



Practical and Legal Perspectives on Deed in Lieu Transactions

by Joseph A. McFalls and Michael Pollack of Blank Rome LLP. Reprinted with permission.

When a borrower defaults on its mortgage, a lender has a number of remedies available to it. In recent years, lenders as well as borrowers have increasingly chosen to pursue alternatives to the adversarial foreclosure process. Chief among these is the deed in lieu of foreclosure (referred to as a "deed in lieu" for short) in which the lender forgives all or most of the borrower's obligations in return for the borrower voluntarily handing over the deed to the property.

During these difficult economic times, deeds in lieu offer lenders and borrowers numerous advantages over a traditional foreclosure. Lenders can diminish the uncertainties inherent in the foreclosure process, reduce the time and expense it takes to recover possession, and increase the likelihood of receiving the property in better condition and in a more seamless manner together with a proper accounting. Borrowers can avoid expensive and protracted foreclosure fights (which are usually unsuccessful in the long run), manage continuing liabilities and tax implications, and put a more positive spin on their credit and reputation. Even so, deeds in lieu can also pose substantial risks to the parties if

the issues attendant to the process are not thoroughly considered and the documents are not properly drafted.

A deed in lieu should not be considered unless a professional appraisal values the property at less than the remaining mortgage obligation. Otherwise, there is the threat of another creditor (or trustee in bankruptcy) claiming that the transfer is a fraudulent conveyance and, in any case, the borrower would obviously be reluctant to relinquish a property in which it might stand to recover some value following a foreclosure sale. Also, a deed in lieu transaction should not be forced upon a borrower; rather, it must be a free and voluntary act, and a representation and warranty reflecting this should be memorialized in the agreement. Otherwise, there is a risk that the transaction could be vitiated by a court in a subsequent proceeding on the basis of undue influence or similar theories. If a borrower is resistant to completing a deed in lieu transfer, then a lender intent on recovering the property should instead com-

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Hamilton County Law Library

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The Future of Legal Information Publishing

Law Librarian Mary Jenkins was an invitee to an American Association of Law Libraries-hosted colloquium, *Creating, Disseminating, Using, and Preserving Legal Information in Challenging Times*, held February 28-March 1, 2011. As described on the [AALL Spectrum Blog](#), "...the organizers sought to bring together decision-makers and influencers in order to address common concerns related to the changing environment of legal information publishing..." Librarians, vendor representatives, and other stakeholders deliberated on a range of issues including vendor-librarian relations, preservation of legal information, customer service, cost of legal information, metrics, trends, and more. Joyce Manna Janto, president of the AALL, commented that the conversations were "wide-ranging, introspective, and remarkably frank". Colloquium attendees identified a set of shared principles. Next, a working group will refine the principles and develop an action plan for comment and then implementation.

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Here is a listing of all the topics that are available to you. To use any of these materials, click on Member Login on our home page (<http://www.hamilton-co.org/cinlawlib/>). After logging in, click on the tab for Topical Databases. You will see the Loislaw topics list there.

- Aspen / CCH Bankruptcy Law Library
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- Business Torts Law Library
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- Family Law Library
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- Internet and E-Commerce Law Library
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- Personal Injury Law Library
- Product Liability Law Library
- Real Estate Law Library

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mence a traditional foreclosure.

Ensuring that there are no other adverse liens on the property, and that there will be no such liens pending the delivery and recordation of the deed in lieu of foreclosure, is perhaps the biggest pitfall a lender must avoid in structuring the transaction. Subordinate liens on the property can only be discharged through a foreclosure process or by agreement of the adverse creditor. Therefore, before initiating, and again before consummating, the deed in lieu transaction, the lender must do a sufficient title check; after receiving the report, whether a lender will move forward will usually be a case-by-case decision based on the existence and amount of any discovered liens. Often it will be prudent to attempt to negotiate for the purchase or satisfaction of relatively minor third party liens. If the lender does decide to proceed with the transaction, it should evaluate the benefits of obtaining a new title insurance policy for the property and to have a non-merger endorsement included in it.¹

For protection against known or unknown subordinate liens, the lender will also want to include anti-merger language in the agreement with the borrower, or structure the transaction so that the deed is given to a lender affiliate, to enable the lender to foreclose (or use leverage by reason of the ability to foreclose) such other liens after the delivery of the deed in lieu. Reliance on anti-merger provisions, however, can be risky. Cancelling the original note can endanger the lender's security interest, so the lender should instead provide the borrower with a covenant not to sue. This also affords the lender flexibility to retain any "bad boy" carve-outs or any other continuing liabilities that are agreed to by the parties, including environmental matters. Depending on the jurisdiction or particular factual circumstances, however, another creditor might successfully attack the validity of the attempt to preclude merger. Moreover, a non-merger structure may, in some jurisdictions, have a transfer tax consequence. The bottom

line is that if there is not a high degree of confidence in the property and the borrower, the lender needs to be especially vigilant in structuring the transaction and setting up the appropriate contingencies.

One significant benefit of a carefully structured deed-in-lieu process is that there will be a detailed agreement setting forth the conditions, representations and provisions that are contractually binding and which can survive the delivery of the deed and related releases. Thus, in addition to the normal pre-foreclosure due diligence that would be conducted by a lender, the agreement will provide a roadmap to the transition process as well as critical information and representations regarding operating accounts, accounting, turnover of leasing and contract documents, liability and casualty insurance, and the like. Indeed, once the lender takes possession of the property through a voluntary deed process as opposed to foreclosure, it will likely (both as a legal and practical matter) have greater exposure to claims of tenants, contractors and other third parties so a well crafted deed-in-lieu agreement will go a long way toward enhancing the lender's comfort with the overall process while at the same time providing order and certainty to the borrower.

Another substantial concern for the lender is to make certain that the transfer of the property from the borrower to the lender fully and unequivocally extinguishes the borrower's interest in the property. Any remaining interest that the borrower maintains in the property may later give rise to a claim that the transfer was not an absolute conveyance and was instead an equitable mortgage. Therefore, a lender should strongly resist any offer from the borrower to lease, manage, or reserve an option to purchase any part of the property following the transaction.

These are just a few of the most important issues in a deed in lieu transfer. Other significant issues must also be considered in order

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to protect the parties in this relatively complex process. Indeed, every transaction is unique and can raise different issues, and each state has its own rules and customs relating to these arrangements, ranging from transfer tax issues to the fact that, for example, in New Jersey, deed in lieu transactions likely fall under the state's Bulk Sales Act and its requirements. However, these issues should not dissuade—and certainly have not dissuaded—lenders and borrowers from increasingly using deeds in lieu and thereby reaping the substantial benefits of structuring a transaction in this way.

1. For many years it was also possible—and highly preferred—for the lender to have the title insurance company include a creditors' rights endorsement in the title insurance policy. This protected the lender against having to defend a claim that the deed in lieu transaction represented a fraudulent or preferential transfer. However, in March of 2010, the American Land Title Association decertified the creditors' right endorsement and thus title companies are no longer offering this protection. It should be further noted that if the deed in lieu were set aside by a court based on undue influence or other acts attributable to the lender, there would likely be no title coverage because of the defense of "acts of the insured".

For more information, please contact Joseph A. McFalls (McFalls@BlankRome.com) or Michael Pollack (Pollack@BlankRome.com.)

Attorneys in Solo Practice or Small Firms

The Law Library offers our solo and small firm practitioners an email discussion list (a.k.a. listserv) for information sharing and discussion.

To sign up, contact library staff; we'll be glad to subscribe you. If you prefer, you may manage your own subscriptions online at <http://www.hamilton-co.org/cinlawlib/interact/list.html>.

Upcoming CLEs

To register for any of these CLE events: Contact Mary Ann at the law library or at 513.946.5300 or via email at masweeney@cms.hamilton-co.org.

Westlaw

Thursday, April 14

Two sessions:

12:30-1:30-Westlaw Basics/Search Tips

1:45-2:45– Westlaw: Focus on Secondary Sources– OhJur, AmJur, Formfinder

Each session is approved for 1.0 hour of general Ohio CLE credit.

Lexis

Tuesday, April 19

1:00-2:00– Lexis Search Tips/Strategies

Approved for 1.0 hour of general Ohio CLE credit.

Prenuptial Basics

Friday, May 27

1:00-2:00

Just in time for wedding season, this presentation will cover the basics of drafting pre-nuptial agreements. Attorney Cathy R. Cook will discuss when they can be used, who should have a prenup, what issues should be spelled out, and what makes them vulnerable to attack.

Approved for 1.0 hour of general Ohio CLE credit.

Free to law library subscribers: \$50 for non-subscribers.

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You and the Legal System: Consumer Credit

The Hamilton County Law Library, in conjunction with the Cincinnati Bar Association's Lawyer Referral Service, will present *You and the Legal System: Consumer Credit* on Friday, April 15, 2011 at 12:00 noon at the Law Library.

We're pleased to announce that Albert T. Brown, Jr., a Cincinnati attorney and law library subscriber, will be the speaker. There will be time for questions from the audience.

This program is free and open to the public. It is not a CLE. Attorneys are welcome to attend but please note that the session is intended primarily for the non-lawyer citizen. It will last one hour. Please pass the information along to clients and colleagues as desired.

Please call 513.946.5300 at the Hamilton County Law Library or email masweeney@cms.hamilton-co.org to reserve a seat.

Looking ahead: On May 20, 2011, attorney Katrina Farley will offer the next session in this series, focusing on estate planning.

Law Library Board Meets April 7

The Hamilton County Law Library Resources Board will hold its next meeting on Thursday, April 7, 2011 at 1:00 p.m. in the Robert S. Kraft Board Room at the Law Library.

The meeting is open to the public. Regularly scheduled 2011 meetings include July 7 and October 6, both at 1:00 p.m.

Library Resources on Consumer Credit

Many of these books are publications of the National Consumer Law Center. We also offer online access to them in the Law Library. Contact a member of the reference staff at 513.946.5300 or reference@cms.hamilton-co.org for other suggestions for online and print materials on consumer credit legal issues.

Consumer banking and payments law : credit, debit & stored value cards; checks; money orders; e-sign; electronic banking and benefit payments /
Mark Budnitz, Lauren K. Saunders, Margot Saunders. KF1040.Z9 B83 2009

Consumer bankruptcy law and practice / Henry J. Sommer ; John Rao, editor and contributing author. KF1040.Z9 S65 2009-

Consumer class actions / Stuart T. Rossman, Charles Delbaum, Arielle Cohen ; contributing authors, Robert Bramson ... [et al.]. KF1040.Z9 R65 2010

Consumer warranty law : lemon law, Magnuson-Moss, UCC, manufactured home, and other warranty statutes / Carolyn L. Carter, John W. Van Alst, Jonathan Sheldon ; contributing author, Elizabeth De Armond KF1040.Z9 C57 2010

The cost of credit : regulation, preemption, and industry abuses / Elizabeth Renuart, Kathleen E. Keest ; contributing authors: Carolyn L. Carter ... [et al.]. KF1040.Z9 K33 2009

Credit discrimination / Alys Cohen ; contributing authors, Sandra Mitchell Wilmore ... [et al.]. KF1040.Z9 C74 2009

Dodd-Frank Wall Street Reform and Consumer Protection Act : law, explanation and analysis / [by CCH attorney-editor staff]. KF974 .D63 2010

Fair credit reporting / Chi Chi Wu, Elizabeth De Armond ; contributing authors, Carolyn L. Carter ... [et al.]. KF1040.Z9 W83 2010-

Foreclosures : defenses, workouts, and mortgage servicing / John Rao ... [et al.] ; contributing authors, Andrew G. Pizor ... [et al.]. KF1040.Z9 S542 2010

Repossessions / Carolyn L. Carter ; contributing authors, Jonathan Sheldon ... [et al.]. KF1040.Z9 S541 2010-

Student loan law / Deanne Loonin ; contributing author, Geoff Walsh. KF1040.Z9 L66 2010-

Truth in lending / Diane E. Thompson, Elizabeth Renuart ; contributing authors, Carolyn L. Carter ... [et al.]. KF1040.Z9 T7 2010-

The National Consumer Law Center guide to surviving debt / Deanne Loonin. KF1040.Z9 L661 2008-



Upcoming Events

April 14: Westlaw CLEs (Two sessions)

Westlaw Basics/Search Tips

Focus on Secondary Sources– OhJur, AmJur, Formfinder

April 15: You and the Legal System: Consumer Credit

April 19: Lexis Search Tips and Strategies CLE

May 20: You and the Legal System: Estate Planning

May 27: Prenuptial Basics CLE



April 2011 Law Library Newsletter

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