LEGAL UPDATE

by Morton P. Fisher, Jr., CRE

A number of important legislative developments are underway which will have a dramatic and long term effect on real estate and its values and valuation. Several of the most significant legal actions, which are interest-related to The Counselors of Real Estate, are federal laws dealing with bankruptcy reform, brownfields, new lender liability protections under CERCLA, telecommunications, foreclosure, good faith and fair dealing, and the electronic age.

Bankruptcy Reform As It Relates To Real Estate

The Bankruptcy Review Commission, mandated by the 1994 amendments to the Bankruptcy Code, is expected this year to make its recommendations for changes in the bankruptcy laws related to real estate. The changes are motivated primarily by lending institutions which have suffered in time and money from the delay in foreclosure and the take back of properties secured by loans in default. As most Counselors know, the filing of bankruptcy by a borrower will result in the automatic stay of a foreclosure and other legal actions against the borrower, such as the appointment of a receiver. Another strong motivation has been the claim of shopping center landlords that retailer bankruptcies have given retailers an unfair advantage by permitting a retailer in bankruptcy to reject undesirable leases and to profit, or permit others to profit, from the assignment of desirable leases.

In December 1996, the Bankruptcy Commission held hearings in Washington, DC where the leading real estate associations participated in a panel discussion on single asset real estate bankruptcies. The panel members represented the interests of the American College of Real Estate Lawyers, the National Association of Real Estate Investment Trusts and the International Council of Shopping Centers. Although it is premature to predict the precise recommendations which will be made, it is predictable and almost certain that any recommendations will be structured to streamline, economize and speed up real estate bankruptcies. It is less clear whether the claims of secured creditors (lenders) will be any better protected from a so-called cram down.

Significant to The Counselors is that such changes, if adopted by Congress, may benefit and impact real estate. And, if certain recommendations are adopted, e.g., the debtor's ability to bring new value to the table, the services of a Counselor of Real Estate (CRE) will almost always be required.

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Brownfields

Another significant development is the ongoing passage of brownfield legislation underway by many states. Brownfields are abandoned, vacant or underutilized properties which cannot be readily recycled because they are contaminated. Brownfield programs, authorized by state law, provide incentives for the owners and potential owners to undertake voluntary action to clean up contaminated properties in return for protection under state law. Such voluntary programs will frequently include a Phase I environmental assessment and a Phase II program where warranted and remedial action, which, if approved by state authorities, will relieve the owner or potential owner, from liability through the issuance of a no action letter.

Here, too, CRE services will be needed to advise owners and potential owners of brownfields regarding the impact on valuation for real estate tax assessment purposes. Brownfields are likely to be prominent in the redevelopment of older cities. Already shopping centers and power centers are under construction in brownfield sites in Chicago and other cities.

New Lender Liability Laws

Two years after a federal court ruled that the Environmental Protection Agency's Lender Liability rules were not consistent with the Comprehensive Environmental Responsive, Compensation and Liability Act, (CERCLA), Congress legislated the same protection which had been proposed by the EPA. The act, known as the Asset Conservation Lender Liability and Deposit Insurance Protection Act of 1996 (Lender Liability Act), amends CERCLA to limit the liability of fiduciaries and lenders. Although the act does not achieve the total goal of limiting liability for owners, it is significantly beneficial to lenders. The act provides that the term "Owner or Operator," upon which rests virtually all the lender liability cases under CERCLA, "does not include a person who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect its security interest in the vessel or facility."

And, very much like the ill-fated lender liability rule, the lender liability act defines the term "participating in management" with some degree of certainty and offers examples of actions that, taken alone, do not constitute participation and management. The act also benefits lenders who foreclose on properties. Many court decisions held that foreclosing lenders were not entitled to the security interest exemption because once they foreclose, they no longer held only "indicia of ownership." The act provides that a lender may foreclose upon, operate, release or sell its collateral and wind down the affairs of the borrower as long as the lender intends to divest its collateral "at the earliest practicably, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements."

Finally the Lender Liability Act lists nine separate categories or activities which do not constitute "participating in management," the problem which many lenders had difficulty with under CERCLA. The sum and substance of the act is that lenders have a great deal less to worry about when they enter into a loan on, foreclose on, or own for purposes of disposal properties which are environmentally unclean. The Act does not give lenders all that they wished, but it is certainly a very big step forward.

Laws Relating To Telecommunications

One of the lesser known laws enacted by the 1996 Congress is the Telecommunications Act of 1996. This act requires the Federal Communications Commission (FCC) to create statutory rules and regulations rendering unenforceable community association restrictions impairing individual homeowners' receipt of transmissions. As originally written, the regulations intended by the act would have dramatically impaired the ability of developers and lessors to place restrictions on the erection and maintenance of telecommunication devices. Of special interest to The Counselors, such regulations would have dramatically impaired the ability of developers to create aesthetically pleasing communities. They would have precluded community association boards of directors from attempting to preserve property values by enforcement of architectural restrictions which restricted antennas and other communication receiving devices.

The proposed rules under the Telecommunications Act of 1996 are under attack by many organizations as being overly liberal in permitting telecommunications devices without restrictions. It remains to be seen whether the proposed rules will be enacted. Of special interest to The Counselors is that a new cottage industry has developed where Counselors can provide advise to clients on the placement and valuation of communication devices which range in purpose from communications through satellites to everything from airliners to households. It remains to be seen whether the regulations under the act will be as liberal as currently envisioned.

The New Proposed Federal Foreclosure Law

Of all the state laws which have remained individual in character, perhaps the foreclosure laws have been especially unique. Each state has had its own laws and procedures regarding foreclosures, and they vary widely from state to state. Now, federal foreclosure laws are here, and more may be on the way. In October 1995, the House of Representatives

made a last minute amendment to HR 2491 that added a federal Non-Judicial Foreclosure Law. The Federal Foreclosure Law was an instant away from becoming law as part of last minute budget negotiations. Ultimately the provision was removed from the final budget bill. However, as a proposal, a Federal Foreclosure Law remains very much alive.

If passed in its proposed format, the Federal Foreclosure Law would preempt all state laws and provide for a fast and final private foreclosure of federal agency home mortgages and deeds of trust. The bill would apply to all federal loans, both commercial and residential, including loans held by HUD, SBA, VA and FMHA and GMNA. In short, the bill is a precursor of a Federal Foreclosure Law, which would preempt the states' laws. There are many defects in the proposed Federal Foreclosure Law. Much controversy exists regarding the need for such a law and whether a Federal Foreclosure Law would apply to all foreclosures or only so-called federal foreclosures.

Good Faith And Fair Dealing

The doctrine of good faith and fair dealing has become an established part of real estate law and contract law. It has supplanted the legal principal that two parties of relatively equal bargaining power are free, in a legal sense, to slug it out; the winner is the winner and the loser is the loser, no matter what terms they agree upon. In some respects, the doctrine is similar to the rules of boxing: no low blows, no kicking, no butting and all participants must play by the Marquis of Queensberry rules.

Whether or not this is a good idea is not the question. The point is that the doctrine of good faith and fair dealing requires the parties in a real estate transaction to deal fairly with each other, to not take unfair advantage of each other and to act reasonably in their negotiations when carrying out previously agreed upon arrangements. For example, when a lender and borrower assign a commitment, both parties are subject to the doctrine of good faith and fair dealing when negotiating the loan documents. The doctrine has obvious appreciation in situations where a landlord's consent is sought for approval of an assignment or a subletting.

Although the doctrine of good faith and fair dealing imposes an obligation of reasonableness upon the parties, it is left open for the courts to decide, on a case by case basis, whether the parties played on a level playing field and whether they were fair and reasonable with each other. In the previous doctrine of buyer beware, the borrower was at the mercy of the lender as was the developer on the anchor tenant. Today, no matter what side you are on, you need to be reasonable and you need to negotiate in good faith.

The Electronic Age Raises Ethical Dilemmas

In the electronic age, virtually every agreement produced is probably susceptible to being discovered in some manner. Is it fair and ethical for a law firm which represents developers to pass from one developer to another the specific economic and other lease terms relevant to the same national tenant? The electronic age presents numerous major legal issues for lawyers and nonlawyers regarding what information can be exchanged and the safeguards which must be imposed to obstruct or impede the ability of an outsider to obtain information.

Then there is the situation regarding car phone usage. There are already several cases where law firms and attorneys have been held responsible for revealing confidential information which was picked up from a car phone and the provider of information failed to identify that a car phone was in use. In an age where Dick Tracy's wrist watch telephones and faxes have become a reality, the law of confidentiality raises difficult and pressing issues. The Counselors could play a major role in working to establish the rules and ethics that deal with such issues.

Proposed Changes To The Forms Of The American Institute Of Architects (AIA)

The most prevalent of the architect and contractor agreements are the forms produced by the AIA. These forms have changed approximately every 10 years. The 1997 revisions to the forms are close to being finalized, and they will have a major impact on the following areas: the financial information furnished to the contractor by the owner; the contractor's responsibilities to review design drawing and to advise of discrepancy; responsibility for jobsite safety; targeted dispute resolution and consolidation and joiner in arbitration; a mutual waiver by the owner and contractor of consequential damages; payment for changes in the work; responsibility for hazardous conditions and materials; the correction of work after substantial completion; termination by the owner for convenience; and provisions intended to avoid inequities to subcontractors which result from the application of the bankruptcy laws. For anyone who deals with the AIA forms, the changes will be dramatic and will impact the real estate industry.

Conclusion

Significant changes are taking place within the real estate industry with more to come. Changes could impact the types of services provided by CREs along with presenting new challenges. In many instances, change could result in greater demand by clients on the services, skills, experience, knowledge, professionalism and networking capabilities for which CREs are recognized worldwide.