" to potential purchasers. Also of concern is the use of proprietary materials, components, and systems that tie an owner to a specific vendor for service contracts, maintenance, and supplies.



Many times, the scope of work depicted in the drawings and specifications will be modified by exclusions, clarifications, or alternatives provided in the construction agreement. The construction agreement will also outline warranty and bonding requirements, which may prove beneficial to a new owner.

As a quality control check, copies of all change orders (adds and deducts) should also be obtained along with evidence that each change order was approved by the appropriate designer-of-record. Also obtain a complete schedule of all accepted value engineering items.

Final waivers of lien should be obtained from the CM/GC and subcontractors to verify that all subcontracts were closed and the vendors paid.

Construction Documents, As-Builts, Shop Drawings, and Submittals

A complete set (prints and files) of the construction drawings, specifications, and informational sketches should be obtained — along with the sealed and certified as-built survey (foundation and site plan) and drawings.

It should be noted whether the as-built drawings were updated by the CM/GC, subcontractor, or appropriate designer-of-record. If updated by the contractors, the drawings should be reviewed by the appropriate designer-of-record and accepted. Further research should divulge whether the as-built drawings were updated as the construction progressed. This is a much better practice than updating the drawings at the end of the project. If updated at that time, often the preparer is relying on memory or notes, and there is a tendency to expedite their completion to simply close-out the project.

Shop drawings and submittals should also be obtained. These documents — more than the construction drawings, specifications, and as-builts — tell the real story regarding the manner in which the building was constructed and what materials were used.

Government Agency Approvals/Development Agreements

It is important to determine whether there were any Zoning Board Approval (ZBA) variances obtained, and whether there are any development or current use restrictions that may have been imposed by the ZBA as a condition to grant the variances. Copies of the approved site plan, the ZBA's written decision, and the variances granted should be obtained.

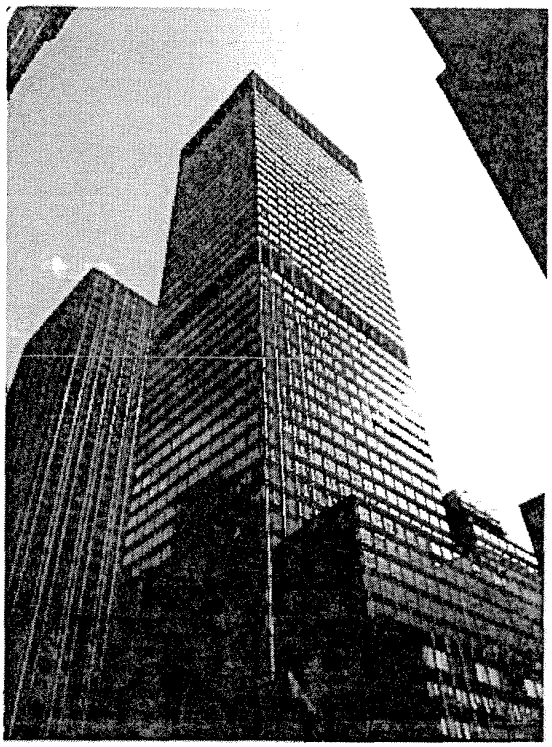
Planning board approvals should also be examined. Restrictions may have been imposed on signage, colors, design, parking, operation hours, use of space, etc. Sometimes there are utility maintenance requirements that run with the property.

With respect to the Certificate of Occupancy, make sure you understand exactly what has been issued for the building. Is it a partial or temporary? Does it expire? Most importantly, is the use (or uses) permitted?

Technical Studies, Construction Inspection, and Testing Reports

Obtain copies of all pre-design technical studies, construction inspections, and testing reports. In lieu of receiving a voluminous amount of documents, a statement from the testing firm attesting to compliance may suffice for certain testing items such as concrete, steel, etc. Additionally, the close-out testing reports for the HVAC system balancing, fire and life-safety testing, and security systems – to name but a few systems – are important documents to review and have on file.

Guarantees and Warranties



All guarantees and warrantees should be provided in a bound and indexed notebook complete with a table of contents. Each section should include the responsible subcontractor or vendor, the guarantee/warranty complete with start and end dates, contact information, and any correspondence regarding giving notice or the exercising by ownership of any warranties or guarantees. Make sure that all specialty and vendor-designed systems are included.

It is important to understand the type of guarantees and warranties presented by the seller. Are they issued by the contractor or the manufacturer/vendor? Is it necessary to have a warranty provided by the manufacturer and another provided by the installing contractor? Are they for labor *and* materials, or for materials *only*? Special attention should be given to the assignability of the warranties upon transfer of the property's title. Many warranties are not automatically assignable to a new owner; some require a transfer fee and/or a re-inspection fee. Sometimes, a manufacturer's re-inspection will note repair work performed by a non-authorized contractor, which would void the warranty.

Performance, Labor and Material Payment, and Maintenance Bonds

Obtain copies of all provided bonds as well as the respective consents of the surety for final release of retainage. Having copies of the bonds and the Consents of Surety may assist in the resolution of claims made by a subcontractor for non-payment and also non-performance of a contractor on any warranty work. Many bonds provide for one to two years of coverage beyond final payment.

Certificates of Completion for Designers-of-Record and Contractors

Obtain Certificates of Substantial Completion and Final Completion from all designers-of-record in the form of AIA Document G704. Receipt of these documents, or the lack thereof, provides insight into the project's quality control and contract administration procedures. The wording of each certificate should divulge the designer's role in quality control, and whether such designer conducted periodic site visits during construction or provided contract administration services. Furthermore, be aware that the date of substantial completion may represent the start date for various warranties and guarantees. For certain trades or systems, warranty or guarantee start dates are not contingent upon substantial completion but on the completion or installation of the system or component.

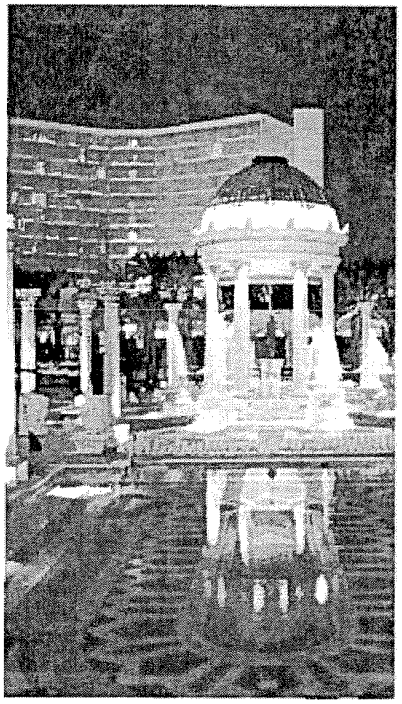
Statements of Acceptance

If the asset has a major tenant, anchor, or hotel operating entity, most probably the design and construction were required to meet certain standards. Such requirements will be detailed in the lease or operating agreement, and they may require the tenant or end-user to provide a certificate of acceptance upon completion of the work. Sometimes, a certificate of acceptance is not always required — and if required, it may not have been provided. It is important to review all such agreements and letters of final acceptance to make sure there are no open issues or landlord requirements that could survive the property's transfer.

Often the municipality may be required to accept developer-constructed improvements, such as roads, traffic signaling, sewage lift stations, etc. Such improvements need to be constructed in compliance with local or state requirements, since the municipality usually assumes the responsibility for maintenance.

There are also many specialized systems where, if possible, it would be advantageous to obtain the manufacturer's written acceptance of the work due to exacting preparation requirements or the requirement of skilled or specially trained installers. Examples of such systems would be coatings and waterproofing systems, EIFS, roofing, fire and security alarms, tennis court and swimming pool coatings, etc.

Start-Up, Preventative Maintenance, Procedure and Protocol Manuals, and Client/Tenant Complaint Logs



Obtain all start-up, preventative maintenance programs, and procedure and protocol manuals for MEP and specialty systems. Such manuals are usually custom prepared for complex projects and systems.

Start-up training is usually provided by the manufacturer or installer for MEP equipment, security systems, etc. If this has not been provided to the seller's maintenance staff, make sure such training will be made available to the new building management staff.

For some systems, the typical manufacturer's manual alone may not suffice. Today, many buildings have computerized preventative maintenance systems and building operation/energy management systems that are not user-friendly. Without a thorough turnover of their operating knowledge, a new building management/engineering staff may resort to entirely bypassing the systems, operating them manually, or not utilizing them to their full capacity.

In addition to obtaining the operation and maintenance manuals, make sure all the basics are completed: all circuit breakers are identified, plumbing shut-off valves are tagged, electrical panels and circuit breakers are identified, pumps labeled, HVAC units identified as to the areas served, spare or the locations of buried conduit are identified, all passwords for specialty systems are provided, the locations and labeling of all telecommunication wiring, all keys are labeled and turned-over, etc.

Interview Building Service Providers and the Building Engineer

Obtain a schedule of all building service providers and copies of their service agreements. Inquire whether or not there are any pending or outstanding repairs, improvements, or code-mandated proposals. Sometimes the original construction subcontract includes a cost-free service period. If a building system is still within the warranty period, a separate agreement may not exist. This is common with conveying systems.

The schedule should be complete with contact names and information for the individual's office, cell phone, and pager. The acquisition team should phone-interview each company. More often than not, service firms are usually able to provide the repair history and identify chronic defects or problematic systems. Such problems may also be flagged in the service firm's invoicing records, which should also be examined.

Another important due diligence step is to take time to thoroughly interview and document the knowledge possessed by the "Building Engineer." Sometimes, such individuals were involved in the original construction and have a specialized knowledge regarding the building's systems, problem areas during the construction, where everything is located and buried, and the building's quirks.

A purchaser should obtain the tenant, client, or guest complaint logs. Such logs may readily identify latent or chronic problems.

Attic Stock

Many building specifications contain the provision for providing "attic stock," which are extra supplies or replacement components to be provided for certain building systems. Attic stock is usually provided where a replacement or repair is required of a component or system that is critical, difficult to obtain, requires long lead time in ordering, or where the match to the original system is difficult to realize with respect to aesthetics or a particular use.

For example, attic stock usually consists of one or two panes of each type and size of glass panel, suspended ceiling tiles, wood flooring, marble or ceramic tile, paint, EIFS coatings, VAV or PTAC units, etc. It is important to have ownership provide an inventory of the attic stock and verify the quantity, condition, identification, and storage location. At a minimum, the manufacturer, contact number, model number, or specification should be provided for each item. A schedule of all paint and coating finishes should also be obtained identifying the manufacturer, color, specification number, and the locations where they were applied.

An explanation should be provided if the proper amount of attic stock material is missing or if certain items have already been depleted. Reduced inventory may be indicative of undisclosed or chronic deficiencies.

Direct and Indirect Cost Information

Actual construction cost information is not ordinarily provided or readily available. However, if such information can be obtained, it could potentially save the purchaser thousands of dollars in subsequent professional fees for tax engineering services. Substantial tax benefits are often available by conducting a construction cost segregation study to realize accelerated depreciation or by bringing a tax certiorari proceeding against the municipality in order to receive a lower valuation and corresponding reduction in real estate taxes. Such tax engineering services often utilize actual construction cost data, if available. If such data is not available, additional professional fees are incurred to develop such data through cost estimating services.

. Environmental Site Assessments and Compliance Audits

A. Background

1. **Scope of liability:** If there is a release of a "hazardous substance" (as defined in CERCLA), there is a broad range of parties with a connection to the site that could be responsible for cleaning up the contamination under CERCLA. Potentially responsible parties (PRPs) include:

   a. present owners or operators;

   b. past owners or operators of the site at the time of disposal of the hazardous substances;

   c. any transporters of such hazardous substances; or

   d. any party who arranged for disposal at the site, and any transporters that carried hazardous waste to the site.[7]

2. **Defenses:** There are only three defenses to liability: act of God; act of war; and the "third party" defense, which is denied to a person having a contractual or agency relationship with the PRP. CERCLA § 101(35)(A) specifies that a purchaser's "contractual relationship" with the seller is no barrier to the third party defense *if* the purchaser can establish that:

> At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.[8]

3. **All appropriate inquiries:** CERCLA § 101(35)(B) specifies:

> To establish that the defendant had no reason to know, as provided in clause (i) of subpart (A) of this paragraph, the defendant must have undertaken, at the time of the acquisition, *all appropriate inquiry* into the previous ownership and uses of the property *consistent with good commercial or customary practice* in an effort to minimize liability.[9]

4. **No owner-operator liability for bona fide prospective purchasers:** The brownfield amendments passed in 2002,[10] however, provided a broad new exemption from liability—not merely a defense—for "bona fide prospective purchasers" who have undertaken "all appropriate inquiry" (a somewhat heightened Phase I Environmental Site Assessment) into past uses of a property and find that contamination is present. Notwithstanding the strict liability of owners and operators under CERCLA § 107(a)(1), new CERCLA § 107(r)(1) provides:

> A bona fide prospective purchaser whose potential liability for a release. . . is based solely on the purchaser's being considered to be an owner or operator of a facility shall not be liable as long as the bona fide prospective purchaser does not impede the performance of a response action or natural resource restoration.[11]

B. Practical Aspects of Deciding What Kind of ESA Is Needed

1. **What kind of information do you need?:** Before undertaking an environmental site assessment, it is crucial to determine the *right* kind of information needed about the property or facility for, among other things, showing the property conditions at the time of sale. An accurate picture of property conditions, in addition to overcoming the fear and insecurity that comes with facing unknown and therefore frightening problems, also facilitates the contract negotiations, because parties are less likely to posture about theoretical protections or guarantees they think they need, and instead focus on the most likely concerns.

2. Phase I Environmental Site Assessment:

   a. A proper Phase I ESA will provide:

      i. Satisfaction of recently enacted federal standards to demonstrate "all appropriate inquiry" by a prospective purchaser into the previous

ownership and uses of the property "consistent with good commercial or customary practice" as defined in 42 U.S.C. §9601(35)(B). This standard must be met in order to qualify for the innocent landowner, contiguous property owner, or bona fide prospective purchaser limitations on CERCLA liability, for properties purchased on or after November 1, 2006;

ii. The means to reach the goal of the processes established by meeting the "all appropriate inquiries" standard, discussed below, namely, to identify "recognized environmental conditions" on the subject property. A Phase I ESA is not invasive (i.e., no holes are dug to collect soil or groundwater samples), but does require a thorough development of information. "Recognized environmental conditions" means the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release of any hazardous substances or petroleum into structures on the property or into the ground, ground water or surface water of the property.

b. The first step to develop pre-existing information requires the prospective buyer to make a formal request for complete documentation from the seller. Some of the information that the buyer may request includes:

i. Copies of prior ESAs, compliance audits and any subsurface investigations (however named) or other reports on environmental conditions or compliance at the site;

ii. **Permits, applications, notices of violation:** For all facilities on the property: all permits and pending permit applications; correspondence with government regulatory agencies; copies of notices of violation, administrative orders, consent orders, consent decrees, and civil orders; records of negotiations with enforcement agencies concerning environmental compliance; monitoring and non-compliance reports; past or present judicial actions, including citizen suits; and documents reflecting liens or encumbrances under any environmental laws or regulations;

iii. Lists and descriptions of all "hazardous wastes" under RCRA that a facility at the site generates, treats, stores, transports or disposes of;[12]

iv. Description of all underground storage tanks (USTs) currently presently or formerly on the property, whether the USTs have been registered, have been tested for "tightness" or "integrity," and results of those tests, dates of removal (if no longer present), and reports from any removal activities;

v. Any report, notice, correspondence, or other document relating to hazardous substances or wastes found on or disposed of or released from the property;

vi. Copies of all material safety data sheets relating to substances used by the companies operating on the property;

vii. Copies of all insurance policies as they may provide coverage for environmental damages, with dates of coverage;

viii. List of pollution abatement or treatment devices which are or have been in use on the property

c. Under the current ASTM standard (E-1527-05), which EPA has stated meets the standard set by EPA's AAI regulations, the Phase I ESA will include:

i. *Title search*: reconstruct the chain of title as far back as possible to determine if property ever used for on-site generation, storage or disposal of hazardous materials;

ii. *Historical facility records*: manufacturing and other facilities have usually changed their practices over the years; areas that appear now not to pose any risk may have been used previously as lagoons, landfills, disposal areas;

iii. *Regulatory compliance records*: businesses are required to maintain a variety of records on-site, and to file reports with federal/state environmental agencies, including hazardous waste manifests, permits, monitoring and discharge reports, spill reports. (See discussion of compliance audits, below);

iv. *Neighboring properties*: nearby properties can themselves be a source of contamination on the site to be purchased, and/or the site's contamination can migrate "off-site";

v. *Off-site disposal*: wherever the company has sent even its non-hazardous solid waste (as well as, of course, its hazardous wastes);

vi. *Data base searches*: about the property and nearby properties: spills, tanks, Superfund sites there and nearby;

vii. *Site visits by consultant*: on-site investigations, interviews of caretakers, managers, operational people, even neighbors.

d. Some of the investigation performed in a Phase I ESA is optional, *e.g.*, asbestos and lead-based paint. The party seeking to have a Phase I ESA performed should develop with the consultant a plan of what additional work should be performed, according to the nature of property and how many "generations" of operations took place there.

e. The transaction screens (under ASTM's E-1528 standard) done by banks, usually costing $500 are of even more limited utility than they once were. Most importantly, with the 2002 Brownfields Law changes, *a property purchaser can no longer use the transaction screen of ASTM E-1528 and hope to qualify for protection from CERCLA liability*. It is well worth the cost to pay more and undertake the full Phase I ESA under ASTM 1527-05.

3. Changes in the Final "All Appropriate Inquiries" Standard from the pre-E-1527-05 ASTM Standard

a. As noted, for the first time since the enactment of CERCLA in 1980, *a person may purchase property with the knowledge that the property is contaminated without being held potentially liable* for the cleanup of the contamination. This is the "bona fide prospective purchaser" provision of the 2002 amendments to CERCLA. But this change in the law came at a price: the Environmental Protection Agency (EPA) was charged with developing the first federal environmental due diligence standard, to define what constitutes "all appropriate inquiry" into the previous ownership and uses of the property consistent with "good commercial or customary practice" as defined in 42 U.S.C. § 9601(35)(B).

b. The "AAI standard," now found at 40 C.F.R. Part 312, is stricter in several important respects than the ASTM standard that existed at the time, namely, E-1527-00 [i.e., year 2000] standard. Under the AAI standard, the environmental professional must meet federal or state licensing or registration requirements (as a professional engineer or geologist) *and* meet relevant experiential requirements. Also, it is mandatory that the environmental professional interview the current owner and occupants of the property, rather than merely make the "reasonable attempt" to do so that was previously required. A visual inspection is now required of adjoining properties, as well as subject properties.

c. The final federal AAI rule, effective November 1, 2006, recognizes the *revised* ASTM standard, ASTM E-1527-05, as an acceptable guidance document for satisfying AAI inquiries. The timing of the property purchase governs which standard applies. As noted, the AAI rule applies to property purchases made after November 1, 2006.[13]

4. Phase II Environmental Site Assessment

a. A Phase II ESA is a more extensive investigation that follows up on the finding of "recognized environmental conditions" in the Phase I ESA. It is more expensive because it involves "invasive" work on the property, typically, and as appropriate, soil, groundwater and surface water sampling.

b. The Phase II ESA should never be performed before first undertaking a Phase I ESA. Without having completed a proper Phase I ESA, the Phase II will lack

sufficient direction; the persons undertaking the Phase II ESA may well fail to investigate problems requiring an investigation, and, therefore, the resulting Phase II ESA may not be a reliable document.

c. Before beginning the Phase II ESA, a second scope will need to be prepared in consideration of the "recognized environmental conditions" set forth in the Phase I ESA. The Phase II ESA scope is often prepared in tandem with preparation of the actual Phase I ESA written report. There is another ASTM standard specifically for the Phase II ESA.[14] The scope of the Phase II may include:

i. preliminary subsurface investigation: soil or groundwater sampling in areas of suspected contamination;

ii. groundwater monitoring wells;

iii. sometimes, to avoid unnecessary invasive work, a preliminary noninvasive screening method will be used, *e.g.*, metal detectors to identify buried metal storage tanks, or a photo-ionization-detector (PID) meter, which is a volatile organic analyzer that can "smell" gases that are volatilizing or evaporating in the field, rather than require sample-taking and a five to ten day wait to obtain laboratory results.

d. The fact that the intrusive sampling in a Phase II ESA is expensive further defines the reason why problems arise if a Phase II ESA is performed without first doing a complete Phase I ESA. Without the results of the Phase I ESA, the scope of the problems has not been defined. There will be added costs if the Phase II investigator misses installing one necessary well—and have to "remobilize" a drilling rig—or if one unnecessary well is installed.

C. Compliance Audits

1. A compliance audit requires an in-depth examination of facility operations and detailed review of permits, monitoring records and other documents not obtained and/or not reviewed thoroughly in the Phase I ESA process. See Appendix A for a checklist.

2. A compliance audit review must include an examination of all air emissions, discharges into all water bodies, waste management and cleanup, Community Right-to-Know compliance, Toxic Substances Control Act issues, asbestos, lead, radioactive materials, and worker safety. The compliance audit report should also detail how significant facility operational and environmental permit deficiencies may be remedied.

3. If the seller's facility on the property will continue operation after the buyer closes, the parties may chose to transfer any permits from the seller to the buyer.[15] Issues arise, however, if there are previously unresolved matters, such as consent orders with

continuing obligations. The federal or state environmental agency will likely take the position that either party can fulfill any agency requirements, as long as the terms of the consent decree are met. The buyer and seller will have to determine in the contract for sale which party must fulfill prior unresolved permit obligations. (If the buyer is likely to be subject to successor liability requirements by virtue of the nature of the deal, those liabilities may pass by operation of law.)

D. Access and Confidentiality Agreements

1. A site access agreement will become necessary if the party that does not yet have title to the property wants to undertake either a Phase II ESA, with its invasive work, and even more so, if pre-closing remediation may take place under the contract; it is also necessary if the prospective buyer wants to do a compliance audit.

   See Appendix B for a sample Site Access Agreement.

2. There are several issues to be mindful of if the seller is asked for access:

   a. Do not allow invasive work on the property unless there is a firm basis in a Phase I ESA, discussed below;

   b. Insist on minimal disruption to operations: *e.g.*, require flush mounted wells where periodic monitoring of groundwater is required, rather than wells that stick up a few inches or feet above the ground;

   c. Make sure there is adequate insurance, and the right parties are named;

   d. Require robust indemnifications by the party seeking access, to back up assumption of risk; and

   e. Require clear property repair and site restoration provisions.

3. A confidentiality agreement may be necessary:

   a. before disclosing environmental reports to the prospective buyer, for example, to prevent further dissemination or where trade secrets are involved; and

   b. before permitting a compliance audit to be performed.

   See Appendix C for a typical Confidentiality Agreement.

4. The seller may want a confidentiality agreement in place with the environmental consultant. Some issues to consider in this situation are: non-disclosure except with client consent, exclusions from coverage, degree of resistance to disclosure; and scope of non-disclosure. However, this is not often required.

Counseling the Client

A. Environmental Consultants

1. *Choice of Consultant.* Several factors that are important to consider when choosing and working with a consultant are: education, experience or expertise of the type relevant to the client's needs, the consultant's reputation with government agencies, references from others, report-writing abilities, and rates. The environmental lawyer should officially retain the environmental consultant (for privilege purposes). See, III. B (3)(b), above, concerning the new All Appropriate Inquiry standard, by which the environmental professional must meet federal or state licensing or registration requirements (as a professional engineer or geologist) *and* meet relevant experiential requirements.

2. *Scope of Work.* Let the consultant know by defining early on: the limits of the consultant's responsibility and authority; payment terms; ownership of materials; insurance to be maintained; indemnification by the consultant; standard of care to be observed (negligence v. gross negligence); liability: do not allow form consultant contracts that limit recovery to the amount of the consultant's contract, as damages arising from consultant negligence—*e.g.*, puncturing an underground tank—are often multiples of the contract price.

3. *Reports to Clients:*

   a. Prior to even a draft report, the consultant and the environmental attorney should be in regular contact, and should discuss the results of the assessment orally and how the consultant plans to present the results. There is a need for a good working relationship between the consultant and the environmental attorney, so that the consultant understands that the attorney may need to edit the report to account for legal concerns, and the attorney understands that consultant may have to refuse if the attorney edits are technically inaccurate.

   b. Additionally, several privileges may be at issue when dealing with consultant's reports.

      i. *Attorney-client privilege*: narrowly construed; not usually applicable to consultant reports, at least not the factual part, which is the bulk of the report. The consultant's evaluation of what the data mean, however, might be protected as reflecting an opinion developed with counsel;

      ii. *Work product privilege* (or trial preparation privilege): broader than attorney-client privilege and covers two types of materials: opinion work product, which is strictly protected; and "ordinary work product," which is discoverable upon a showing of sufficient need by another party.[16]

iii. *Self-Evaluative Privilege*: although the U.S. EPA has vigorously opposed it, many states have adopted such a privilege by statute to encourage businesses to self-evaluate without fear of creating bases for governmental enforcement proceedings.

c. Following the oral report, discussed above, the consultant should prepare a draft report, insuring the report is limited as much as possible to factual observations. There should be no conclusions or opinions, *e.g.*, about the status of regulatory compliance or speculation on the sources of potential contamination. The report should not be finalized until the attorney has reviewed a revised draft (if attorney revisions are anything other than minor editing, spelling corrections, etc.).

d. Similar to concerns of confidentiality with releasing environmental reports to a prospective purchaser, there also may be confidentiality issues with allowing a consultant to review prior environmental reports and/or inspect the subject property. Confidentiality issues should be addressed in a separate agreement, usually before the consultant undertakes any work.

B. Major issues and pitfalls

1. When performing due diligence, in general and especially for multi-facility business, it is important to allow sufficient time. Important historical information is usually found in voluminous reports that may take some time to go through. It is crucial to be thorough; for example, do not ignore former facilities of company, even for small businesses (e.g., gas stations).

2. Research which disposal facilities are used by the company operating at the subject property, both current facilities and past ones.

3. Know the source and date of older reports. The seller's audits are no good to you if you are the buyer; and old audits should not be trusted.

4. When remediating contamination on the property, make sure estimates of costs are based on actual cleanup standards.

5. Pay careful attention to knowing what you must report to government authorities.

Reporting to the Government the Results of a Phase I or Phase II ESA

A. *State Notice Requirements: Petroleum/ Oil Spills*

1. The New York State Navigation Law governs reporting of and clean up of oil spills in New York State. "Any person" responsible for causing a discharge of petroleum must notify the Department of Environmental Conservation (DEC) of the discharge within 2 hours of the discharge.[17] The owner or operator "and any person who was in

actual or constructive control of such petroleum immediately prior to such discharge" are also required to notify DEC.[18]

2. The Petroleum Bulk Storage provisions of New York's Environmental Conservation Law require "any person with knowledge" of a spill, leak or discharge of petroleum to "report the incident to the [DEC] within two hours of discovery." [19] This provision is strictly enforced in New York State. Also, the "result of any inventory record, test or inspection which shows that a [petroleum bulk storage] facility is leaking must be reported . . . within two hours of the discovery." [20] Under the regulations a petroleum bulk storage facility is any facility that stores over 1,100 gallons of oil.

3. There has, however, been an administrative modification to these requirements. Petroleum spills need not be reported to the DEC if they meet the following criteria:

   a. spill is known to be less than 5 gallons;

   b. spill is contained and under the control of the spiller;

   c. spill has not reached and will not reach the State's water or any land; and

   d. spill is cleaned up within two hours

B. *Federal Notice Requirements: Petroleum/ Oil Spills*

1. Under the Clean Water Act, discharges of oil into or upon navigable waters of the United States that violate applicable water quality standards, or cause a film or sheen, or cause a sludge or emulsion to be deposited beneath the water surface, must be immediately reported to the National Response Center.[21]

2. Similarly, owners or operators of underground storage tanks and their systems must report a spill or overfill of petroleum that result in a release to the environment that exceeds twenty-five gallons, or that causes a sheen, within twenty-four hours, to the appropriate state implementing agency.[22] There are additional requirements for suspected releases, or even unusual operating conditions observed by owners and operators (*e.g.*, erratic behavior of product dispensing equipment, sudden loss of product from UST, unexplained presence of water in the tank), with some exceptions.

3. There are separate federal requirements for PCB spills reporting under CERCLA and also the Toxic Substances Control Act.[23]

4. CERCLA also addresses the release of hazardous substances. As noted above, oil is specifically exempted under CERCLA. However, the reporting requirements for hazardous substances under CERCLA are similar to those for oil under the Clean Water Act. CERCLA § 103(a) requires "any person in charge" of a facility to report the release of a reportable quantities of any hazardous substance within twenty-four hours.[24] The 1986 Superfund Amendments and Reauthorization Act (SARA)

Amendments to CERCLA added the requirement of notification to "community emergency coordinator for the local emergency planning committee of any area likely to be affected by the release and the state emergency response commission."[25]

Conclusion

With the assistance of competent environmental professionals—attorneys and consultants—the parties to a property or business transaction can protect themselves both by proper contract drafting and by appropriate environmental site assessments from unnecessary liability that counters the parties' respective assumptions of risk in entering into the transaction with each other. Parties can also protect themselves from unnecessary environmental claims by the government or adjoining property owners.

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[1] This section is a combination of nearly twenty years of experience in private practice as well as conversations and parallel topics at Continuing Legal Education programs and some of the best outlines, including especially, and with appreciation, from a due diligence presentation at a New York State Bar Association Continuing Legal Education program by George Rodenhausen, Esq., Rapport Meyers Whitbeck Shaw & Rodenhausen, LLP (grodenhausen@rapportmeyers.com).

[2] 42 U.S.C. § 9601 *et seq.*

[3] The term "Governmental Authority" may be defined to mean "the Federal government, and any state or other political subdivision thereof, and any agency, court or body of the Federal government, any state or other political subdivision thereof, exercising executive, legislative, judicial, regulatory or administrative functions."

[4] *Allied Princess Bay Co. No. 2 v. Atochem North American, Inc.*, 855 F.Supp. 595 (E.D.N.Y. 1993); *Channel Master Satellite Sys., Inc. v. JFD Electronics Corp.*, 702 F.Supp.1229 (E.D.N.C. 1988).

[5] *See Southland Corp. v. Ashland Oil, Inc.*, 696 F.Supp. 994 (D. N.J. 1988); *Marden Corp. v. C.G.C. Music LPD*, 600 F.Supp. 1049 (D. Ariz. 1984), *aff'd*, 804 F. 2d 1454 (9th Cir. 1986).

[6] *See Northern Star Co. v. Archer Daniels Midland*, 1993 WL 285942 (D. Minn. 1993).

[7] CERCLA § 107; 42 U.S.C. § 9607.

[8] *Id.* § 101(35)(A)(i).

[9] *Id.* § 101(35)(B)(i)(I) (emphases added).

[10] Small Business Liability Relief and Brownfields Revitalization Act, Pub. L. No. 107-118 (2002).

[11] CERCLA § 107(r)(1).

[12] 40 C.F.R. Part 261.

[13] For property purchases between May 31, 1997 and Nov. 1, 2005, when the EPA promulgated a new standard, ASTM E1527-97 ("Standard Practice for Environmental Site Assessment: Phase 1 [ESA] Process") is sufficient to meet due diligence requirements under the innocent landowner defense. For pre-May 31, 1997 purchases, there is a list of criteria, including "any specialized knowledge or experience on the part of the defendant"; "the relationship of the purchase price to the value of the property, if the property was not contaminated"; "commonly known or reasonably ascertainable information about the property"; "the obviousness of the presence or likely presence of contamination at the property"; and "the ability of the defendant to detect the contamination by appropriate inspection."

[14] ASTM E 1903-97 (reapproved 2002).

[15] *See, e.g.* N.Y. ENVTL. CONSERV. LAW § 70-0155; 6 NYCRR Part 621.

[16] *See Hickman v. Taylor*, 329 U.S. 495 (1947).

[17] N.Y NAV. LAW § 175 and 17 NYCRR § 32.3.

[18] 17 NYCRR § 32.3.

[19] 6 NYCRR § 613.8

[20] *Id.*

[21] 40 C.F.R. §§ 110.3, 110.6.

[22] 40 C.F.R. § 280.53.

[23] 40 C.F.R. § 761.125(a)(1).

[24] CERCLA § 103(a); 40 C.F.R. § 302.6(a).

25 40 C.F.R. § 355.40(a)+(b)

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Appendix A

EXHIBIT 5-3 (CONT.) COMPLIANCE AUDIT CHECKLIST

2. "Due Diligence" Reviews of Environmental Compliance and Conditions including Effects on Operations

If the business to be acquired is engaged in manufacturing, processing, mining or other industrial operations, phase I and phase II environmental site assessments are not adequate to evaluate environmental compliance and a "due diligence" review is needed. The review team should use care in hiring an environmental professional for the review because many firms that perform phase I and II assessments do not have enough experience to perform a "due diligence" review which has much more extensive scope.

A checklist for an environmental "due diligence" review is as follows:

Clean Air

- Identify point source emissions and fugitive emissions and the hazardous substances and pollutants emitted.
- Identify the control equipment for the emissions.
- Review construction permits for the point sources and control equipment.
- Review operating permits including the emission limits and monitoring and reporting requirements.
- Determine whether compliance is based on standards for sources existing in 1972 or new source performance standards.
- Review monitoring records and reports.
- Review history of excursions over permit limits and any violation proceedings and corrective actions.
- Review adverse effects, if any, on capacity and operating rates of any inability to meet permit limits and the capital operating costs to upgrade facilities to achieve compliance at higher capacity and operating rates.
- Review the capital and operating costs of upgrading facilities to meet new source performance standards if they are not being met.
- Review permits and controls on fugitive emissions.
- Review effects of "no significant deterioration" rules if the plant is in a nonattainment area.
- Review compliance with any applicable national emission standards for hazardous air pollutants (NESHAPs), if applicable, such as the carbon monoxide or the nitrogen oxides standard.
- Review compliance with the acid deposition control (acid rain) and stratospheric ozone (Montreal Protocol) regulations and the proposed accidental release regulations.

Clean Water

- Identify direct point source discharges of pollutants to an ocean, lake, river or stream.
- Identify indirect discharges of pollutants to sewer systems leading to publicly owned treatment works (POTWs).
- Identify stormwater discharges.
- Identify equipment and facilities used to control and pretreat direct and indirect discharges. Does the business have collection and treatment systems? What are the capabilities of the systems? Do they neutralize acid or caustic effluent? Do they skim or filter solids? Do they treat and biodegrade organics?
- Review national pollution discharge elimination system (NPDES) permits including the pollutant limits and monitoring and reporting requirements. Review monitoring records and reports.
- Determine whether there are other dischargers to the receiving water and the effects of their discharges.
- Review permits, ordinances or regulations of POTWs restricting discharges to sewers and imposing sewer charges and pretreatment requirements.
- Determine whether the POTW is complying with its NPDES permit and, if not, whether it plans to tighten restrictions on any indirect dischargers.
- Review stormwater permits.
- Review the Spill Control Program.
- Identify any tidal or freshwater wetlands and transition areas on the seller's properties.
- Review exceedances over permit limits and any violation proceedings.
- Review processes and equipment and the capital and operating costs required to achieve compliance.

Waste Management

- Identify solid wastes generated, both hazardous and nonhazardous and test procedures used to characterize waste.
- Obtain EPA generator identification number.
- Review any treatment, storage and disposal (TSD) facilities located on seller's properties. If any exist, except for storage less than 90 days, review the TSD permit and compliance history. Has the seller complied with "corrective action" requirements for the entire facility?

EXHIBIT 5-3 (CONT.)

- Review the TSD facilities for compliance such as secondary containment, labeling, etc. Review the closure and postclosure plan and estimated costs.
- Review registrations and records relating to underground storage tanks (USTs). What are and were the contents? Are the USTs registered? Are the USTs active or inactive? Have the inactive USTs been properly closed? Have active USTs been tightness tested and upgraded to meet RCRA requirements?
- Review aboveground storage tanks. What are their contents? Are they properly constructed, including adequate secondary containment?
- Review arrangements for off-site disposal of hazardous waste and compliance with manifest and labeling requirements. Identify present and former waste transporters and disposal sites. Are any of the disposal sites listed in the National Priority List (NPL) or the CERCLIS database or any state "mini-superfund" or other cleanup list? How costly are the disposal arrangements? What methods are used at the present disposal sites? What is their capacity and how long will they remain available?
- Review arrangements for off-site disposal of nonhazardous waste. Identify present and former transporters and disposal sites. Are any of the disposal facilities listed on any federal, state or local list for cleanup? What disposal methods are used at the disposal facilities? Are any of the disposal sites nearing capacity and planning to close or to adopt stricter specifications for acceptable wastes? How costly are the disposal arrangements?
- Review waste minimization and recycling activities. Can raw materials and intermediates not fully converted to products be returned to early stages of the process and blended with similar materials? Does the process produce coproducts or by-products? Are any wastes reclaimed or recycled? If wastes are transported for reclamation or recycling at off-site locations, identify the transporters and the locations. How do they accomplish the reclamation or recycling? Does it involve land application or use as fuel? Obtain copies of permits and beneficial use determinations.
- If application, verify compliance with small generator regulations, if applicable.

Community Right-to-Know

- Review any history of releases of hazardous chemicals and compliance with requirements for notification of state and local emergency response officials, including continuous releases.
- Review compliance with supplier notification requirements.
- Review material safety data sheets (MSDS) of hazardous chemicals from suppliers and evidence of their delivery to state and local officials.
- Review Tier One/Tier Two reports to state and local officials.
- Review Form R—Toxic Chemical Release Inventory Forms and their filing with state and local officials including the inventory of hazardous chemicals and any reported releases.
- Review compliance with record keeping requirements.

Waste Cleanup

- Review the National Priority List (NPL) and the CERCLIS database for the properties of the business to be acquired and properties near them. Review state "mini-superfund" and other property cleanup lists for the same purpose.
- Walk through the seller's properties to understand its present and historical manufacturing processes including raw materials, finished products and intermediates and onsite and off-site disposal practices.
- Perform a "windshield" review of neighboring properties to learn about their manufacturing processes and products.
- Review available aerial photographs, Sanborn maps and other data showing the history of properties.
- Obtain lists of present and former waste haulers and disposal sites for hazardous and nonhazardous wastes.
- Determine whether the seller has received any CERCLA § 104 letters from the EPA or has been named as a potentially responsible party (PRP) at any site listed or under review by the EPA or a state or local environmental agency.
- If the seller is responsible for any remedial activity, what are the levels of the soil, surfacewater, groundwater or other contamination? How do the levels compare to the residential and nonresidential cleanup guidelines? What progress has been made to accomplish the cleanup? What are the estimated cleanup costs? What share of the cleanup costs is likely to be allocated to the seller and any successors to the seller's obligations?
- Will the transaction trigger cleanup obligations under responsible property transfer laws such as those in Connecticut, Illinois, Indiana and New Jersey? Are the seller's properties subject to any lien or superlien under the environmental laws?

EXHIBIT 5-3 (CONT.)

Toxic Substances Control (TSCA)

- Determine whether all chemical substances produced or used appear on the TSCA inventory.
- Review compliance with premanufacturing notice (PMN) requirements for any new chemical substances and any consent orders or significant new use regulations (SNURs) under which they are being manufactured, used or sold.
- Determine whether any products are or may be subject to testing orders by the EPA.
- Determine whether any chemical substances are or may be applied to significant new uses and, if so, whether seller is in compliance with the EPA's regulations.
- Determine whether seller is in compliance with Section 8(e) reporting requirements.
- Determine whether seller's properties have any transformers, capacitors or other electrical equipment containing polychlorinated biphenyl (PCB) dielectric fluid and, if so, whether seller is in compliance with applicable regulations. If the equipment is owned by a public utility, verify the status with the utility.

Asbestos; Lead; Radioactive Materials

- Determine whether the seller's properties may have asbestos containing materials (ACMs). Are they hazardous (i.e., friable) or nonhazardous (i.e., nonfriable)? Does the seller have an operations and maintenance program? Are there any plans for demolition, renovation or remodeling that may disturb ACMs?
- Determine whether seller historically manufactured or used ACMs. Is there any history of worker exposure or claims?
- Determine whether seller's properties may have lead-based paint (LBP). Are they intact or in deteriorated condition? Does the seller have an operations and maintenance program? Are there any plans for demolition, renovation or remodeling that may disturb LBP? Does the drinking water contain lead at a concentration in excess of the EPA's "action level" of 15 parts per billion.
- Determine whether seller historically manufactured products containing lead or used lead in its processes. Is there any history of worker exposure or claims?
- Determine whether seller's properties have any radioactive materials, equipment or wastes. Does seller have a license from the Nuclear Regulatory Commission (NRC) or a state having a regulatory agreement with the NRC?
- Determine whether seller historically manufactured radioactive materials or equipment or used radioactive materials in its processes. Is there any history of worker exposure or claims?

Worker Safety

- OSHA 200 Log.
- OSHA (or state agency) inspection reports.
- Insurer inspection reports.
- Safety committee minutes and reports.
- Workers compensation "loss runs."
- Compliance with OSHA's hazard communication system including MSDS and labeling requirements.
- Compliance with OSHA's process safety management (PSM) regulations including "lockout/tagout" and "confined space entry" rules, if applicable.
- Air test results if manufacturing processes result in workplace air emissions.
- Repetitive stress injuries, i.e., carpal tunnel syndrome.
- Equipment for the engineering control of health hazards.
- Personal protective equipment including respirators.

APPENDIX B

[Form of Confidentiality Agreement for Disclosing Environmental Reports]

_____, 1995

Re: Environmental Reports

Dear _____:

In connection with the possible purchase by _____ ("Buyer") from _____ ("Seller") of certain property located at _____ (the "Property"), Buyer has requested that Seller furnish Buyer with certain environmental reports and evaluations of the Property, which reports and evaluations are attached hereto as Exhibit A (collectively, the "Environmental Reports").

As a condition to Buyer being furnished the Environmental Reports, Buyer hereby agrees as follows:

1. The Environmental Reports shall be used by Buyer solely in connection with Buyer's evaluation of the environmental condition of the Property and for no other purpose. The information contained in the Environmental Reports shall be kept confidential by Buyer.

2. Buyer acknowledges and agrees that (a) neither Seller, nor its affiliates, nor their directors, officers, employees or representatives has made or makes any representation or warranty whatsoever, express or implied, regarding the Environmental Reports, including, without limitation, any representation or warranty regarding the accuracy or completeness of the Environmental Reports, (b) neither Seller, nor its affiliates, nor their directors, officers, employees or representatives shall have any liability to Buyer or any of its representatives or advisors resulting from Buyer's use of the Environmental Reports, and (c) Buyer shall not rely on the Environmental Reports, which are being furnished solely as an accommodation to Buyer, and Seller encourages Buyer to undertake its own investigation of the Property and any matters contained in the Environmental Reports. Buyer may disclose any information contained in the Environmental Reports to its employees, agents, lawyers and consultants whom it determines has a need to know such information in connection with Buyer's use of the Environmental Reports in accordance with Paragraph 1, provided such persons have been informed of Buyer's confidentiality obligations under this letter agreement and agree to be bound by the terms of this letter agreement.

3. In the event that Buyer or any of its representatives are requested or required (by oral questions, interrogatories,

requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process) to disclose any information contained in the Environmental Reports, Buyer shall provide Seller with prompt written notice of any such request or requirement so that Seller may seek a protective order or other appropriate remedy and/or waive compliance with the provisions of this letter agreement. If, in the absence of a protective order or other remedy or the receipt of a waiver by Seller, Buyer or any of its representatives nonetheless are, in the written opinion of counsel reasonably acceptable to Seller, legally compelled to disclose any information contained in the Environmental Reports to any tribunal or else be liable for contempt or suffer other censure or significant penalty, Buyer and its representatives may, without liability hereunder, disclose to such tribunal only that portion of the Environmental Reports which such counsel advises Buyer is legally required to be disclosed, provided that Buyer exercises its reasonable efforts to preserve the confidentiality of the Environmental Reports, including, without limitation, by cooperating with Seller (at Seller's expense) to obtain an appropriate protective order or other reliable assurance that confidential treatment will be accorded the Environmental Reports by such tribunal.

4. Buyer shall keep a record of any copies, extracts or reproductions which are made of all or any part of the Environmental Reports received by Buyer and each person having possession thereof. Upon Seller's request at any time, Buyer shall promptly (i) deliver to Seller all Environmental Reports, including all copies of all or any part thereof, which is in written or other tangible form, (ii) destroy all documents, memoranda, notes and other writings, computer tapes, disks or other forms whatsoever prepared by Buyer, or any of its directors, officers, employees or representatives, based on information in, or containing any information from, such Environmental Reports and (iii) certify to Seller in writing that all such materials have been so returned or destroyed. Notwithstanding the return or destruction of the Environmental Reports, Buyer and its representatives will continue to be bound by their obligations of confidentiality and other obligations hereunder.

5. It is understood and agreed that money damages would not be a sufficient remedy for any breach of this letter agreement by Buyer or any of its affiliates and that Seller shall be entitled to equitable relief without bond or other security, including injunction and specific performance, as a remedy for any such breach. Such remedies shall not be deemed to be the exclusive remedies for breach by Buyer or any of its affiliates or partners, or their directors, officers, employees or representatives, of this letter agreement but shall be in addition to all other remedies available at law or equity to Seller.

6. Unless and until a definitive agreement between the parties with respect to the potential transaction has been executed and delivered, neither party shall be under any obligation, legal or otherwise, of any kind with respect to any such potential transaction.

7. This agreement shall be governed by and construed in accordance with the laws of _____ without regard to the principles of conflicts of laws thereof.

Very truly yours,

_____

Agreed to:

_____

By: _____

Appendix C

SITE ACCESS AGREEMENT

THIS AGREEMENT, dated as of ____ is between _____ ("Seller") and _____ ("Buyer").

Seller and Buyer have entered into a certain Purchase Agreement (the "Purchase Agreement") for the sale and purchase of _____(the "Sites").

Buyer desires to examine the Sites for the purpose of conducting environmental site assessments and other tests to determine the suitability of the Sites for Buyer's purpose.

NOW, THEREFORE, in consideration of the mutual covenants contained herein, Seller hereby agrees to grant Buyer access to the Sites on the following terms and conditions:

1. All capitalized terms used in this Agreement and not otherwise defined shall have the same meanings assigned thereto in the Purchase Agreement.

2. Seller hereby grants to Buyer and its employees, agents, consultants and contractors (collectively, "Buyer's Representatives") a license to enter upon the Sites in order to conduct such analyses, studies, tests, and Phase I and Phase II environmental audits as are reasonably necessary to determine whether the Sites are suitable for Buyer's purposes (collectively, the "Activities") and for no other purpose. The Activities shall be carried out at Buyer's sole cost and expense. This Agreement shall begin on the date hereof and shall end on ____. This Agreement represents a license that is limited in purpose and scope to the least amount of access which is required to undertake and complete the Activities and does not represent a lease or create in Buyer any interest in the Sites or any other property owned by Seller or create a partnership, joint venture or any association or relationship between Seller and Buyer other than licensor and licensee.

3. Access by Buyer and Buyer's Representatives shall be restricted to the areas at the Sites which are owned or leased by, or otherwise under the control of, Seller. Prior to entry onto any Site, Buyer or Buyer's Representatives shall provide Seller with a detailed description of the planned Activities with respect to that Site. Notwithstanding the foregoing, Buyer may not conduct a Phase II environmental audit or take any samples or perform any surface or subsurface tests unless Seller has (a) agreed, based upon the results of a Phase I environmental audit, that a Phase II audit and/or sampling and testing is appropriate, and (b) expressly approved a detailed work plan which, among other things, identifies the number and general location of any planned borings, piezometers and monitoring wells and the analyses to be performed.

4. Buyer and Buyer's Representatives shall use their best efforts to minimize disruption to current activities on, and to prevent damage to any personal property and structures of Seller and others located at, on or near the Sites.

5. Buyer and Buyer's Representatives shall maintain for the term of this Agreement insurance policies covering all Activities at and related to each Site of the type and in the minimum amounts listed below:

(a) Worker's Compensation insurance at statutory limits and Employer's Liability insurance with a limit of liability not less than _____;

(b) Comprehensive General Liability insurance, covering all claims of damages for injury to person or persons, including death, to Buyer's Representatives and others, and all claims on account of property damage, including without limitation Contractual Liability, with a total limit of liability of (including umbrella coverage) at least $_____ each occurrence and in aggregate;

(c) Comprehensive Automobile Liability insurance, a total of (including umbrella coverage) $_____ each occurrence; and

(d) Professional Liability insurance (errors and omissions) $_____ each claim and in the aggregate.

11. After the Activities have been completed, Buyer shall repair and restore those portions of the Sites which are in any way affected, damaged or disturbed due to the performance of the Activities to a condition which is, to the extent practical, identical to the condition that existed before the commencement of the Activities, including without limitation removal of all machinery and equipment, removal of monitoring wells and sealing of bore holes with non-contaminated soil, grout or other appropriate material.

12. Buyer and Buyer's Representatives shall hold and maintain as confidential, to the extent permitted by law, all information and data obtained and report(s) generated as a result of the Activities and shall not, without first obtaining Seller's written approval, divulge or release such information to any third party. Buyer shall provide Seller with a copy of all data received as a result of the Activities and all draft and final reports of the Activities.

13. Notwithstanding anything to the contrary which may be contained in this Agreement, the parties agree that, prior to the commencement of the Activities, Buyer and Buyer's Representatives have neither created nor contributed to the creation or existence of any Environmental Condition on any Site and shall have no liability to Seller for simply discovering and/or informing Seller of the discovery of such pre-existing Environmental Condition.

14. Seller agrees to cooperate with Buyer and Buyer's Representatives in the conducting of the Activities contemplated by this Agreement.

ENVIRONMENTAL AND LAND USE LAW

by Ralph A. DeMeo and Lynn S. Scruggs

All Appropriate Inquiries in Commercial Real Estate Due Diligence: What Inquiring Minds Need To Know

On November 1, 2006, the U.S. Environmental Protection Agency (EPA) adopted an "All Appropriate Inquiries" (AAI) rule. The AAI rule, found at 40 C.F.R. Part 312, 70 Fed. Reg. at 66,070 (November 1, 2005), codifies new requirements for conducting environmental due diligence inquiries in all transactions involving commercial real estate. The AAI rule establishes good commercial and customary practices for environmental site assessments of commercial real estate within the scope of the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§9601 *et seq.* (CERCLA). Sellers or buyers of commercial property must comply with these new requirements or risk losing innocent purchaser and other defenses. This article will explain the purpose and history of AAI, the legal liability context for buyers and sellers of commercial real estate, and the key provisions of AAI.

Purpose of AAI

Liability and cost are the two mainstays of conducting environmental due diligence under CERCLA and Florida law. This process was introduced at the federal level with the enactment of CERCLA in December 1980, where the threat of liability and costs of cleanup brought new concerns for real estate transactions. The effect of CERCLA imposed liability on those properties which had suffered a release or threatened release of hazardous substances. In October 1986, the Superfund Amendments and Reauthorization Act (SARA), Pub. L. No. 99-499 (1986), amended CERCLA by establishing an innocent landowner defense to liability. However, SARA did not establish eligibility requirements for the defense. As a result, in January 2002, the Small Business Liability Relief & Revitalization Act, Pub. L. No. 107-118 (2002) (known as the Brownfields Amendments), clarified requirements of the innocent landowner defense and added two more defenses, discussed below. In order to be eligible for these defenses, a buyer or seller must have performed "all appropriate inquiries" into previous ownership, uses, and environmental conditions.[1] The phrase "all appropriate inquiries" has become the EPA's version of conducting environmental due diligence, the process of assessing conditions within a property for the presence or threatened presence of contamination.

History of AAI

The high costs associated with cleaning up contaminated properties motivated Congress to establish a superfund that would attempt to deal with some of the costs incurred by prospective purchasers. The enactment of CERCLA set up this superfund to allay the costs, but also imposed liability on owners and operators of the contaminated properties. Owners and operators are held strictly liable for the incurrence costs regardless of who caused the actual contamination. The enactment of SARA established the innocent landowner defense to avoid liability for acquiring contaminated property. Yet again, in January 2002, the Brownfields Amendments added two additional defenses to CERCLA liability: bona fide prospective purchaser and contiguous property owner. All three defenses required those seeking protection from liability to conduct "all appropriate inquiries." The effect of these new defenses begged the question: what exactly were "all appropriate inquiries"? The SARA amendments touched upon this concept in their innocent landowner defense, but it remained a mystery to many. In response, Congress directed the EPA to promulgate a set of standards delineating what is necessary to perform all appropriate inquires, and in the meantime set up interim standards to assist parties involved in real estate transactions. In November 2005, the EPA published the "Standards and Practices for All Appropriate Inquiries" which became effective on November 1, 2006. Additionally, the American Society for Testing and Materials (ASTM), a private standard-setting organization, established standards that comply with these federal requirements and assist buyers and sellers in conducting successful all appropriate inquiries. The ASTM also created a new standard, E1527-2005, to comply with the new EPA AAI rule.

Defenses to CERCLA Liability

To claim a defense to CERCLA liability, a buyer or seller must demonstrate they had no reason to know that a hazardous substance was present on the property by conducting all appropriate inquiries into the previous ownership and uses on

or before the date of acquiring the property. It is important to note that the EPA's new AAI rule is just one of the many steps required for protection from liability. Additionally, to be afforded liability protection, one must perform other continuing obligations, such as providing access and information to the contaminated property. Moreover, the new EPA AAI rule relates to the federal standard only, and does not apply expressly to state and local standards, which are discussed below.

To claim an innocent landowner defense, the buyer or seller must establish by a preponderance of evidence that the release or threatened release was caused by an independent third party and that they did not know or have reason to know of the contamination or threatened contamination. Also, they must show they exercised due care with respect to identifying any conditions related to hazardous substances and with respect to foreseeable acts or omissions of the third party.[2]

To claim a bona fide purchaser defense, purchasers must have purchased the property after January 11, 2002 (the date of the Brownfields Amendments), and show they are not liable or associated with any party potentially liable. A bona fide prospective purchaser may have knowledge of the contamination and continue to purchase the property, but only after conducting all appropriate inquiries and performing the other continuing obligations.[3]

A contiguous property is a property situated near the contaminated property that may be contaminated as a result of the activities on the contaminated property. To claim this defense, the owner or buyer must show they did not cause, contribute, or consent to any release and also that they did not know or did not have reason to know of contamination at the time they acquired the property after conducting all appropriate inquiries.[4]

In addition to conducting all appropriate inquiries into previous ownership and uses, a party seeking a defense to liability must also perform other continuing obligations. This includes complying with any land use restrictions, taking reasonable steps with regard to hazardous substances, not impeding institutional controls, and providing assistance, cooperation, and access to the EPA.[5]

Defenses to Florida Law Liability

In Florida, discharges or releases of pollutants from facilities are heavily regulated. Liability is imposed generally under the Pollutant Discharge Prevention and Control Act and the Florida Air and Water Pollution Control Act, F.S. Chs. 376 and 403. Specifically, F.S. §376.302 provides that "it shall be prohibited for any reason: to discharge pollutants or hazardous substances into or upon the surface or ground waters of the state or lands...." In addition, F.S. §403.161(1) provides that "it shall be prohibited for any person: to cause pollution ... so as to harm or injure human health or welfare, animal, plant, or aquatic life or property."

The Florida Department of Environmental Protection is authorized to file a civil suit against any person who caused a discharge of pollutants or hazardous substances, or who owned or operated a facility at which the discharge occurred.[6] Individuals who have suffered damages resulting from a discharge or condition of pollution are also covered by these statutes.[7] In *Aramark Uniform and Career Apparel v. Easton*, 894 So. 2d 20 (Fla. 2004), the Florida Supreme Court held that F.S. §376.313(3) creates a private cause of action imposing strict liability for damages against an adjoining landowner without proof that the defendant actually caused the pollution. In addition, the court held the defendant is limited to the statutory defenses found in F.S. §376.308(1)(c).[8]

It should be noted that the environmental due diligence requirements discussed in this article under federal and Florida law apply to purchase and sale of commercial property only and not to residential property. It also should be noted that in Florida, caveat emptor applies in the sale of commercial property only.[9]

The statutory defenses available under F.S. §376.308(2) include an act of war, an act of government, an act of God, or an act or omission of a third party. To claim a defense based on an act or omission of a third party, the statute requires that defendant exercised due care with respect to the contamination and took the appropriate precautions against the third party's acts or omissions. Additionally, Florida Statutes provide a functional equivalent to the EPA's all appropriate inquiries. In cases of petroleum products or dry cleaning solvents, the defendant must establish that the prior owner or other third party caused the contamination. Furthermore, under F.S. §376.308(1)(c), if the owner acquired the property after July 1, 1992, the defendant must have conducted "all appropriate inquiry into the previous ownership and use of the property." Florida's all appropriate inquiry standards in F.S. §376.308(1)(c) include visual inspections, defendant's specialized knowledge, relationship of purchase price to value, commonly known information, and the degree of obviousness of contamination. In light of Florida's all appropriate inquiry scheme, taking into account its acceptance of the ASTM standards, it seems likely that compliance with EPA's AAI would also extend to compliance with Florida's AAI requirements.[10]

Key Provisions of the AAI Rule

The purpose of the AAI rule is expressed in its "objectives and factors." Environmental professionals, sellers, and buyers should always keep an eye on these in conducting all appropriate inquiries under the rule.

Prior to the new AAI rule, it was not clear who qualified as an "environmental professional." Now, there are specific standards to be met in order to qualify, with an emphasis on experience. One with 10 or more years of full-time relevant experience may qualify as an environmental professional without having a college degree. Those who have a science or engineering degree coupled with five or more years of full-time

relevant experience also qualify as an environmental professional. The requirement of experience lessens to three or more years with a professional engineering or professional geologist license. A qualifying environmental professional may also be licensed or certified by the federal or state government and have three or more years of relevant full-time work experience. All types of qualifying professionals must remain current in their field, and their experience should consist of participation in environmental site assessments.

Regarding documentation of results, while there are no requirements as to length or format or even submission to the EPA, the new rule requires a written report documenting the results of all appropriate inquiries. The party seeking liability protection should use this opportunity to document the required evidence to qualify for the protection. Additionally, the new rule requires two signed declarations by the environmental professional. The first declaration should attest that the environmental professional meets the qualifications, but there is no explicit requirement of proof. The second declaration states that the standards and requirements of all appropriate inquiries have been carried out successfully.

The new rule requires the environmental professional or someone under his or her supervision to conduct "interviews" of past and present owners, occupants, operators, facility managers, and even nearby owners and operators in cases of abandonment. Whether all of these interviews are necessary is left to the environmental professional's discretion. However, interviews must be conducted in full accordance with the objectives and factors of all appropriate inquiries. It should always be kept in mind that the fundamental purpose of conducting all appropriate inquiries is to identify conditions that would lead one to believe a release has or will occur. The new rule does not specify which questions should be asked during the interview, but the environmental professional should have those goals in mind.[11]

The new rule requires "on-site visual inspections" of the subject property, including the facilities and places where hazardous substances may have been used, stored, or handled. There are certain foreseeable instances where an on-site visual inspection may be impractical, such as where the current owner will not allow the inspection or it is physically impossible to inspect certain areas. However, in these limited cases, the environmental professional must document these situations. Also, it is important to note that mere refusal to allow access by the current owner should not be accepted until a good faith effort has been made to inspect the property. One could imagine inquiring repeated times or possibly taking aerial photos and

even standing at the property line to inspect. Additionally, the new rule recognizes that most of these limited situations involve a local government attempting to cleanup an abandoned property and gives certain flexibility to those situations for the benefit of the community.

The inclusion of "specialized knowledge" on behalf of the defendant originates from the 1986 SARA amendments. Since CERCLA imposes liability, the party claiming a defense to liability is known as the "defendant." In the course of conducting all appropriate inquiries, which in essence is to identify any conditions that may evidence a release or threatened release of a hazardous substance, the defendant is required to include any specialized knowledge he or she may possess. In determining whether all appropriate inquiries have been successfully completed, courts use their discretion to take into account any specialized knowledge the defendant had. For instance, a bona fide prospective purchaser would be unable to claim he or she had no reason to know the property was contaminated if he or she possessed knowledge of the prior owners' business activities. While the defendant is not required to share his or her knowledge with the environmental professional, the written report prepared by the professional must treat that as a data gap and inquire whether the choice not to share is indicative of an environmental condition leading to contamination.

When the property is not contaminated, the new rule still requires that a "comparison between the purchase price of the property and the fair market value" of the property be made. This requirement was first introduced in the 1986 SARA amendments, and the new rule is merely a continuation of the old rule. This relationship may be ascertained by the defendant (prospective landowner) or the environmental professional, despite public concern that environmental professionals lack adequate knowledge to make a judgment of value. However, if this concern exists, the prospective landowner may hire a third party to evaluate the relationship between price and value, although an appraisal is not required. In evaluating this relationship, one should take into account any discrepancies between the price and value and ask whether this may be evidence of a potential environmental condition of contamination.[12]

A search of any "environmental cleanup liens" is important in identifying possible releases of hazardous substances for obvious reasons.

The requirement to include any "commonly known information" is another holdover from the 1986 SARA amendments. In establishing defense to liability, the prospective landowner should take into account any information that is commonly known. This includes a variety of sources such as newspapers, community organizations, Web sites, and local government officials. As one can imagine, much of this information may have already been collected at some point during the all appropriate inquiries process. Again, the prospective landowner and the environmental professional must always consider the objectives of conducting all appropriate inquiries: to identify conditions indicative of a release or threatened release of hazardous substances. Neighboring owners may have information that cannot be found on public record and those conducting all appropriate inquiries must take these possibilities into account.

A review of "historical sources" is necessary to identify past uses and occupancy that may give rise to potential contamination. The new rule requires the search to be conducted far enough into the past to reasonably evaluate the possibility of contamination, and may need to go back to the first use of the property or when the first structures were placed there. It is the environmental professional's discretion as to how far back the review should be. While there is no set number of documents required, again, the idea is to meet the objectives and factors required in conducting all appropriate inquiries. A search of historical sources may include chain of title documents, aerial photographs, building department records, land use records, or fire insurance maps.

A search of any "environmental cleanup liens" is important in identifying possible releases of hazardous substances for obvious reasons. A lien for an environmental cleanup is placed when incurrence costs have resulted from an environmental condition. These conditions are likely to identify past and future contamination. The search may be conducted by either the prospective landowner or the environmental professional, although the landowner may prefer to conduct the search in efforts to reduce costs. Liens can typically be found on chain of title documents and are rather easy to identify. Be aware though, the EPA may issue a lien on the property after all appropriate inquiries have been completed if they are in the process of cleaning up a property.[13]

A review of "federal, state, local and tribal records" with emphasis on "engineering and institutional controls" is also required. The scope of this inquiry is limited only to the subject property and not to nearby properties, although reviewing those in addition may be helpful. Institutional controls may include any legal limitations or land use restrictions imposed upon the property that attempt to protect the public. Engineering controls work to eliminate possible exposure to hazards that may include a physical barrier. Identifying any engineering or institutional controls is valuable for the prospective landowner, as they will be required to cooperate with those controls after acquiring the subject property. This requirement is part of the continuing obligations

imposed upon those who claim a defense to liability, and is separate from conducting all appropriate inquiries. In addition to identifying controls on the property, there are other sources which should be reviewed including records of landfill locations, disposal units, storage tanks, hazardous waste handlers, other cleanup sites, and spills.

Once all the information has been gathered, the prospective landowner and environmental professional should look at the totality of circumstances to identify whether "any obvious" contamination has occurred or will occur. Additionally, the environmental professional should determine whether the data and information collected renders necessary additional inquiry into the possibilities of contamination. Although taking samples of the land is not required at this stage, it may be helpful in completing this step successfully. Any efforts to identify harmful conditions should be taken.

The new rule requires extensive documentation of "data gaps," especially since the prospective landowner is not required to share information they ascertain with the environmental professional. In those cases, the environmental professional should treat the lack of information as a data gap and consider whether additional investigation is appropriate. Additionally, the sources used in gathering information should be documented.[14]

While the statutory language of CERCLA does not provide hard criteria as to "when" one should conduct all appropriate inquiries, the new rule says it should be within one year prior to acquiring title to the property. The new rule permits use of prior "all appropriate inquiries"; however, if they were performed more than a year prior, the study must be completely updated. Also, the rule allows prior studies that were conducted in compliance with past standards, including the standards from the ASTM.[15] For instance, studies on property purchased on or after May 31, 1997, may have been conducted in compliance with the ASTM E1527-97 standard or the ASTM E1527-2000 standard. For studies on property purchased before May 31, 1997, compliance with CERCLA will be accepted. However, the prior studies must be updated using the standards and practices set forth in the new rule. Furthermore, the following parts of all appropriate inquiries must be conducted within 180 days of acquiring title to the property: interviews, environmental cleanup lien searches, reviews of federal, tribal, state and local government records, visual inspections, and the environmental professional's declaration.[16]

Finally, it should be noted that the ASTM is a not-for-profit organization that publishes the standards required to be in compliance with CERCLA and the other statutory provisions amending CERCLA. ASTM is made up of committees, such as Committee E-50 on Environmental Assessment, which in turn is composed of environmental engineers, real estate and insurance professionals, and government representatives. ASTM has updated its standards for a Phase I environmental site assessment. The new standard, ASTM E1527-2005 has been updated to reflect EPA's new all appropriate inquiries rule.[17]

Conclusion

The new EPA AAI rule and the new ASTM standard for conducting environmental site assessments of commercial real estate are important new tools in the process of evaluating impacts to commercial real property associated with environmental conditions and the allocation of responsibility and liability related thereto. It is important for buyers and sellers of such properties, as well as attorneys and environmental professionals, to be familiar with these new rules. Should such persons fail to comport with these requirements, the protections of federal and state law otherwise available to them will be lost. In addition, as a practical matter, a purchaser of contaminated property in particular will not know what he or she is buying, and this lack of knowledge could diminish significantly the value of such property and frustrate his or her plans. In this regard, inquiring minds need to know the new all appropriate inquiry standards or beware of the consequences. In this case, what you do not know *can* hurt you! ❑

[1] *See* 42 U.S.C. §9601(35)(B)(i).
[2] AAI, 70 Fed. Reg. at 66,074.
[3] AAI, 70 Fed. Reg. at 66,073.
[4] AAI, 70 Fed. Reg. at 66,073.
[5] Parties looking to receive a Brownfields grant (under the 2002 Brownfields Amendments) are also required to conduct all appropriate inquiries. *See* 42 U.S.C. §9604(k)(2)(B).
[6] FLA.STAT. §376.308(1).
[7] FLA.STAT. §376.313(3).
[8] For a discussion of this case, *see* Ralph A. DeMeo, Carl Eldred, Lisa J. Feuerstein, *Florida Supreme Court Takes Property Owners to the Cleaners: The Impact of* Aramark v. Easton, 79 FLA. B.J. 66 (June 2005).
[9] *See RNK Family Limited Partnership v. Alexander-Mitchell Associates*, 788 So. 2d 1035 (Fla. 2d D.C.A. 2001); *Moustoufi v. Presto Food Stores, Inc.*, 618 So. 2d 1372 (Fla. 2d D.C.A. 1993).
[10] For a comparison of the new AAI and state standards, *see* EPA, All Appropriate Inquiry Criteria Analysis/Comparison to State, Federal, and Commercial Assessment Approaches, EPA 500-F-03-229 (June 2003).
[11] AAI, 70 Fed. Reg. at 66,077-89.
[12] AAI, 70 Fed. Reg. at 66,095-99.
[13] AAI, 70 Fed. Reg. at 66,092-100.
[14] AAI, 70 Fed. Reg. at 66,088-101.
[15] For a comparison of the new AAI and previous standards *see* EPA, Comparison of the Final All Appropriate Inquiries Standard and the ASTM E-1527-00 Envtl. Site Assessment Standard, EPA 560-F-05-242 (Oct. 2005); *see also* New Envtl. Due Diligence Standards (ABA Section of Environment, Energy, and Resources and the ABA Center for Continuing Legal Education, Oct. 31, 2006); New EPA "All Appropriate Inquiry" Regulations: EPA Clarifies the Standard for Envtl. Site Assessments (ABA Section of Environment, Energy, and Resources and the ABA Center for Continuing Legal Education CD-ROM, Sept. 27, 2004).
[16] AAI, 70 Fed. Reg. at 66,084.

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This column is submitted on behalf of the Environmental and Land Use Law Section, Robert J. Riggio, chair, and Gary K. Oldehoff, editor.

REQUIREMENTS FOR QUALIFICATION OF INNOCENT LANDOWNER DEFENSE UNDER ALL APPROPRIATE INQUIRIES RULE

- The purchaser "must consider whether the purchase price...reasonably reflects the fair market value of the property, if the property were not contaminated." In other words, the environmental assessment must demonstrate that the purchaser did not negotiate or otherwise receive a price break based on known environmental concerns.

- The purchaser "must take into account, their specialized knowledge of the subject property, the area surrounding the subject property, the conditions of adjoining properties, and any other experience relevant to the inquiry, for the purpose of identifying conditions indicative of releases or threatened releases at the subject property..."

- The purchaser must make "a search for the existence of environmental cleanup liens against the subject property that are filed or recorded under federal, tribal, state, or local law."

- Either the purchaser or the environmental professional must "take into account commonly known or reasonably ascertainable information within the local community about the subject property and consider such information when seeking to identify conditions indicative of releases or threatened releases... [They] must gather information from varied sources whose input either individually or taken together may provide commonly known or reasonably ascertainable information about the subject property...[Such sources may include] newspapers, Web sites, community organizations, local libraries and historical societies..."

- The environmental professional must determine whether, "to the extent necessary to achieve the objectives and performance factors" applicable to the environmental inquiry, it is necessary to interview past property owners, occupants, operators, managers, and/or employees.

- The environmental professional must determine whether, any physical limitations to visually inspecting adjoining properties from the subject line, public right of way, or other vantage point must be noted. The report must comment on the significance of such data gaps.

- The environmental inquiry generally must be conducted within one year prior to the purchase date. Several components must be updated within 180 days of the purchase price, including interviews, lien searches, government record reviews, visual inspection of the property, and the environmental professional's declaration that all appropriate inquiries were conducted in conformance with the All Appropriate Inquiries Rule.

- The environmental professional must Review historical sources, such as chain of title documents and aerial photographs, to determine previous uses and occupancies of the site since it was first developed;

- The environmental professional must Review government records, waste disposal records, underground storage tank records, and hazardous waste handling, generation, treatment, disposal, and spill records, concerning contamination at or near the facility;

- The environmental professional must visually inspection the facility and of adjoining properties, and if this is not possible, the professional must visually inspect the property by another method (aerial imagery), view from an alternative viewpoint, document the efforts taken to gain access to the subject property, document the use of other sources of information to determine the existence of

potential contamination, and express an opinion about the significance of potential environmental contamination;

- The Purchaser's Specialized knowledge or experience will be taken into account when determining if the Purchaser conducted the necessary inquiries to qualify for the defenses;

- The degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation.

QUALIFICATIONS FOR ENVIRONMENTAL PROFESSIONALS

- Hold a current Professional Engineer's or Professional Geologist's license or registration from a state, tribe, or U.S. territory and have the equivalent of 3 years of full-time relevant experience; or

- Be licensed or certified by the federal government, a state, tribe, or U.S. territory to perform environmental inquiries and have the equivalent of 3 years of full-time relevant experience; or

- Have a Baccalaureate or higher degree from an accredited institution of higher education in science or engineering and have the equivalent of 5 years of full-time relevant experience; or

- Have the equivalent of 10 years of full-time relevant experience.

The Value Provided to Owners and Lenders by the New 2006 ALTA Policy Forms

Presented by:

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The Value Provided to Owners and Lenders by the New 2006 ALTA Policy Forms -

Changes to the Basic ALTA Policy Forms in 2006

Introduction: Development of the 2006 Policy Forms

The present basic policy revision project began early in 2002, to revise the basic title insurance policy forms used for owners and lenders. The ALTA Forms Committee members who worked on this project are a group of title insurance company counsel representing all the major title insurance underwriters. The members have an aggregate of over 384 years of title industry experience in underwriting, management and claim resolution.

For many years, the ALTA has developed residential forms, such as the 1998 Homeowner's Policy and the 2003 Expanded Coverage Residential Loan Policy. The short form of the basic loan policy for residential loans, and the short form version of the Expanded Coverage Residential Loan Policy, are also designed for the residential lender. The 2006 policy forms represent the basic policy forms intended for all transaction types.

The 2006 policy forms have been designed to more adequately satisfy the needs of the commercial market. The new forms will also continue to be appropriate for residential property. However, where the land is improved residential property that qualifies for the residential forms, the best coverage will continue to be offered by those expanded coverage policy forms.

A. Revisions to the Covered Risks and Exclusions

One of the primary goals of the 2006 forms is to correct the format of the policy in reaction to judicial interpretations of coverage and exclusions. In several cases, courts have interpreted the ALTA policy forms in a manner to deny coverage in circumstances where the title industry probably intended to give coverage by an exception to an exclusion. The 2006 forms resolve the past judicial inconsistency by stating all coverage within the Covered Risks.

The 2006 policy forms do reflect substantial changes in the Covered Risks, Exclusions and Conditions designed to alleviate many stated problem areas. The feedback provided by several, major customer groups consistently requested revisions to clarify the rights and duties of both parties. The primary customer groups were the American College of Real Estate Lawyers, the American College of Mortgage Attorneys, Fannie Mae and Freddie Mac.

Another significant motivation for the new forms is the clear market pressure for title insurance to provide more coverage. There is an impression among some market segments that the title industry does not provide sufficient value in return for the premium investment. The title industry clearly responds with these 2006 forms to provide improved coverage, improved procedures for claim administration and deliver more value.

At first glance, it appears there are many new covered risks. There are ten covered risks in the new owner's policy, compared to four in the 1992 owner's policy. There are fourteen covered risks in the new loan policy, compared to eight in the 1992 loan policy. Upon analysis, there is not such a significant increase in the covered risks.

1. Redundant Restatement of Risks

Many of the specific risks that are explained in detail were previously included within the simple, broad covered risks of the 1992 forms. One goal of the revised language is to show the customers all of the types of risks that are covered. Another goal is to ensure title officers and policy agents keep all of those separated risks in mind while handling the transaction.

For example, review the detailed list within Covered Risk 2(a) and note that each of those risks, even the reference to electronic forms, should be covered by the simple paragraphs of the 1992 forms.

> 2. Any defect in or lien or encumbrance on the Title. This Covered Risk includes but is not limited to insurance against loss from
>
> (a) A defect in the Title caused by
>
> (i) forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;
>
> (ii) failure of any person or Entity to have authorized a transfer or conveyance;
>
> (iii) a document affecting Title not properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;
>
> (iv) failure to perform those acts necessary to create a document by electronic means authorized by law;
>
> (v) a document executed under a falsified, expired, or otherwise invalid power of attorney;
>
> (vi) a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or
>
> (vii) a defective judicial or administrative proceeding.

Another example can be found in Covered Risk 2(c) providing coverage against the risk of encroachments and other survey matters:

> Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land. The term "encroachment" includes encroachments of existing improvements located on the Land onto adjoining land, and encroachments onto the Land of existing improvements located on adjoining land.

Although this paragraph is certainly new within the 2006 coverage paragraphs, the protection was previously offered when no Schedule B general exceptions removed that coverage. The 1992 and prior forms provided extended coverage including risks based upon survey matters and based upon claims of title by parties in possession. The title company practice in most states lists these issues in Schedule B as exceptions to coverage, to create standard coverage that does not include those risks. That same title company practice is expected for the 2006 forms, when only standard coverage is to be issued.

The significance of the 2006 change is demonstrated when extended coverage is provided. For loan policies, and for owner's policies providing extending coverage, the present title company practice is to remove the Schedule B exception. That practice is commonly believed to provide coverage, but judicial interpretation looks only to the covered risks to find coverage. Deleting the Schedule B exceptions for survey matters using the 2006 policy forms will clearly provide this coverage in Covered Risk 2(c).

2. Exceptions within Exclusions

Several of the new coverage paragraphs state coverage that was previously only a qualification contained within the exclusions. This responds to judicial policy interpretation that coverage must be found within the covered risks, rather than construed from exclusions within the exclusions. The 2006 policy forms clearly give coverage for the issues that were previously an exception to the Exclusions, so Insureds will not need to rely upon judicial interpretation to find coverage.

For example, notice the exception within the 1992 Exclusion 1(b) regarding governmental regulations:

> Any governmental police power not excluded by (a) above, ***except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.***

It is technically correct to state that the appearance of a recorded document giving notice of a violation of governmental police power did not provide coverage against the risk of governmental police power in the 1992 policy forms. That recording (if not excepted in Schedule B) eliminated application of the Exclusion to the extent of that recording. This is an example where judicial interpretation might not conclude the former policies intended to give coverage, and where the 2006 policy clearly provides such coverage.

This list shows the 1992 Exclusions that contain exceptions related to notices:

- environmental, except if disclosed by notice
- police power, except if disclosed by notice
- condemnation, except if disclosed by notice
- condemnation, except if apparent previously
- creditors' rights, except due to insufficient or late recording

Many Exclusion paragraphs in prior forms included a limitation of the Exclusion, if a recorded document gave notice of the subject matter. However, judicial interpretation of the "exception within the exclusion" may not be dependable for the conclusion that the prior policy forms provided affirmative coverage against loss suffered related to that subject matter.

Courts have interpreted that coverage must be stated in the coverage paragraphs, and cannot be interpreted from the Exclusion paragraphs. See, *Somerset Savings Bank v. Chicago Title Insurance Co.*, 420 Mass. 422, 649 N.E.2d 1123, 1126 (Mass.1995), *Lick Mill Creek Apartments v Chicago Title Ins. Co.*, 231 Cal. App. 3d 1654, 283 Cal. Rptr. 231 (Cal. App. Dist. 1991) and *Elysian Investment Group, LLC v. Stewart Title Guaranty Co.*, 105 Cal.App.4th 315 (2002).

The 2006 policy forms provide substantive coverage against the subject matters of the exclusion risks, if the record discloses a notice. Each coverage paragraph based on a recorded notice is paired with a simple exclusion where no notice is recorded. For example:

Coverage:

1. The exercise of the rights of eminent domain if a notice of the exercise, describing any part of the Land, is recorded in the Public Records.
2. Any taking by a governmental body that has occurred and is binding on the rights of a purchaser for value without Knowledge.

Exclusion:

2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.

3. Creditors' Rights Coverage

The issue of creditors' rights was extensively discussed between 1990 and 1992. This essay does not restate that history. In the same way that other 1992 exclusions contained exceptions, the creditors' rights exclusion by 1992 included an exception that the customers and the title industry agreed upon as a division of the risks. The 2006 policy forms are designed to give coverage for creditors' rights in those circumstances where the 1992 exclusion contained an exception.

The 2006 policy forms are designed to give coverage for creditors' rights in those circumstances where the 1992 exclusion contained an exception. Although oversimplified, the 2006 forms provide coverage against two creditors' rights risks. First, the policy protects against any attack against the prior chain of conveyances. Second, the policy protects against any attack against the present transaction due to the failure to record, or the failure of the recording to give legal notice binding upon the bankruptcy trustee.

The 2006 Owner's Policy provides that coverage more precisely, using a few more words:

9. Title being vested other than as stated in Schedule A or being defective

   (a) as a result of the avoidance in whole or in part, or from a court order providing an alternative remedy, of a transfer of all or any part of the title to or any interest in the Land occurring prior to the transaction vesting Title as shown in Schedule A because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws; or

   (b) because the instrument of transfer vesting Title as shown in Schedule A constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws by reason of the failure of its recording in the Public Records

      (i) to be timely, or

      (ii) to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

That coverage is paired with a matching exclusion:

4. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction vesting the Title as shown in Schedule A, is

   (a) a fraudulent conveyance or fraudulent transfer; or

   (b) a preferential transfer for any reason not stated in Covered Risk 9 of this policy.

The title insurance industry is often willing to provide affirmative coverage against creditors' rights, based upon specialized underwriting. The ALTA basic form does not automatically provide that coverage. The only proper method to provide that coverage is to issue the ALTA 21 endorsement, which provides:

> The Company insures against loss or damage sustained by the insured by reason of the avoidance in whole or in part, or a court order providing some other remedy, based on the voidability of any estate, interest, or mortgage shown in Schedule A because of the occurrence on or before Date of Policy of a fraudulent transfer or a preference under federal bankruptcy, state insolvency or similar creditors' rights laws.

There are many customers who appear willing to rely upon judicial interpretation that the removal of a policy Exclusion will give affirmative coverage against loss caused by the matter described in the exclusion. For example, many customers prefer the 1970 ALTA basic policy form, because it does not contain a creditors' rights exclusion.

Particularly in light of the format of the 2006 policies, customers should not expect that be creditors' rights exclusion will be deleted in the 2006 form. Also now, the theory of requesting the prior 1970 form since it contains no exclusion for creditors' rights would seem much less likely to be interpreted to provide affirmative coverage.

Based on the *Somerset Savings Bank* and *Mill Creek Apartments* decisions, *supra*, it seems more likely that a judge will not find creditors' rights coverage in the insuring clauses of any of the basic policy forms prior to this 2006 form.

4. Loan Policy Coverage

In the 1992 Loan Policy, Exclusion 6 excluded coverage for mechanic's liens not financed by the insured loan. When the forms committee analyzed that exclusion to design an appropriate covered risk, it determined that no exclusion was required. Therefore in the 2006 policy, a covered risk provides coverage against loss due to mechanic's liens that are financed by the insured loan.

The 1992 Loan Policy Exclusion 6 provided:

> 6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which at Date of Policy the insured has advanced or is obligated to advance.

The 1992 Loan Policy also contained Condition paragraph 8(d) that provided:

> (d) The Company shall not be liable for: ... (ii) construction loan advances made subsequent to Date of Policy, except construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the land which at Date of Policy were secured by the insured mortgage and which the insured was and continued to be obligated to advance at and after Date of Policy.

The application of Exclusion 6 and the slightly different phrasing of condition paragraph 8(d) created uncertainty about the protection of the policy against labor and material liens. The 2006 loan policy deletes both provisions, stating construction loan coverage more clearly. The 2006 Loan Policy Covered Risk 11 provides:

> 11. The lack of priority of the lien of the Insured Mortgage upon the Title
>
> (a) as security for each and every advance of proceeds of the loan secured by the Insured Mortgage over any statutory lien for services, labor, or material arising from construction of an improvement or work related to the Land when the improvement or work is either
>
> (i) contracted for or commenced on or before Date of Policy; or

(ii) contracted for, commenced, or continued after Date of Policy if the construction is financed, in whole or in part, by proceeds of the loan secured by the Insured Mortgage that the Insured has advanced or is obligated on Date of Policy to advance; and

(b) over the lien of any assessments for street improvements under construction or completed at Date of Policy.

The street assessment coverage provided by covered risk 11(b) may not be new, if the title companies in the particular state have been using "Form 1" 1992 ALTA loan policy forms that include street assessment coverage. It is the same coverage provided by ALTA endorsement form 1.

5. New Coverage for "the Gap"

Both the 2006 policy forms include coverage for matters created after the date of policy through the time of recording the insured instruments. Depending upon the common procedures used for the settlement of a transaction, this coverage may be very valuable.

The lender's version of the covered risk provides:

14. Any defect in or lien or encumbrance on the Title or other matter included in Covered Risks 1 through 13 that has been created or attached or has been filed or recorded in the Public Records subsequent to Date of Policy and prior to the recording of the Insured Mortgage in the Public Records.

In some states, the standard settlement procedure considers closing has occurred when funds are delivered and documents are exchanged, the title policy is dated at that time, then the title company takes the documents for subsequent recording. This is particularly true in commercial transactions, known as "New York style" closing.

The 2006 gap coverage allows the policy to be delivered at the time of that settlement, providing coverage at that time, and further providing coverage for risks between the settlement and the recording.

Many states, particularly western states, use a settlement procedure where the insured instruments are recorded prior to delivery of funds. Covered Risk 14 (Covered Risk 10 for Owner's) provides no additional protection when the date of policy is the same as the recordation.

Yet, this coverage may prove valuable, allowing standard procedures to change. Residential lenders that require a title policy dated at the time of recording often encounter difficulty when funding occurred previously. This clear gap coverage will allow lenders to relax about this issue, allowing the recordation to occur subsequently without concern about a gap.

There is a new exclusion for taxes incurred in that gap, paired to the gap coverage. It also only affects transactions where the policy is dated prior to recordation. The lender's version provides:

7. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the Insured Mortgage in the Public Records. This Exclusion does not modify or limit the coverage provided under Covered Risk 11(b). *[11(b), street assessment coverage, is intended to protect against future liens].*

6. New Coverage for Encroachments onto a Neighbor

The 2006 policy clearly gives coverage for loss where the Insured's improvement encroaches off the land onto a neighbor. That probably is properly considered as new coverage.

Note this is the opposite issue than the neighbor's improvement that encroaches into the insured land. The neighbor's improvement on the insured land represents the claim of a party in possession that is not recorded, but would be disclosed by an accurate survey and also by an inspection. Unless an exception appears in Schedule B, the 1992 policy form in Washington practice provides extended coverage including that risk. The 2006 policy will clearly provide that same coverage.

However, even extended coverage using the 1992 form probably does not provide coverage for encroachment of the Insured's improvement off the land onto a neighbor's land.

The portion of the land under that encroaching improvement is outside the insured legal description. The legal description of the policy defines a boundary line from the deeds in the public records. The title companies do not intend to affirmatively insure any matter outside the definition of the insured land, because no search or inspection is conducted for that land.

The 1992 form insuring paragraphs do not provide coverage against loss due to an encroachment of the Insured's improvement outside the insured legal description. The 2006 forms clearly do provide coverage for both encroachment onto the land and encroachment off the land onto the neighbor. The owner's policy version in Covered Risk 2(c) provides:

> The term "encroachment" includes encroachments of existing improvements located on the Land onto adjoining land, and encroachments onto the Land of existing improvements located on adjoining land.

Extended coverage following the typical state title practice using the 1992 form does not include any insuring provisions that the Insured has legally vested ownership of the portion of the neighbor's land that the improvement may be upon. The removal of General Exceptions does not provide insurance that the improvements are entirely upon the insured land.

B. Policy Provisions for Digital Documents and Procedures

The real estate world has changed to adopt the creation of documents on computer screens, using signatures and acknowledgments by digital methods, and even recording by digital transmission and receipt. These new technologies create new risks that are covered by the 2006 forms.

Working primarily at the request of Fannie Mae and MERS® (Mortgage Electronic Registration System[1]), the ALTA forms committee included digital risks in coverage paragraphs and included digital procedures to create and transfer digital notes within definitions.

The 2006 Loan Policy now provides in Covered Risk 2(a):

> 2... (a) A defect in the Title caused by
>
> (iv) **failure to perform those acts necessary to create a document by electronic means authorized by law;**
>
> (vi) a document not properly filed, recorded, or indexed in the Public Records **including failure to perform those acts by electronic means authorized by law**;

The definition of Insured now includes, "if the Indebtedness is evidenced by a "transferable record," the person or Entity who has "control" of the "transferable record," as these terms are defined by applicable electronic transactions law."

The Loan Policy's definition of Indebtedness now includes, "The obligation secured by the Insured Mortgage including one evidenced by electronic means authorized by law."

C. Revisions of the Definitions

Both policy forms now contain more definitions. The 1992 Owner's and Loan Policies contain seven definitions; the 2006 Owner's Policy contains eleven definitions and the 2006 Loan Policy contains thirteen definitions. Many of these enable easy and clear drafting throughout the policy. There are several very significant changes improving the rights of the Insureds.

1. Insured

Both policy forms improve the rights of successors and assigns. These changes should avoid the need for Insureds to obtain endorsements in many circumstances to acknowledge rights to the policy, such as transfers to a trust, mergers, or changes in entity form.

The owner's policy definition includes:

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[1] MERS was created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper. Our mission is to register every mortgage loan in the United States on the MERS® System. http://www.mersinc.org

(A) successors to the Title of the Insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives, or next of kin;

(B) successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization;

(C) successors to an Insured by its conversion to another kind of Entity;

(D) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title

(1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named Insured,

(2) if the grantee wholly owns the named Insured,

(3) if the grantee is wholly-owned by an affiliated Entity of the named Insured, provided the affiliated Entity and the named Insured are both wholly-owned by the same person or Entity, or

(4) if the grantee is a trustee or beneficiary of a trust created by a written instrument established by the Insured named in Schedule A for estate planning purposes.

The loan policy definition also includes:

"(A) the owner of the Indebtedness and each successor in ownership of the Indebtedness, whether the owner or successor owns the Indebtedness for its own account or as a trustee or other fiduciary,..."

2. Indebtedness

The 2006 Loan Policy uses the definition of indebtedness as a tool for clarity of the rights of the lender, but it also includes significantly more types of financial loss to the lender within the rights of the lender for compensation.

Condition paragraph 1(d) includes:

the Indebtedness is the sum of

(i) the amount of the principal disbursed as of Date of Policy;

(ii) the amount of the principal disbursed subsequent to Date of Policy;

(iii) the construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the Land or related to the Land that the Insured was and continued to be obligated to advance at Date of Policy and at the date of the advance;

(iv) interest on the loan;

(v) the prepayment premiums, exit fees, and other similar fees or penalties allowed by law;

(vi) the expenses of foreclosure and any other costs of enforcement;

(vii) the amounts advanced to assure compliance with laws or to protect the lien or the priority of the lien of the Insured Mortgage before the acquisition of the estate or interest in the Title;

(viii) the amounts to pay taxes and insurance; and

(ix) the reasonable amounts expended to prevent deterioration of improvements;

3. Amount of Insurance

The significant aspect of this simple definition is by comparison to the confusion in the 1992 and earlier policy forms. It is a new definition in the 2006 forms, stating:

(a) "Amount of Insurance": The amount stated in Schedule A, as may be increased or decreased by endorsement to this policy, increased by Section 8(b) *[10% in the event of unsuccessful litigation instituted by the title company]* or decreased by Section 10 *[claim payments]* of these Conditions.

Several places in the 1992 forms referred to decreases in the amount of insurance, such as the consequence of a voluntary payment, or increases, such as interest, where the intended meaning probably was a decrease in the amount of indebtedness. The 2006 form keeps these definitions separate.

4. Entity

(c) "Entity": A corporation, partnership, trust, limited liability company, or other similar legal entity.

5. Public Records

(i) "Public Records": Records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without Knowledge. With respect to Covered Risk 5(d), "Public Records" shall also include environmental protection liens filed in the records of the clerk of the United States District Court for the district where the Land is located.

6. Unmarketable Title

(k) "Unmarketable Title": Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title to be released from the obligation to purchase, lease, or lend if there is a contractual condition requiring the delivery of marketable title.

D. Revisions of the Conditions

The previous discussion shows that the 2006 policy forms do not offer substantially more coverage. The primary value of the new basic policy forms is realized from the revisions of the definitions and conditions paragraphs. A few revisions are discussed elsewhere where appropriate. Some revisions delete entire paragraphs of the 1992 policy forms. The deleted paragraphs are discussed in a subsequent section.

1. Duties of the Insured upon Discovery of a Possible Claim

The claim administration paragraphs have been revised to accommodate circumstances where a defect, lien or encumbrance that is insured against has been discovered and a potential loss exists, but the Insured has not suffered a loss. The Notice of Claim remains a critical duty of the Insured.

Condition paragraph 3 follows the same language as the 1992 and prior forms.

The 1992 and prior policy forms in Condition paragraph 5 required the Insured to furnish a Proof of Loss, in a form of a sworn statement, within 90 days. The consequence of failure was, "If the Company is prejudiced by the failure of the insured claimant to provide the required proof of loss or damage, the Company's obligations to the insured under the policy shall terminate."

Condition paragraph 4 of the 2006 policy form does not require the Insured to provide a subsequent written statement except, "In the event the Company is unable to determine the amount of loss or damage, the Company may, at its option, require as a condition of payment that the Insured Claimant furnish a signed proof of loss."

Several provisions of the 1992 policy provided requirements of the Insured to cooperate and produce information that may be needed by the title company in litigation and otherwise to determine the matter or avoid loss to the insured. These duties were contained in condition paragraphs 4 and 5. The 2006 policy forms in Condition paragraph 6 provide the duties of the insured to cooperate and provide assistance to the title company. The duties are essentially not different.

There are changed provisions about records from third parties and confidential records, that state:

> (b) ... Further, if requested by any authorized representative of the Company, the Insured Claimant shall grant its permission, in writing, for any authorized representative of the Company to examine, inspect, and copy all of these records in the custody or control of a third party that reasonably pertain to the loss or damage. All information designated as confidential by the Insured Claimant provided to the Company pursuant to this Section shall not be disclosed to others unless, in the reasonable judgment of the Company, it is necessary in the administration of the claim. ...

2. Consequences of Title Company Litigation That Does Not Succeed

The 2006 policy forms include two new provisions related to cases where the title insurance company chooses to defend, or prosecute, in order to avoid loss to the insured payable under the policy. That important right of the title company to establish the title, or to prevent or reduce loss To the Insured, as provided by Condition paragraph 5(b), is essentially the same as ALTA policies since 1970.

When the title company litigation is successful, the loss is avoided or reduced. The request of customer groups to the ALTA Forms Committee was to provide a consequence to more adequately compensate the Insured in those cases when the title company litigation is not successful. Since condition paragraph 5(c) allows litigation to a final determination, substantial time can elapse, causing consequence to the rights of the Insured.

The 2006 policy forms in condition paragraph 8(b) provide two consequences. The Amount of Insurance is increased by 10% and the Insured may determine or measure its loss either when the claim was made or at the conclusion of the litigation. The policy language is:

> (b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title or the lien of the Insured Mortgage, as insured,
>
> (i) the Amount of Insurance shall be increased by 10%, and
>
> (ii) the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as of the date it is settled and paid.

There is no question these consequences will be considered by title companies when proceeding with protracted litigation. These provisions represent significant additional coverage value to the Insured provided by the 2006 policy.

3. The "Last Dollar" Issue is Resolved

The "last dollar" endorsement may no longer be needed. That endorsement attempts to resolve a problem caused by condition paragraph 9(b) of the 1987, 1990 and 1992 loan policies that reduced the "Amount of Insurance" upon a borrower payment.

1992 paragraph 9(b) stated, "Payment in part by any person of the principal of the indebtedness ... shall reduce the amount of insurance pro tanto." That operated in conjunction with condition paragraph 8(d) of those forms that provided, "The Company shall not be liable for: (i) any indebtedness created subsequent to Date of Policy."

Therefore, in any under-secured loan where the amount of indebtedness could exceed the face amount of the policy, and especially in any loan where subsequent advances would be likely, the Insured requested a custom endorsement that came to be known as "Last Dollar." That form provides:

> The Company has been advised by the Insured that the mortgage/deed of trust to secure debt insured under the Policy (as the same may be amended, supplemented, extended or renewed, the "Mortgage") secures an indebtedness to the Insured in an amount in excess of the amount of the policy. The Company agrees that in calculating, for the purposes of the Policy, the amount of outstanding indebtedness secured by the Mortgage and covered by the Policy, payments made to reduce the amount of said indebtedness (except payments made by the Company pursuant to provisions of the Policy) shall be deemed applied first to the portion of said indebtedness that is in excess of the policy limit set forth in Schedule A of this policy.

The 2006 Loan Policy does not contain either of those troublesome provisions. The Amount of Liability remains the face amount and is not reduced by payments. Condition paragraph 10 reduces insurance only by claim payments. The 2006 definition of Indebtedness clearly includes subsequent advances.

4. Arbitration is Retained

The 1987 ALTA policies introduced a provision allowing either party to seek arbitration of a dispute related to the policy, as long as the policy amount was below $1 million. Both 2006 policy forms retain essentially the same provision, but the policy amount limit was increased to $2 million.

Above that increased policy amount, unilateral arbitration does not apply. The increase is slightly more than the effect of inflation over the intervening 19 years. It is common in many states for that provision to be deleted from the policy, where permitted by the insurance regulations.

E. Deletion of Certain Conditions and Stipulations

It may require some time and familiarity before customers fully appreciate how the revised Conditions of the 2006 policy resolve prior policy objections. Yet, there is clear and immediate satisfaction when a paragraph that reduced the Insured's rights, or caused uncertainty among the parties, can be deleted outright. Several such deletions were made by the ALTA forms committee.

1. The Owner's Policy Coinsurance Paragraph is Gone

When the coinsurance paragraph first appeared in the 1987 owner's policy, its intent was to address the circumstance where a person requested title insurance for less than the value of the land and improvements. In that circumstance, the Insured would be entitled to a portion of any subsequent loss. Such provisions are common to other lines of insurance.

Condition paragraph 7(b) of the 1992 Owner's Policy requires mathematical skills to determine if it applies and to determine the amount of reduction in a claim. It provided:

> (b) In the event the Amount of Insurance stated in Schedule A at the Date of Policy is less than 80 percent of the value of the insured estate or interest or the full consideration paid for the land, whichever is less, or if subsequent to the Date of Policy an improvement is erected on the land which increases the value of the insured estate or interest by at least 20 percent over the Amount of Insurance stated in Schedule A, then this Policy is subject to the following:
>
> (i) where no subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that the amount of insurance at Date of Policy bears to the total value of the insured estate or interest at Date of Policy; or
>
> (ii) where a subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that 120 percent of the Amount of Insurance stated in Schedule A bears to the sum of the Amount of Insurance stated in Schedule A and the amount expended for the improvement.

The following example shows the effect of 1992 coinsurance paragraph [Condition 7(b)] where $75,000 is spent on improvements. If the Insured

suffers $50,000 loss for a covered matter, when the value of the land is $200,000, the policy provides only $40,625 in indemnification.

Policy Amount:	**$125,000**
Amount Expended for Post-Policy Improvements:	**$75,000**
Value of Insured Estate After Post-Policy Improvements:	**$200,000**
Amount of Actual Loss:	**$50,000**
Pro Rata Proportion:	**75.0%**
Amount of Reduction:	**$9,375.00**
Amount of Loss Payable:	**$40,625.00**

The Insured in this example would be entitled to $9,375.00 additional loss payment under the 2006 Owner's Policy. In actual claims, the title companies did not consistently apply this provision to reduce loss payments. When the coinsurance provision was enforced, it was the subject of debate, defenses and ultimately negotiation. Therefore, it may not be true that the 2006 policy will provide higher payments than an Insured would have received with the 1992 policy. It is clearly true that the 2006 policy no longer contains a coinsurance paragraph that could be used to reduce an Insured's claim.

2. The Owner's Policy Apportionment Paragraph Is Gone

Condition paragraph 8 of the 1992 Owner's Policy has existed since the 1970 forms. Contained only in owner's policies, it applies to limit the recovery for loss incurred on one parcel affected by a title claim, when the policy includes more than one parcel of land. It provided:

> If the land described in Schedule A consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, **the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole**, exclusive of any improvements made subsequent to Date of Policy, unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement attached to this policy.

The deletion of this paragraph has tremendous value where multiple parcels are insured with one policy. For example, if both parcels are worth $200,000 at date of policy, then increased in value to $300,000 at the time of loss, a $400,000 title insurance policy will totally protect the insured against failure of title of one parcel. The 1992 apportionment Paragraph would limit the claim to 50% of the loss.

3. The Lender's Policy "Subsequent Advance" Limitation Is Gone

The deletion of Condition & Stipulation paragraph 8(d)(ii) of the 1992 loan policy is described above as a benefit to clarify mechanic's lien coverage for a loan policy. Paragraph 8(d)(i) also contained an extremely significant limitation on the amount a lender was entitled to receive pursuant to the 1992 policy.

In the event of a claim, the insurance company has the right to pay the amount of indebtedness to discharge its obligations. However, the 1992 policy did not require payment of subsequent advances, by stating:

> The Company shall not be liable for: (i) any indebtedness created subsequent to Date of Policy except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of improvements.

The 2006 Loan Policy does not contain any provision similar to paragraph 8(d)(ii) of the 1992 loan policy. As described above, the definition of indebtedness includes subsequent advances.

Where lenders make additional advances after the policy date, this policy change provides significant value. However, it must be emphasized that the 2006 Loan Policy does not insure against loss of priority of the lien of the mortgage to the extent of the additional advance. Risk of loss of priority of additional advances is protected by using ALTA form 14, 14.1 or 14.2 endorsements, issued at the date of policy or at the date of the advance.

For any type of loss to the lender other than a claim of priority against the lien for the amount of the additional advance, the inclusion of the additional advance in the indebtedness will require payment to the lender when the title company exercises that option.

4. The Lender's Policy "Liability Noncumulative" Provision Is Gone

The 1992 Loan Policy contains a Condition & Stipulation paragraph 10 that has an effect on the rights of a junior lien lender that can be somewhat difficult to justify in some circumstances. A version of this paragraph has been in policies since 1970. It provides:

> If the insured acquires title to the estate or interest in satisfaction of the indebtedness secured by the insured mortgage, or any part thereof, it is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A, and the amount so paid shall be deemed a payment under this policy.

If a title company issued a loan policy to a senior mortgage and later issued a loan policy to a junior mortgage, then the second lender acquired the property in foreclosure, this paragraph limits the coverage of that second lender. The junior lender paid a premium for protection of its lien, but is

subject to reduced coverage for claim payments to the first lender. Credit is given to the US Small Business Administration that objected to this paragraph leading to standard procedures deleting the paragraph for junior lien policies.

In these circumstances, the deletion of the 1992 Condition 10 represents a substantial increase in the value of the title insurance policy.

F. Continued use of the 1992 Policies

Based on the actions of the title industry in the past, it is likely that the title companies will have both the 1992 and the 2006 policy forms available, allowing the customer to choose. All the title companies are likely to obtain approval to issue the 2006 forms.

Preliminary commitments are likely to continue to show the 1992 policy form will be issued, unless customers request the new form. When customers begin to accept the new forms, commitments will begin to show the 2006 policy form will be issued. Even thereafter, the title companies will issue the old form upon customer request, in states where that is allowed.

The ALTA has decertified the 1992 policy forms as of December 31, 2006. In many states, title companies are allowed to issue older, replaced forms upon request of the customer, even though the forms become "decertified" by the ALTA. The decision to issue an older form is at the discretion of each particular underwriter.

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Understanding Creditors' Rights Title Insurance

BY BERNIE BITTNER
Special to the Legal, PLW

The use of creditor's rights title insurance has increased substantially during the past several years. This has occurred, to some extent, as a result of the need to meet securitized mortgage debt financing criteria, which typically will require creditor's rights title insurance.

Although title insurance underwriters will, in most instances, quickly approve a request for creditor's rights insurance, obtaining this coverage for certain types of transactions may prove to be challenging. As a result of the recent downturn in the real estate markets and the resulting negative impact that this can have on a real estate owner's balance sheet, you may find that title insurers are undertaking more due diligence before agreeing to provide creditor's rights coverage for some deal structures.

Understanding the insurance and the analysis that the title company will complete should place you in a better position to timely obtain the creditor's rights protection.

THE RISKS INSURED

Under the federal Bankruptcy Code and under state Uniform Fraudulent Transfer and Uniform Fraudulent Conveyance Acts, a transaction may be set aside or voided as to certain creditors if it is found to be a fraudulent or preferential transfer or conveyance, or as the result of an equitable subordination action. Creditor's rights title insurance protects against loss due to a determination that a transfer of a property and/or the granting of a mortgage represents a fraudulent or preferential transfer. Because the lender's own actions and malfeasance are the basis of an equitable subordination claim, the title industry takes the position that equitable subordination is not covered under the policy as the result of the application of the "acts of the insured" policy exclusion.

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Although the federal Bankruptcy Code and the state acts are not identical, they are very similar in the manner in which they address fraudulent transfers. However, unlike the federal laws, the state acts do not include prohibitions against preferential transfers, except in the case of insider transactions. Additionally, the statutes of limitations under the state statutes are generally up to four years in length and can be as long as six years as opposed to the one year limit that is provided for in the Bankruptcy Code.

Both the federal and state acts set forth two types of fraudulent conveyances, intentional fraud and constructive fraud. Intentional fraud allows a transaction to be set aside if it is determined that the transfer was completed with the intent to hinder, delay or defraud a then current or future creditor. The underlying principles of intentional fraud tend to be rather basic in that the transferor knows that its equity in the asset is in jeopardy of being lost and, as a result, the asset is transferred with the intent of removing or hiding the asset from creditors that would otherwise have had rights to a distribution of some of that equity.

Although title companies must maintain vigilance against fraudulent activities, the analysis and due diligence completed by title companies regarding creditor's rights insurance is most often focused on constructive fraud issues as opposed to intentional fraud. The threshold test for constructive fraud is to determine if the parties to the transaction received reasonably equivalent value or fair consideration for the transfer (this reasonably equivalent value/fair consideration test will be referred to as the "value/consideration test"). In addition, any property transfer or mortgage involving an insider raises a possible fraudulent conveyance risk.

In purchase and sale transactions, there are several factors that a title company will look for to confirm the existence of reasonably equivalent value or fair consideration, including the use of standard marketing and sales processes to bring the parties together, arms length negotiations between unrelated parties, preferably including the use of professionals such as brokers, accountants, attorneys and investment bankers, and a property appraisal that supports the sale price. In a loan transaction, the analysis will turn mostly on the use of the proceeds of the loan to confirm that the borrower received a substantial benefit from the funds.

If it appears that the grantor did not receive reasonably equivalent value or fair consideration, or if the transfer was to an insider, then the title insurer will complete an analysis to determine if the transferor is insolvent at the time of the transfer or becomes insolvent as a result of the transfer; is inadequately capitalized for the business it is in; or is unable to pay its debts as they become due (these three tests will be referred to as the "financial tests").

In addition to fraudulent transfers, a mortgage loan may be voided as a preferential transfer under the Bankruptcy Code if the transfer enables a creditor to receive more than it would otherwise have received in a liquidation of the debtor, and if the transfer fits the following:

- It was to or for the benefit of a creditor;
- It was relating to an antecedent debt;
- It was made while the debtor was insolvent; and
- It was made within 90 days of the filing of a bankruptcy petition, or within one year if the transfer was to an insider (the "four-prong test").

CHALLENGES TO OBTAINING THE INSURANCE

If the purchase price in a sale transaction does not approximate fair market value, the transaction will likely fail the value/consideration test. Although judicial mortgage foreclosure sales will generally withstand an attack based upon the value/consideration test because of the protections that are deemed to exist under the foreclosure statutes and procedures, non-foreclosure transfers of properties for very low prices by distressed sellers will be viewed cautiously.

Certainly, deeds in lieu of foreclosure will draw additional scrutiny to confirm that the grantor has received sufficient consideration for its property. The sale or mortgaging of equity interests in a leveraged buy out or the distribution of cash in a leveraged cash out may fail both the value/consideration and financial tests because the company will assume a potentially large debt without gaining the benefit of the proceeds of the loan.

In transactions containing up-stream and cross-stream guarantees secured with a mortgage, a subsidiary company guarantees the debt of a parent or sister company and secures the guaranty with a mortgage on its real estate. This type of structure may not meet the value/consideration test because the subsidiary has taken on more debt than it has received assets. Because of this balance sheet mismatch, it is also possible that the guarantor will have become illiquid the moment the guaranty is given, adding to the constructive fraud risk because of the failure to meet the financial tests.

Similarly, when a loan is cross collateralized, a fraudulent conveyance risk arises because the mortgagor is pledging its already encumbered assets for a new loan being made to another entity for which the mortgagor may not receive any proceeds or direct benefit. This can result in a balance sheet increase in obligations without an offsetting increase in assets, again possibly resulting in an illiquid mortgagor or otherwise failing the value/consideration and/or financial tests.

There are certain steps that can be taken to reduce the creditor's rights risk in up-stream and cross-stream guarantee and cross-collateralized loan transactions. One suggestion would be to have the borrower and guarantors enter into a contribution agreement that would allow any guarantor called upon to repay a portion of the parent or sister company's loan to demand repayment from the other parties to the contribution agreement for any part of the repayment that the guarantor makes beyond its proportionate share of proceeds or benefit of the loan.

Another option would be to include a release price for each guarantor that would allow the guarantor to have its pledged real estate released upon payment of a predetermined amount. Including a net worth limitation in the guaranty such that the guarantor would never be obligated to make a payment that would cause it to fail any of the fraudulent conveyance financial tests may also be helpful. Finally, an indemnity from the parent to the title company against losses due to a claim of fraudulent conveyance may be sufficient to obtain the required coverage.

Regarding preferential transfers, although they can take on many different structures, one of the most easily recognizable preference transactions consists of a mortgage that is given to secure debt that was previously unsecured. If the borrower is illiquid at the time of the loan modification, this transaction will likely fail the four-prong test. Similarly, transactions in which a borrower provides substitute collateral or additional collateral for an existing debt because the lender was under collateralized (and therefore, partially unsecured) or in which the borrower transfers assets to an insider to repay a debt that is owed by the borrower to the insider, will likewise create a preferential transfer risk.

THE ALTA 21 POLICY ENDORSEMENT

Prior to the adoption of the ALTA 2006 title insurance policy, there were generally two policies utilized for commercial transactions in Pennsylvania, the ALTA 1970/84 policy and the ATLA 1992 policy. One notable difference between these policies is that the 1992 policy contains a specific exclusion against insuring loss or damage arising from a fraudulent or preferential conveyance or equitable subordination, which exclusion is not set forth in the 1970/84 form.

Although the title industry has always taken the position that neither policy insured creditor's rights risks, because the 1970/84 policy did not include the creditor's rights exclusion, many lenders requested that policy over the 1992 form.

The ALTA 2006 policy was approved in Pennsylvania in April 2007, and neither the 1970/84 nor the 1992 policy may be utilized to insure commitments issued after that date. As of September 2007, affirmative creditor's rights insurance became available through the use of the ALTA 21 Creditor's Rights Endorsement. This endorsement provides insurance against loss due to fraudulent and preferential transfers but, as was discussed earlier, does not give coverage for equitable subordination.

CONCLUSION

There are several suggestions that I can make regarding creditor's rights title insurance. First and foremost, try to determine early on what endorsements the lender will require. If creditor's rights coverage is necessary, promptly request the coverage from the title company and provide the title company with information regarding the structure of the transaction and financing.

Depending on the nature of the transaction, be prepared to provide the title company with information regarding the negotiation/due diligence process leading to the execution of the agreement of sale, property valuations including an appraisal if available, borrower and guarantor financials, loan parameters such as loan to value and debt service ratios, and the use of the loan proceeds. Because clients are sometimes reluctant to offer these items, you may want to consider requesting that the title company enter into a confidentiality agreement with your client.

Finally, use a title insurance company with which you are comfortable and that has the necessary expertise to promptly complete its analysis to provide you with the requested coverage.

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THE ALTA COMMERCIAL ENDORSEMENTS

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THE ALTA COMMERCIAL ENDORSEMENTS

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THE ALTA COMMERCIAL ENDORSEMENTS

A. An Overview of the ALTA endorsements

The early American Land Title Association endorsements were primarily designed for residential risks. The evolving secondary market for residential mortgages in the 1970s pushed the development of those endorsements to address risks that troubled investors. Although we view the ALTA 3 and 3.1 zoning endorsements as commercial endorsements, all of the other endorsements from the ALTA 1 Street Assessment Endorsement to the ALTA 8.1 Environmental Protection Lien Endorsement were designed to protect residential mortgages.

Of course, simplicity is crucial to the volume residential mortgage market, and endorsements are a bulky fix for inadequate title insurance coverage. The recent enlargement of policy coverage, as exemplified by the ALTA Expanded Coverage Residential Loan Policy, is a more efficient solution for the residential market. Consequently, we are witnessing a shift from the emphasis on residential issues for ALTA endorsements to an emphasis on commercial issues.

The endorsements beginning with the ALTA 9 Restrictions, Encroachments, Minerals Endorsement to the ALTA 11 Mortgage Modification Endorsement made a good transition between residential and commercial, because they can be used comfortably in either market. The ALTA then began developing a series of commercial endorsements designed to meet the needs of the commercial securitization markets, beginning with the ALTA 12 Aggregation Endorsement.

With the turn of the twenty first century, this process kicked into gear as the ALTA has adopted twenty six new endorsements before turning to the development of the new basic loan policies. They were designated the ALTA 13 to ALTA 28, with most being a series of one or two endorsements.

After the 2006 policies were drafted, a new series, designated the "-06" endorsements, from the ALTA 1-06 to the ALTA 21-06 were adapted to the new policies. The changes are modest. The new endorsements incorporate the defined terms used in the new policies, and any references to policy provisions will be changed, or eliminated (*e.g.*, the ALTA 13 leasehold endorsement drops Section 2 of the old endorsement that deletes the coinsurance provision because the 2006 Owners policy has no coinsurance provision).

The new endorsements are designated with a "-06" to avoid confusion with the existing endorsements. Thus, an ALTA 14.2 endorsement is designed for a 1992 or earlier policy, and an ALTA 14.2-06 is the equivalent adapted for the new policies. As we shall see, the ALTA Forms Committee also submitted eight new endorsements for adoption on June 17, 2006.

B. Zoning

ALTA 3-06 (Vacant Land) and 3.1-06 (Completed Structure)

The Zoning Endorsements were an anomaly when they appeared in 1973 as a pair of commercial endorsements in a population of residential endorsements. They are not new, but deserve recognition as commercial endorsements, and you deserve an explanation for their 1998 amendments.

The ALTA 3 Zoning – Vacant Land Endorsement is designed for insuring vacant land. It insures against loss if the zoning classification at the Date of Policy is not as shown on the endorsement and if the list of uses given in the endorsement are not allowed. However, it does not insure that the current use complies with the zoning because there are no improvements or structures to measure. As a result, it has not been very popular. Many buyers of vacant land order an ALTA 3.1 instead if there are immediate plans to develop the land. They seek insurance that improvements and structures shown on an identified plan will comply with the zoning regulations.

The ALTA 3.1 Zoning – Completed Structure Endorsement gives the same basic insurance that is found in the ALTA 3, but includes insurance against loss if the structures and improvements do not comply with the zoning with respect to

(i) Area, width or depth of the land as a building site for the structure;

(ii) Floor space area of the structure;

(iii)Setback of the structure from the property lines of the land; or

(iv)Height of the structure; or

(v) Number of parking spaces.

In 1998 the endorsements were amended as a result of a decision reached in in *Alliance Mortgage Company v. Rothwell*, 10 Cal. 4th 1226, 44 Cal. Rptr. 2d 352 (1995) that indicated that the prelude in the 1987 and earlier forms of the zoning endorsements were inappropriate to title insurance. The old endorsements began:

> 1. The Company insures the Insured against loss or damage sustained by reason of any incorrectness in the assurance that, at Date of Policy:
>
> (a) According to applicable zoning ordinances and amendments thereto, the land is classified Zone _____.
>
> (b) The following use or uses are allowed under that classification subject to compliance with any conditions, restrictions, or requirements contained in the zoning ordinances and amendments thereto, including but not limited to the securing of necessary consents or authorizations as a prerequisite to the use or uses:
>
> _____.

An indemnity policy must insure against loss or damage if a specified event or fact is <u>not</u> as indicated in the policy. The turn of the twenty-first century witnessed a scramble by the ALTA and CLTA to revise all of their endorsements to fit the new model. The result made the ALTA 3 and 3.1, more than any other form, negative and rather awkward. They now begin:

> The Company hereby insures the insured against loss or damage sustained in the event that, at Date of Policy:
>
> 1. According to applicable zoning ordinances and amendments thereto, the land is not classified Zone _____.
> 2. The following use or uses are not allowed under that classification: _____.

With the appearance of the new 2006 policy forms, we also saw two new ALTA zoning endorsements, the ALTA 3-06 and ALTA 3.1-06. In addition, the new policies are the first ALTA policies to include express coverage against loss if notice of violation or enforcement of a zoning ordinance is filed in the Public Records. This coverage may have been implied in the 1970, rev. 1984 and later ALTA policies, but it is now express in the 2006 policies. It is not the equivalent of an ALTA 3 or 3.1 coverage, so you should not change your requirements for zoning endorsements just because your project is insured with a new policy.

C. Variable Rate Mortgage
ALTA 6-06 (Variable Rate Mortgage) and 6.2-06 (Variable Rate Mortgage – Negative Amortization)

The Variable Rate Mortgage Endorsements were crafted for residential transactions at the request of Fannie Mae and Freddie Mac, but any mortgage loan, residential or commercial, may have a variable interest rate feature. There is nothing in the ALTA 6 or 6.2 (the ALTA 6.1 was a form of limited ALTA 6 coverage that has become obsolete since the 1970s) that limits its use to residential mortgages, only. So, it is not unusual to encounter an endorsement request on a commercial loan that specifies one of these ALTA 6 endorsements.

Commercial lenders especially had one objection to the ALTA 6 and 6.2. The endorsements use the term "changes in the rate of interest" but the definition of "changes in the rate of interest" was limited to ". . . only those changes in the rate of interest calculated pursuant to the formula provided in the Insured Mortgage at Date of Policy." The parties to a mortgage, and especially commercial mortgages, do not want to reveal the negotiated interest rate in a document that will be recorded in the Public Records. Under the original form, a lender faced a Hobson's choice of either disclosing the confidential interest rate in the mortgage to get the coverage, or not disclosing the interest rate in the mortgage and risking losing its coverage. It was incongruous that the ALTA endorsement required a disclosure in the mortgage that nobody in the marketplace was willing to make. Title insurance protects the lien of the Insured Mortgage, not the repayment of the indebtedness, so the ALTA composed the definition to refer to the mortgage.

On reflection, the original approach was too rigid, so the endorsements were amended by the ALTA on October 16, 2008 to correct that problem. The definition was changed to read:

> "Changes in the rate of interest", as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to the formula provided in the loan documents secured by the Insured Mortgage at Date of Policy.

D. Environmental Protection Lien
ALTA 8.2-06 (Commercial Environmental Protection Lien)

Fannie Mae required the ALTA 8.1 Environmental Protection Lien Endorsement as a condition to its acceptance of the 1987 ALTA Loan policies because environmental liens were th big issue in the mid 1980s. Several states had just enacted environmental cleanup statutes that not only gave the state a lien against land for the cost of cleanup, but also super-priority over any other lien on the land as well. Paragraph (a) of the endorsement indemnified the Insured against loss of priority to environmental protection liens filed on the Date of Policy in the Public records, and paragraph (b) insured against loss of priority to any state environmental liens even if the lien is filed after the Date of Policy. The endorsement was expressly limited to residential mortgages because virtually all super-priority lien statutes included a residential exemption. If Fannie Mae discovered a super priority environmental lien statute without a residential exemption, it would threaten to suspend purchases of mortgages in that state until the law was revised because it expected the title insurers to except to them following paragraph (b).

The ALTA 8.1 is unsuitable for commercial transactions because the exemptions in the super-priority lien statutes apply only to residential mortgages. The risk of loss to an environmental superlien on a commercial mortgage is unmanageable. A thorough phase I environmental survey report can be expected to list pages of chemical compounds identified on the property, and title insurers do not have the skill to determine if a state might require a cleanup of any of them.

To address the demand for a commercial variation of the environmental lien protection endorsement, the ALTA adopted the ALTA 8.2 Commercial Environmental Protection Lien Endorsement on October 16, 2008. It broadens the paragraph (a) coverage by eliminating the limitation of the coverage to "lack of priority of the lien of the insured mortgage." Instead the new endorsement "insures against loss or damage sustained by the Insured by reason of an environmental protection lien that, at Date of Policy, is recorded in the Public Records. . ." Consequently, it is suitable for owner's coverages as well as loan coverages.

Of course, neither of these environmental protection lien endorsements insure that the land is clean, or even suggest that it does. Title insurance is a "monoline" industry that is prohibited by law from insuring any other kind of risk. Environmental cleanup insurance is a property/casualty line of insurance, so title insurers may not accept that risk. The monoline restrictions are imposed on title insurance because an insurance line without deductibles, annual renewal premiums, and low statutory reserves cannot bear these risks.[1]

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[1] *Chicago Title Insurance Co. v. Kumar*, 24 Mass. App. Ct. 53, 506 N.E.2d 154 (1987); *South Shore Bank v. Stewart Title Guaranty Co.*, 688 F. Supp. 803 (D. Mass. 1988); *Lick Mill Creek Apartments v. Chicago Title Insurance Company*, 231 Cal. App. 3d 1654, 283 Cal. Rptr 231 (1991), *appeal denied,* Aug. 29, 1991; and *Fleet Finance, Inc. of Georgia v Lawyers Title Insurance Corporation*, No 1:88-cv-1672-HTW (N.D. Ga. Dec. 29, 1989). Related decisions in *Manley v Cost Control Marketing and Management, Inc.*, 583 A.2d 442 (Pa. Super. 1990), *Frimberger v. Anzellotti*, 594 A.2d 1029 (Conn. App. 1991) and *Bear Fritz Land Co. v. Kachmak Bay Title Agency, Inc.*, 920 P.2d 759 (1996) held that latent physical environmental defects were not "encumbrances" on title. Where a party attempts to

E. Restrictions, Encroachments, Minerals
ALTA 9-06 (Loan), 9.1-06 (Owners-Unimproved Land), 9.2-06 (Owners-Improved Land), 9.3-06 (Loan), 9.4-06 (Owners-Unimproved Land), 9.5-06 (Owners-Improved Land)

The ALTA adopted the ALTA 9 Restrictions, Encroachments, Minerals (REM) Endorsement for Loan Policies in October 1988. Ten years later, the ALTA adopted two versions for owner's policies, the ALTA 9.1 for unimproved land, and the ALTA 9.2 for improved land. The ALTA 9 is a derivation of a California endorsement, the CLTA 100.

These endorsements are often referred to as the "comprehensive" endorsements, but the name is a misnomer and I discourage it. The endorsements deal only with discrete issues, as their official names suggest.

The most important issue is coverage over risks posed by covenants, conditions or restrictions. It is spread throughout the ALTA 9 in sections 1.a, 1.b, 2 and 5, and I have extracted those coverages in the following paragraphs:

> The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:
>
> 1. The existence, at Date of Policy, of any of the following:
>
> a. Covenants, conditions, or restrictions under which the lien of the Insured Mortgage can be divested, subordinated, or extinguished, or its validity, priority, or enforceability impaired.
>
> b. Unless expressly excepted in Schedule B
>
> (i) Present violations on the Land of any enforceable covenants, conditions, or restrictions, and any existing improvements on the land described in Schedule A that violate any building setback lines shown on a plat of subdivision recorded or filed in the Public Records.
>
> (ii) Any instrument referred to in Schedule B as containing covenants, conditions, or restrictions on the Land that, in addition, (A) establishes an easement on the Land; (B) provides a lien for liquidated damages; (C) provides for a private charge or assessment; (D) provides for an option to purchase, a right of first refusal, or the prior approval of a future purchaser or occupant.. . .
>
> (v) Any notices of violation of covenants, conditions, or restrictions relating to environmental protection recorded or filed in the Public Records.
>
> 2. Any future violation on the Land of any existing covenants, conditions, or restrictions occurring prior to the acquisition of title to the estate or interest in the Land by the Insured, provided the violation results in
>
> a. the invalidity, loss of priority, or unenforceability of the lien of the Insured Mortgage; or
>
> b. the loss of Title if the Insured shall acquire Title in satisfaction of the Indebtedness secured by the Insured Mortgage. . .

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rescind a purchase of contaminated real estate, the Sixth Circuit held that "_environmental contaminants may diminish the value of the realty, but they do not constitute an encumbrance because they do not affect title." *Donehey v. Bogle*, 987 F.2d 1250 (6th Cir. 1993), reh'g denied, 1993 USApp LEXIS 14303 (1993).

5. Any final court order or judgment denying the right to maintain any existing improvements on the Land because of any violation of covenants, conditions, or restrictions, or building setback lines shown on a plat of subdivision recorded or filed in the Public Records.

Wherever in this endorsement the words "covenants, conditions, or restrictions" appear, they shall not be deemed to refer to or include the terms, covenants, conditions, or limitations contained in an instrument creating a lease.

As used in paragraphs 1.b(i) and 5, the words "covenants, conditions, or restrictions" do not include any covenants, conditions, or restrictions (a) relating to obligations of any type to perform maintenance, repair, or remediation on the Land, or (b) pertaining to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances, except to the extent that a notice of a violation or alleged violation affecting the Land has been recorded or filed in the Public Records at Date of Policy and is not excepted in Schedule B.

Coverage over encroachments is found in sections 1.b.iii, 1.b.iv, 3.a and 4. Those coverages are extracted on the top of the next page.:

The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:

1. The existence, at Date of Policy, of any of the following: . . .

   b. Unless expressly excepted in Schedule B . . .

      (iii) Any encroachment of existing improvements located on the Land onto adjoining land, or any encroachment onto the Land of existing improvements located on adjoining land.

      (iv) Any encroachment of existing improvements located on the Land onto that portion of the Land subject to any easement excepted in Schedule B. . .

3. Damage to existing improvements, including lawns, shrubbery, or trees

   a. that are located on or encroach upon that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved; . . .

4. Any final court order or judgment requiring the removal from any land adjoining the Land of any encroachment excepted in Schedule B.

Mineral coverage in the ALTA 9 is contained in Section 3.b. As we shall see, it changes in the ALTA 9.3. It reads:

3. Damage to existing improvements, including lawns, shrubbery, or trees . . .

   b. resulting from the future exercise of any right to use the surface of the Land for the extraction or development of minerals excepted from the description of the Land or excepted in Schedule B.

The coverage in the ALTA 9 and 9.3 (and their "-06" equivalents) for loan policies is more complete than you will find in the various endorsements for owners' policies. A title insurer may be willing to insure against damage to lawns, shrubbery and trees for a lender because the risk is so remote, but it would be unmanageable to protect an owner from damage to lawns, shrubbery and trees for the exercise of a right to service or maintain an easement. Consequently, the policies for owners are noticeably shorter.

The ALTA 9, 9.1 and 9.2 were revised on June 17, 2006 to add two provisions. First, the revision added a new part (v) to section 1.b. Second, the ALTA added the definition at the end of the covenants, conditions and restrictions provisions in the endorsement. It reflects the

inability of a title insurer to determine if an environmental covenant has been violated by a release of toxic or hazardous material on the land.

In addition to these changes to the existing ALTA 9, 9.1 and 9.2, the ALTA adopted three more endorsements, and then adopted -06 variations of those, so this family of endorsements now consists of twelve new endorsements. The new ALTA endorsements correspond to the first set of three REM endorsements as follows:

New endorsement:	Corresponds to:
ALTA 9.3	ALTA 9
ALTA 9.4	ALTA 9.1
ALTA 9.5	ALTA 9.2

They extend the mining coverage, formerly in paragraph 3(b) of the ALTA 9 or paragraph 2 of the ALTA 9.1 or 9.1 to include buildings constructed after the Date of Policy as well as those existing on the Date of Policy. The new provision reads:

> 4. Damage to improvements, including lawns, shrubbery, or trees, located on the land on or after Date of Policy resulting from the future exercise of any right to use the surface of the land for the extraction or development of minerals excepted from the description of the land or excepted in Schedule B.

Compare this mineral coverage in the ALTA 9.3 to the coverage in the ALTA 9 on the preceding page. Unless there is a significant difference in premium, it would be difficult to justify ordering, say, an ALTA 9 if the ALTA 9.3 is available.

A recent federal case misinterpreted paragraph 1.b.ii (D)[2] of the ALTA 9, and its misinterpretation appears to erase the coverage.[3] To summarize the facts of the case, Liberty Mills L/P deeded some land to PMI Associates with some restrictions. PMI obtained a mortgage loan form Nationwide Life Insurance. Nationwide's loan policy included an ALTA 9. PMI defaulted and gave Nationwide a deed in lieu of foreclosure. Nationwide asked Liberty Mills' successor, Franklin Mills, to waive a right to approve a purchaser of the property contained in the restrictions imposed by Liberty. Franklin Mills refused.

Nationwide tendered a claim against its title insurer; Commonwealth Land Title Insurance Company, asserting that paragraph 1.b.2 of the ALTA covered this loss. Commonwealth moved to dismiss because the policy included an exception for the restrictions. Paragraph 1 of the ALTA 9 states:

> The Company insures the owner of the indebtedness secured by the insured mortgage against loss or damage sustained by reason of:
>
> 1. The existence at Date of Policy of any of the following: . . .
>
> b. *Unless expressly excepted in Schedule B:* . . .

---

[2] I have cited the official ALTA designation for the paragraph. The variant quoted in the decision, and many on the market, use slightly different numbering systems.

[3] *Nationwide Life Insurance Company v. Commonwealth Land Title Insurance Company*, 2005 WL 2716492 (E.D. Pa. 2005).

ii. Any instrument referred to in Schedule B as containing covenants, conditions or restrictions on the land which, in addition, (A) establish an easement on the land; (B) provides a lien for liquidated damages; (C) provide for a private charge or assessment; *(D) provides for* an option to purchase, a right of first refusal or *the prior approval of a future purchaser or occupant.* (Emphasis added).

The court granted Commonwealth's motion to dismiss because there was an exception to the restrictions in Schedule B of the policy, but read paragraph 1.b.ii.

It's plain that 1.b.ii. applies only to instruments referred to in the exceptions in Schedule B, so it makes no sense that an exception to the restrictions also excuses the title insurer of liability. An exception to the restrictions alone should not be enough. The exception must also expressly inform the policyholder that the restrictions include, in this case, a right of Liberty Mills, or its successor, to approve a future purchaser.

How does an insured now get the benefit of paragraph 1.b. of the ALTA 9 with this as a precedent? I suppose you could ask for another endorsement to state that no exception in Schedule B limits the coverage in the ALTA 9. It is clear that the ALTA 9s should be revised so this error will not be repeated. That process is underway.

F. Aggregation

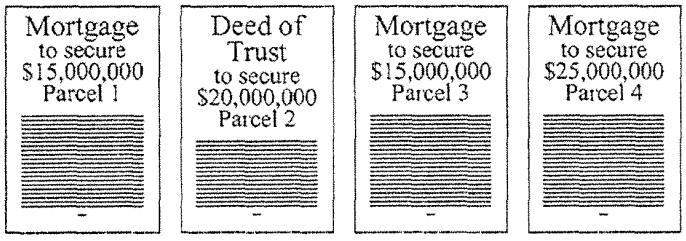
ALTA 12-06

1. Mortgage lien types

A group of liens in a financing may be created as a group of separate liens, or a group of aggregate liens. For illustration, let's imagine that we have a $75,000,000 financing that will be secured by four properties, each located in a different state.

a. Separate Liens.

Using separate liens, we could encumber our parcels 1 through four with mortgages limited to the value of a discrete note for each mortgage. Although the total of these liens is $75,000,000, the lender is limited to allocation on each site, as illustrated by these security instruments.

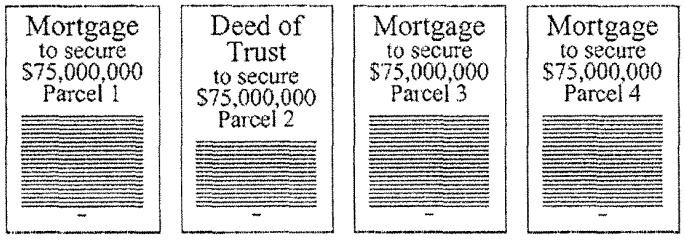


A competing creditor that examines the title to Parcel 1 will conclude that it is encumbered by a lien in the amount of $15,000,000. If Parcel 1 is worth more, say $25,000,000 the competing creditor expects equity in the amount of $10,000,000 to secure its extension of credit to the same borrower. Upon foreclosure of the first loan, the holder of this mortgage will be limited to the first $15,000,000 of proceeds. The mortgages do not each secure the aggregate loan amount of $75,000,000.

If these liens are "cross-defaulted" and "cross-collateralized, does that convert the liens to an aggregate lien? No. The mortgages are still limited to the amount they state that they secure. "Cross-default" simply means that a default on one mortgage is a default on all of them. That has no effect on the amount secured. If the mortgages are cross-collateralized, the lien may secure all four notes, but it is still limited by the amount the mortgage states that it secures. For example, if our lender accelerates the indebtedness on these loans and is partially paid, it may apply the payment to retire the notes on Parcels 1 & 2, and keep its liens on those parcels to secure the payment of the notes on Parcels 3 & 4. However, the lien on Parcel 1 remains at $15,000,000, not $40,000,000. The lien on Parcel 2 is still $20,000,000. By adding cross-default and cross-collateralization features, the lender has a more flexible security package, but it is not as flexible as an aggregate lien.

b. Aggregate Liens.

The lender can also structure its security instruments as "blanket mortgages" to give competing creditors notice that each stands as security for a total indebtedness of $75,000,000 by showing that amount in the mortgage, instead of discrete values allocated to each site.



Each "blanket mortgage" must state the entire indebtedness that the lender seeks to secure with all four parcels. An aggregate lien is cross-defaulted and cross-collateralized by its very nature since it is a single loan secured by four mortgages. A default on the single obligation is a default on all four mortgages, and all four mortgages secure the same obligation.

Structuring with an aggregate lien does have some weaknesses. It may take some persuasion to convince the clerk or registrar that any mortgage tax that may be due, is just due on an allocated amount when the mortgage shows an aggregate amount. It may take some extra effort, but we are usually successful. In addition, a blanket mortgage can defeat the isolation sought when a borrower is structured with Special Purpose Vehicles to hold title to the security. In many transactions this is overcome with an allocated first mortgage and a blanket second mortgage.

c. Requiring an Aggregate Lien for Aggregate Title Insurance.

Does it make any sense to increase the Amount of Insurance on Parcel 1 to $75,000,000 if the lender limited its own lien to $15,000,000? If we increase the Amount of Insurance to $75,000,000 on a separate lien for Parcel 1, are we misleading the insured into thinking that it successfully created an aggregate lien on all four properties? What happens if the lender, having separate liens, tries to recover substantially more than $15,000,000 on Parcel 1 after suffering a total failure of title on that site? Isn't the risk substantially greater once the lender seeks a recovery above its stated lien? Have you noticed that there are no answers, only questions, in this section?

d. Are There any Aggregate Ownership Interests?

There are few parallels in ownership or leasehold interest to an aggregate lien. Each parcel has its own discrete value. Of course, if a group of parcels are assembled into one parcel in a single site, you can argue that the values are now an aggregate, and may bear no relation to the values of the individual lots. Also, its conceivable that a group of unconnected sites might have an independent value as a group. A cell tower net might be an example. If one site is lost, it could create a hole in cell coverage, reducing the value of the network.

2. Aggregation in title insurance

a. Owner's Policies.

We have observed that aggregation exists in only very limited circumstances when we consider ownership and leasehold interests. Section 8 of the ALTA 1992 and earlier ALTA owner's policies is an "Apportionment" provision. It prevents aggregation in owner's coverages. Section 8 of a 1992 ALTA Owner's policy states:

> If the land described in Schedule A consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole, exclusive of any improvements made subsequent to Date of Policy, unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement [attached to this policy].

In a multi-site transaction, this Apportionment clause limits recovery under an owner's policy to the pro rata allocation or value of the affected property on the date of the policy and prevents shifting of coverage from an unaffected property to the affected property. It applies automatically, even if there is no express allocation of property values in the policy or at the closing.

If a multi-property transaction assembles the properties into a "single site" the apportionment provision does not apply to the assemblage. The individual values for the assembled lots become irrelevant to the insurance. Otherwise, aggregation in owner's policies has been quite rare.

The 2006 ALTA Owner's Policies dropped the Apportionment provision. It opens the door for aggregation of owner's coverages. It is too early to see how title insurance companies and consumers will react to this development.

b. Loan Policies.

The ALTA Loan policies contain no apportionment provision. As a result, the insured is not restricted from "shifting" coverage from an unaffected property to a property affected by a defect, lien or encumbrance insured against by the same policy to realize any appreciation in value of the affected property as an offset for a diminution in value of unaffected properties. By this form of aggregation of the coverage amounts, lenders can reduce their risk of loss due to inflation and fluctuations in real property values.

In our second illustration, if the title insurer issues a single policy for all four sites in the aggregate amount, the insured can shift the coverage from one site unaffected by title problems

to another suffering a title loss. The aggregation of the title insurance coverage matches the aggregation of the lien of the mortgages.

Aggregation in a single loan policy works, but this form of aggregation often creates some problems. The policy forms used in some states may not be available in others, making this solution unavailable in some transactions. In addition, reviewing large policies with numerous properties can be tedious. It may be a manageable solution for transactions with a limited number of properties, but it can be unmanageable for larger transactions. Many states require a licensed resident to countersign a title insurance policy, so in multi-state transactions, delivery of the loan policy can be delayed while the policy is passed from one office to the next for review and execution.

Issuing separate policies, each in the aggregate amount exposes the title insurer to questions about the premium and premium tax due. In a claim, the insured may expect a limit of $75,000,000 for each site, an aggregate of $300,000,000. This approach can be very confusing and expensive for all parties.

Of course, one might buy more insurance. For example, if the borrower is restricted to a loan not to exceed 80% of the value of the real estate, a loan policy issued for the full value of the property may provide enough cushion. Where the borrower is buying owner's policies as well as loan policies, this technique would cost no more than ordering loan policies at the allocated amount because the simultaneous premium rate would apply to both. Some lenders initially ask their borrowers to buy a policy on each property in the full amount of the aggregate loan, but this requirement is unnecessarily extravagant.

c. Regulation of Aggregation.

Do any states impose restrictions on the use of aggregation in title insurance? There are a few restrictions and they are detailed in the following table.

FL	Aggregation is restricted to properties within Florida. Florida properties cannot be aggregated with properties outside the state.
PA	Aggregation is restricted to properties within Pennsylvania. Pennsylvania properties cannot be aggregated with properties outside the state.
DE	As of April 2003, Delaware was considering restricting aggregation to instate aggregation only (as in PA).
NC	Aggregation is restricted to properties within North Carolina. North Carolina properties cannot be aggregated with properties outside the state.
TX	Texas allows interstate aggregation. All policies, however, must be issued simultaneously.

d. The ALTA 12-06 Aggregation Endorsement.

In October 1996, the American Land Title Association adopted the ALTA 12 Aggregation Endorsement. It solves several problems. First it allows each policy to state an allocated value for each property, making the process of defending allocated recording costs and

taxes, and title insurance premiums much easier. It overrides that value for the Amount of Insurance, so the Amount of Insurance on each mortgage is the aggregate amount, but reductions caused by payment of claims on any property reduces the aggregate amount. It makes local countersignatures easy and efficient.

When the parcels are scattered in different areas it has been the custom to open the title order for individual policies for each parcel with an office in that parcel's locality. Instead of a single policy, individual policies are generally issued. It's easier on everybody and using the ALTA 12 gives the same result as using a single policy.

As we have seen, individual policies for each parcel can be produced more quickly and accurately and the coverages can be reviewed more easily than a single policy, but the amount of coverage suffers by losing the ability to aggregate amounts. Adding an ALTA 12 aggregation endorsement to each single policy for all parcels or individual policies restores the ability to shift coverage among the properties, but without sacrificing the effect of using a single policy. Review is simplified because the exceptions for a particular property are the only exceptions that will appear in the policy for that property.

G. Leaseholds

ALTA 13-06 (Owners) & 13.1-06(Loan)

The original 1975 Leasehold policies were designed with a simple operating lease in mind. If the holder of leased space was dispossessed as a result of a defect in either the landlord's title or the lease itself, the title policy would indemnify the holder for the increased cost of leasing an alternate space, and give some "Miscellaneous Items of Loss" as well. The ALTA may have seen the market in 1975 as the market for simple operating leases of offices and store bays in shopping centers, but leaseholders in those markets did not sense enough coverage in the leasehold policy to make it a worthwhile hedge to the risks they faced. Consequently, the ALTA leasehold policy was never popular. The policy missed the developing markets in real estate leasing.

Leases have been used as a financing tool for decades. Sale-leaseback transactions have been commonplace at least since the 1960's in my own experience. In the last two decades of the twentieth century, leasing transactions have become even more significant in financing real estate transactions. We see leveraged leasing of build to suit projects, ground leases with tenant build to suit projects, and synthetic leases, just to name some of the recent applications.

1. Definitions.

The ALTA 13 begins by adding seven definitions to the policy. Here is a look at Section 1 of the ALTA 13:

1. As used in this endorsement, the following terms shall mean:
   a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.
   b. "Lease": the lease agreement described in Schedule A.
   c. "Leasehold Estate": the right of possession for the Lease Term.

d. "Lease Term": the duration of the Leasehold Estate, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.

e. "Personal Property": chattels located on the land and property which, because of their character and manner of affixation to the land, can be severed from the land without causing appreciable damage to themselves or to the land to which they are affixed.

f. "Remaining Lease Term": the portion of the Lease Term remaining after the insured has been Evicted as a result of a matter covered by this policy.

g. "Tenant Leasehold Improvements": Those improvements, including landscaping, required or permitted to be built on the land by the Lease that have been built at the insured's expense or in which the insured has an interest greater than the right to possession during the Lease Term.

The Leasehold policy limited its definition of "Lease" as "subject to any provisions contained in the Lease which limits the right of possession." The limitation was dropped because it received so much resistance from customer groups consulted in the drafting process. Although title insurers do not intend to protect policyholders from the consequences of their own agreements, the limitation in policy definition of "Lease" was not the only provision giving the title insurer this protection in the policy. The insurer is also protected by the "acts of the insured" Exclusion 3(a).

2. Valuation.

Although the valuation provision of the ALTA 13 does not appear until Section 3 of the endorsement, it is the most significant change in the ALTA leasehold coverages.

3. Valuation of Estate or Interest Insured

If, in computing loss or damage, it becomes necessary to value the estates or interests of the insured as the result of a covered matter that results in an Eviction, then that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The insured claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

There is no method specified for valuing either the Leasehold Estate or the Tenant Leasehold Improvements. It does recognize that the Leasehold Estate and the Tenant Leasehold Improvements can be valued independently. In short, the methods for valuing a loss and its deductions under this new endorsement are left to negotiation between the insured and title insurer when adjusting a claim.

3. Coinsurance.

Most leasehold interests are shorter than 99 years; so applying the coinsurance provisions of Section 7(b) makes little sense in the leasehold endorsement. The values we must use for insuring most leasehold estates are imprecise, at best. We don't have a convenient, arms length purchase price as we do in most real estate conveyances. In the development of the ALTA 13, the Forms Committee made the coinsurance provision inapplicable to Leasehold Estates. It provides:

2. The provisions of subsection (b) of Section 7 of the Conditions and Stipulations shall not apply to any Leasehold Estate covered by this policy.

However, Section 2 of the ALTA 13 may mislead the incautious insured. It does provides that the coinsurance limitations on coverage contained in Section 7(b) of the policy do not apply to the Leasehold Estate, but does not make Section 7(b) inapplicable to Tenant Leasehold Improvements. If Leasehold Estates and Tenant Leasehold improvements are independent primary items of loss, then Section 7(b) still must apply to the Tenant Leasehold Improvements. This shouldn't be too alarming. If the insured owns or builds Tenant Leasehold Improvements at the outset of the leasehold estate, it should have an investment or purchase value for those assets. It has not bargained to rent them for the term of the leasehold estate.

You will not find a provision corresponding to Section 2 of the ALTA 13 in the ALTA 13.1, but leaving it out was no oversight. ALTA Loan policies do not have coinsurance provisions. Consequently, there is no need to include a corresponding coinsurance section in the ALTA 13.1. The coinsurance provision is also missing from both the ALTA 13-06 and 13.1-06 because the 2006 ALTA policies have no coinsurance provisions. We have come full circle to the position of the 1970 ALTA Policies on coinsurance.

4. Tenant Leasehold Improvements.

As we have seen, Section 1(g) of the ALTA 13 added a definition of Tenant Leasehold Improvements to protect the insured's investment in these assets. The definition encompasses any improvements, including landscaping, taking a lead from the ALTA 9 Endorsement that protects interests in "lawns, shrubbery or trees" in several sections. Recognizing landscaping as "improvements" is not unique, but certainly a new development for leasehold coverages.

Of course, as we saw on page 16, Section 3 of the ALTA 13 brought a recognition of damage or loss to the Tenant Leasehold Improvements to leasehold title insurance. In addition, supporting the conclusion that loss to Tenant Leasehold Improvements is a primary coverage, Section 3 empowers the insured to elect whether to have the Leasehold Estate and Tenant Leasehold Improvements valued together or separately. However, there is one other provision for valuation of Leasehold Tenant Improvements that was added in the ALTA 13.

Determining the value of Tenant Leasehold Improvements becomes really difficult if the tenant is in the process of building a significant structure on its leasehold when its right to possession is challenged. This isn't just a case of bad luck. The risk of a challenge to title is greatest during the construction of improvements because the evidence of the construction announces the tenant's claim to the land to any who see it.

An appraiser will not give a high value to incomplete improvements. Indeed, many times an incomplete project may actually reduce the appraised value of land. If the incomplete structure must be demolished as useless, the cost of removal must be deducted from the market value of the raw land. Even if the construction is only interrupted, it often costs substantially more to resume and finish the construction than it would if the construction had progressed without the interruption. If a leasehold was insured with either a leasehold or owner's policy, the title insurer might reduce or deny a claim for the value of the tenant's investment in the leasehold improvements by asserting that the incomplete project had little or no value.

This problem with valuation of improvements under construction is not confined to leasehold estates. It applies to any project under construction. Title insurance had never

addressed this problem in a standard policy or endorsement coverage until the ALTA 13 addressed it in Section 4(g) of the Additional Items of Loss:

> 4. Additional items of loss covered by this endorsement:
>
> If the insured is Evicted, the following items of loss, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estates or interests insured by this policy. . . .
>
> g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction. Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, landscaping costs and fees, costs and interest on loans for the acquisition and construction.

Section 4(g) allows the insured to recover its investment in the construction, as well as those "soft costs" it expressly lists. It significantly expands the measure of damages under a title insurance policy, and the only reason for confining this coverage to leasehold estates is the greater difficulty that title insurers have experienced in breaking into the leasehold title market. We should expect pressure to migrate this type of coverage into fee ownership development transactions as well.

5. The "Eviction" Trigger.

In the process of drafting this endorsement, several of those involved questioned the use of the terms "Evicted" and "Eviction" as the trigger for coverage under the ALTA 13. It was criticized as sounding too rigid and might suggest that loss under the endorsement required a judicial eviction. The word "ouster was also considered, but rejected because the definitions of "ouster" included denial of possession to a rightful owner. It didn't fit. To resolve this concern, the definition was crafted to avoid a rigid construction for the term.

Section 15 of the old leasehold Policy also used the terms "evict" and "eviction," though it did not define them. The definition added to the ALTA 13 in Section 1(a) of the endorsement should allay any concerns that the words imply a requirement for a judicial proceeding:

> a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.

Under this definition "Eviction" may be either a lawful deprivation of the right of possession under the lease or the lawful prevention of the use of the land "for the purposes permitted by the lease." That's an additional nugget for the insured. Title insurance policies do not usually insure land use issues without an endorsement like the ALTA 3.1, but the ALTA 13 requires a prudent title insurance underwriter to compare the uses specified in a lease with the land use regulations that apply to the land to avoid losses under this definition.

The definition does create a coverage trigger. You must have an eviction before you can show a loss under this policy. It is important to recognize that this is no mere definition, even though it is included in Section 1 of the endorsement.

6. Additional Items of Loss.

When the first Leasehold policies were adopted in 1975, their best feature was a set of unusual consequential damage provisions in Section 15 that were entitled "Miscellaneous Items of Loss" On reflection, the Forms Committee twenty five years later decided that it could improve the title. The old caption in the policy suggests that these provisions are "miscellaneous," almost an afterthought. However, they were revolutionary for their time, at least, they were revolutionary for the realm of title insurance. Title insurers avoid recognizing consequential damages as "loss" because consequential damages are so open ended. The new title is just a revision of the old, but it does invite the policyholder to read Section 4 of the ALTA 13 to find those 'additional' coverages.

It should be no surprise that these consequential damage provisions were kept in the ALTA 13. They were edited for some minor grammatical changes, to reflect the new definitions of terms in Section 1 of the ALTA 13, and to include the addition of Leasehold Tenant Improvements into the coverage. The grammatical changes were fairly harmless, like the substitution of "that" for "which" in Sections 4(c) & (e). With the addition of new definitions in Section 1, it makes sense that they would be incorporated wherever they would fit in the leasehold coverage. The definition of "personal property" formerly found in Section 15(a) of the Leasehold Policy was edited and moved to Section 1(e) of the ALTA 13.

Section 15(a) of the old "Miscellaneous Items of Loss" allowed payment of the costs of relocating personal property removed from the insured land to a replacement leasehold, but the title insurer would only pay for cost of transportation for the initial twenty-five miles. The idea was to limit the insured to relocations in the same area as the insured land. Title insurers did not want to be caught paying for transportation over long distances. I think this meant that the title insurer would pay for all the removing and relocating operations that take place at the origin and destination, but if the distance between the two exceeds twenty-five miles, the insurer would pay for the first twenty five miles of travel and the insured must pay for any additional travel.

Section 15(a) expanded the radius from twenty-five to one hundred miles. There are perhaps two reasons for this wider radius. First, title insurers have experienced very little, if any, losses based on Section 15(a), so the Forms Committee saw little risk in expanding the range to one hundred miles. Secondly, a one hundered mile radius is more attractive to title insurance consumers than a twenty-five mile radius, and the Forms Committee saw an opportunity to make the ALTA 13 more appealing than its predecessor.

Expanding from a twenty-five mile radius to a one hundred mile radius is a substantive change, but not very material. If our experience with Section 15(a) of the Leasehold Policy is any measure, few, if any, policyholders will realize a benefit from the change. Of course, all policyholders are better off for the change because we cannot identify that few at the outset. Some customers in the past have asked for changes to old Section 15(a) because it didn't meet their needs. A jet engine rework facility located at a south Florida airport many years ago asked for a change because the business required a location on the ramp at an airport. The customer was concerned that no suitable site might be located within twenty-five miles. We agreed to modify Section 15(a) to encompass a move anywhere within the state.

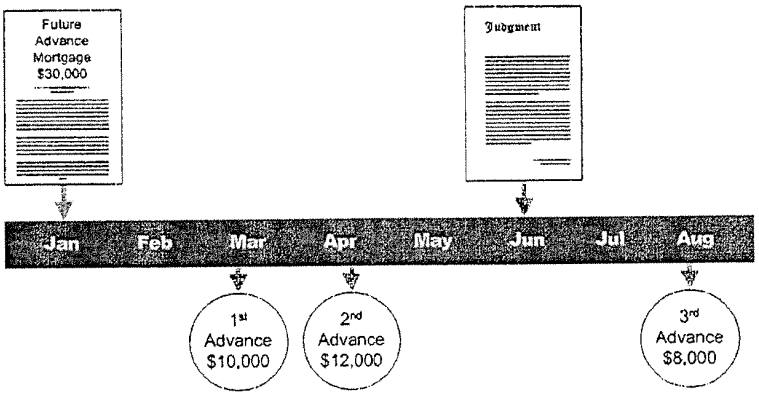
For title insurance customers with bond leases with "hell or high water" provisions that require the lessee to continue paying its 'rent' even after it has been evicted from the premises, Section 4(c) provides protection against that risk. I am mildly astonished that so few of these customers raise this issue and seek this coverage. Many, in recent years, have demanded ALTA Owner's Policies instead of leasehold policies, and have let the coverage slide in making the requirement. It should not be necessary with the ALTA 13.

The ALTA also added two new provisions to the Additional Items of Loss in the ALTA 13. We examined the valuation provisions for a new project under construction in new Section 4(g) in the discussion of Leasehold Tenant Improvements on page 18. Section 4(f) is also new, and reimburses the policyholder for the expenses to get a replacement Leasehold Estate. Like Section 4(g), Section 4(f) introduces the prospect of including "soft costs" into the computation of an insured's damages.

H. Future Advances

ALTA 14-06 (Priority), 14.1-06 (Knowledge), 14.2-06 (Letter of Credit) & 14.3-06 (Reverse Mortgage)

Let's begin by illustrating the future advance issue with a simple example. A borrower gives its lender a future advance mortgage to secure $30,000 in January. The lender advances $10,000 in March and another $12,000 in April. A competing judgment lien is perfected against the borrower in June. The lender makes a final advance of $8000 in August. What are the issues created by this structure? Advances 1 & 2 should be safe in any state. That third advance might have priority over the judgment lien, or not.



With an ALTA loan policy, the future advance lender has no protection for the lien of the mortgage as security for these future advances. The loan policy was designed to insure mortgages securing conventional term loans, so it does not insure that the lien of the mortgage either:

a. secures future advances made to or on behalf of the borrower; or

b. has priority over matters intervening in the records between the recording of the mortgage and the date of a future advance.

It might seem that these are deficiencies in the policy itself that would be better addressed by amending the policy, but many states impose requirements on the mortgage form if it is

expected to secure future advances. An underwriter must first decide if the mortgage meets state requirements before it is appropriate to insure future advances

In addition, the priority rules for future advances vary from state to state. A title insurance underwriter must also satisfy itself that the coverage matches the state priority rule before insuring advances. Before we address the ALTA future advance endorsements, let's take a brief look at the risks and those policy provisions that apply to future advances, so we will understand why we must have at least three forms of endorsement.

1. Protective Advances.

If the third advance in the illustration on page 20 was not made to the borrower, but was used to pay real estate taxes, or to prevent or repair waste to the security, the title policy does insure that the mortgage secures it. These protective advances are not made to or on behalf of the borrower, but are made by the lender to preserve the value of the security where the borrower is in distress.

If the lender fails to make a protective advance, it might lose its security to a tax foreclosure, or witness a decline in value as the improvements fall into disrepair. Also, if the lender fails to police its security, its neglect may harm junior creditors and the borrower, as well. So most states allow these advances, even if the mortgage itself gives no notice that the lender might advance funds in the future.[4]

The 1992 ALTA Loan policy recognized the preferred status of a protective advance. As we shall see on page 23, the policy expressly covered protective advances in Section 8(d) of the policy Conditions and Stipulations. They are also included in the amount of insurance defined in Section 2(c)(ii):

> (c) Amount of Insurance. The amount of insurance after the acquisition or after the conveyance shall in neither event exceed the least of:
>
> (i) the Amount of Insurance stated in Schedule A;
>
> (ii) the amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, *amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made*; or
>
> (iii) the amount paid by any governmental agency or governmental instrumentality, if the agency or instrumentality is the insured claimant, in the acquisition of the estate or interest in satisfaction of its insurance contract or guaranty. [Emphasis added]

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[4] **TENN CODE. ANN. § 47-28-109 Increases or advances exceeding contract limits or not covered by contract**

Notwithstanding the limitations specified in any mortgage, or imposed by a borrower by means of serving and recording a notice of limitation: . . .

(2) Any advance which the creditor is obligated under the terms of the mortgage or related agreement or undertaking to make to a third party, or any disbursement made by a creditor pursuant to the terms of the mortgage to protect the efficacy of the creditor's security, including, without limitation, payment of taxes, insurance premiums, or expenses incurred in making repairs to the property or in the collection of the debt or the enforcement of the mortgage; . . .

The 2006 ALTA Loan policy recognizes protective advances in its definition of the term "indebtedness" in Condition 1(d).

2. Does the policy insure that the mortgage secures advances to or on behalf of the borrower?

A mortgage may be silent about the potential for future advances, contain a future advances provision or contain a 'dragnet' provision. However, it would be imprudent to insure any but protective advances if the mortgage gives no notice that it secures future advances.

We can distinguish between future advance provisions and 'dragnet' provisions. A future advance provision indicates that the note or loan agreement establishes the potential for advances in the future that will be secured by the mortgage. A revolving credit line or home equity loan is a familiar example of a future advance loan.

A 'dragnet' provision may appear in a mortgage with or without a future advance provision. It may indicate that the mortgage secures all debts, past, present and future that the borrower may owe the lender. It is named for its ambitious scope. Courts tend to be more critical of mortgages with dragnet provisions than mortgages with typical future advance features because of the potential overreach. *Home Federal Bank FSB of Middlesboro v. First National Bank of Lafollette*, 2002 TN 1392 (TNCA 2002); *see*, *Uransky v. First Federal Savings and Loan Association of Fort Meyers*, 684 F2.d 750 (11th Cir. 1982).

Even if the mortgage includes a 'dragnet' provision, it can only secure advances that are of the same kind and nature as the loan secured. It usually cannot secure both the outstanding balance of the loan and liability for unrelated tortious conduct.

a. The risk that the mortgage does not secure advances to the borrower.

So, at a minimum, a mortgage must give other creditors notice that it secures future advances and it must state the maximum indebtedness it secures. These requirements may be set by statute or expressed in case decisions addressing future advances or dragnet provisions. If a mortgage fails to indicate that it will secure future advances and set a maximum amount, a court is unlikely to extend its protection for subsequent advances to or on behalf of the borrower. In addition, some state statutes require additional provisions in the mortgage or deed of trust form before it will secure future advances. These may be simple captions at the top of the mortgage. In most states the mortgage should also specify that it secures a 'credit line' or 'readvances' if the loan is a revolving credit line.

Even if a mortgage meets all state requirements for future advances, the lender cannot proceed with advances after a petition in bankruptcy has been filed by or on behalf of the borrower. The automatic stay under 11 U.S.C. 362 will bar the mortgage from securing post-petition advances, unless the bankruptcy court authorizes them. There is an exception to this rule for payments made under a letter of credit, but I will address it separately on page 26.

There are some other obstacles to future advances. Mortgage recording taxes can make revolving credit lines unworkable if the tax is due on the aggregate amount disbursed. In New York, one can pay mortgage tax on the maximum balance to be secured by a commercial mortgage for more than $3,000,000, and record the mortgage. The state will not seek any more tax unless the mortgage is modified or foreclosed. If the parties modify the mortgage, they must

disclose the aggregate amount disbursed in the 255 affidavit, and pay tax for the aggregate in excess of the maximum amount stated in the mortgage. *See*, N.Y. TAX LAW §255. If the lender forecloses, it must also pay tax on the excess of the aggregate over the maximum balance on which the original tax was paid. However, New York will not seek extra tax just to record a satisfaction of the mortgage, even if the aggregate amount disbursed exceeded the maximum balance on which the original tax was paid. That potential mortgage tax liability for mortgage modifications and foreclosures chills the market for commercial future advance mortgages in New York.

A few states have laws that automatically release the lien of the mortgage if the outstanding principal balance of the loan reaches zero. A lender can usually defeat these statutes by adding a provision for securing advances following a zero balance of principal indebtedness. *Martin v. Fairburn Banking Company*, 463 S.E. 2d 507 (Ga. App. 1995).

Some states impose a time limitation for making secured advances. For example, Florida and New York set a limit of twenty years. North Carolina limits the protection of the lien of the mortgage to advances made within fifteen years from the date of the mortgage. South Dakota sets a maximum of five years.[5]

b. Section 8(d) of the loan policy Conditions and Stipulations.

Most future advance lenders expect, as a minimum, that their title insurance policy would insure that their mortgage or deed of trust would *secure* advances made after the date of the policy. Although all states recognize that mortgages or deeds of trust can *secure* future advances or obligations, as we have seen, there are some circumstances where security may be lost. So, as basic as security for future advances may appear, a lender with an unmodified ALTA loan policy will not have coverage for any advances except protective advances because of Section 8(d) of the Conditions and Stipulations:

> (d) The Company shall not be liable for: (i) *any indebtedness created subsequent to Date of Policy* except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of the improvements: or (ii) construction loan advances made subsequent to Date of Policy, except construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the land which at Date of Policy were secured by the insured mortgage and which the insured was and continued to be obligated to advance at and after Date of Policy. [Emphasis added].

A title insurer can overcome Section 8(d) and insure that advances are secured by the lien of the insured mortgage, but it should first review the mortgage or deed of trust to assure itself that the mortgage contains those provisions required by state law to secure future advances. We will examine how to alter the policy for future advances after we look at priority.

There is no equivalent for Section 8(d) in the 2006 ALTA Loan Policy. However, the Covered Risks do not include future advances, so there is no express coverage for the validity and enforceability of the lien of the Insured Mortgage as to advances.

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5 FLA. STAT. §697.04; N.Y. REAL PROPERTY LAW §281; N.C. GEN. STAT. §45-68; S.D. CODIFIED LAWS §44-8-26.

4. Priority of advances.

It's not enough to insure that an advance is secured by the mortgage, a prudent lender also wants insurance of the priority that advance will enjoy against liens junior to the mortgage. If we refer back to our example on page 20, assuming that we have a future advance mortgage, the advances in March and April are pretty safe. Its that August advance that might be subordinate to the judgment lien. To evaluate its priority, we must know the answers to two questions:

a. Are the advances optional or obligatory?

b. If the advances are optional, what priority rule applies?

a. Optional or obligatory?

To be an obligatory advance, the lender must have a duty to make the advance, even if it would prefer to decline advancing the disbursement. If an advance is optional, the lender has a choice. It may advance or not.

If the borrower is financially healthy, the lender will readily advance because it is in the business of making loans. If it thinks the borrower is in distress, it may decline a request for an advance, if it can. These distinctions may look clear, but there are problem areas. Although a lender may characterize its advances as obligatory, few will 'obligate' themselves to advance funds without also requiring the borrower to meet certain financial tests before each advance. If the borrower must pass a test before each advance, is the advance really obligatory or is it optional? Just when the lender needs the priority of obligatory advances, it may lose them where the borrower fails the tests set up in the loan documents.[6]

b. Priority

Many states have statutes or case law that apply the priority of the mortgage itself to any advance, whether obligatory or optional and whether or not the future advance lender has received notice of an intervening lien. In some cases, it appears that a statute was intended to create this result, but it might be poorly worded, so there is some risk that a court may construe it as creating notice priority. However, where this rule applies, it is unnecessary to distinguish between optional advances and obligatory advances.

'Priority' is a bit of a misnomer. The advances don't have priority over everything, but they are superior to advances made under notice priority rules. A priority advance may still be subject to certain risks:

- Real estate taxes and assessments. This should be no surprise because any amount secured by the mortgage is subject to taxes and assessments.
- A federal tax lien under 26 U. S. C. §6321 filed more than 45 days before the advance.
- Federal or state environmental protection liens.

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6 *See*, Colavito: *Credit Line Mortgages – Problems and Challenges*, Lawyers Supplement to the GUARANTOR (Chicago Title Insurance Company, January/February 1985).

- In some states, specified risks like judgments or mechanic's liens may take priority over full priority advances.[7]

c. Notice priority

The distinction between 'priority' and 'notice priority' is quite simple. An advance in a notice priority state may be subject to all of the risks that it would be subject to in a full priority state, but it is also subject to a lien perfected after the mortgage if the intervening lienor gives either actual or written notice of the intervening lien to the future advance lender. If we look at our simple future advance example on page 20, the third advance would take priority over the intervening judgment lien in a full priority state, but it would be subject to the judgment lien in a notice priority state if the judgment creditor gives the lender notice of its judgment. The first two advances would take priority over the judgment in both cases. Lenders see the 'full priority' risks listed above as unpleasant but manageable. However, losing priority to a competing creditor is especially galling.

The real problem here is determining if notice is effective. When the notice rule evolved, most mortgage lenders were local, so a competing creditor could take its notice to the bank building, and leave confident that it had upset the priority of any subsequent advances. With national lenders, it is conceivable that some director, officer employee or agent might learn of facts that could upset the priority of an advance, but not know anything about the significance of those facts to a future advance loan.

d. Exclusion 3(d)

In addition to insurance that advances are *secured* by the insured mortgage, a lender will request coverage insuring that the *priority* of each advance will relate back to the mortgage and be superior to any matter intervening between the time the mortgage was recorded and the time the advance is made. Exclusion 3(d) of the Exclusions from coverage expressly excludes priority coverage for advances from the ALTA policy forms. If it remains unmodified in the policy, there will be no coverage against loss of priority of future advances as a result of matters that attach or are created after the policy date (which should be the date the mortgage is recorded).

ALTA loan policies - Paragraph 3(d) of the Exclusions:

> The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of: ...
>
> 3. Defects, liens, encumbrances, adverse claims or other matters: ...
>
> (d) attaching to or created subsequent to Date of Policy (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material) ...

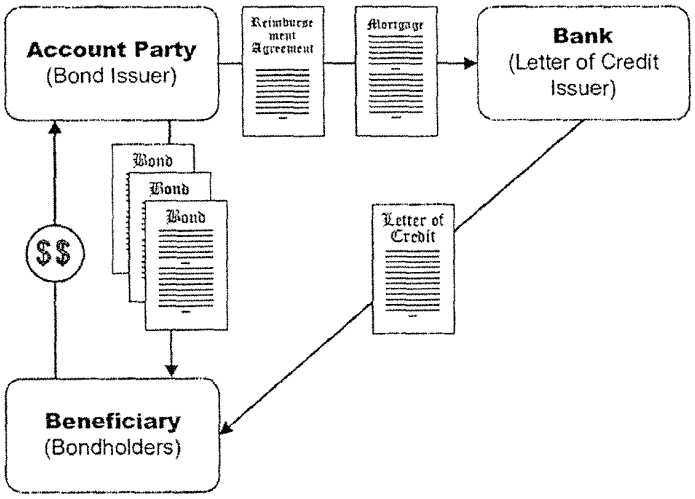
---

[7] *See*, D.C. CODE ANN. §42-2303; S.C. CODE ANN. §29-3-50; VT. STAT. ANN. tit. 27 §410; VA. CODE ANN. §55-58.2; W. VA. CODE §38-1-14.

5. Letters of credit and surety bonds.

Some disbursements enjoy general recognition as obligatory, but, as we have seen, others may be in doubt. The disbursements universally recognized as obligatory beyond question arise from standby letters of credit and surety bonds. They play by rules not generally applicable to future advances.

A letter of credit transaction involves three parties, the letter of credit issuer, its customer who asks for the letter of credit and a third party contracting with that bank customer who will not accept the customer's credit for a transaction. It wants the bank's credit instead. Let's imagine a simple bond transaction, where the bondholders are unwilling to accept the bond issuer's credit, and don't want the trouble of foreclosing as a remedy if the bond issuer defaults. The bank will issue its letter of credit and take a mortgage to secure its customer's reimbursement obligation. The transaction will diagram like this:



If the Account Party defaults in its obligation to the bondholders, the advance, if you want to call it that, will be paid to the bondholders when they present the letter of credit to the bank. No money will be disbursed to the Account Party, although it is the real borrower. This structure gets favored treatment in bankruptcy and for federal tax liens because the bank has an absolute obligation to pay if the letter of credit is duly presented to it.

a. Bankruptcy

Disbursing after presentment of a letter of credit is not a violation of the automatic stay in bankruptcy when the account party is in bankruptcy. The letter of credit is an obligation of the bank, not an obligation of the account party. After all, that was the point when the beneficiary or principal insisted on the letter of credit in the first place. That means the draw is not stayed, even if the reimbursement obligation securing the letter of credit or surety bond is secured by a lien on property in the bankrupt's estate.

> It is well established that a letter of credit and the proceeds therefrom are not the property of the debtor's estate under 11 U.S.C. § 541. [*citations omitted*] When the issuer honors a proper draft under a letter of credit, it does so from its own

> assets and not from the assets of its customer who caused the letter of credit to be issued. As a result, a bankruptcy trustee is not entitled to enjoin a post petition payment of funds under a letter of credit from the issuer to the beneficiary, because such a payment is not a transfer of debtor's property (a threshold requirement under 11 U.S.C. § 547(b)). *Kellogg v. Blue Quail Energy, Inc.* (*In re Compton Corp.*), 831 F.2d 586 at 589 (5th Cir. 1987); *See also*, *Willis v. Celotex Corp.*, 970 F.2d 1292, *modified*, 978 F.2d 146 (4th Cir. 1992).

b. Federal tax liens

Federal tax liens, established under the INTERNAL REVENUE CODE, 26 U. S. C. § 6321, do not take priority over an "obligatory disbursement agreement" 26 U. S. C. § 6323(c)(1)(A)(3). An 'obligatory disbursement agreement' is defined in 26 U.S.C 6323(c)(4)(A) as:

> The term "obligatory disbursement agreement" means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made *by reason of the intervention of the rights of a person other than the taxpayer. (Emphasis added).*

The demand for payment by a beneficiary or principal under a standby letter of credit or surety bond constitutes the 'intervention of the rights of a person other than the taxpayer', so disbursement of the funds keeps its priority over a federal tax lien. A state definition of 'obligatory advance' or rule that optional advances are treated as if they were obligatory advances has no effect on §6323. Only advances satisfying §6323(c) take priority over previous federal tax liens.

Since a letter of credit mortgage is valid, enforceable and loses no priority even if the account party is bankrupt, or the IRS has filed a tax lien against its property, the title insurance for letters of credit will be substantially cleaner than for an obligatory advance of funds to the borrower.

If an advance does not meet the standards expressed in 26 U.S.C 6323(c), they are considered optional. 26 U. S. C. § 6323(d) gives optional advances a 45-day grace period after a federal tax lien is filed. After 45 days have elapsed after filing a lien, any optional advance is subordinate to the tax lien.

3. Insuring future advances.

Caveat: If there is *any* chance of future advances in a secured loan facility, you must counteract Section 8(b) and Exclusion 3(b) if you expect your title insurance to protect those advances. Lenders often order title insurance for a loan that includes some future advance features, but they never disclose those features. They trust the title policy to protect the advances without realizing that it must be modified to protect them. This can occur in loans where the future advance features are included in the "boilerplate" of the loan documents, but were never a significant concern in the loan as it was originally conceived. Five years later, the borrower and lender decide to take advantage of the mortgage's capability to secure future advances, but the title policy was set up to insure the loan as it was originally conceived. If the policy had been structured to insure future advances from the start, the borrower and lender could proceed with

the advance without getting a modification of the title policy. There are two ways to adapt a policy to future advances.

a. Datedown endorsements

The date of the policy can be changed by a 'datedown' endorsement each time a disbursement is made. Advancing the date of the policy does not modify Exclusion 3(d) or Section 8(d); instead, it complies with them. The original policy is usually prepared for datedowns with a 'pending disbursement' provision that announces that the date of the policy will be advanced. A typical 'pending disbursement' exception reads:

> Pending disbursement of the full proceeds of the loan secured by the mortgage (deed of trust) set forth under Schedule A, this Policy insures only to the extent of the amount actually disbursed but increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title, up to the face amount of the policy. At the time of each disbursement of the proceeds of the loan, the title must be continued down to such time for possible liens or objections intervening between the Date of Policy and the date of such disbursement.

This method is practical only in cases where there will be sufficient notice before each disbursement to schedule the supplemental examination (but it is usually necessary for construction loans in states where mechanics' liens can take priority over the construction loan).

Some lenders object to a "pending disbursements" exception in Schedule B of a policy insuring a construction loan. However, as we have seen, a policy without any provision for the construction advances will not cover them. A typical notice revolving credit endorsement takes exception to the lender's actual knowledge of liens intervening between the recording of the mortgage and the future advance. Construction lenders know that contractors, materialmen and laborers are providing services, material and labor on a project, so, if the local law grants them an inchoate lien for payment, the revolving credit endorsement does not protect the construction advances. The procedures established in a "pending disbursements" exception may be cumbersome, but they protect the lender. *See, Lincoln Federal Savings and Loan Assoc. v. Platt Homes, Inc.*, 185 N.J. Super 457, 449 A.2d 553 (1982).

You don't need a pending disbursements provision in your policy as a condition for bringing the date forward. A title insurer can agree to bring the policy date forward in most states, but it may charge a premium if it did not initially agree to datedown endorsements in the policy with a pending disbursements provision. If you plan on policy updates, it makes sense to set a procedure and the cost for it at the outset.

b. Section 9(b) and the "last dollar" issue

The 'last dollar' issue was recognized by some title insurance customers upon reading Section 9(b) of the Conditions and Stipulations after it was added to the 1987 ALTA Loan Policies (it has been continued through the 1990 and 1992 loan policy forms). Section 9(b) was intended to reassure customers that accrued interest and protective advances would be covered if the aggregate loss was less than the Amount of Insurance in Schedule A. Instead, it became an apt example of the law of unintended consequences because it left observers with the impression that its purpose was to reduce the Amount of Insurance by each payment of principal indebtedness. It provides:

> *Payment in part by any person of the principal of the indebtedness,* or any other obligation secured by the insured mortgage, or any voluntary partial satisfaction or release of the insured mortgage, to the extent of the payment, satisfaction or release, *shall reduce the amount of insurance* pro tanto. The amount of insurance may thereafter be increased by accruing interest and advances made to protect the lien of the insured mortgage ad secured thereby, with interest thereon, provided in no event shall the amount of insurance be greater than the Amount of Insurance stated in Schedule A. [Emphasis added].

The idea of reducing the *amount of insurance* makes very little sense when the policy also limits the *liability* of the title insurer under section 7 of the policy. This subsection appears wholly unnecessary, and it can have some pernicious effects. Its operation in a revolving credit loan could destroy the insurance coverage as the borrower draws on the credit line, pays it down and draws readvances during the term of the loan. The payments would reduce the amount of insurance, but a series of optional advances made to the borrower would not restore the coverage under a strict reading of Section 9(b).

It also threatens loans where the value of the insured property is only a fraction of the loan amount. If the title policy was issued in the amount of $10 million (the value of the property), but the loan was made in the amount of $100 million and was also secured on other assets, the lender would be dismayed to learn that the title insurance was gone as soon as the borrower repaid the outstanding balance below $90 million.

The 2006 ALTA Loan policy dropped Section 9(b) to eliminate the last dollar issue. There is no equivalent provision in the new policies.

c. Future advance or revolving credit endorsements

Until now, the ALTA had no endorsement for future advances, so the industry has used CLTA endorsements or proprietary endorsements instead. There are so many forms that it would overwhelm us to consider all of them, but that should end shortly. Future advance endorsements don't bring the transaction into compliance with Exclusion 3(d) and Section 8(d) of the policy as a datedown does. Instead they override Exclusion 3(d) and Section 8(b) so the policy will expressly insure the enforceability, validity and priority of the lien of the insured mortgage as to future advances, with exceptions for real estate taxes, bankruptcy, tax liens, etc.

3. The ALTA future advance endorsements

a. The ALTA 14.0 Future Advance – Priority Endorsement

The ALTA 14 is designed for use in states that have future advance statutes giving *optional advances* either:

i. the same priority as obligatory advances or

ii. priority as of the date the mortgage was filed.

The statute must not include exceptions where the lender has received actual or written notice of any form of lien. So, does a Tennessee "open end mortgage" meet that standard? Certainly, the "open-end mortgages" in Tennessee under TENN. CODE ANN. §47-28-103(1) meets the standard. However, under §47-28-103(3)(c) mortgages with optional advances that don't meet the open-end standard (which appears to include all optional advances under commercial mortgages) are subject to a notice standard so the ALTA 14.1 would apply instead.

THE ALTA COMMERCIAL ENDORSEMENTS

The ALTA 14 begins by listing the policy sections that it modifies, including Exclusion 3(d) and Sections 8(d) and 9(b) of the Conditions and Stipulations. It thus modifies those sections discussed above that make a bare policy inappropriate for insuring mortgages that are intended to secure advances.

Section 1 defines what an advance is and ties the endorsement to the note or loan agreement. The definition does not distinguish between obligatory and optional advances because it was intended to cover both equally. It does expressly include 'protective' advances, even though the basic policy includes some coverage for them. With the endorsement, the insured is given the freedom to make a protective advance without checking to see if its advance matches the description for 'protective advances' in Section 2(c) of the policy.

Section 2 of the endorsement gives the basic coverages against loss caused by the unenforceability, invalidity or loss of priority of the lien of the insured mortgage as it secures advances. On the day before the endorsements were adopted, a comment raised the concern that the original language of paragraph 2(b) might not protect a lender if a competing creditor was given equal priority to the advance, although it was clear that the lender was protected if it lost priority to the competing creditor. The provision was changed so it should protect against loss caused by 'equal priority' as well as 'lost priority.'

Section 2 also insures that the lender can re-advance funds and the lien will not fail if the outstanding balance of the loan equals zero. Section 3 gives the lender ALTA 6 variable rate mortgage coverage in addition to future advance coverage.

Section 4 contains the exceptions from coverage for advances made after the borrower's bankruptcy, loss of priority to real estate taxes and assessments, federal tax liens; environmental liens or usury. It has an optional exception for mechanic's liens if the lender fails to achieve statutory priority over unfiled liens.

The ALTA 9 should not be used in states that impose a loss of priority if the lender has actual knowledge of a competing lien even if lender's counsel argues that the advances are 'obligatory' because only letter of credit advances are obligatory if the borrower is in default when the advance is made. A title insurer cannot determine if the borrower will be in compliance at the time of an advance simply by reading the loan agreement.

b. The ALTA 14.1 Future Advance – Knowledge Endorsement

The ALTA 14.1 has all of the provisions in the ALTA 14, but adds paragraph 4(d) excluding coverage if the insured had actual knowledge of an intervening lien. Let's take a closer look at paragraph 4(d):

> 4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) resulting from: . . .
>
> d. The loss of priority of any Advance made after the insured has knowledge of the existence of liens, encumbrances or other matters affecting the land intervening between the Date of Policy and the Advance, as to the intervening lien, encumbrance or other matter.

The ALTA 14.1 was designed for states that have "knowledge" priority rules. If a lender argues that it should have full priority coverage because the loan agreement makes advances 'obligatory', your title insurer can add a second sentence to paragraph 4(d) to the effect that "Paragraph 4(d) does not apply if the advance is obligatory." By adding that sentence, the policy

does not insure that the advance is obligatory, but if a court determines that it was obligatory, the endorsement will then insure that it had priority.

c. The ALTA 14.2 Future Advance – Letter of Credit

The last endorsement, the ALTA 14.2 should be used where the mortgage secures a reimbursement obligation for a letter of credit or surety bond. With the ALTA 14 the distinction between obligatory and optional advances made no difference. With the ALTA 14.1, optional advances are subject to notice of an intervening lien. The ALTA 14.2 insures 'advances' that are given special protection in bankruptcy and against federal tax liens.

This endorsement was adopted without the ALTA 6 coverage because it was not considered necessary for letters of credit. Eliminating the ALTA 6 coverage puts the endorsement exceptions in Section 3 instead of 4, and it only has exceptions for real estate taxes and environmental liens. There is no exception for advances made after the borrower's bankruptcy or loss of priority to a federal tax lien created under 26 U. S. C. § 6321, as you would find in the ALTA 14 and 14.1. There is an optional exception for mechanic's liens for use if the mortgage did not achieve statutory priority over the inchoate rights of providers of services labor or materials.

As a result of the decision in *In re Mayan Networks*, 306 B.R. 295 (9th Cir, BAP 2004), in 2009 the ALTA Forms Committee added an exception for:

> "Limitations, if any, imposed under the Bankruptcy Code on the amount that may be recovered from the mortgagor's estate."

c. The ALTA 14.3 Future Advance – Reverse Mortgage

On June 17, 2006, the Forms Committee passed a reverse mortgage endorsement to be added to the ALTA 14 series as the ALTA 14.3. It is designed to insure residential reverse mortgages that fall under the Fannie Mae and Freddie Mac reverse mortgage programs.

I. Non-imputation
ALTA 15-06 (Full Equity Transfer), 15.1-06 (Additional Insured) & 15.2-06 (Partial Equity Transfer)

1. Imputation of knowledge.

We have been asked to include some form of non-imputation coverage in many of the policies we issue in larger commercial transactions. Purchasers of partnership interests, joint venture interests, memberships in limited liability companies or shares in a corporation seek to shift the risk to the title insurer that notice or knowledge of existing or departing partners, venturers, members or shareholders might affect the title (and reduce the value) of real property owned by the entity. These purchasers fear that the notice or knowledge of the unrecorded matter might be imposed on them by imputation.

The rules for imputation of knowledge are found in agency law, although we frequently think of them in the context of corporation or partnership law. The general rule is that a principal is bound by the knowledge of its agent. So a principal-agency relationship must exist between the parties before knowledge of one (the agent) can be imputed to the other (the principal). Both the 1914 and 1997 Uniform Partnership Acts provide that notice to a partner

(the agent) operates as notice to the partnership (the principal).[8] Corporations and banks are bound by the knowledge of or notice to their officers, agents and employees.[9] Notice is crucial in real estate transactions, because, in most states, a purchaser without actual or constructive notice of a prior conveyance or encumbrance on title is protected against the prior matter.

2. Recording Acts.

When a party in interest conveys an interest in property by deed, mortgage or deed of trust, recording the document to another party in the United States, the recording acts of the state where the property lies will govern which of competing interests will prevail. In all states, *a recorded instrument* creating an interest in a property *is constructive notice* of the interest, and any subsequent purchaser or encumbrancer takes subject to the recorded interest. Constructive notice means a purchaser is charged with notice of the recorded instruments, whether or not the purchaser orders a title examination to discover those recorded interests. Title insurers manage the risk of constructive notice of outstanding interests with an examination of title to reveal the interests of record.

However, where there is an *unrecorded interest* outstanding when the property is either conveyed or encumbered, one of three rules may be applied to determine priority of the competing interests, depending on the recording act of the state where the property is located. Of the three distinct types of recording acts in effect among the states, the two most common, Notice and Race-Notice type acts, require a purchaser to have no notice, either actual or constructive, of prior matters to establish priority. The three types of recording acts are:[10]

a. "Notice" type acts

Under the notice type act, found in most states, an unrecorded instrument is invalid as against a subsequent purchaser without notice, whether or not the subsequent purchaser records

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[8] UPA (1914) § 12:

Partnership Charged with Knowledge of or Notice to Partner

Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

RUPA (1997) § 102(f):

Knowledge and Notice ...

(f) A partner's knowledge, notice or receipt of notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

[9] *See,* 10 AM. JUR.. 2d, *Banks* §163; 18B AM. JUR.. 2d *Corporations* § 1671; and 58 AM. JUR.. 2d *Notice.*

[10] These definitions are from Sweat, *Race, Race-Notice and Notice Statutes The American Recording System,* PROBATE AND PROPERTY, May/June 1989 p.27. This excellent article also contains a list of the states identifying the type of recording act and its citation for each state.

before the first purchaser.[11] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones will take free of Brown's interest. Even if Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Brown's interest will be subject to Jones' interest.

b. "Race-notice" type acts

The race-notice type statute contains the same provisions except that if the subsequent purchaser records before the earlier purchaser records and the subsequent purchaser takes without actual knowledge of the earlier conveyance, the subsequent purchaser has priority.[12] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

c. "Race" type acts

The race statutes place a premium on the "race" to the courthouse. The subsequent purchaser must record before the earlier purchaser, but is protected even though aware of the earlier conveyance.[13] If Jones takes an interest in real estate, it won't matter if he has actual notice of Brown's prior unrecorded interest. Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

3. Exclusion 3d and imputed knowledge.

The ALTA policies are designed to protect the lien of a real estate interest with a "notice" standard, giving the title insurer a defense against policy liability if the policyholder knew of the unrecorded matter that caused the loss at the time of closing, but failed to disclose it to the insurer. This limitation on coverage is contained in paragraph 3b of the Exclusions from Coverage. Exclusion 3 also cancels coverage for acts of the insured, incidents allowed by the insured and incidents resulting in loss or damage that would not have been endured if the insured had paid value for the insured mortgage. Exclusion 3 provides:

> The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorney's fees or expenses which arise by reason of: ...

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[11] Alabama, Arizona, Arkansas [other than mortgages], Connecticut, Florida, Illinois, Iowa, Kansas, Kentucky, Maine, Massachusetts, Missouri, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia and West Virginia. Derived from Sweat, *supra*, p.31.

[12] Alaska, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire [Sweat lists N.H. REV. STAT. ANN. §477:3-a(1983) as a Notice statute, but the recent decision in *Amoskeag Bank v. Chagnon*, 572 A.2d 1153 (N.H. 1990) interprets it as a Race-Notice Act], New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania [other than mortgages], South Dakota, Utah, Washington, Wisconsin and Wyoming. Derived from Sweat, *supra*, p.31, except as noted.

[13] Arkansas [mortgages only], Delaware, Louisiana, North Carolina, and Pennsylvania [mortgages only]. Derived from Sweat, *supra*, p.31.

3. Defects, liens, encumbrances, adverse claims or other matters:

(a) created, suffered, assumed or agreed to by the insured claimant;

(b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy;

(c) resulting in no loss to the insured claimant;

(d) attaching to or created subsequent to Date of Policy(except to the extent that this policy insures the priority of the lien of the insured mortgage over statutory lien for services, labor or material); or

(e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the insured mortgage.

In the beginning, the non-imputation risk focused solely on Exclusion 3(d), but recently investors have broadened the focus to include concerns about Exclusions 3(a) and 3(e) as well. It could be argued that a title insurer could not apply the acts of the others, incidents allowed by others and incidents resulting in loss or damage that would not have been endured if others had paid value for the insured mortgage because the exclusion only applies to acts and knowledge of the 'insured claimant.' Acts and knowledge of anyone else, even if an insured, should not affect the coverage. However, the argument is still enough of a stretch to make ordering a non-imputation endorsement a prudent decision.

4. Managing the non-imputation risk.

A title insurer is without a means of managing the risk of unrecorded documents, the existence of which are known to the insured, so it protects itself with Exclusion 3(b) if no non-imputation coverage is requested. This position is consistent with the stance of other insurance lines. Even casualty lines of insurance take exception to such risks, e.g., life and health insurers do not accept liability for pre-existing health conditions of the insured that are not communicated to the insurer on the application.

Can the title insurer manage the risk of a loss due to an unrecorded matter not known to the insured (or an incoming owner of an interest in an insured entity) when notice of it is imputed to the insured or insured entity? Protection against such a risk appears similar to other protections against "hidden risks" afforded by a title policy. The insured has clean hands in such a case, unless a thorough "due diligence" investigation would reveal the unrecorded transfer or encumbrance. Under limited circumstances, title companies began to underwrite these risks.

At the beginning of the 1980's, certain life insurance companies began to invest in partnerships or joint ventures holding or developing real property. In most cases, the insurance company would convert a construction loan into an equity position after the developer completed construction and began the rent-up phase. By purchasing a partner's or joint venturer's share, there was no conveyance of title to the real estate. Thus, the life insurer's interest was not protected by the recording acts, so any unrecorded matter affecting title would be unaffected. By purchasing a share in the partnership or joint venture, the life insurance company also accepted its developer partner as the agent of the venture, so the law imputes to it any knowledge of or notice given to the developer.

The life insurers were not satisfied with this risk of loss through imputation, so they demanded that the partnership's title policy contain affirmative coverage against the imposition of Exclusion 3(b) as a defense to a claim under the policy by the partnership. Title insurers agreed to give this coverage limited to knowledge of the owner or developer at the Date of Policy, if satisfied that the risk of loss was eliminated by:

a. receipt of a written description of the complete structure of the transaction,

b. receipt and review of satisfactory current financial statements of any party or entity required as indemnitor (*i.e.*, all withdrawing partners, or all existing and remaining partners in a partnership, or current and former officers and directors of the acquired corporation),

c. receipt of satisfactory affidavits from individuals, partners or partnerships, officers, and directors of the acquired corporation. Copies of specimen affidavits are included in Appendix B together with copies of basic non-imputation endorsements.

d. receipt of satisfactory indemnity bonds from individuals, partners or partnerships, officers, and directors of the acquired corporation, and

e. receipt of a written request for the non-imputation endorsement.

This coverage applies to situations where a party buys an interest in an insured property, but acquires the interest through the purchase of shares of stock, a partnership share or membership in an LLC. Virtually all of the circumstances requiring non-imputation coverages involve these ownership interests. Lenders rarely need non-imputation coverage.

5. Automatic non-imputation for mortgage assignees

Most transfers of loan indebtedness are made by assignment. The loan policy protects assignees of the indebtedness in its definition of the term "insured" in paragraph 1(a) of the Conditions and Stipulations.[14] Thus an assignee for value should not be troubled by potential defenses of the title insurer based upon matters known to the original named insured in the policy if it has no notice of that matter.

6. Non-imputation endorsements

For years title insurers have issued proprietary non-imputation endorsements. Most have been limited to protecting a new owner from the impact of Exclusion 3(b) only. The ALTA Forms Committee reported three non-imputation endorsements to the ALTA. They broaden the coverage to protect the party from the operation of Exclusions 3(a), 3(b) and 3(e) as they apply to existing or former participants in the entity owning the insured land.

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[14] (a) "insured": the insured named in Schedule A. The term "insured" also includes

(i) the owner of the indebtedness secured by the insured mortgage and each successor in ownership of the indebtedness except a successor who is an obligor under the provisions of Section 12(c) of these Conditions and Stipulations (reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor insured, *unless the successor acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy as affecting title to the estate or interest in the land.* (Emphasis added).

I have one important caution about non-imputation endorsements. A prudent title insurer must manage the risk that the selling party has not created any off-record matter that might emerge at a later time to cause a loss. It does this first by limiting the coverage to matters that occurred before the Date of Policy. Limiting the risk to past events permits the title insurer to manage the risk by requiring the existing party to affirm that there is no off record matter that might affect title. Although limiting the coverage to the past is necessary, as we shall see with the ALTA 15.1, it might create a coverage gap if you aren't paying attention to the details.

a. The ALTA 15 Non-Imputation – Full Equity Transfer Endorsement

The ALTA 15 was designed for situations where the entire ownership of the entity owning the land has changed hands. It protects the incoming partners against defenses that the title insurer may have had against the outgoing owners of the landholding entity under Exclusions 3(a), 3(b) or 3(e). It is intended for a new policy issued to protect the incoming owners.

b. The ALTA 15.1 Non-Imputation - Additional Insured Endorsement

The ALTA 15.1 is similar to the ALTA 15 but is formatted for situations where the existing entity is the named insured in the policy and landholder to protect an incoming partner, member, or shareholder.

I think this endorsement continues a flaw that began with the earliest non-imputation endorsements. It does not bring the Date of Policy forward, so it either misses the period of greatest risk to the additional insured, or, if it is construed as insuring the period from the Date of Policy to the date of the endorsement, it may lull an issuing office or agent into issuing it without conducting a fresh title rundown. I would caution its use only after careful examination and amendment so its meaning is clear.

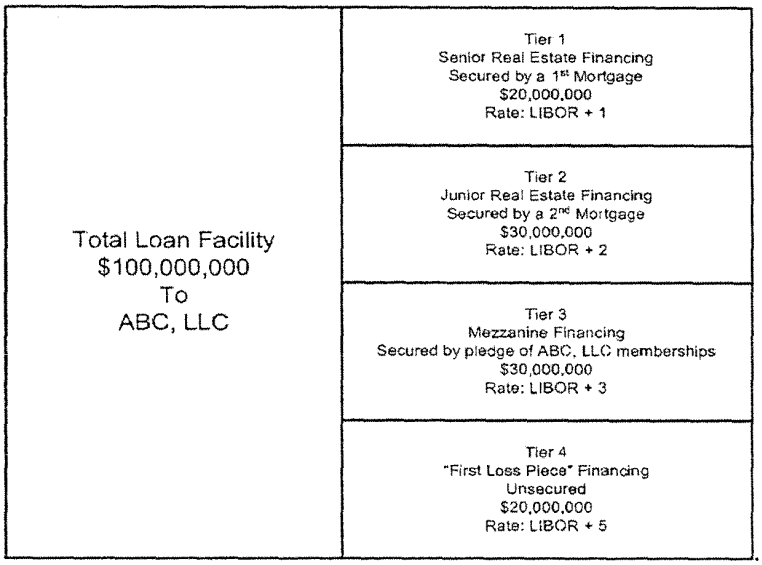
c. The ALTA 15.2 Non-Imputation – Partial Equity Transfer Endorsement

Finally, the ALTA 15.2 is also similar to the ALTA 15, but is formatted for an incoming partner, member, or shareholder, as the named insured in its own policy, where the landholder is a partnership, limited liability company or corporation.

J. Mezzanine Financing
ALTA 16-06

1. Structured Financings.

Many commercial borrowers divide their borrowings into tiers or 'tranches' to optimize the cost of borrowing. For a very simple illustration, let's imagine that ABC, LLC seeks to borrow $100,000,000 and discovered that it would cost LIBOR + 3% to borrow the full amount in one slug. However, if it structures the financing into tiers, having two levels of debt secured by mortgages, one level secured by a pledge of the memberships in the LLC, and the last an unsecured level as shown in this diagram, the effective interest rate in this simple example is LIBOR + 2.7%



Until recently, title insurers limited their participation in these structured transactions to those top two tiers that were secured by mortgages on the real estate. The bottom tiers were not a part of the title insurance market. However, those subordinate lenders recognized the critical role that real estate plays in so many of these transactions, and if there is a major title loss, it may exceed the title insurer's liability on the two loan policies. If the lenders in the bottom two tiers, the mezzanine and the unsecured 'first loss piece[15]' financing, can require the borrower to buy an owner's policy, and capture the title insurer's liability to it, they will gain some protection against that title risk.

In mezzanine financing, it's not the landowner that transfers a security interest in the collateral to the Mezzanine Lender. The landowner owns the land. Its owners pledge their interests in the landowner itself for the Mezzanine Lender's security. Thus the pledging entities may be shareholders, partners or members of the landholding entity, or even shareholders, partners or members of an entity that owns the entity that owns the land. Although some earlier mezzanine financing endorsements required the Mezzanine Lender to take title to the pledged ownership interests in the landowner as a condition to its right to payment for a loss, there is no real rationale for making that requirement.

2. Insuring a mezzanine financing.

The mezzanine lender usually has a security interest in the ownership interests of the entity that holds title to the land. It can seek UCC insurance for this security interest, and most title insurers can either issue or obtain the UCC policy for it. However, the UCC policy is another policy to buy, and it is an additional expense for a junior loan. There is a title insurance solution that has become popular in recent years.

[15] Its unfortunate that the endorsement allowing a claim before requiring foreclosure on all the collateral in a multi-site mortgage transaction has also been named "first loss." The different usages for this term in a transaction may cause some confusion.

THE ALTA COMMERCIAL ENDORSEMENTS

If a Mezzanine Lender or first loss piece lender has no ownership interest, or mortgage, does it have any insurable interest in land at all? Well, we can't insure its interest with a loan title insurance policy because there is no lien to insure. These lenders will not have an ownership interest in the land unless the Mezzanine Lender realizes upon its pledges of the ownership interests, and even then the interest is indirect, so it appears that these lenders have no traditional insurable interest in the land or in a mortgage on the land.

However, these lenders have recently sought title insurance coverage in the owner's policy with a 'loss payable' provision similar to those found in a typical property/casualty homeowner's policy. The borrower does have an insurable interest because it is the landowner. If it gets an owner's policy, the mezzanine lender can bargain for the right to receive any title insurance proceeds that the borrower might receive from the title insurer.

So a lender that is not secured by a mortgage lien on the land can nevertheless find some protection from title risks to the borrower in a Mezzanine Financing Endorsement. New York had a Mezzanine Financing Endorsement that served as a model for the ALTA 16 Mezzanine Financing Endorsement.

The New York endorsement limits its liability to a lender that has taken possession of ownership interests in the entity holding title to the land. The ALTA endorsement rejects that restriction, so although it is named a Mezzanine Financing Endorsement, it will serve an unsecured lender, as well. Perhaps the endorsement is misnamed, but it is convenient to continue a name recognized by our customers and it gives the loss payable beneficiary a convenient name, Mezzanine Lender.

The insured in the Owner's Policy must be the landowner, because it has the only insurable interest. To assign its rights to receive payments from the title insurer in the 'loss payable' provision, the landowner must also execute the endorsement. Consequently, the process of executing this endorsement is more cumbersome than our ordinary experience with endorsements. The Mezzanine Financing Endorsement can be issued with a new owner's policy when the loan is closed, or issued to amend an existing owner's policy held by the borrower.

In addition to recognizing the Mezzanine Lender as a loss payee, the title insurer agrees in paragraph 5 of the endorsement that Exclusions 3(a), 3(b) and 3(e) will not be applied against the borrower to defeat a recovery by the Mezzanine Lender

The ALTA 16 removes the requirement for the insured's consent before a Mezzanine Lender can participate in claims negotiations. The Forms Committee decided that a Mezzanine Lender has too much at stake to be denied a place at the table, as it is in the New York endorsement.

The Mezzanine Lender must consent to any later change in the policy coverage. Paragraph 8 of the revised draft includes a 'standstill' provision with respect to the title insurer's right of subrogation against the insured, the borrower or a guarantor of the Mezzanine Loan.

Paragraph 6 is a "Fairway" provision protecting the Mezzanine Lender in case it acquires the ownership interests pledged to it. It may be the only '*Fairway*' provision ever to be adopted by the ALTA. That's not because the ALTA wants to preserve the *Fairway* issue, but because it never applied to ALTA policies in the first place, and the new policy revisions should put this issue to rest, at last.

THE ALTA COMMERCIAL ENDORSEMENTS

K. Access and Entry
ALTA 17-06 (Direct), 17.1-06 (Indirect) & 17.2-06 (Utility Access)

1. Access in the policy forms.

Both the ALTA owner's and loan policies insure access to the insured land. It is insuring provision 4, and it states, succinctly that the Company insures against loss or damage cause by a, "Lack of a right of access to the land."

Access should be a simple concept. To insure 'access' to the land, a title insurer must only show that the insured can go to and from at least one public street and some point on the boundary to the land without the interference of the rights of another party. An owner can establish a right to access if the land abuts a public road, or if there is an appurtenant easement of right of way or a private road to the land.

To illustrate, imagine two lots numbered 1 & 2. At some time in the past (before subdivision control laws), an owner of Lot 2 sold its road frontage to the owner of Lot 1. Lot 1 has apparent access to the street, but Lot 2 is "landlocked" by Lot 1 and the other surrounding lots. It has no access to the street because the rights of the owner of Lot 1 block it.

Lot 2 does not have insurable access in this illustration, so a title insurer will take an express exception to access in its title insurance policy to override insuring provision 4. However, if a right of way easement to the street had been reserved for Lot 2 when the frontage was sold, it would still have insurable access. It would also have insurable access if the title to both lots were vested in one owner.

2. Insurable access in court decisions.

The insured has access even if the way between the street and the boundary is long and dangerous. *Gates v. Chicago Title Insurance Company*, 813 S.W.2d 10 (Mo. App. 1991). A 2½ foot barrier in a parking lot might make it impractical to travel from one lot to another, but it is not a lack of a right of access. *Magna Enterprises, Inc. v. Fidelity National Title Insurance Company*, 104 Cal. App.4th 122, 127 Cal. Rptr. 681 (2002). These cases apply the conventional standard - if the insured has the right to get to its land, it has access.

The opinions in both *Gates* and *Magna Enterprises* distinguished the earlier decision in *Marriott Financial Services, Inc. v. Capitol Funds, Inc.*, 288 N.C. 122, 217 S.E.2d 551 (1975). Marriott Financial bought a parcel of land, from Capitol Funds, along Wake Forest Road in Raleigh for development of a Roy Rogers fast food restaurant. Its purchase was insured by Lawyers Title. The City of Raleigh denied Marriott's application for driveway permits. The lot's frontage along Wake Forest Road was within 150 feet of a bridge over Crabtree Creek. The city would not allow driveway permits closer than 200 feet to the bridge because the road had such heavy traffic. Earlier, Capitol sold an adjacent parcel to an automobile dealer, and the city placed a notation on the dealership lot's plat that the parcel later sold to Marriott was "not an approved lot." Marriott sued capitol for rescission, or alternatively for recovery under its title insurance policy

The Supreme Court of North Carolina reversed an order dismissing an access claim against Lawyers Title because it found the insured had 'pedestrian' access only to Wake Forest

Road. Marriott's access was described as 'pedestrian only' because the city had refused to grant it the driveway permit to the road. The *Marriott* court confused a permit for a driveway with access, and applied a right of way classification to an access right. It ignored the terms in paragraph 4 of the Lawyers Title policy by holding that mere 'pedestrian' access was not 'reasonable' access when the insured sought 'vehicular' access for development of the fast food restaurant. I suspect that the Supreme Court thought that the city's notation on the auto dealer's plat that the adjacent parcel later sold to Marriott was "not an approved lot" was warning enough to the title insurer. It could have ruled that the title insurer had a duty under the policy to disclose the limitation stated on the auto dealer's plat to reach the same outcome without confusing the issues.

The *Marriott* decision is unrealistic because it suggests that the policy insured 'reasonable' access for Marriott's planned use, even though land was undeveloped. Of course, access has nothing to do with permits to build or use driveways and parking areas inside the boundaries of the land. The process of securing development permits often requires some concessions. Changing the facts slightly, if Marriott's optimal design had included two curb cuts on Wake Forest Road and two on an adjacent side street that empties onto Wake Forest, would it have had a title claim if Raleigh had limited it to one curb cut on Wake Forest and one on the side street, if that plan would still work for the business? Title insurers have no means for managing the risk of insuring the outcome of a future development permit process. Insuring the existing permitting may seem reasonable for most cases, but it would not have helped Marriott.

It would seem that the *Marriott* decision, having misstated the concept of access, and suffered criticism in subsequent access cases, should simply melt away into obscurity. Unfortunately, the court coined the terms "pedestrian and vehicular access." Afterwards, title insurers agreed to those terms in affirmative access coverage endorsements. The ALTA followed suit by including them in the Homeowner's and Expanded Coverage Residential Policies.

3. "Pedestrian and vehicular".

The law recognizes pedestrian ways (foot paths) and vehicular ways (streets and highways), so a right of way can be described as a pedestrian or vehicular way. Access may involve either kind of way or both, but the *Marriott* case is the only decision that I can find that transfers the concept of a "pedestrian and vehicular way" to access. The Marriott interpretation has been rejected in subsequent cases, but the term lingers on, so what does it mean? If it means anything, it must be that the public street or way to a public street needed as an element of access must allow both foot and vehicular traffic.

Others have suggested that it means that the owner can drive up to and on the insured land. That means there is no 'pedestrian and vehicular access' to many urban residential and commercial properties built on lots on city blocks because the sidewalk keeps a vehicle away. That rules out a large set of real estate from coverage eligibility. It also raises some other questions. If the boundary between the land and the street is the edge of the actual roadbed, but there are no curb cuts, does the owner have 'pedestrian and vehicular access?' What if the frontage is a 'no parking' zone?

If we return to *Gates*, the policyholder asserted a claim after being denied access to his land over an "east road." Chicago Title said the lot had access by a "west road" as well. However, Gates testified that the "west road" was a "goat path." He once traveled the 'west road' in a four-wheel drive vehicle with the 'passengers' walking alongside "watching that we didn't fall over the side of the mountain." Perhaps a mountain bike would easily make that journey. Mountain bikes are vehicles. What if the road easily accommodates automobiles, but is too narrow for heavy earth moving trucks? Does the insured have reasonable access? Where do we now draw the lines? 'Pedestrian and vehicular access' may confuse a concept that was reasonably settled before.

4. Utility Access.

Many lists of requested endorsements include a "utility facility endorsement" or a "utility availability endorsement" Until 2008, these were not standard endorsements, and often they were drafted by people outside the industry who were taking a stab at the coverage. Recognizing that some discipline was necessary, the ALTA considered several of the endorsements in circulation to determine how to craft a title insurance coverage to meet our customer's needs. Insurance must be specific so each party understands the insurer's liability to the insured. Insuring against loss if specified services are not "available" to the Land is ambiguous.

Certainly, nobody expected the title insurer to pay all of the utility bills for the specified services during the period that the Insured occupies the Land. So, does it mean that these utilities are actually connected? Should a policyholder have a claim in a power outage because the "availability" of electrical power has been interrupted? Should the title insurer race around on the day of closing to transfer all of the utility billing accounts to the buyer? If it is a loan policy, does the insurer have this obligation if the Insured forecloses on its mortgage? No, that doesn't make much sense either, and few customers want the title insurer to be that involved in their affairs in any event.

Are we being asked to insure that connection fees are paid? I am sure that many would like that coverage, but it has nothing to do with title. Why stop here? Why not ask for coverage against loss if any improvement on the land was not built to code with a building permit? Better yet, insurance against loss if the local jurisdiction refuses to permit development of the Land as the buyer envisions? This spins out of control so quickly. If we view the issue from a title perspective, what do we have? It is an access issue.

5. Insuring Access

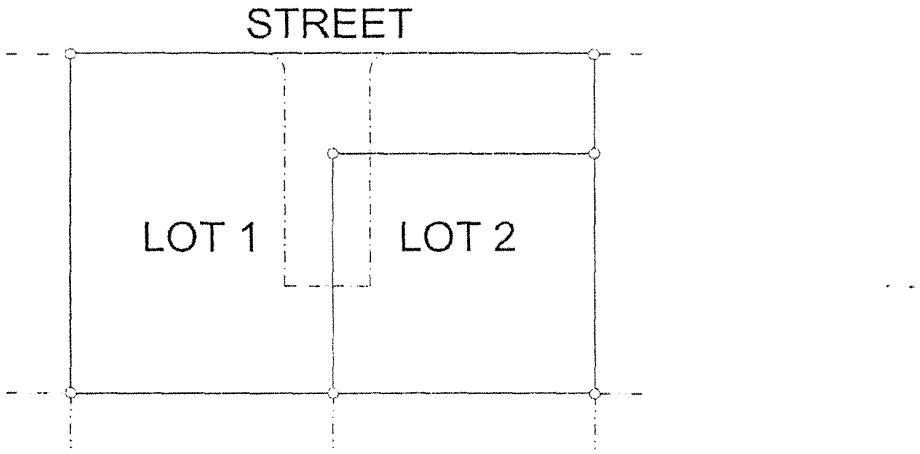
a. ALTA 17 Access and Entry Endorsement

The ALTA has adopted the ALTA 17 Access and Entry Endorsement to insure that the land abuts a public street; the insured has actual "vehicular and pedestrian access" and has the right to use existing curb cuts or entries. The express wording of the endorsement limits the insurance to the state of facts existing at the Date of Policy, so it should not be construed as insuring against interruption or obstruction of access for a later cause like street repairs or street widening. It does not insure the policyholder's first choice for a development plan for the land, either.

b. ALTA 17.1 Indirect Access and Entry Endorsement

Upon considering this endorsement, the ALTA forms Committee decided that it should also propose an ALTA 17.1 for land not abutting a public street. It insures when the policyholder has access to the public streets over an easement. The Commercial Endorsements Subcommittee drafted the proposed ALTA 17.1 endorsement, in December 2003 and the ALTA Board of Governors swiftly adopted it just a little more than a month later on January 17, 2004.

The coverages in the ALTA 17.1 are substantially the same as in the ALTA 17, but access and entry are insured over an easement identified in the endorsement. The endorsement indemnifies the insured if it cannot use "curb cuts and entries along that portion of the street abutting the easement."



c. Selecting the correct endorsement.

It should be easy to select the correct endorsement. The facts will dictate. Let's take our original example, and add a common driveway and easement to serve both Lots 1 & 2 (designated by the broken lines). We can use an ALTA 17 to insure access and entry for Lot 1, but an ALTA 17.1 must be used to insure access and entry for Lot 2

c. ALTA 17.2 Utility Access Endorsement

If the words "available" and "availability" are too vague to define this interest in real estate, "access" should do nicely. The endorsement insures against loss if there is no access for the specified services through an abutting street or an easement. Connecting to the service is the policyholder's responsibility. We can designate which services by check boxes on the endorsement, or add other services on the blank lines on the form.

The endorsement actually goes farther than most "utility facility" or "utility availability" endorsements because it expressly insures that there are no gaps between the boundary of the land and the right of way, or gaps in the right of way itself, or a termination of the right of way. It's not unheard of to receive a request to search the title to all utility right of way back to the water plant, power substation, gas plant, etc. That coverage against gaps in the right of way even addresses that issue.

THE ALTA COMMERCIAL ENDORSEMENTS

L. Tax parcel
ALTA 18-06 (Single) & 18.1-06 (Multiple)

1. Tax parcel issues.

A buyer of a single lot or parcel has concerns about how that parcel is taxed by the local jurisdiction. If taxes are unpaid, all of the property in the tax parcel can be sold so the taxing jurisdiction can recover the unpaid taxes, penalties, interest and expenses of sale. A landowner controls the payment of taxes for land it owns if the 'tax parcel' is congruent with land described in the transaction. If not, the landowner may be paying somebody else's taxes as well, or might lose all or a portion of its land if the property is sold to satisfy unpaid taxes for a larger tax parcel. It's important to be sure that no mistakes were made in describing the tax parcel for the land, and in properly designating the landowner, or its mortgagee, to receive the tax bills.

The owner of a single lot wants insurance against loss caused by the tax parcel including more land than is described in the title insurance policy because the taxing jurisdiction did not post the subdivision of the insured land from the larger parcel. It also wants protection against the possibility that the insured land includes land in two tax parcels. If the land is dependent on another parcel for access, parking, etc., the owner may want assurance that a tax sale of that easement parcel will not unseat its rights in that parcel.

2. Insuring tax parcel risks

a. ALTA 18 Single Tax Parcel Endorsement

The ALTA 18 is a conventional tax parcel endorsement that insures against loss if the tax parcel includes more land than is described in Schedule A, or does not include all of the land described in Schedule A. If there are no easements critical to access or any other purpose to the land, the ALTA 18 is a suitable choice.

b. ALTA 18.1 Multiple Tax Parcel Endorsement

The ALTA 18.1 adds indemnification against loss where "the easements, if any, described in Schedule A being cut off or disturbed by the non-payment of real estate taxes assessed against the servient estate." A comment indicated some concern about the affect of an assessment lien as well as real estate taxes. The Forms Committee added assessments imposed by a governmental authority to the coverage. It is designed for properties, like shopping center outlots, that depend on easement rights for vital service like access and entry. .

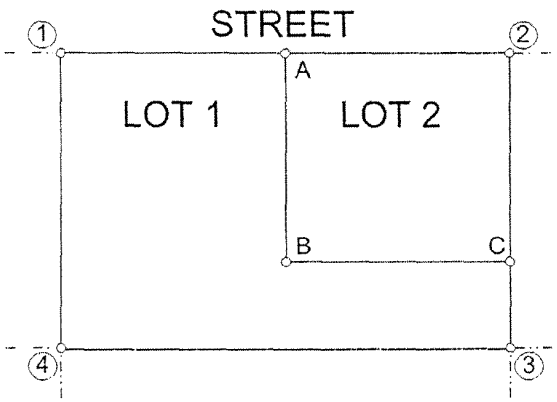
M. Contiguity
ALTA 19-06 (Multiple Parcels) & 19.1-06 (SingleParcel)

I see a proper 'contiguity' coverage as eliminating *all* outside interests that may come between two parcels. However, simply stating that two parcels are 'contiguous' doesn't eliminate the possibility that the rights of another may separate the two parcels at some point.

THE ALTA COMMERCIAL ENDORSEMENTS

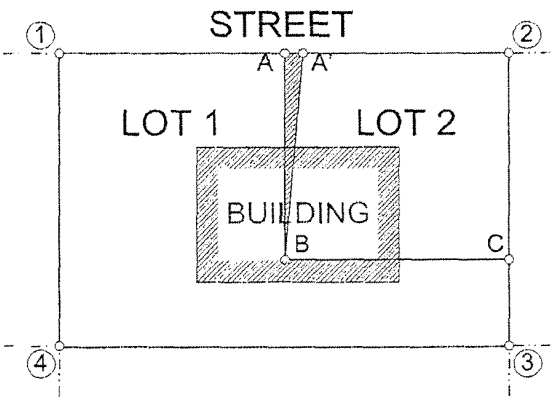
1. Assemblages

Let's imagine a very simple assemblage of two parcels of real estate into one larger parcel that the buyer intends to use as a single large parcel. In the diagram, Lots 1 & 2 have been assembled into a single parcel defined by corners 1, 2, 3 & 4.



The buyer expects the two lots, Lot 1 & Lot 2, to be contiguous along lines AB and BC so nobody else will have any rights to interfere with its abilities to build a structure straddling lots 1 & 2, and since both lots front on the street along line □-□, the buyer expects no impediment to unfettered access between the lots.

That is the expectation, but let's change the facts slightly. After buying the two lots, the owner discovers a problem. The lots are contiguous along the line BC, but a gore appears along the line AB, and it widens as we get closer to the street at A. So, if a title insurer insures that Lots 1 & 2 are contiguous, can it defend on the basis that they are indeed contiguous along BC? Will it lose because the lots are *not* contiguous along AB?



Why should AB make such a difference? It is plain that Lot 1 has four other lines that are not contiguous with any other line (A-□, □-□, □-□ & □-C), and Lot 2 has two such lines (A-□ & □-C). Nobody expects a contiguity endorsement to insure that any of those lines are contiguous to a line in the other lot because they are so plainly not contiguous. BC makes the two lots contiguous, so isn't that enough?

I doubt if the policyholder would be satisfied with this minimal contiguity if its goal was to construct a building straddling the two assembled lots, or to have unfettered access from one to another across AB. It seems to me that our conventional contiguity coverage is ambiguous and insufficient.

2. Perimeter descriptions

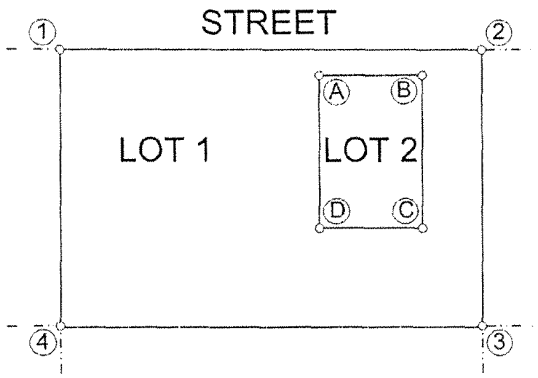
We can easily correct this problem by using a perimeter description of the assembled parcel within lines □-□, □-□, □-□ & □-□. If we use this perimeter description, we are insuring that nobody else has any rights inside that perimeter, unless we take exception to specific rights in Schedule B. This solution neatly resolves the contiguity issue, and makes any endorsement unnecessary. Unfortunately, it is not always possible to apply this tidy solution.

Often custom, practice or the title insurance customer prevents creating a new description for the assembled lots. In some other cases, the two estates may not be the same, so we can't use

a new perimeter description. If Lot 1 is a fee estate, and Lot 2 is a leasehold a perimeter description will not work.

Also we might have an outlot in a shopping center, owned in fee, but the insured may want its easement rights in the center insured as well, so the policy will insure title to a fee parcel surrounded by an easement parcel.

Most shopping centers have reciprocal easement agreements or operating agreements that give the tenants rights to the common areas, including the parking lots. Those easements are crucial to fee owners of anchor outlots because the shopping center landlocks the outlot. The outlot owner may also demand insurance that the lot lines for outlot are contiguous to the adjacent lines of the center so nobody else has the right to interrupt access to the outlot. It should be obvious that a perimeter description will not work here, because the two parcels are not being assembled in this transaction.



3. Contiguity endorsements

I see three basic ways to construct a contiguity endorsement. Let's return to our first illustration (with no gore at AB).

First, the endorsement may insure that Lot 1 is contiguous to Lot 2. I hope the weaknesses of this approach are obvious from the previous discussion.

Second, the endorsement could insure that nobody else has any rights between Lot 1 & Lot 2. I actually favor this form of coverage because it avoids vague concepts like 'contiguity' and goes to the heart of the matter. If the company insures that no other has rights between Lots 1 & 2, the coverage protects against any gore that would separate the two lots. We avoid the problems of saying Lots 1 & 2 are contiguous to each other along lines AB and BC (if that was true).

The third approach is to insure that the lots are contiguous along specified lines. This approach avoids the ambiguity. Now this form of endorsement would specify that lines AB & BC in both lots are contiguous to one another. This is perhaps the most precise of the contiguity endorsement forms, but it is a bit clumsy, especially if the assemblage involves multiple parcels or a large number of calls between parcels. Like our first endorsement form, this form speaks of 'contiguity' and makes the reader infer that 'contiguity' eliminates the rights of anyone else to interfere with the insured's rights across the lines. After all, isn't that the insured's goal?

4. Contiguity risks

a. ALTA 19 Contiguity – Multiple Parcels

The ALTA Forms Committee combined insuring specified lines with coverage for, "the presence of any gaps, strips or gores separating any of the contiguous boundary lines described above" for the ALTA 19 and 19.1. It's a hybrid form of coverage.

The ALTA 19 is a conventional contiguity endorsement for insuring the contiguity of two or more parcels described in Schedule A. It meets the conventional role for contiguity coverages where a number of separate lots or tracts are assembled into one larger tract.

b. ALTA 19.1 Contiguity – Single Parcel

The ALTA 19.1 is designed for insuring that the land described in the policy is contiguous to adjacent land not insured by the policy. Although it may seem marginal compared to the demand for the assemblage coverage, it can be used for that shopping center outlot. In addition, it might be useful if a landowner buys adjacent land and wants insurance that the new lot is contiguous to the old lot. By using an ALTA 19.1, the buyer could insure contiguity without disturbing the title insurance for the original lot.

N. First Loss
ALTA 20-06

A "first loss" endorsement is requested by lenders in some multi-property transactions to accelerate the payment of a loss under a loan policy if the value of one of the properties is diminished by a matter covered by the title insurance. Several forms of first loss coverage have been in circulation since the 1980s, but the endorsements are vague.

When the ALTA Forms Committee began exploring the value of a standard form, many legal commentators remarked that they did not know what the endorsements meant, or what they would do. Many real estate lawyers were skeptical that the ALTA Forms Committee could ever fashion a workable endorsement. Of course, it was obvious that a new standard endorsement must do at least as much as the general perception of the existing endorsements, or the new endorsement would not replace them. It has taken the Forms Committee longer to produce this endorsement than the others because the concept is both elusive and controversial.

1. The early first loss endorsements.

The general perception is that first loss coverage should entitle the lender to a payment on a loss without requiring foreclosure of all of its security (subject to certain limitations). Lenders seeking first loss think it gives them the same protection in a title insurance claim as if the loan was secured by a single property, but in practice first loss coverage probably goes beyond that.

If a loan is secured by one property and that property is affected by a title defect that substantially reduces its value, the lender can declare a default, accelerate the indebtedness and foreclose (unless foreclosure is futile). It may then seek indemnity from its title insurer to the extent its security is inadequate to repay the loan, interest and costs as a result of a defect in title covered by the title insurance. The decision to foreclose and realize upon the collateral is rarely complicated by the problem of whether the borrower could survive without the property; because in most cases it can't.

In multi-property transactions, however, lenders are concerned about the consequences of potential title defects affecting just one of the properties that may cause a substantial loss of value to that property and impair the security for the loan. The lender's choice either to accelerate the indebtedness to protect itself or to allow the loan to continue to protect the borrower becomes complicated if the lender has an otherwise financially healthy borrower capable of surviving the loss of the affected property. If the lender accelerates and forecloses

against all of its security to protect itself, it will destroy its borrower; if it doesn't accelerate, it may be undersecured and runs the risk that it may suffer a greater loss later. Under a loan policy of title insurance, however, such a lender has suffered no loss requiring indemnity, because: (i) the coverage will continue to protect the lender from loss as a result of the defect, in effect replacing the value lost in the property securing the loan; (ii) most loan security packages include more value in the collateral than is loaned and (iii) the other unaffected properties may adequately secure the loan.

2. The ALTA 20-06 First Loss Endorsement – Multiple Parcel Endorsement

The ALTA Forms Committee played with several concepts for this endorsement before landing on the current form. If title insurance is an indemnification line of insurance, it seems inconsistent to create a coverage that will compensate an insured when it determines its collateral has been impaired, but has not exhausted its collateral to establish a monetary loss. If the borrower and insured lender proceed with the loan after the title insurer makes a payment under the endorsement, the one of them may realize a windfall at the end of the transaction.

Liability is triggered under the endorsement when a loss insured against by the policy materially impairs the insured's security under the insured mortgage. The endorsement begins by defining "Indebtedness", "Collateral" and "Material Impairment Amount." The "Material Impairment Amount" is the difference between the value of the insured's Collateral and the value of the Indebtedness after a loss caused by a title defect lien, encumbrance or other matter. If the loss does not reduce the value of the Collateral below the value of the Indebtedness, there is no Material Impairment Amount and no liability under the endorsement. When the value of the Collateral is less than the Indebtedness because of a loss, the company is liable to pay the insured the Material Impairment Amount, not to exceed the limits of Sections 2 and 7 of the Conditions and Stipulations.

The liability is triggered even if the insured has not accelerated the payment of the debt, pursued its remedies against any of the Collateral, whether real or personal, or pursued any remedies under guaranties, bonds or insurance policies. The title insurer agrees to a 'standstill' against remedies against the borrower until the insured lender has been paid in full. The Title insurer does reserve its rights of subrogation against the borrower or a guarantor after the insured lender has been paid, and has the right to recoup from the insured lender any money received in excess of the amount it is due.

O. Creditors' Rights
ALTA 21-06

1. The Creditor's Rights exclusion.

In the 1980's the title insurance industry recognized that certain financial structures created the potential for challenges to the insured mortgage by competing creditors. The mortgage might create a preference or a fraudulent conveyance (or transfer) under the Bankruptcy Act (11 U.S.C.) or similar state creditors' rights laws. The title insurers reacted by taking exception to those creditors' rights risks in Schedule B of the loan policy. Lenders disliked the exception because it indicated that even a relatively unsophisticated title insurer

recognized that a transaction presented a risk that it might be held as a preference or fraudulent conveyance.

The solution to avoid tainting transactions was to add an exclusion in the 1990 ALTA policy forms for creditor's rights risks. Unfortunately the 1990 exclusion was overbroad, so lenders sought to remove it from their policies. In 1992, the Exclusion was recast to specifically address the precise title insurance problems that had been addressed in the earlier exceptions, but the damage was done. It had become the practice to seek removal of the 1990 Exclusion because of its breadth, and that practice didn't change when the more reasonable 1992 exclusion was adopted. The 1992 exclusion for the loan policy provides:

> 7. Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:
>
> (a) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or
>
> (b) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine of equitable subordination; or
>
> (c) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:
>
> (i) to timely record the instrument of transfer; or
>
> (ii) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

2. Avoiding the creditor's rights exclusion

We can eliminate the Creditors' Rights Exclusion in three ways:

1. By issuing an 1987 or earlier policy form that has no creditor's rights exclusion,
2. By issuing an endorsement to a 1992 policy that deletes the exclusion, but doesn't define any coverage
3. By issuing an endorsement that modifies the exclusion and insures against the risk.

Historically, the creditors' rights risk has been handled by options 1 & 2 in most cases. Option 3 has been used in a very few cases, and title insurers resist giving coverage against loss caused by a preference or fraudulent transfer. On the other hand, using options 1 & 2 to leave the issue in limbo makes little practical sense. Nobody knows how a court will view deleting the exclusion in any individual case. It has been addressed only once, in a case where the insured had a 1970 loan policy (Option 1).

Although this issue is frequently debated between title underwriters and their customers' counsel, there is only one case which addresses it, albeit in *dicta*. Citizens and Southern National Bank brought its title insurer in to defend against an attempt by a borrower to invalidate its mortgages as preferences in bankruptcy. In *Chicago Title Insurance Company v. Citizens and Southern National Bank*[16], the district court ruled that Exclusion 3(d) of the ALTA policy forms,

[16] 821 F.Supp 1492 (N.D. Ga. 1993).

which precludes coverage of matters attaching to or created subsequent to the date of the policy, applied to the claim by Citizens and Southern. The court stated:

> As the matter was never resolved by the bankruptcy court, it cannot be said definitively that the conveying of the security interests were preferred transfers. Even assuming that they were, that condition arose only because Hooker chose to file bankruptcy and chose to file within the critical time period. Both of these events, which might give rise to an avoidance, transpired after the title policy issued, and, therefore, the loss of the secured position would be excluded from the coverage of the policy because it was occasioned by subsequent events.[17]

3. The ALTA 21 Creditor's Rights Endorsement.

The endorsement insures over loss if a court avoids the estate, interest or lien of the mortgage insured against by the policy by finding a fraudulent conveyance or preference in a transaction. This endorsement is a step ahead of the most frequent practices, because it expressly insures against loss caused by the avoidance, or some other remedy predicated on the avoidability of the estate interest or mortgage of a fraudulent conveyance or preference. The endorsement still excludes loss if the insured knew that the transfer was intended to hinder, delay or defraud any creditor or if the insured is not a transfer in good faith. The endorsement can be issued on both owners and loan policies, but I expect the lion's share of demand to come from lenders.

The 2006 policies contain creditor's rights coverage in the covered risks. The coverage protects against fraudulent or preferential transfers in all prior transfers except the actual transfer insured by the policy. And as to the "negligent preference" caused by a failure to timely perfect the lien of a mortgage, the new covered risks protect the insured transfer, too. The ALTA 21 fills the gap left by the new coverages, and insures against loss caused if the insured transfer is itself challenged as a fraudulent transfer or preference.

P. Location
ALTA 22-06 (Location) & 22.1-06 (Location and Map)

The ALTA acknowledged the pressure for a location endorsement modeled on the form of the CLTA 116.1 by passing new location endorsements on June 17, 2006. The ALTA 22 insures that a described improvement with an identified address is located on the land at the Date of Policy. The ALTA 22.1 adds coverage that a map attached to the policy correctly shows the location and dimensions of the land according to the public records.

Q. Coinsurance
ALTA 23-06 (Me, Too)

In some jurisdictions, notably, New York, transactions are frequently insured by several title insurers, ostensibly to spread risk, although reinsurance does that more efficiently from the Insured's point of view. The Coinsurance Endorsement contemplates one of the insurers as the "Issuing Insurer" that will do all of the work of searching, examining and issuing the policy, and the other coinsurers simply issue the ALTA 23-06 to ratify the policy of the Issuing Coinsurer.

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[17] 821 F.Supp at 1495 (Emphasis added).

THE ALTA COMMERCIAL ENDORSEMENTS

Many years ago, each coinsurer did its own work, but it's manifest that having several different forms of coverage on the same property causes more work for the insured who generally negotiated a single form of coverage among the coinsurers. The "Me, Too" form of endorsement was devised to relieve the Insured of the burden of negotiating separate agreements with each insurer to follow a single model, and then to review each policy to verify that they are all congruent.. Of course, if there is a need for modifying the title insurance coverage after the policy has been issued, all coinsurers must agree to the modification, so the insured has not escaped entirely by using the endorsement. In addition, one company can't endorse the policy of another, so each company's execution of the Coinsurance Endorsement is actually a separate, but identical policy. Finally, regulators do not permit joint and several liability among companies because that would make reserving for losses almost impossibly difficult, so the insured must make a claim against each coinsurer if it has suffered a covered loss.

Now that the ALTA facultative[18] reinsurance agreements used by the title insurance industry include "Direct Access" provisions that empower an insured to seek recovery against the reinsurers of its transaction, despite not having privity with the reinsurers, reinsurance is much cleaner than coinsurance. All reinsurers must accept the issued policy, and a claim against the reinsured company is a claim against all. Making a claim under the "Direct Access" provision is very rare, and only necessary if the reinsured company can't respond to the claim, but it is a necessary backup.

R. Doing Business

ALTA 24-06 (Doing Business)

All ALTA Loan Policies since, at least 1970, have included an exclusion to a state's doing business laws as Exclusion 4. Exclusion 4 in the 2006 ALTA Loan Policy says:

> 4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing business laws of the state where the Land is situated.

If there is no exclusion for the insured loan in the state doing business law, this exclusion protects the insured from claims that a mortgage is unenforceable if the lender fails to comply with the law. The exclusion is a carve out from Covered Risk 9 of the 2006 ALTA Loan Policy that insures against loss caused by the invalidity or unenforceability of the lien of the Insured Mortgage.

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[18] "Facultative reinsurance" is reinsurance negotiated and purchased on individual transactions. If a title insurer is required or decides to reinsure a risk, it will use a facultative reinsurance agreement to make its arrangement with its reinsurers. Reinsurers for title insurance in the United States must be qualified as title insurance companies, so the reinsurers on most transactions are usually the large national title insurance companies. Some small regional title insurers may not have the capital that will allow them to insure all but the smallest risk because of state statutory retention formulas. To increase their capacity, they can enter into a "treaty" with a larger insured that will cover all risks above a stated amount without the necessity of entering into a facultative agreement for each one.

However, most states do not require a lender to comply with their doing business laws if the lender only makes a mortgage loan on land located in the state without actually conducting business operations in the state. If there is an exemption, Lender's counsel may ask the title insurer to override Exclusion 4 with a "doing business" endorsement. Virginia exempts mortgage lenders from its requirement to obtain a certificate of authority from the State Corporation Commission in §13.1-757 of the Code of Virginia.[19] So, your title insurer has no reason to refuse a request to issue the endorsement.

However, the endorsement does not protect a lender if it conducts other activities that are not exempt under §13.1-757(B), even if making the loan itself is exempt. It only protects a lender if its making these loans is its only activity in the state. Policyholders with owners'

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[19] **§13.1-757. Authority to transact business required.** - A. A foreign corporation may not transact business in the Commonwealth until it obtains a certificate of authority from the Commission.

B. The following activities, among others, do not constitute transacting business within the meaning of subsection A:

1. Maintaining, defending, or settling any proceeding;

2. Holding meetings of the board of directors or shareholders or carrying on other activities concerning internal corporate affairs;

3. Maintaining bank accounts;

4. Maintaining offices or agencies for the transfer, exchange, and registration of the corporation's own securities or maintaining trustees or depositories with respect to those securities;

5. Selling through independent contractors;

6. Soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside this Commonwealth before they become contracts;

7. Creating or acquiring indebtedness, deeds of trust, and security interests in real or personal property;

8. Securing or collecting debts or enforcing deeds of trust and security interests in property securing the debts;

9. Owning, without more, real or personal property;

10. Conducting an isolated transaction that is completed within 30 days and that is not one in the course of repeated transactions of a like nature;

11. For a period of less than 90 consecutive days, producing, directing, filming, crewing or acting in motion picture feature films, television series or commercials, or promotional films which are sent outside of the Commonwealth for processing, editing, marketing and distribution. The term "transacting business" as used in this subsection shall have no effect on personal jurisdiction under § 8.01-328.1; or

12. Serving, without more, as a general partner of, or as a partner in a partnership which is a general partner of, a domestic or foreign limited partnership that does not otherwise transact business in the Commonwealth.

C. The list of activities in subsection B is not exhaustive. [*Emphasis added*].

policies don't need this endorsement because there is no "doing business" exclusion in the ALTA Owners Policy.

S. Survey

ALTA 25-06 (Same as Survey) & 25.1-06 (Same as Portion of Survey)

Basic title evidence comes from two places, the recorder's office and surveys of the land. A search of the records in the recorder's office is common to every title insured, but not all title examinations include an examination of a current survey of the Land. If the buyer or borrower orders a current survey, or if there is an acceptable existing survey, the policyholder may have some concerns that the Land described in the recorder's documents is the same land shown on the survey. The insured can tie these two sources together by asking for a "same as survey" endorsement.

Property descriptions can change from one survey to the next because the surveyors may use different base points, and, of course, technology has greatly improved the accuracy of surveys. In many cases, the documents will use a historical description and the survey will show the results of the surveyor's own measurements. That can make the policyholder uneasy.

The ALTA 25 Same as Survey Endorsement can be used where the title insurer is confident that the property description in Schedule A of the policy is the same land as that shown in the survey, even if the calls for the metes and bounds differ in the two documents. The ALTA 25.1 Same as Portion of Survey Endorsement is used where the survey shows more land than the Land insured in the policy. For example, if a buyer is purchasing an outlot in a shopping center and doesn't want to pay for a survey of just the outlot because it is adequately depicted in a survey of the entire shopping center, the title insurer can accept the shopping center survey and issue an ALTA 25.1 designation the outlot as the Land.

T. Subdivision

ALTA 26-06 (Subdivision)

Until the 2006 ALTA policies, Exclusion 1 of the policies provided:

> The following matters are expressly excluded from the coverage of this policy:
>
> Any law, ordinance or governmental regulation (including but not limited to building and zoning ordinances) restricting or regulating or prohibiting the occupancy, use or enjoyment of the land, or regulating the character, dimensions or location of any improvement now or hereafter erected on the land, or prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part. [*Emphasis added*].

That last clause in the exclusion (this is the 1984 revision language that continued through the 1992 policies) was intended to describe subdivisions of the land. Many policyholders failed to grasp what the clause addressed, until they had a claim about an improper subdivision. Others recognized the exclusion and asked for an endorsement to cover subdivision risks. The California Land Title Association developed a CLTA 116.7 Subdivision Map Act Compliance endorsement decades ago, but it had to be altered for use outside the state because it insured compliance with the Subdivision Map Act, §66410, et seq., of the California Government Code.

The language "Any law, ordinance or governmental regulation . . . restricting or regulating or prohibiting . . . prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part ." lasted until 2006. With the new policies, the ALTA dropped the obscure reference to subdivision and substituted the word itself in both Covered Risk 5(c) and Exclusion 1(a)(iii). Covered Risk 5 now insures against

> 5. The violation or enforcement of any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to . . .
>
> (c) the subdivision of land; or
>
> if a notice, describing any part of the Land, is recorded in the Public Records setting forth the violation or intention to enforce, but only to the extent of the violation or enforcement referred to in that notice.

So a subdivision endorsement is unnecessary if the title insurer misses a notice in the Public Records. If there is no notice the title insurer would not be liable under the policy. The ALTA 26 has no requirement that there be notice in the Public Records, so it extends the policy coverage by an assumption of the risk of loss by the title insurer due to a subdivision violation not noticed in the Public Records.

U. Usury

ALTA 27-06 (Usury)

Title insurance policies insure against title and lien risks, so a usury endorsement insures against:

> loss or damage sustained by the Insured by reason of the invalidity or unenforceability of the lien of the Insured Mortgage as security for the Indebtedness because the loan secured by the Insured Mortgage violates the usury law of the state where the Land is located.

The endorsement does not insure against a loss caused by a judgment that the debt is unenforceable, or against penalties assessed against the insured because the loan is usurious. Title insurers are restricted to insuring the title or the lien of the mortgage, and cannot insure the validity or enforceability of the debt itself.

A title insurer will generally require that the loan fit into a statutory exemption before it will offer a usury endorsement. In Virginia, §6.1-330.61 provides the following exemption:

> No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter or any other section relating to usury to avoid or defeat the payment of interest, or any other sum, upon a loan made to a person by a bank, savings institution, industrial loan association or credit union, provided the initial principal amount of the loan is $5,000 or more.

At first, the coverage sounds disappointing, but lenders us the coverage to determine if their loans meet a statutory exemption. If the title insurer gives the coverage, the loan should be exempt. If the title insurer must calculate the interest rate to determine if the loan is usurious, most companies will not issue the endorsement. So the lender can take comfort from the endorsement even if the coverage is not everything it would like to have.

THE ALTA COMMERCIAL ENDORSEMENTS

V. Easements

ALTA 28-06 (Easement – Damage or Enforced Removal)

Occasionally review of a survey will show a building that encroaches on an easement. Buyers of policies who see an exception for such an encroachment will often ask for some "affirmative" coverage over the risks posed by the encroachment. The title insurer cannot insure that the encroachment does not exist, because it does. We often receive requests for coverage against loss caused by "any exercise or attempted exercise of the right of use or maintenance of the easement referred to in exception ___." Of course, if the survey shows an active pole line or manholes in the right of way, it would be imprudent to insure an owner against the right to use or maintain the easement. A title insurer who did that would create a claim merely by issuing the policy.

That affirmative coverage is even broader than the lender's coverage in an ALTA 9.3 endorsement. It provides in paragraph 3:

> 3. Damage to existing improvements, including lawns, shrubbery, or trees, located or encroaching on that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved.

That language originated in California where lawns shrubbery and trees are coaxed out of desert soil and conditions. In the eastern U.S., it is unthinkable to give coverage against damage to trees to an owner because our utility companies try to prevent power outages by trimming back trees, with painful results. With a little more editing, we can craft an endorsement that makes sense.

> The Company insures against loss or damage sustained by the Insured by reason of:
>
> (1) damage to an existing building located on the Land, or
>
> (2) enforced removal or alteration of an existing building located on the Land,
>
> as a result of the exercise of the right of use or maintenance of the easement referred to in Exception ___ of Schedule B for the purpose for which it was granted or reserved.

W. Boilerplate

The ALTA Forms Committee decided that even the boilerplate should be brought up to date with the new endorsements. It has applied it to all ALTA endorsements.

The old boilerplate read:

> This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

The new boilerplate sheds some archaic usage, and adds a second sentence to declare that the endorsement controls over any inconsistency in the policy or a previous endorsement. That would be implied under the general rules of construction, but now the endorsements say so.

THE ALTA COMMERCIAL ENDORSEMENTS

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

On January 17, 2004, the ALTA Board of Governors adopted the recommendation of the ALTA Forms Committee to substitute the new boilerplate into all of the ALTA endorsement forms. It now applies to all ALTA endorsements. In addition the ALTA included a complementary provision in subsection (d) of Conditions 14 and 15 of the 2006 Loan and Owner's policies respectively. If a title insurer inadvertently leaves off the boilerplate from an endorsement, these policy provisions will incorporate the endorsement into the policy without it. It's belts and suspenders.

In the revisions to the 2006 policies, it became evident that nothing in the policies addressed the effect of endorsements, and so Section 14(d) was added to the 2006 Loan Policy and section 15(d) was added to the 2006 Owners Policy to correct that deficiency. They say:

(d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

II
THE ALTA ENDORSEMENTS
(In numerical order)

Form	Name	Introduced	Current Revision
ALTA 1	Street Assessments	4/2/70	6/1/87
ALTA 1-06	Street Assessments	6/17/06	6/17/06
ALTA 2	Truth-in-Lending	4/2/70	6/1/87
ALTA 2-06	Truth-in-Lending	6/17/06	6/17/06
ALTA 3	Zoning – Vacant Land	10/3/73	10/17/98
ALTA 3-06	Zoning – Vacant Land	6/17/06	6/17/06
ALTA 3.1	Zoning – Completed Structure	10/3/73	10/17/98
ALTA 3.1-06	Zoning – Completed Structure	6/17/06	6/17/06
ALTA 4	Condominium	9/27/78	3/27/92
ALTA 4-06	Condominium	6/17/06	10/16/08
ALTA 4.1	Condominium	10/17/92	10/17/92
ALTA 4.1-06	Condominium	6/17/06	10/16/08
ALTA 5	Planned Unit Development	10/17/79	3/27/92
ALTA 5-06	Planned Unit Development	6/17/06	10/16/08
ALTA 5.1	Planned Unit Development	10/17/92	10/17/92
ALTA 5.1-06	Planned Unit Development	6/17/06	10/16/08
ALTA 6	Variable Rate Mortgage	10/17/80	6/1/87
ALTA 6-06	Variable rate Mortgage	6/17/06	10/16/08
ALTA 6.1	Variable Rate Mortgage	10/17/80	6/1/87
ALTA 6.2	Variable Rate Mortgage – Negative Amortization	1982	6/1/87
ALTA 6.2-06	Variable Rate Mortgage – Negative Amortization	6/17/06	10/16/08
ALTA 7	Manufactured Housing	3/12/82	6/1/87
ALTA 7-06	Manufactured Housing	6/17/06	6/17/06
ALTA 7.1	Manufactured Housing-Conversion; Loan	6/17/06	6/17/06
ALTA 7.1-06	Manufactured Housing – Conversion; Loan	6/17/06	6/17/06
ALTA 7.2	Manufactured Housing -	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Conversion; Owners		
ALTA 7.2-06	Manufactured Housing - Conversion; Owners	6/17/06	6/17/06
ALTA 8.1	Environmental Protection Lien	6/1/87	3/12/88
ALTA 8.1-06	Environmental Protection Lien	6/17/06	6/17/06
ALTA 8.2-06	Commercial Environmental Protection Lien	10/16/08	10/16/08
ALTA 9	Restrictions, Encroachments, Minerals	10/19/88	6/17/06
ALTA 9-06	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.1	Restrictions, Encroachments, Minerals -- Owner's Policy: Unimproved Land	10/17/98	6/17/06
ALTA 9.1-06	Restrictions, Encroachments, Minerals -- Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.2	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	10/17/98	6/17/06
ALTA 9.2-06	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	6/17/06	6/17/06
ALTA 9.3	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.3-06	Restrictions, Encroachments, Minerals	6/17/06	6/17/06
ALTA 9.4	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.4-06	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	6/17/06
ALTA 9.5	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	6/17/06	6/17/06
ALTA 9.5-06	Restrictions, Encroachments, Minerals – Owner's Policy:	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Improved Land		
ALTA 10	Mortgage Assignment	10/21/95	10/21/95
ALTA 10-06	Mortgage Assignment	6/17/06	10/16/08
ALTA 10.1	Mortgage Assignment and Datedown	10/21/95	10/21/95
ALTA 10.1-06	Mortgage Assignment and Datedown	6/17/06	10/16/08
ALTA 11	Mortgage Modification	10/19/96	10/19/96
ALTA 11-06	Mortgage Modification	6/17/06	6/17/06
ALTA 12	Aggregation	10/19/96	10/19/96
ALTA 12-06	Aggregation	6/17/06	6/17/06
ALTA 13	Leasehold Owners	10/13/01	10/13/01
ALTA 13	Leasehold Owners	6/17/06	6/17/06
ALTA 13.1	Leasehold Loan	10/13/01	10/13/01
ALTA 13.1	Leasehold Loan	6/17/06	6/17/06
ALTA 14	Future Advances – Priority	10/22/03	10/22/03
ALTA 14-06	Future Advances – Priority	6/17/06	6/17/06
ALTA 14.1	Future Advances – Notice	10/22/03	10/22/03
ALTA 14.1-06	Future Advances – Notice	6/17/06	6/17/06
ALTA 14.2	Future Advances – Letter of Credit	10/22/03	10/22/03
ALTA 14.2-06	Future Advances – Letter of Credit	6/17/06	6/17/06
ALTA 14.3	Future Advances – Reverse Mortgage	6/17/06	6/17/06
ALTA 14.3-06	Future Advances – Reverse Mortgage	6/17/06	6/17/06
ALTA 15	Non-Imputation – Full Equity Transfer	10/22/03	10/22/03
ALTA 15-06	Non-Imputation – Full Equity Transfer	6/17/06	6/17/06
ALTA 15.1	Non-Imputation – Additional Insured	10/22/03	10/22/03
ALTA 15.1-06	Non-Imputation – Additional	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Insured		
ALTA 15.2	Non-Imputation Partial Equity Transfer	10/22/03	10/22/03
ALTA 15.2-06	Non-Imputation Partial Equity Transfer	6/17/06	6/17/06
ALTA 16	Mezzanine Financing Endorsement	10/22/03	10/22/03
ALTA 16-06	Mezzanine Financing Endorsement	6/17/06	6/17/06
ALTA 17	Access and Entry	10/22/03	10/22/03
ALTA 17-06	Access and Entry	6/17/06	6/17/06
ALTA 17.1	Indirect Access and Entry	1/17/04	1/17/04
ALTA 17.1-06	Indirect Access and Entry	6/17/06	6/17/06
ALTA 17.2-06	Utility Access	10/16/08	10/16/08
ALTA 18	Single Tax Parcel	10/22/03	10/22/03
ALTA 18-06	Single Tax Parcel	6/17/06	6/17/06
ALTA 18.1	Multiple Tax Parcel	10/22/03	10/22/03
ALTA 18.1-06	Multiple Tax Parcel	6/17/06	6/17/06
ALTA 19	Contiguity – Multiple Parcels	10/22/03	10/22/03
ALTA 19-06	Contiguity – Multiple Parcels	6/17/06	6/17/06
ALTA 19.1	Contiguity – Single Parcels	10/22/03	10/22/03
ALTA 19.1-06	Contiguity – Single Parcels	6/17/06	6/17/06
ALTA 20	First Loss – Multiple Parcel Transactions	4/19/04	4/19/04
ALTA 20-06	First Loss – Multiple Parcel Transactions	6/17/06	6/17/06
ALTA 21	Creditors' Rights	4/19/04	4/19/04
ALTA 21-06	Creditors' Rights	6/17/06	6/17/06
ALTA 22	Location	6/17/06	6/17/06
ALTA 22-06	Location	6/17/06	6/17/06
ALTA 22.1	Location and Map	6/17/06	6/17/06
ALTA 22.1-06	Location and Map	6/17/06	6/17/06
ALTA 23	Coinsurance	1/1/08	1/1/08

Form	Name	Introduced	Current Revision
ALTA 23-06	Coinsurance	1/1/08	1/1/08
ALTA 24-06	Doing Business	10/16/08	10/16/08
ALTA 25-06	Same as Survey	10/16/08	10/16/08
ALTA 25.1-06	Same as Portion of Survey	10/16/08	10/16/08
ALTA 26-06	Subdivision	10/16/08	10/16/08
ALTA 27-06	Usury	10/16/08	10/16/08
ALTA 28	Easement – Damage or Enforced Removal	10/16/08	10/16/08

2005 MINIMUM STANDARD DETAIL REQUIREMENTS FOR ALTA/ACSM LAND TITLE SURVEYS

as adopted by

American Land Title Association

and

National Society of Professional Surveyors

(a member organization of the American Congress on Surveying and Mapping)

It is recognized that members of the American Land Title Association (ALTA) have specific needs, peculiar to title insurance matters, which require particular information for acceptance by title insurance companies when said companies are asked to insure title to land without exception as to the many matters which might be discoverable from survey and inspection and not be evidenced by the public records. In the general interest of the public, the surveying profession, title insurers and abstracters, ALTA and the National Society of Professional Surveyors, Inc. (NSPS) jointly promulgate and set forth such details and criteria for standards. It is recognized and understood that local and state standards or standards of care, which surveyors in those respective jurisdictions are bound by, may augment, or even require variations to the standards outlined herein. Where conflicts between the standards outlined herein and any jurisdictional statutes or regulations occur, the more restrictive requirement shall apply. It is also recognized that title insurance companies are entitled to rely on the survey furnished to them to be of an appropriate professional quality, both as to completeness and as to accuracy. It is equally recognized that for the performance of a survey, the surveyor will be provided with appropriate data which can be relied upon in the preparation of the survey.

For a survey of real property and the plat or map of the survey to be acceptable to a title insurance company for purposes of insuring title to said real property free and clear of survey matters (except those matters disclosed by the survey and indicated on the plat or map), certain specific and pertinent information shall be presented for the distinct and clear understanding between the client (insured), the title insurance company (insurer), and the surveyor (the person professionally responsible for the survey). These requirements are:

1. The client shall request the survey or arrange for the survey to be requested and shall provide a written authorization to proceed with the survey from the person responsible for paying for the survey. Unless specifically authorized in writing by the insurer, the insurer shall not be responsible for any costs associated with the preparation of the survey. The request shall specify that an "ALTA/ACSM LAND TITLE SURVEY" is required and shall designate which of the optional items listed in Table A are to be incorporated. The request shall set forth the record description of the property to be surveyed or, in the case of an original survey, the record description of the parent parcel that contains the property to be surveyed. Complete copies of the record description of the property (or, in the case of an original survey, the parent parcel), any record easements benefiting the property; the record easements or servitudes and covenants burdening the property ("Record Documents"); documents of record referred to in the Record Documents; and any other documents containing desired appropriate information affecting the property being surveyed and to which the survey shall make reference shall be provided to the surveyor for notation on the plat or map of survey.

2. The plat or map of such survey shall bear the name, address, telephone number, and signature of the professional land surveyor who performed the survey, his or her official seal and registration number, the date the survey was completed, the dates of all of the surveyor's revisions and the caption "ALTA/ACSM Land Title Survey" with the certification set forth in paragraph 8.

3. An "ALTA/ACSM LAND TITLE SURVEY" shall be in accordance with the then-current "Accuracy Standards for Land Title Surveys" ("Accuracy Standards") as adopted, from time to time by the National Society of Professional Surveyors and the American Land Title Association and incorporated herein by reference.

4. On the plat or map of an "ALTA/ACSM LAND TITLE SURVEY," the survey boundary shall be drawn to a convenient scale, with that scale clearly indicated. A graphic scale, shown in feet or meters or both, shall be included. A north arrow shall be shown and when practicable, the plat or map of survey shall be oriented so that north is at the top of the drawing. Symbols or abbreviations used shall be identified on the face of the plat or map by use of a legend or other means. If necessary for clarity, supplementary or exaggerated diagrams shall be presented accurately on the plat or map. The plat or map shall be a minimum size of 8½ by 11 inches.

5. The survey shall be performed on the ground and the plat or map of an "ALTA/ACSM LAND TITLE SURVEY" shall contain, in addition to the required items already specified above, the following applicable information:

(a) All data necessary to indicate the mathematical dimensions and relationships of the boundary represented, with angles given directly or by bearings, and with the length and radius of each curve, together with elements necessary to mathematically define each curve. The point of beginning of the surveyor's description shall be shown as well as the remote point of beginning if different. A bearing base shall refer to some well-fixed line, so that the bearings may be easily re-established. The North arrow shall be referenced to its bearing base and should that bearing base differ from record title, that difference shall be noted.

(b) When record bearings or angles or distances differ from measured bearings, angles or distances, both the

record and measured bearings, angles, and distances shall be clearly indicated. If the record description fails to form a mathematically closed figure, the surveyor shall so indicate.

(c) Measured and record distances from corners of parcels surveyed to the nearest right-of-way lines of streets in urban or suburban areas, together with recovered lot corners and evidence of lot corners, shall be noted. For streets and highways abutting the property surveyed, the name, the width and location of pavement relative to the nearest boundary line of the surveyed tract, and the width of existing rights of way, where available from the controlling jurisdiction, shall be shown. Observable evidence of access (or lack thereof) to such abutting streets or highways shall be indicated. Observable evidence of private roads shall be so indicated. Streets abutting the premises, which have been described in Record Documents, but not physically opened, shall be shown and so noted.

(d) The identifying titles of all recorded plats, filed maps, right of way maps, or similar documents which the survey represents, wholly or in part, shall be shown with their appropriate recording data, filing dates and map numbers, and the lot, block, and section numbers or letters of the surveyed premises. For non-platted adjoining land, names, and recording data identifying adjoining owners as they appear of record shall be shown. For platted adjoining land, the recording data of the subdivision plat shall be shown. The survey shall indicate platted setback or building restriction lines which have been recorded in subdivision plats or which appear in Record Documents which have been delivered to the surveyor. Contiguity, gores, and overlaps along the exterior boundaries of the surveyed premises, where ascertainable from field evidence or Record Documents, or interior to those exterior boundaries, shall be clearly indicated or noted. Where only a part of a recorded lot or parcel is included in the survey, the balance of the lot or parcel shall be indicated.

(e) All evidence of monuments shall be shown and noted to indicate which were found and which were placed. All evidence of monuments found beyond the surveyed premises on which establishment of the corners of the surveyed premises are dependent, and their application related to the survey shall be indicated.

(f) The character of any and all evidence of possession shall be stated and the location of such evidence carefully given in relation to both the measured boundary lines and those established by the record. An absence of notation on the survey shall be presumptive of no observable evidence of possession.

(g) The location of all buildings upon the plot or parcel shall be shown and their locations defined by measurements perpendicular to the nearest perimeter boundaries. The precision of these measurements shall be commensurate with the Relative Positional Accuracy of the survey as specified in the current Accuracy Standards for ALTA/ACSM Land Title Surveys. If there are no buildings erected on the property being surveyed, the plat or map shall bear the statement, "No buildings." Proper street numbers shall be shown where available.

(h) All easements evidenced by Record Documents which have been delivered to the surveyor shall be shown, both those burdening and those benefiting the property surveyed, indicating recording information. If such an easement cannot be located, a note to this effect shall be included. Observable evidence of easements and/or servitudes of all kinds, such as those created by roads; rights-of-way; water courses; drains; telephone, telegraph, or electric lines; water, sewer, oil or gas pipelines on or across the surveyed property and on adjoining properties if they appear to affect the surveyed property, shall be located and noted. If the surveyor has knowledge of any such easements and/or servitudes, not observable at the time the present survey is made, such lack of observable evidence shall be noted. Surface indications, if any, of underground easements and/or servitudes shall also be shown.

(i) The character and location of all walls, buildings, fences, and other visible improvements within five feet of each side of the boundary lines shall be noted. Without expressing a legal opinion, physical evidence of all encroaching structural appurtenances and projections, such as fire escapes, bay windows, windows and doors that open out, flue pipes, stoops, eaves, cornices, areaways, steps, trim, etc., by or on adjoining property or on abutting streets, on any easement or over setback lines shown by Record Documents shall be indicated with the extent of such encroachment or projection. If the client wishes to have additional information with regard to appurtenances such as whether or not such appurtenances are independent, division, or party walls and are plumb, the client will assume the responsibility of obtaining such permissions as are necessary for the surveyor to enter upon the properties to make such determinations.

(j) Driveways, alleys and other ways of access on or crossing the property must be shown. Where there is evidence of use by other than the occupants of the property, the surveyor must so indicate on the plat or map. Where driveways or alleys on adjoining properties encroach, in whole or in part, on the property being surveyed, the surveyor must so indicate on the plat or map with appropriate measurements.

(k) As accurately as the evidence permits, the location of cemeteries and burial grounds (i) disclosed in the Record Documents provided by client or (ii) observed in the process of performing the field work for the survey, shall be shown.

(l) Ponds, lakes, springs, or rivers bordering on or running through the premises being surveyed shall be shown.

6. As a minimum requirement, the surveyor shall furnish two sets of prints of the plat or map of survey to

the title insurance company or the client. If the plat or map of survey consists of more than one sheet, the sheets shall be numbered, the total number of sheets indicated and match lines be shown on each sheet. The prints shall be on durable and dimensionally stable material of a quality standard acceptable to the title insurance company. The record title description of the surveyed tract, or the description provided by the client, and any new description prepared by the surveyor must appear on the face of the plat or map or otherwise accompany the survey. When, in the opinion of the surveyor, the results of the survey differ significantly from the record, or if a fundamental decision related to the boundary resolution is not clearly reflected on the plat or map, the surveyor may explain this information with notes on the face of the plat or map or in accompanying attachments. If the relative positional accuracy of the survey exceeds that allowable, the surveyor shall explain the site conditions that resulted in that outcome with a note on the face of the map or plat.

7. Water boundaries necessarily are subject to change due to erosion or accretion by tidal action or the flow of rivers and streams. A realignment of water bodies may also occur due to many reasons such as deliberate cutting and filling of bordering lands or by avulsion. Recorded surveys of natural water boundaries are not relied upon by title insurers for location of title.

When a property to be surveyed for title insurance purposes contains a natural water boundary, the surveyor shall measure the location of the boundary according to appropriate surveying methods and note on the plat or map the date of the measurement and the caveat that the boundary is subject to change due to natural causes and that it may or may not represent the actual location of the limit of title. When the surveyor is aware of changes in such boundaries, the extent of those changes shall be identified.

8. When the surveyor has met all of the minimum standard detail requirements for an ALTA/ACSM Land Title Survey, the following certification shall be made on the plat:

To (name of client), (name of lender, if known), (name of title insurance company, if known), (name of others as instructed by client):

This is to certify that this map or plat and the survey on which it is based were made in accordance with the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys," jointly established and adopted by ALTA and NSPS in 2005, and includes Items _____ of Table A thereof. Pursuant to the Accuracy Standards as adopted by ALTA and NSPS and in effect on the date of this certification, undersigned further certifies that in my professional opinion, as a land surveyor registered in the State of _____, the Relative Positional Accuracy of this survey does not exceed that which is specified therein.

Date: (signed) (seal)
Registration No.

NOTE: If, as otherwise allowed in the Accuracy Standards, the Relative Positional Accuracy exceeds that which is specified therein, the following certification shall be made on the plat:

To (name of client), (name of lender, if known), (name of title insurance company, if known), (name of others as instructed by client):

This is to certify that this map or plat and the survey on which it is based were made in accordance with the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys," jointly established and adopted by ALTA and NSPS in 2005, and includes Items _____ of Table A thereof. Pursuant to the Accuracy Standards as adopted by ALTA and NSPS and in effect on the date of this certification, undersigned further certifies that in my professional opinion, as a land surveyor registered in the State of _____, the maximum Relative Positional Accuracy is _____feet.

Date: (signed) (seal)
Registration No.

The 2005 Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys are effective January 1, 2006. As of that date, all previous versions of the Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys are superseded by these 2005 standards.

Adopted by the American Land Title Association on October 5, 2005.
Adopted by the Board of Directors, National Society of Professional Surveyors on October 24, 2005.
American Land Title Association, 1828 L St., N.W., Suite 705, Washington, D.C. 20036.
National Society of Professional Surveyors, Inc., 6 Montgomery Village Avenue, Suite 403, Gaithersburg, MD 20879

TABLE A

OPTIONAL SURVEY RESPONSIBILITIES AND SPECIFICATIONS

NOTE: The items of Table A must be negotiated between the surveyor and client. It may be necessary for the surveyor to qualify or expand upon the description of these items, e.g., in reference to item 6, there may be a need for an interpretation of a restriction. The surveyor cannot make a certification on the basis of an interpretation or opinion of another party. Items 16, 17 and 18 are only for use on projects for the U.S. Department of Housing and Urban Development (HUD).

If checked, the following optional items are to be included in the ALTA/ACSM LAND TITLE SURVEY, except as otherwise negotiated:

1. _____ *Monuments placed (or a reference monument or witness to the corner) at all major corners of the boundary of the property, unless already marked or referenced by an existing monument or witness to the corner.*

2. _____ *Vicinity map showing the property surveyed in reference to nearby highway(s) or major street intersection(s).*

3. _____ *Flood zone designation (with proper annotation based on federal Flood Insurance Rate Maps or the state or local equivalent, by scaled map location and graphic plotting only.)*

4. _____ *Gross land area (and other areas if specified by the client).*

5. _____ *Contours and the datum of the elevations.*

6. _____ *List setback, height, and floor space area restrictions disclosed by applicable zoning or building codes (beyond those required under paragraph 5d of these standards). If none, so state. The source of such information must be disclosed. See "Note" above.*

7. _____ *(a) Exterior dimensions of all buildings at ground level*

(b) Square footage of:

_____ *(1) exterior footprint of all buildings at ground level*

_____ *(2) gross floor area of all buildings; or*

_____ *(3) other areas to be defined by the client*

_____ *(c) Measured height of all buildings above grade at a defined location. If no defined location is provided, the point of measurement shall be shown.*

8. _____ *Substantial, visible improvements (in addition to buildings) such as billboards, signs, parking structures, swimming pools, etc.*

9. _____ *Parking areas and, if striped, the striping and the type (e.g. handicapped, motorcycle, regular, etc.) and number of parking spaces.*

10. _____ *Indication of access to a public way on land such as curb cuts and driveways, and to and from waters adjoining the surveyed tract, such as boat slips, launches, piers and docks..*

11. *Location of utilities (representative examples of which are shown below) existing on or serving the surveyed property as determined by:*

_____ *(a) Observed evidence*

_____ *(b) Observed evidence together with evidence from plans obtained from utility companies or provided by client, and markings by utility companies and other appropriate sources (with reference as to the source of information)*

- *railroad tracks and sidings;*
- *manholes, catch basins, valve vaults or other surface indications of subterranean uses;*
- *wires and cables (including their function, if readily identifiable) crossing the surveyed premises, all poles on or within ten feet of the surveyed premises, and the dimensions of all crossmembers or overhangs affecting the surveyed premises; and*
- *utility company installations on the surveyed premises.*

12. _____ *Governmental Agency survey-related requirements as specified by the client.*

13. _____ *Names of adjoining owners of platted lands.*

14. _____ *The distance to the nearest intersecting street as designated by the client*

15. _____ *Rectified orthophotography, photogrammetric mapping, laser scanning and other similar products, tools or technologies may be utilized as the basis for the location of certain features (excluding boundaries) where ground measurements are not otherwise necessary to locate those features to an appropriate and acceptable accuracy relative to a nearby boundary. The surveyor shall (a) discuss the ramifications of such methodologies (e.g. the potential accuracy and completeness of the data gathered thereby) with the title company, lender and client prior to the performance of the survey and, (b) place a note on the face of the survey explaining the source, date, relative accuracy and other relevant qualifications of any such data.*

16. _____ *Observable evidence of earth moving work, building construction or building additions within recent months.*

17. _____ *Any changes in street right of way lines either completed or proposed, and available from the controlling jurisdiction. Observable evidence of recent street or sidewalk construction or repairs.*

18. _____ *Observable evidence of site use as a solid waste dump, sump or sanitary landfill.*

19. _____

Accuracy Standards for ALTA/ACSM Land Title Surveys

Introduction

These Accuracy Standards address Relative Positional Accuracies for measurements that control land boundaries on ALTA/ACSM Land Title Surveys.

In order to meet these standards, the surveyor must assure and certify that the Relative Positional Accuracies resulting from the measurements made on the survey do not exceed that which is allowable.

If the size or configuration of the property to be surveyed, or the relief, vegetation or improvements on the property will result in survey measurements for which the allowable Relative Positional Accuracies will be exceeded, the surveyor must alternatively certify as to the Relative Positional Accuracy that was otherwise achieved on the survey.

Definition:

"Relative Positional Accuracy" means the value expressed in feet or meters that represents the uncertainty due to random errors in measurements in the location of any point on a survey relative to any other point on the same survey at the 95 percent confidence level.

Background

The lines and corners on any property survey have uncertainty in location which is the result of (1) availability and condition of reference monuments, (2) occupation or possession lines as they may differ from record lines, (3) clarity or ambiguity of the record descriptions or plats of the surveyed tracts and its adjoiners and (4) Relative Positional Accuracy.

The first three sources of uncertainty must be weighed as evidence in the determination of where, in the professional surveyor's opinion, the boundary lines and corners should be placed. Relative Positional Accuracy is related to how accurately the surveyor is able to monument or report those positions.

Of these four sources of uncertainty, only Relative Positional Accuracy is controllable, although due to the inherent error in any measurement, it cannot be eliminated. The first three can be estimated based on evidence; Relative Positional Accuracy can be estimated using statistical means.

The surveyor shall, to the extent necessary to achieve the standard contained herein, (1) compensate or correct for systematic errors, including those associated with instrument calibration, (2) select the appropriate equipment and methods, and use trained personnel and (3) use appropriate error propagation and other measurement design theory to select the proper instruments, field procedures, geometric layouts and computational procedures to control random errors.

If radial survey methods, GPS or other acceptable technologies or procedures are used to locate or establish points on the survey, the surveyor shall apply appropriate procedures in order to assure that the allowable Relative Positional Accuracy of such points is not exceeded.

Computation of Relative Positional Accuracy

Relative Positional Accuracy may be tested by:
(1) comparing the relative location of points in a survey as measured by an independent survey of higher accuracy or
(2) the results of a minimally constrained, correctly weighted least square adjustment of the survey.

Allowable Relative Positional Accuracy for Measurements Controlling Land Boundaries on ALTA/ACSM Land Title Surveys

0.07 feet (or 20 mm) + 50 ppm

Lender

REQUIREMENTS FOR LAND SURVEYS

1. The Survey for the property shall be prepared by a land surveyor licensed to practice surveying in the jurisdiction where the property is located and done pursuant to the 2005 ALTA/ACSM Minimum Standard Detail Requirements for Land Title Surveys (the "ACSM Standards") including items 2, 3, 4, 6, 7(a), 7(b)(1), 8, 9, 10, 11(a) (as to utilities, surface matters only) and 13 on Table A thereof. In certain cases, other Table A items may be required.

2. The Survey shall be dated no more than 30 days prior to closing, must be certified to _____ ("Lender") and its successors and assigns, must contain the certification set forth in the ACSM Standards, and must be signed and sealed by the surveyor. A copy of the certification contained in the ACSM Standards is set forth below.

3. The Survey shall also be certified to the title insurance company insuring title in the transaction, shall be satisfactory to the title insurance company, shall refer to the title insurance commitment by number and effective date, and shall list every recorded exception appearing in the title insurance commitment, with a note stating whether the exception affects the property, and if so whether the exception is plottable. If the exception is plottable, it must be plotted on the Survey. Any appurtenant easement which is plottable must also be plotted on the Survey.

4. Where the loan is a construction loan, the proposed locations of all improvements shown on the site plan shall be plotted on the Survey, and identified as proposed improvements; and the Survey shall indicate the locations of all necessary utility lines and the distances from the property to the proposed connections to distribution lines.

5. The Survey shall contain a note concerning the flood zone designation of the property in substantially the following form: "Said described property is located within an area having a Zone Designation _____ by the Secretary of Housing and Urban Development, on Flood Insurance Rate Map No. _____, with a date of identification of _____, for Community Number _____, in _____ County, State of _____, which is the current Flood Insurance Rate Map for the community in which said property is situated."

6. All set back, side yard and rear yard lines shown on the recorded plat shall be drawn on the Survey, and identified by recording number. All setback, height and floor space area restrictions disclosed by applicable zoning or building codes shall be listed, with the source of such information.

7. The number of regular and handicap parking spaces located on the property shall be stated on the Survey, and all parking spaces shall be drawn on the Survey to the extent possible.

REQUIRED CERTIFICATION

To (name of client), (name of Lender and its successors and assigns), (name of title insurance company), (name of others as instructed by client):

This is to certify that this map or plat and the survey on which it is based were made in accordance with the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys," jointly established and adopted by ALTA and NSPS in 2005, and includes items 2, 3, 4, 6, 7(a), 7(b)(1), 8, 9, 10, 11(a) (as to utilities, surface matters only) and 13 of Table A thereof. Pursuant to the Accuracy Standards as adopted by ALTA and NSPS and in effect on the date of this certification, undersigned further certifies that in my professional opinion, as a land surveyor registered in the State of _____, the Relative Positional Accuracy of this Survey does not exceed that which is specified therein.

Date:_____

(signed)_____(seal)
Registration No.

Survey Checklist for Fannie Mae DUS Lender
Lender and ALTA/ACSM Requirements

Property Name: _____ Lender: _____

Location (City/State): _____

Surveyor: _____

Reviewer: _____ Review Date: _____

Show on ALTA Map	OK	Not OK	Notes
A. Property Description			
1. Written survey description (or footnotes explanations), if survey description differs from title report/commitment description	_____	_____	_____
2. Legal description that forms a closed loop or an explanation of why not	_____	_____	_____
3. Bearing & distance for each side written on/at boundary lines	_____	_____	_____
4. Monument from which survey started	_____	_____	_____
5. Bearings & distances from monument to point of beginning	_____	_____	_____
B. Easement			
1. Locations for all located easements, rights of way, covenants and restrictions	_____	_____	_____
2. All easements serving the project	_____	_____	_____
3. Location of all utilities and their ingress/egress points (include all rail-road tracks, manholes, catch basins, valves, wires, cables etc.)	_____	_____	_____

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Show on ALTA Map	OK	Not OK	Notes
C. Improvements			
1. All improvements	_____	_____	_____
2. Distances from buildings to boundary lines, perpendicular to boundary line	_____	_____	_____
3. Current set back lines on all sides, or explanation of why not shown	_____	_____	_____
4. Mark all parking areas on survey map and number of parking spaces	_____	_____	_____
D. Encroachments			
1. All encroachments of improvements from property onto adjoining lands, including distance	_____	_____	_____
2. All encroachments of improvements, with adjoining land onto property, including distance	_____	_____	_____
E. Adjacent Property			
1. Boundary line (both sides of adjacent streets)	_____	_____	_____
2. Label adjacent streets as "public" or "private"	_____	_____	_____
3. Mark all curb cuts & driveways	_____	_____	_____
F. Certificate			
1. Indicate any special hazard areas if "as shown on map" it must be shown with boundaries of area	_____	_____	_____
2. Certified to [NAME OF LENDER], Fannie Mae, its successors and/or assigns, title company and Borrower/Owner	_____	_____	_____

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Show on ALTA Map	OK	Not OK	Notes
G. Miscellaneous Map Details			
1. "Label" or "Title Block" showing city, county, state and name of project			
2. Signature of licensed surveyor			
3. Surveyor's seal, unless redated			
4. Date of ground survey (90 days or less before closing)			
5. Date of revision, if necessary			
6. North direction arrow			
7. Scale must be 1" = 50' or less, and this must be written out			
8. Area of land in square feet and acreage			
9. Legend of all symbols			
10. Flood Zone designation			
11. Evidence of Cemeteries			
12. Vicinity Map (showing location in reference to nearest highway or street intersection)			
13. Names of all adjacent property owners			
14. Exterior dimensions on all sides of buildings			

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SURVEYOR'S CERTIFICATE

The undersigned, being a registered surveyor of the State of _____ certifies to (i) _____ (name of DUS Lender), (ii) Fannie Mae, its successors and or assigns, (iii) (Name of title company), (iv) (Name of Borrower), as follows:

1. This is to certify that this map or plat and the survey on which it is based were made in accordance with the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys", jointly established and adopted by ALTA and NSPS in 2005, and includes items 1, 2, 3, 4, 6, 7A, 8, 9, 10, 11A and 13 of Table A thereof. Pursuant to the Accuracy Standards as adopted by ALTA and NSPS and in effect on the date of this certification, undersigned further certifies that in my professional opinion, as a land surveyor registered in the State of _____, the Relative Positional Accuracy of this survey does not exceed that which is specified therein.

2. The survey was made on the ground between [insert dates] and correctly shows the area of the subject property, the location and type of all buildings, structures and other improvements situated on the subject property, and any other matters situated on the subject property.

3. Except as shown on the survey, there are no visible easements or rights of way of which the undersigned has been advised.

4. Except as shown on the survey, there are no observable, above ground encroachments (a) by the improvements on the subject property upon adjoining properties, streets or alleys, or (b) by the improvements on adjoining properties, street or alleys upon the subject property.

5. The location of each easement, right of way, servitude and other matter affecting the subject property and listed in the title insurance commitment dated _____, _____ issued by (name of title company) with respect to the subject property, has been shown on the survey, together with appropriate recording references, to the extent that such matters can be located. The property shown on the survey is the property described in the title commitment. The location of all improvements on the subject property is in accord with minimum setback provisions and restrictions of records referenced in such title commitment.

6. The subject property has access to and from a duly dedicated and accepted public street or highway.

7. Except as shown on the survey, the subject property does not serve any adjoining property for drainage, utilities or ingress or egress.

8. The record description of the subject property forms a mathematically closed figure.

9. Except as shown on the survey, no portion of the property shown on the survey lies within a Special Hazard Area, as described on the Flood Insurance Rate Map for the

{65745; 1}
community in which the subject property is located. [The survey correctly indicates the zone designation of any area shown as being within a Special Hazard Area]

[If the certificate is attached to rather than typed or otherwise reproduced on the face of the survey, add a paragraph specifically identifying the survey (such as by date, property description, and survey number) to which the certificate relates]

The parties listed above are entitled to rely on the survey and this certificate as being true and accurate.

[Surveyor's Seal] _____
Name of Surveyor

Registration No.:

Dated: _____

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ACC Extras

Supplemental resources available on www.acc.com

902 After the Closing: Practical Methods for When the Real Legal Work Begins Post Acquisition.
Program Material. May 2007
http://www.acc.com/legalresources/resource.cfm?show=20040

Due Diligence Document Request List.
Sample Form & Policy. June 2009
http://www.acc.com/legalresources/resource.cfm?show=314845

Due Diligence Check List.
Quick Reference. June 2008
http://www.acc.com/legalresources/resource.cfm?show=16452

Please note, these additional resources are provided by the Association of Corporate Counsel and not by the faculty of this session.