BINGHAM

Capital Commitments as Additional Collateral in Commercial Real Estate Loans

By Erica H. Weiss and Daniel W. Hardwick

At the heart of any commercial real estate loan is the actual real estate that serves as the lender's collateral. But, as almost all real estate professionals have learned throughout the past few years, the creditworthiness of the borrower and the owners and sponsors of the borrower are, in many cases, as or more important than the attractiveness of the real estate.

If the borrower or guarantor is a newly formed real estate investment trust or private equity fund (in each instance, a "Fund") and does not yet have significant real estate assets, the borrower may seek to use the unfunded capital commitments from the Fund's investors as either a primary source of collateral or as collateral for one or more guarantees. Borrowers with significant real estate assets also sometimes seek to use unfunded investor capital commitments as additional collateral to maximize borrowing capacity. Typically, these investors are composed of high net-worth individuals, financial institutions, life insurance companies, pension funds, endowments and foundations.

Although unfunded capital commitments can constitute attractive collateral to a lender, they present some potential legal risks in the event of a bankruptcy or Chapter 11 reorganization of the Fund. Provisions of the Bankruptcy Code prohibit the assumption or assignment of certain "executory contracts" by a debtor in proceedings under the Bankruptcy Code. These include agreements to make a loan or to extend other debt financing or financial accommodations to or for the benefit of the debtor. This presents the risk that if the lender seeks to enforce a pledged capital commitment against an investor, and the Fund is involved in bankruptcy proceedings, the investor will seek to use these provisions as a defense. To date, judicial decisions have been favorable to enforcement, notwithstanding pending bankruptcy proceedings involving the Fund. Courts that have dealt with this issue have concluded that unfunded capital contributions are not "executory contracts" or are not the equivalent of requiring the investors to extend new loans or debt financing to a bankrupt debtor. Nevertheless, the question of whether such commitments constitute "other financial accommodations" has not been finally resolved, and lenders, therefore, are likely to be particularly careful in dealing with this type of collateral.

This article describes the additional due diligence frequently undertaken by lenders with

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Bankruptcy Panel Decision Creates Cramdown Problems for Real Estate Lenders

By Steven Wilamowsky and Henry S. Healy

The threat of a "cramdown" in a Chapter 11 proceeding under the Bankruptcy Code is one of a real estate lender's worst nightmares. As a practical matter, however, this has been quite difficult for a debtor to achieve. A recent decision by the Bankruptcy Appellate Panel for the Ninth Circuit has made it much simpler for a debtor to engineer a successful "cramdown." If followed by other courts, this could pose significant risks for real estate lenders.

CHAPTER 11 PLANS AND CRAMDOWNS

In Chapter 11, the debtor has the exclusive right to file a plan for the first 120 days following the commencement of the proceeding. This may be extended, but is subject to an absolute outside limit of 18 months. The development of a proposed Chapter 11 plan involves the division of creditors into various classes based upon Bankruptcy Code priorities associated with their claims as well as any security interests supporting their claims. In general, claims that are substantially similar must be included in the same class. Plans also must divide the claims of undersecured creditors into two classes: a secured claim equal to the value of the collateral and an unsecured claim equal to the remaining balance. Undersecured creditors have both claims even if their obligations would be nonrecourse outside of bankruptcy.[1]

When the plan has been developed, a disclosure statement concerning the plan must be approved by the Bankruptcy Court. When the disclosure statement is approved, the statement is circulated, and the plan is submitted to creditors for approval. The plan must be approved by at least one class of impaired creditors and confirmed by the court. A class of creditors is deemed "impaired" if the terms of the debtor's obligations to the members of the class are modified in any way under the terms of the plan. If the plan provides that a class will be paid in full in accordance with the original terms of the obligations held by its members, that class is not considered impaired.

If more than half of voting creditors holding at least two-thirds of the aggregate amount of voted claims in an impaired class vote for a plan, that class has accepted the plan, and other creditors in the class will be bound by the acceptance. If the required majorities are achieved within each creditor class and the plan meets the applicable tests for confirmation by the court, the plan will be confirmed, and all creditors will be bound by its terms, whether or not they voted in favor of the plan or even voted at all.

The "cramdown" procedure is a second feature of the Bankruptcy Code used to bind dissenting creditors. This procedure permits a plan to be confirmed even if one or more impaired classes of creditors reject the plan. Under this procedure, a plan may be confirmed over the objections of one or more classes of impaired creditors where at least one other class of impaired creditors (an "accepting impaired class") has approved the plan and the plan otherwise satisfies the requirements for confirmation by the court.

CRAMDOWNS AND THE SINGLE ASSET BORROWER

Debtors that are formed to hold a single building or real estate project are sometimes referred to as "single asset" debtors.[2] The overwhelming obstacle to "cramdowns" by single asset debtors is that their primary creditor is usually a single mortgage lender. Single asset debtors in Chapter 11 proceedings sometimes try to propose plans that treat the unsecured portion of the mortgage loan as being in a separate class from other unsecured claims. Other unsecured claims are usually limited to trade creditors. If the trade creditor class can be separated from the "underwater" portion of the mortgage debt, the trade creditor class may constitute the "accepting impaired class" that is a prerequisite for confirmation of the plan. If so, then the plan potentially can be crammed down despite the objection of the mortgage lender. Although some courts have permitted separate classification, most bankruptcy courts that have dealt with this issue have denied confirmation of plans that place the secured lender's deficiency claim in a class separate from other unsecured claims.

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1 Undersecured creditors also have the right to give up their unsecured claim and have their entire claims treated as secured. This election enables a nonrecourse creditor whose claim is "under water" in a depressed real estate market to avoid being paid off at the current market value of its collateral.

2 The Bankruptcy Code itself contains provisions designed to weed out single asset cases that lack merit.

Buying Timberlands: Unique Issues in Purchase and Sale Transactions

By James L. Black, Jr. and Robert A. Kubica

Interest in timberlands investment continues to grow. Those actively acquiring and selling timberlands, including timber investment management organizations, real estate investment trusts, forestry companies, and other investors and owners, are drawn to timberlands investment for a variety of reasons, including potential long-term growth, diversification, inflation hedging, reasonable liquidity and relatively modest volatility. In addition, timber as an asset class is unique in that trees continue to grow in size (and hopefully in value) with the passage of time, therefore affording the timberlands' owner flexibility as to when to cash in on the investment. For example, a savvy timberlands owner will leave the timber standing when prices are low and then deliver cut timber to the market when prices are more favorable.

In many respects, the fundamental components of a purchase and sale agreement for timberlands are similar to other types of commercial real estate. However, because timberlands are unique compared to other commercial real estate assets, a number of issues arise in a timberlands deal that do not apply to other types of real estate assets. Similarly, a number of provisions of a timberlands purchase and sale agreement should be handled differently than in a traditional commercial real estate purchase and sale agreement. Although an exhaustive analysis of all of these distinctions is beyond the scope of this article, a few key distinctions are discussed below.

HARVEST ADJUSTMENTS

The issue of whether to include an appropriate mechanism to adjust the purchase price on account of harvested timber is unique to a timberlands purchase and sale agreement. A timberlands seller may be harvesting timber pursuant to a harvest plan (usually an annual plan). Harvesting of timber on the timberlands to be conveyed may continue after contract signing through the closing date, either by the seller or pursuant to cutting contracts that the seller may have entered into with its affiliates or third parties; this, of course, impacts the value of the timberlands on the closing date. A buyer would be well advised to carefully review the terms of any such cutting contracts to understand their impact on the acquired timberlands. External factors, including market capacity, destruction of the timberlands, timber crop pricing and the weather may influence the amount and type of timber that is harvested and the necessary adjustment on the date of closing.

The preferred purchase price adjustment mechanism depends on the nature and complexity of the transaction. Some adjustment mechanisms delineate in great detail the type of timber to be harvested and establish an adjustment amount that varies based on that type of timber. Others take into account the specific location or region where the harvesting occurs. Some adjustments tie to the actual receipts generated from the timber harvesting while others adjust relative to a baseline estimated harvest value. Some include a combination of these mechanisms. Furthermore, the parties should also determine when to calculate the final harvest adjustment as the size of the timberlands and the scope of the timber harvesting operations may necessitate both a pre-closing adjustment and a subsequent post-closing adjustment.

CASUALTY LOSS

It is important to consider how to address potential casualty loss in any commercial real estate purchase agreement. One major distinction, however, between timberlands and commercial buildings that impacts the sale documentation is that most commercial buildings are covered by casualty loss insurance, while timberlands generally are not. Another important difference is the significantly greater risk of a casualty event occurring with respect to timberlands than with respect to a commercial building.

In a timberlands deal, the parties should negotiate the consequences of a casualty event or natural disaster affecting the timberlands that occurs (or is discovered or disclosed) after the purchase and sale agreement is executed, but before the closing. Common casualty events affecting timberlands include forest fires (whether man-made or caused by lightning strikes, especially in times of prolonged draught), hurricanes, windstorms, floods and earthquakes. Insect infestation, blight and disease can also damage standing timber and thereby materially decrease the asset's value. Damage from a casualty to timberlands is not repaired or restored in the same manner as damage to a commercial

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Massachusetts Adopts Significant Revisions to Foreclosure Statute Following Recent Decisions

By Maurice H. Sullivan, III

Three recent, notable Massachusetts Supreme Judicial Court ("SJC") decisions concerning foreclosure prompted calls for action from lenders, real estate practitioners and title insurance companies. In response, the Massachusetts Legislature on Aug. 3, 2012, revised several sections of the Massachusetts foreclosure statute. Among other things, the legislation expressly requires a mortgagee to: (i) have record title to a mortgage before commencing the foreclosure process; (ii) either own the note or have the express authority to act on behalf of the noteholder; and (iii) certify compliance with provisions of the statute by recording an affidavit with the registry of deeds for the county or district in which the land is situated. The legislation also contains provisions requiring holders of certain residential mortgage loans to demonstrate that they have made good faith efforts to avoid foreclosure before commencing foreclosure proceedings. A brief discussion of the relevant case law and the legislation follows.

In *Ibanez*, decided in 2011, the SJC ruled that a lender must demonstrate that it actually owns the mortgage at the time of the foreclosure. The *Ibanez* decision involved the foreclosure of a residential mortgage loan that was part of a securitized mortgage loan pool, with a bank acting as trustee for the certificate holders. In 2007, the trustee foreclosed on the Ibanez mortgage and purchased the property at the foreclosure sale. At the time of the sale, no assignment of the mortgage to the trustee had been recorded in the public records; rather, an assignment of the mortgage was recorded more than one year after the foreclosure sale. The trustee brought an action to quiet title in the Massachusetts Land Court ("Land Court") seeking to have its title to the Ibanez property confirmed after a title insurer apparently raised questions regarding the foreclosure. A companion case involving similar facts was brought by another bank, also acting as trustee, seeking to confirm title to property it obtained in a separate foreclosure sale. The two cases were heard together by the Land Court.

At trial, the trustees introduced various documents seeking to establish their ownership of the mortgages. These included an unsigned private placement memorandum offering mortgage backed securities to investors and stating that the mortgages "will be" assigned to the trust, but not containing a schedule of the specific loans to be included in the assignment. They also introduced an unsigned copy of a pooling and servicing agreement, which provided that the mortgage loans identified in mortgage loan schedules were transferred and assigned to the trustee. The mortgage loan schedules were not attached to the document introduced into evidence. The trial judge ruled that both foreclosure sales were invalid because the trustees acquired the mortgages by assignment only after the foreclosure sales and thus had no interest in the mortgages at the time of the foreclosure sales.

On appeal, the Land Court decisions were affirmed. The SJC pointed out that to establish clear title after a mortgage foreclosure, the foreclosing entity must prove that it was the mortgage holder at the time of the foreclosure sale. To do this, the foreclosing mortgagee must show the chain of assignments of the mortgage from the last mortgagee of the mortgage as recorded in the public records that clearly and specifically identifies the mortgage at issue as among those assigned. The SJC's decision in *Ibanez* did not necessarily require that the assignments be in recordable form, although the SJC pointed out that recording is likely to be the better practice.

Relying in part on *Ibanez*, in *Bevilacqua*, also decided in 2011, the SJC refused to rescue purchasers of property who obtained the property as the result of a defective foreclosure sale. Here the plaintiff, Francis J. Bevilacqua, acquired a home following a defective foreclosure similar to the one described in *Ibanez*. Bevilacqua sought a judicial determination that he owned the property free of claims from the former owner. The SJC dismissed his case on the theory that a foreclosure that did not comply with *Ibanez* was defective, and, accordingly, any sale following the defective foreclosure is invalid.

Earlier this year, in *Eaton*, the SJC held that a foreclosing lender must not only hold the mortgage, but must also either hold the mortgage note or act on behalf of the noteholder. Previously, many Massachusetts lawyers and title examiners believed that under the relevant statutes, the foreclosing lender was required to hold only the mortgage and there was no need to be concerned about the note.

Eaton executed a promissory note payable to a bank lender and concurrently executed a mortgage securing the

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respect to this type of financing and the customary documentation that a lender requires in these circumstances.

FINANCIALS OF INVESTORS

The lender will frequently advance loan proceeds based on some percentage of a borrowing base comprised of the unfunded capital commitments of creditworthy investors in the Fund (usually those rated highly by credit rating agencies or, with respect to non-rated investors, those whose financial statements evidence a sound financial basis from an underwriting perspective). Therefore, the lender will need to review the financial information available with respect to the investors in the Fund. During the term of the loan, the lender will require evidence that the financial status of each investor has not deteriorated materially since the date of closing; if this is not the case, the investor's capital commitment may be removed from the borrowing base, and availability under the loan would therefore be reduced.

ORGANIZATIONAL DOCUMENTS

The Fund's organizational documents (the limited partnership agreement or limited liability company agreement and subscription agreements between the Fund and each investor) control the Fund's right to call and receive capital from the investors. The lender and its counsel will need to review all of these documents to confirm the following:

1. The investors' obligation to contribute capital is unconditional.
2. The investors have expressly waived any offsets or claims against the Fund and its general partner or manager that would adversely affect the investor's obligation to contribute capital.
3. The investors expressly consent to a pledge by the Fund of the right to call capital from the investors and to receive payment of these capital commitments.
4. The organizational documents contain a clear mechanism relating to the manner in which capital is called and a limited time period in which the investor must fund after the capital call.
5. The organizational documents permit the lender to demand payment directly to the lender of an amount equal to the investor's unfunded capital commitment and provide that any such payment would be deemed by the Fund a payment in satisfaction of the investor's obligations under the organizational documents. This would be of particular importance to a lender if the Fund filed for bankruptcy because it may enable the lender to receive payment directly from the investors rather than having the investor contributions flow into the bankruptcy estate of the Fund.
6. The funding period for capital commitments expires after the maturity of the loan facility so that the lender has adequate time to trigger a capital call if the loan is not repaid at maturity.
7. The investors may not transfer their interests in the Fund.
8. The Fund may not reduce or terminate any investor obligations.
9. Depending upon the identity of the Fund's investors, the organizational documents should also require waiver of sovereign immunity claims from governmental investors and provide consent to jurisdiction in the U.S. from foreign investors.
10. A lender will typically require that the Fund be organized under Delaware law (or another state with similar protections) because Delaware statutory law provides protection for a lender who takes a pledge of capital commitments as collateral, if the lender can demonstrate that it provided the loan in reliance on an investor's obligation to fund its capital commitment.

ERISA ISSUES

If the Fund has ERISA investors or anticipates admitting ERISA investors in the future, the lender will seek evidence of compliance with the prohibited transaction exemptions available to the lender. This may involve representations and warranties from the Fund itself or from the investors. In some cases, the lender may require that investor representations appear in the Fund's organizational documents.

OTHER DOCUMENTATION FROM INVESTORS

If the Fund's organizational documents do not provide all of the lender-friendly protections regarding the Fund's ability to pledge the capital commitments as collateral or the lender has particular concerns about any particular investor, the lender may require confirmation from each investor that the investor agrees to pay its capital commitments directly to the

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CAPITAL COMMITMENTS, *CONTINUED FROM PAGE 5*

lender. In this instance, the lender may require a written acknowledgement and consent from each investor, which typically includes the following:

1. Acknowledgment from the investor as to (a) the total amount of capital it has committed to the Fund; (b) the amount of its capital commitment that remains to be funded to the Fund; and (c) the amount of its capital commitment pledged to the lender
2. Agreement by the investor to periodically deliver financial information to the lender so the lender can confirm that the investor can satisfy its capital call requirements
3. Agreement by the investor to make capital-call payments directly to the lender in the event of a default under the loan
4. Subordination of any claims the investor may have against the Fund to the claims of the lender against the Fund

The lender may also request additional due diligence materials from the investor, including an estoppel certificate, a parent or affiliate guarantee, an opinion of counsel regarding the due formation, valid existence and good standing of the investor and the due authorization, valid execution and delivery, and enforceability of the investor's subscription agreement and the Fund operating or partnership agreement. With respect to high net-worth individuals, the lender may want to determine whether any of them reside in community property states to evaluate potential underwriting issues in the event of divorce.

ADDITIONAL LOAN DOCUMENTATION

The lender will require that the Fund and its general partner or manager execute a pledge and security agreement, which is an agreement between the Fund and the lender whereby the Fund grants to the lender a first priority lien with respect to (i) the right to make demand for payment of the capital commitments; (ii) the right to receive payment of the capital commitments; and (iii) a pledge of the capital commitments themselves. The pledge agreement will typically permit the lender to control the issuance of payment demands for unfunded capital commitments in the event of a default under the loan documents and will require that the Fund appoint the lender as attorney-in-fact to enable it to make the capital call in the name of the Fund. To perfect its security interest in the pledged capital commitments, the lender will file UCC financing statements in the state where the Fund is organized. The lender will also require that all capital contributions from investors be funded directly into a blocked account held by the lender or under the control of lender. With respect to such blocked account, the lender will require a deposit account control agreement and UCCs filed relating to the pledge of this account from the Fund to the lender.

CONCLUSION

If a lender is not satisfied that the real estate assets of a Fund are adequate to meet the Fund's potential recourse obligations, a lender can take a security interest in the capital commitments of the Fund's investors to bolster the financial creditworthiness of the Fund. This requires an extra layer of underwriting, due diligence and loan documentation relating to the investors' ability and obligation to fund their capital contributions, but can provide a Fund with a means to satisfy its working capital needs at a time when the Fund has few other assets. <

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building. If timberlands are damaged by casualty, the soil may need to be made suitable for future tree growth, and, in any case, trees will need to be replanted; it may take dozens of years before the replanted trees mature to a point where they can be economically harvested. Also, when timber is damaged by casualty, the timberlands owner often seeks to recover the salvage value of the damaged timber by selling it to mills or other purchasers. If a casualty event is widespread in a region, the price being paid for such damaged timber might be depressed due to a glut of timber unexpectedly being sold in the market at the same time from similarly situated timberlands owners.

In the purchase and sale agreement, the parties should agree on the appropriate allocation of the risk of casualty loss. If the casualty is significant or exceeds certain thresholds (perhaps measured by acreage), the parties might consider a purchase price adjustment mechanism. The parties also need to decide whether casualty damage to timberlands infrastructure, such as bridges or roads, would result in any purchase price adjustment or whether the adjustment would only be based on damaged timber. In transactions involving very large acres of timberlands, another challenge is determining (as of the closing date) whether a casualty has occurred; to address this timing issue, sometimes the parties agree on a short post-closing period for discovery of such losses and the making of any associated purchase price adjustments.

TITLE ISSUES

No different than any other commercial real estate transaction, a buyer should carefully review the title to the timberlands and obtain a title insurance policy at closing. Since timberlands deals often involve the conveyance of large tracts of land, title diligence can be more time-consuming and complex than a typical commercial property. For example, the legal descriptions for the timberlands may be voluminous and may have emanated from even larger tracts that have been sold off in pieces over time, which makes the title review process more involved and complicated. In some cases, descriptions may be extremely vague, such as a boundary marker like “the old hanging tree.”

Since timberlands deals often involve thousands of acres of land, ALTA surveys for all of the acreage are, in general, prohibitively expensive and impractical. As an alternative to survey review, depending on the jurisdiction, diligence might include a review of tax maps, geographic information system (GIS) data and other available maps. The lack of a survey will probably impact the availability of extended title insurance coverage for the buyer, although some alternative title insurance endorsements or coverages might be available depending on the circumstances. If a particular portion of the timberlands is valuable as so-called “HBU land” (i.e., land that might be suitable for a higher and better use than the growing of timber, such as perhaps future commercial development) or important for another reason, the buyer might consider obtaining a survey for this area.

Another title consideration is whether mineral rights have been severed from the timberlands or are being conveyed with the timberlands. A minerals search is a very expensive and time-consuming search that is separate and distinct from a typical land title search. If minerals have been severed, in most jurisdictions, the general rule of thumb is that the rights of the mineral owner will have primacy over those of the surface owner, so understanding applicable mineral laws, and how those laws impact use of the surface for growing and harvesting timber, is advisable.

The status of legal access to the timberlands is another important due diligence consideration. While most commercial buildings will abut a public way or have dedicated right-of-way or easement rights, some parcels of timberlands may be landlocked and, therefore, may only be accessed over land owned by third parties. The buyer should evaluate whether it has valid easement rights to access and harvest the timberlands and the extent to which it has the right to use, construct and maintain access roads across the lands of others. In the absence of valid legal access rights, the timberlands buyer should evaluate whether there is sufficient verbal, historic or practical access to the timberlands. A key issue to discuss with the title insurer during the due diligence process is the extent to which the insurer is willing to provide access coverage in the title policy.

Common encumbrances affecting timberlands are conservation easements, forestry legislation, or other similar use programs or restrictions. Rights-of-way agreements also frequently encumber timberlands. Careful review of these encumbrances is necessary to understand the impact of, and restrictions created by, such documents on the harvesting of timber and the rights others (such as the general public) might have in and to the timberlands.

For most commercial properties, buyers are certainly familiar with the possessory rights of tenants of the building and the impact of such leasehold rights on the buyer’s title. As an

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promissory note. The mortgage was granted to Mortgage Electronic Registration Systems ("MERS") acting solely as nominee for the bank lender.[1] MERS subsequently assigned its interest as mortgagee to a mortgage servicing company and recorded the assignment in the Suffolk County Registry of Deeds. The record of the case contained no evidence of a corresponding transfer of the promissory note. The note was endorsed in blank by the bank lender on an undetermined date and was subsequently transferred to Federal National Mortgage Association ("Fannie Mae").[2]

After Eaton failed to make payments on the note, the mortgage servicing company, as assignee of MERS, commenced foreclosure proceedings on the mortgage through exercise of the statutory power of sale, the mortgage foreclosure procedure ordinarily used in Massachusetts. The foreclosure took place in November 2009, with the mortgage servicing company being the highest bidder. The mortgage servicing company thereafter assigned the rights to its bid to Fannie Mae, and a foreclosure deed to Fannie Mae was subsequently recorded. Following recording of the foreclosure deed, Fannie Mae commenced eviction proceedings against Eaton. In response, Eaton filed suit in the Superior Court against Fannie Mae and the mortgage servicing company claiming that the foreclosure was invalid because the mortgage servicing company did not hold the mortgage note at the time of the foreclosure sale and seeking a preliminary injunction to stay the eviction proceedings. For purposes of Eaton's motion for a preliminary injunction, the defendants stipulated that the mortgage servicing company did not hold the mortgage note at the time of the foreclosure. After hearing, a Superior Court judge issued a preliminary injunction and the defendants appealed.

On appeal, the SJC vacated the preliminary injunction and remanded the case to the Superior Court for further proceedings to give Eaton the opportunity to show that the mortgage servicing company, at the time of the foreclosure proceedings, neither held the note nor acted on behalf of the noteholder. The SJC ruled that the statutory provisions governing the statutory power of sale require that to foreclose, a mortgagee must be acting on behalf of the holder of the note. If the mortgagee does not have physical possession of the note, it must be acting as the authorized agent of the noteholder. Although not stated expressly, the clear implication of the decision is that the burden is on the borrower to come forward with evidence that the mortgagee has not met either of these preconditions to foreclosure.[3]

Fortunately, the SJC determined that the *Eaton* decision should be given only prospective effect, primarily due to concerns about the problems that its retroactive effect could have on real property titles. Perhaps the SJC learned from the fallout (vividly illustrated by *Bevilacqua*) resulting from its decision to allow *Ibanez* to have retroactive effect.

In the new legislation, the legislature has incorporated and expanded *Ibanez* by conditioning a lender's commencement of the foreclosure process upon ownership of record title to the mortgage. If a party holds a mortgage pursuant to an assignment, Section 14 of Chapter 244, as revised, requires that (i) at the time, the notice of foreclosure is mailed to the mortgagor, an assignment or a chain of assignments, evidencing the assignment of the mortgage to the foreclosing mortgagee has been duly recorded in the registry of deeds for the county or district where the land lies; and (ii) the recording information for all recorded assignments is referenced in the notice of sale required in this section.

The legislature has addressed the *Eaton* holding by adding a new Section 35C to Chapter 244. Subsection (b) of Section 35C prohibits a creditor from publishing a notice of foreclosure pursuant to Section 14 when the creditor knows or should know that the mortgagee is neither the holder of the mortgage note nor the authorized agent of the noteholder. Subsection (b) further requires a certification of compliance of the creditor following its review of its relevant business records to be recorded with the registry of deeds for the county or district in which the land lies. Finally, subsection (b) provides that the recorded affidavit is conclusive evidence in favor of a third-party purchaser, at or subsequent to the resulting foreclosure sale, that the creditor has fully complied with Section 35C, and that the mortgagee is entitled to proceed with the foreclosure.

Other provisions of the legislation have made foreclosure of some residential mortgage loans to consumers much more difficult. If the mortgage secures a consumer loan with

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1 MERS is a Delaware nonstock corporation, owned by its members, that acts as mortgagee for loans registered on its electronic registration system. The MERS electronic registration system was designed to permit mortgages to be assigned without the need for recording each mortgage assignment in the public records. When a loan is sold, the note is transferred by endorsement and delivery between the parties, and the new ownership of the loan is recorded in the MERS system. MERS remains the mortgagee of record so long as the loan is sold to another MERS member. If a loan is sold to a non-member, an assignment of the mortgage is recorded in the public records, and the loan is "deactivated" on the MERS electronic system. MERS registration is frequently used for residential mortgage loans, but is less common for commercial loans.

2 Although there was no evidence in the record as to subsequent ownership of the note, the defendants stated in their brief that after endorsement the promissory note was transferred to Fannie Mae.

3 The decision points out that Eaton is entitled to pursue discovery on this issue in connection with further proceedings in the Superior Court.

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specified features, secured by an owner-occupied one-to-four family residential property, special procedures may apply. Consumer loans subject to these procedures include certain loans that are not fully amortized during the life of the loan by equal monthly payments, loans that did not require full documentation of the borrower's income or assets, and loans with prepayment penalties that exceed those specified in the applicable legislation. Several other features specified in the legislation will bring residential mortgage loans to consumers within the scope of the statute. Before a creditor subject to these procedures may commence foreclosure proceedings, it must demonstrate that it has taken reasonable steps and made good faith efforts to avoid foreclosure. The legislation describes the steps a creditor may take to be presumed to have complied. These procedures are likely to cause considerable additional delay in the foreclosure of consumer mortgage loans that fall within their reach.

Although the revisions to Chapter 244 provide a roadmap for lenders in future foreclosures and should cure pre-existing marketability issues resulting from the failure to comply with *Eaton*, the legislation unfortunately failed to include a curative provision addressing the marketability of title to improperly foreclosed properties under *Ibanez*. In the absence of further legislation, this leaves many current property owners, lenders and title insurance companies exposed to claims and possible litigation. <

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additional revenue source, many timberlands owners lease or license their lands for hunting, camping or other recreational use. Some timberlands may be encumbered by grazing or farming leases. These leases or licenses are oftentimes off-record instruments and usually for a short-term (but with renewal features). If the acreage of timberlands involved is very large, there may be many such agreements. The title company will likely take an exception for the rights of such lessees or licensees in the owner's title policy.

ENVIRONMENTAL ISSUES

As with any commercial real estate transaction, environmental matters (such as environmental due diligence; compliance with federal, state and local environmental laws and regulations; and allocation of responsibility for environmental issues) should be addressed in the timberlands purchase-and-sale agreement. Some environmental issues for timberlands transactions differ from those associated with most commercial properties.

One example is the process for conducting environmental diligence of timberlands. The ASTM standard practice for Phase I environmental site assessments for forestland of 120 acres or greater (ASTM Practice E 2247-08) differs from the ASTM standard practice applicable to commercial buildings. This specialized ASTM standard practice for forestlands takes into account the differing use and larger size of the timberlands. Where extremely large tracts of lands are involved, a complete physical site inspection of every portion of the timberlands would be impractical and cost-prohibitive. Therefore, appropriate environmental diligence of timberlands will depend on a number of considerations, but might include aerial surveillance of properties and assessment of targeted areas. Environmental issues sometimes associated with timberlands are those that arise from activities such as mining on a site, improper use of pesticides and herbicides, and those associated with unauthorized dumping on the timberlands, which can range from minor household dumping to more serious disposal of hazardous substances.

Determining whether the timberlands are environmentally sensitive or culturally important, such as by reason of the habitation by endangered species or the existence of significant archaeological sites, is also an important consideration.

CONCLUSION

The purchase and sale of timberlands has many similarities with other commercial real estate assets, but also many important unique considerations. Although important distinctions include the harvest adjustments, casualty, and title and environmental matters described above, a timberlands transaction has numerous other distinguishing and differing characteristics, including, among others, tax and financing considerations. Investors should seek counsel familiar with these distinguishing features to properly manage the legal risks that accompany timberlands purchase and sale transactions. <

BANKRUPTCY PANEL DECISION, *CONTINUED FROM PAGE 2*

THE LOOP 76 DECISION

In Re Loop 76 LLC, decided recently by the Bankruptcy Appellate Panel for the Ninth Circuit, involved a single asset debtor with a $23 million construction loan secured by a deed of trust on an office and retail complex in Scottsdale, Ariz. The mortgage lender's debt was also secured by third-party guarantees. When the construction loan matured in 2008, Loop 76 was unable to obtain refinancing, and, to avoid appointment of a receiver, it filed a Chapter 11 proceeding. At the time of filing, the value of the real property securing the mortgage loan was substantially less than the outstanding balance of the mortgage debt.

In its proposed plan of reorganization, Loop 76 classified the unsecured portion of the mortgage debt separately from other unsecured claims. The mortgage lender voted to reject the plan, and the other unsecured creditors voted to accept it. The mortgage lender objected to the separate classification of its claim, contending that there was no business or economic justification for the distinction. In response, Loop 76 pointed out that the mortgage lender could look to the guarantors as a separate source of payment of its unsecured deficiency claim. It contended that due to this separate source of payment, the mortgage lender's claim was not substantially similar to the other unsecured claims. The bankruptcy court denied the mortgage lender's objection to classification and held that a claimant having a third-party source of repayment for its claim is dissimilar to a claimant who does not have an alternative source of payment. In his opinion, the bankruptcy judge noted that the mortgage lender was free to introduce evidence tending to show why the existence of the guaranty was not a significant factor affecting the votes of creditors on the plan—such as the insolvency of the guarantors. After a hearing, the court entered an order confirming the plan.

The mortgage lender appealed to Bankruptcy Appellate Panel for the Ninth Circuit. After a hearing, the appellate court rejected the mortgage lender's argument that the focus of claim classification should be the legal character of the claim as it relates to the assets of the debtor and held that the existence of a third-party source of payment justifies separate classification. It also rejected the mortgage lender's argument that evidence of the guarantor's solvency at trial was inconclusive, pointing out that this is a question of fact and noting that "…we question whether [the solvency of the guarantors] is even a factor to consider." The decision of the Bankruptcy Court was affirmed.

Third-party guarantees are a common element of commercial real estate loans in today's market. This decision, if it survives, will make it increasingly difficult for commercial lenders to fend off "cramdown" efforts by single asset borrowers. It remains to be seen how it will fare on appeal and whether the decision will be followed in other jurisdictions. <

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