University of Arkansas, Fayetteville

From the SelectedWorks of Carl J. Circo

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Learning from Real Estate Lore

Carl J. Circo

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tablished constitutional and equitable doctrine, the ATC preserves the effect of a prior statute to the extent "a right is acquired, distinguished, or barred upon the expiration of a prescribed period that has commenced to run under any other statute before September 1, 2005." Additionally, the presumption that a trust is revocable unless expressly stated to be irrevocable "does not apply to a trust created under an instrument executed before September 1, 2005." This deference to prior law may sometimes be important to preserve tax objectives of pre-code trusts that are silent about the settlor's right to revoke or amend. Several other provisions of the ATC only apply to irrevocable trusts created on or after September 1, 2005 and revocable trusts that become irrevocable on or after that date.

Conclusion

Arkansas real estate lawyers will especially appreciate the ATC for its clarity and its nearly comprehensive restatement of trust law. Lawyers advising clients who wish to use Arkansas trusts for management of real estate assets will welcome new rules and concepts that more readily accommodate their clients' objectives. Lawyers negotiating transactions with trustees must adjust to several modernized rules, some of which offer greater protection to trustees than prior law. Lawyers representing trustees who manage real estate will embrace those additional protections, as well as the more flexible trust administration aspects of the ATC. Overall, Arkansas real estate lawyers should find the ATC helpful in real estate transactions involving property held in trust.

In form, this is a book review. More essentially, however, this is a reflection on how lawyers evolve into that peculiar breed we know as real estate lawyers. Let me explain how the reflection eventually came to overshadow the review.

I was immediately attracted to Harris Ominsky's *Real Estate Lore: Modern Techniques and Everyday Tips for the Practitioner*, and I decided that it would be an ideal book review subject. The book was published in 2006, and I hoped to have the review ready for last year's Law Notes. When I missed that window of opportunity, I set the project aside. I was uncertain whether I should complete a review of a book that was more than a year in print and that consisted of so many discrete essays on specialized aspects of real estate law. Yet something about the book beckoned me back to it.

For me, the book's primary attraction does not stem from the interesting legal issues it discusses, most of which are well-known to experienced real estate lawyers and many of which are more comprehensively covered elsewhere. What stuck in my mind was the implied notion that pithy stories about real estate law, passed down with humor and reflection from one generation of accomplished real estate lawyers to the next, create a body of lore that is now part of the fabric of the real estate lawyer's trade. That idea sounded a special chord for me, an academic who rather inad-

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69. Section 28-73-1106(b).
70. Id. § 602(a).
71. See Id. § 108(g) (relating to the rights of qualified beneficiaries concerning changes in the trust's principal place of administration), § 705(d) (concerning resignation of a trustee), § 802(c) (concerning certain detailed rules governing the trustee's duty of loyalty), § 816(e) (concerning the trustee's duty to provide information and reports to beneficiaries), and § 1008(c) (concerning exculpatory terms of a trust).

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*The author dedicates this reflection to his own mentor, Michael G. O'Flaherty, who practiced real estate law for many years in Kansas City, Missouri and who currently is the Director of Assessment for Jackson County, Missouri. Mike has been generously sharing lore with younger lawyers for many years, and we are far better lawyers and people for the experience.*

vertently slipped a 20 year stint as a practicing real estate lawyer between my first faculty appointment at a distant time and place and my current one here at the University of Arkansas. With that background, I have long been intrigued by the familiar distinction between teaching legal doctrine to aspiring lawyers and teaching practical skills to them. It strikes me that Real Estate Lore uniquely illustrates yet another component in every lawyer’s education that is as important as the other two even though we rarely discuss it. That component derives from the absorbing professional stories or lore that make up the collective experiences of legal specialists. In effect, real estate lore is the inheritance that experienced real estate lawyers pass on to the next generation of real estate lawyers. We cannot teach experience. But if a compact book can capture some sense of the seasoned real estate lawyer’s experience, as I believe that Real Estate Lore does, that is something worth noting.

What We Learn from Lore

Most experienced lawyers owe much to their mentors. We advance in the profession gradually through the painstaking process of revising our drafts to meet our mentors’ exacting standards, from watching these masters at work with clients and adversaries, from observing them as they tackle new and difficult legal problems, from strategy sessions with them, from sitting across the negotiating table from them, and (when we are especially lucky) as they regale us with reminiscences of their triumphs and foibles and those of their own mentors.

That is the idea that brought me back to Real Estate Lore. Omnisky is a seasoned Philadelphia real estate lawyer who, according to the About the Author section of the book, has published over 800 articles. The book’s preface discloses that this collection of 65 brief chapters grows out of previous articles and lectures on “disparate topics, based on their practicality and currency.” Omnisky’s book could serve as a text or road map for a series of short lectures at bar programs or within law firms on what every young real estate lawyer should know. It is with the mentor’s role in mind that I present this reflection drawn from a few selected topics covered in Real Estate Lore.

As we begin, consider these additional comments from Omnisky’s preface that distinguish the mentor’s lore from conventional wisdom or common knowledge:

These selections are intended to question perceived occasional flaws in lawyers’ and courts’ legal reasoning. The book raises some ironies, plays some intellectual games, pokes fun at the conventional wisdom, and may even provide a few chuckles about the light side of real estate law.

Mortgage Lore

A. Structuring and Documenting the Loan

Part 1A of the book begins with “Pitfalls for Real Estate Lenders,” an excellent, light introduction to the lending practice for novice real estate lawyers. The other ten chapters of this part of the book deal with several narrow topics, including some useful observations on the business aspects of interest rates and junior financing, as well as the current state of the law on late charges and prepayment penalties. Chapter 2 explores “Nine Advanced Lenders’ Clauses (Plus One),” including some clauses that can be especially helpful after a mortgage default or even after foreclosure. The last chapter, “Mortgage May Be Lost for Lack of Notary Seal,” somberly reminds us that even as real estate lawyers must grasp the rather advanced notions of yield maintenance payments and the income tax nuances of non-recourse lending, simple attention to minute details in loan documents still counts as a critical skill.

Most experienced real estate lawyers will fondly recognize the notorious “End of the World” provision that provides a tongue-in-cheek appendix to Chapter 2. For the benefit of those who do not immediately recognize this clause by its intriguing title, here it is:

**End of the World**

Upon the occurrence of the end of the world before full payment of the Indebtedness, the Indebtedness, at Eank’s option, will become immediately due and payable in full, and may be enforced against Borrower by any available procedure in law, equity, or otherwise. For remedial purposes, Bank will be deemed aligned with the forces of light, and Borrower with the forces of darkness, regardless of the parties’ actual ultimate destinations, unless and until Bank elects otherwise in writing.

For more serious reflection purposes, I have chosen to look closely at one of the mortgage documentation topics that Real Estate Lore covers and to note briefly two others.

1. **Mortgage Modifications**

This mundane topic (Chapter 3) terrorizes careful real estate lawyers. We all can recite some version of the general rule, which purports to protect junior lienholders from "unduly" or "materially" prejudicial modifications to senior mortgages. The two nettle-some questions lawyers constantly face in practice are: (1) under what circumstances will a court regard a modification to be unfair to a junior lienholder; and (2) if a court determines that a modification is unfair, to what extent will a court adjust lien priorities to protect a junior lienholder? The vague answer to the first question counsels transactional lawyers to give conservative advice to lenders. The indeliberate answer to the second invites litigators to construct intricate remedial theories.

A relatively recent Missouri case inspires the mortgage modification discussion in Real Estate Lore. The court saw the issue as a matter of first impression. Perhaps it was for the court, but real estate lawyers have addressed the question constantly for generations. The court's analysis reflects the common approach, which is to announce a rule.

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2. Id. at v.

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that is simple to state, but nearly useless for a transactional lawyer’s purposes. The chapter quickly moves from a review of that one recent case to more general observations about common fact patterns. In that way, the discussion provides a good example of how an experienced practitioner wrestles with black-letter law, knowing all along that the law will not provide the predictability that real estate clients need.

In summary, according to Real Estate Lore, this is what we can say about whether and how a loan modification may affect lien priority:

(a) The guiding principle is that the senior mortgage should retain priority unless the modification is materially prejudicial to the junior lienholder;

(b) Whether or not a specific modification is materially prejudicial is fact-driven by the circumstances of each case;

(c) An extension of the senior mortgage’s maturity date alone normally is not materially prejudicial, but even this simple situation does not invoke a blanket rule in favor of the senior mortgage;

(d) Material prejudice normally does result from an increase in the interest rate or the principal amount of the secured debt (or maximum amount secured in the case of a valid future advance mortgage);

(e) Other changes in senior loan terms, especially those that create additional opportunities for default, may be materially prejudicial;

(f) Courts are often more sensitive to the rights of a lienholder whose junior status results from a subordination agreement because the circumstances of subordination often suggest that the subordinating lienholder reasonably relied on the presumption that the details of the senior loan would not change;

(g) When the modification is materially prejudicial, the court should normally adjust lien priorities only to the extent needed to remedy the prejudice, such as by subordinating the lien of the modified mortgage only to the extent of the increased interest or debt, but there is no exact formula to determine the extent of the remedy, and the appellate cases often leave to the trial court the exact mechanics of adjustment; and

(h) In extreme cases, a court may completely reverse the priorities, but this is rare.

The chapter concludes, as good lore often does, with practical tips, beginning with the most obvious tactic of conservative counsel.

Wherever there is any possibility that a court may view the proposed mortgage change as too prejudicial, the lender should make sure that it has received the consent of all junior lienholders before agreeing to the change. Also, it should require a title search to confirm that it knows about all junior liens on the property. . . . The senior lender should insist on a title insurance endorsement that confirms its existing priority in light of the proposed modification.4

5. Id.
6. Id. at 51-52.
7. This is a modified version of the clause proposed at the end of Chapter 3 of Real Estate Lore. My changes are mostly stylistic.
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Sound advice indeed, but good lore often leaves us with difficult practical questions to resolve. What should the careful lawyer do when a junior lienholder refuses to consent, and when can we expect the title insurer to issue an endorsement without that consent? Unfortunately, our junior lender client will not always be able or willing to choose foreclosure if we cannot secure the appropriate consent and a satisfactory title insurance endorsement. Are there situations in which it is better not to request the consent or endorsement because a documented refusal is worse than the uncertainty of the governing legal standard?

Real Estate Lore offers two other practical tips on modifications. First, the modification agreement could include a savings clause to the effect that although the modification is binding between the lender and the borrower, it is not intended to affect the lien priority of the mortgage or to impair the security of another lienholder. These clauses should also provide that, to the extent a court finds an adverse effect on another security interest or lien, the offending provision shall be invalid.

That is just the sort of creative structural tactic we expect from a veteran practitioner who lives by the motto that the real estate lawyer's job is to advise the client how to achieve the results it wants rather than to explain why it cannot. But is this a new boilerplate provision for every modification agreement or merely a compromising solution for a desperate circumstance? I think it is the latter.

In the first place, invalidating the offending provision may produce a worse situation for the senior lender than the circumstances that led to the modification. If the modification extended the maturity date and increased the interest rate, the lender may be stuck with an uncompensated extension. Additionally, the clause invites the junior lienholder to argue that the senior lender recognized that the modification was materially prejudicial. Moreover, in some situations it may invite the court to craft a devastating remedy. For example, if an agreement for increased interest is "invalid," does that simply mean the lender must refund the excess interest, or does it mean that the court should somehow reconstruct the relationships so that the results are the same as they would have been if the increased rate had never been in effect? The second approach could require dangerous speculation about whether defaults or other adverse events might have been avoided.

The other practical tip is both more broadly useful and more familiar: "mortgage lenders should consider using a mortgage form that specifically permits mortgage modifications . . . without notice to or consent from a junior lienholder." While most comprehensive mortgage forms contemplate modifications, this proposal suggests a more aggressive approach than many forms offer. The only problem with the suggestion is, as Ominsky acknowledges, it merely allows the senior lender to argue that the junior lienholder cannot be unduly prejudiced by a modification when the recorded mortgage gives notice of the risk. Real estate clients, especially mortgage lenders, prefer certainty to good legal arguments. Here is a sample clause:

4. Real Estate Lore, supra note 1, at 51.
5. Id.
6. Id. at 51-52.
7. This is a modified version of the clause proposed at the end of Chapter 3 of Real Estate Lore. My changes are mostly stylistic.
Lender may at any time (1) extend or accelerate the time for payment of the secured debt, (2) agree to increase or otherwise modify the interest rate or any other payments or change any other terms of the secured debt or this mortgage, (3) release any person or entity liable for payment of any secured debt or for the performance of any obligation, (4) release all or any part of the security for any debt, or (5) exercise or refrain from exercising or waive any right. Lender may have. Lender may exercise any one or more of these rights or options without notice to, or consent of, any person or entity except for Borrower in the case of a modification of the terms of the secured debt or this mortgage.

Lender’s exercise of any one or more of these rights will not affect the lien or priority of this mortgage in any way or the continuing liability of any person or entity, even if the exercise of one or more of these rights impairs, prejudices, or otherwise adversely affects any rights or interests of any guarantors, sureties, junior lienholders, judgments creditors, or any other rights, interests, claims, or encumbrances.

The suggested provision may not be substantively different from what appears in many standard mortgage forms, but it more bluntly notifies potential lienholders to expect changes that could be materially prejudicial. Both the experienced transactional lawyer and the clever litigator will immediately recognize that this approach raises interesting questions. What are the relative advantages and disadvantages of a clause that is broad but general over one that attempts to identify all likely modifications? Will the provision embolden a lender to agree to modifications without consulting legal counsel or taking other precautions? Will a court applying equitable principles abandon established notions of undue prejudice solely because a mortgage includes better boulderplate? Will a clause in a recorded mortgage have any effect on junior lienholders who do not rely on the real estate records, such as mechanics lien claimants? Alas, we are left with a harsh reality: absent an updated priority endorsement to the lender’s title policy, a mortgage modification continues to carry a priority risk that is both ill-defined and difficult to manage.

2. Inspection Clauses

Another especially interesting discussion in Part IA concerns the inspection clauses that most commercial mortgages include. The key question, as raised in Chapter 2, is “how many mortgages make it clear that the lender may have access to the property to do the required inspections when there is no clear defect under the mortgage?” Just such a provision can be especially important when the lender suspects brewing environmental problems and the borrower prefers to avoid any inspections that might lead to enforcement proceedings or trigger reporting requirements. The cases cited in the discussion stand as reminders why careful drafters periodically review and clarify boulderplate.

3. Late Charges and Prepayment Fees

A number of recent cases consider the enforceability of these common mortgage provisions. While these cases raise several important questions discussed at some length in Chapters 5 and 6, for our purposes it is sufficient to note a few of the conclusions that Real Estate Lore reaches. First, with respect to traditional percentage late fees charged in commercial mortgage loans, “for the moment at least, lenders have won the battle.” In states such as Arkansas in which usury limits continue to apply to some lending transactions, there may remain questions about whether late fees are additional interest or liquidated damages. Usury considerations aside, however, courts have generally upheld percentage late fees as valid liquidated damage provisions. But a court might invalidate a charge as unconscionable in special situations. A court might find it unconscionable, for example, if the charge is stated as a percentage of the entire mortgage balance rather than the overdue installment or if the lender attempts to enforce the late charge in conjunction with related remedies, such as acceleration or the option to apply a current payment to earlier overdue installments so that a current installment is also deemed overdue. Contemporary cases also tend to uphold default interest rates. Finally, at least outside of the bankruptcy context, courts will generally uphold prepayment charges in commercial loans, although some courts may reject prepayment charges that are based on formulas that seem to produce a profit rather than merely compensate for costs associated with prepayment.

One troubling issue that remains for lenders’ counsel is that some cases seem to impose on the lender the burden of showing that the agreed late charges are related to the lender’s actual costs associated with the late payment. Chapter 6 argues persuasively that this judicial tactic, if it persists, is only likely to encourage lenders to restructure the loan documents in some artificial way, such as by recharacterizing a late charge as a fee for an automatic extension when a payment is not made on time, using the higher (default) rate as the contract rate and allowing a rate discount for payment by the scheduled date, or providing for a scheduled increase in the interest rate at the beginning of the last month of the loan term. There is a revealing observation here about the relationship between mortgage law and the commercial behavior it attempts to regulate. “These hypotethicals are just a few of the examples that courts may have to struggle with once they intervene in arm’s-length agreements between sophisticated parties who have agreed on what results should follow when a borrower defaults on a commercial loan.”

8. Real Estate Lore, supra note 1, at 29.


10. Real Estate Lore, supra note 1, at 64.


12. Real Estate Lore, supra note 1, at 72.

13. Id. at 73.

14. Id. at 84-89.

15. Id. at 79.
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10. Real Estate Lores, supra note 1, at 64.


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13. Id. at 73.

14. Id. at 84-89.

15. Id. at 74.
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B. Enforcing the Mortgage

The distinction between topics concerning loan documentation and enforcement is somewhat artificial because many drafting issues ultimately concern remedies and many enforcement questions arise out of inadequate drafting. Part IB of Real Estate Lore covers 9 distinct topics ranging from “Banks Win the Tug of War over Rents” and several other chapters concerned primarily with issues that arise in the borrower’s bankruptcy, to chapters that deal with extremely narrow topics, such as aspects of Pennsylvania foreclosure practice, and a concise and helpful restatement of fundamental law in “Bank’s Conduct May Forfeit Rights against Guarantors.”

The chapter I found most interesting is 14, “Mortgages: Hardball Strategies Prove Expensive.” Given the chapter’s title, I expected a discussion of risks that greedy lenders create for themselves. Instead, the chapter is a reflection on a California case that reminds us that the common law of waste can bite the borrower who puts too much reliance on the apparent protection of non-recourse financing. In addition to confirming that even sophisticated real estate lawyers must remember some of what they studied in their first year property courses, it provides the occasion for our literary mentor to offer this moral: “In negotiating a business deal, a hardball player can easily wind up striking out.”

The fascinating case that stimulates this discussion is Nippon Credit Bank, Ltd. v. 1335 North California Boulevard. The summary and analysis of the case from Real Estate Lore, as reproduced here in edited form, largely speaks for itself. Notice how Ominsky, playing well the mentor’s role, weaves several practical lessons into the case story.

The case held the mortgagor liable for tortious waste for deliberate nonpayment of taxes, and for punitive damages when the tactic of withholding taxes was used as a weapon against the lender in attempting to evict a defaulted loan. . . . There are relatively few cases making nonpayment of taxes a tort, but the Nippon Credit case stands as a warning light for real estate borrowers throughout the country.

In that case, a limited partnership had borrowed $73 million secured by office buildings in California and when the real estate market deteriorated, the borrower asked to postpone interest payment for six months. The bank refused.

Borrower’s Tactics

In response to this, the borrower refused to pay $350,000 in property taxes owed on the property although it had received the cash to do so. Instead, the partnership paid over $800,000 to one of the partners to reduce its equity position in the partnership.

In the restructuring negotiations with the bank, one of the principals stated that the bank was not cooperating in restructuring and that he wanted it to “share the pain” of the problems with the buildings . . . .

Later the bank paid the taxes and added that claim to the debt. It then sued the limited partnership, and the principal for committing tortious waste to the bank’s security interest by acting in bad faith. According to the court, the property was then worth millions of dollars less than the loan.

A jury did not take kindly to the borrower’s tactic. It found that withholding the tax payment constituted waste that was perpetrated maliciously and in bad faith. It awarded compensatory damages to the lender of $394,000 and punitive damages of $8.3 million! The court granted a remittitur of the punitive damages and reduced them to $1.2 million, and on appeal the California appeals court upheld the verdict.

The court pointed out that there was a split in jurisdictions about whether nonpayment of taxes could constitute waste, but it agreed with the Restatement on Mortgages that the best policy was to recognize that type of claim. The court rejected the borrower’s argument that a tort action should not be recognized where a contract action would lie for a breach of mortgage. It noted that the relationship between a mortgagor and mortgagee is that the mortgage is a holder of a present interest and a contingent future interest in land that is entitled to protection against torts.

LEARNING FROM REAL ESTATE LORE

Bad Faith

In this case, the jury and the court obviously reacted to the bad-faith conduct of the borrower. However, some observers have expressed concern that the decision may be used in future cases to find the tort of waste even when the borrower is not acting in bad faith.

In summary, Nippon Credit is unusual because it permitted a tort action for nonpayment of real estate taxes even though the loan was non-recourse. It may be the first case ever to award punitive damages under those circumstances.

Carve-Outs

It seems that the borrower in Nippon Credit would have fared better even if it had been stuck with a non-recourse carve-out that provided personal liability for failing to pay real estate taxes. Under those circumstances, most borrowers would know that they should not take a chance of risking personal liability, and they might then be alerted to using the money to pay the real estate taxes, even in preference to making a required mortgage payment.

On the other hand, because of the way that the court viewed the borrower’s hardball tactics, the lender may have come out better with a punitive damage recovery in Nippon Credit than
LEARNING FROM REAL ESTATE LORE

In the restructuring negotiations with the bank, one of the principals stated that the bank was not cooperating in restructuring and that he wanted it to "share the pain" of the problems with the buildings.

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**Lease Lore**

Parts IA and I B, on mortgage issues, and Part II, on lease issues, account for 43 of the 65 short chapters in *Real Estate Lore*. While each mortgage chapter generally stands in isolation, several chapters of Part II could together serve to introduce novice real estate lawyers to some of the most important aspects of commercial leasing. For this purpose, the most useful chapters are:

21. **Tips for Finding the Best Bargain Rentals**

22. **Four Most Commonly Missed Tenant Needs in the Commercial Lease**

24. **Percentage-Rent Lease**

25. **Holdover Tenants**

26. **The Hazards of Lease Renewal Notices**

27. **Renewal Options Must Be Specific**

28. **Who Is Being Reasonable?**

29. **Landlord Unreasonably Withholds Consent to Below-Market-Rate Sublease**

30. **Tenants Must Protect Themselves against Landlords’ Mortgages**

31. **Lease Guaranties Can Be Tricky**

32. **Lease Guarantor Liable Even for an Improperly Extended Term**

Several other chapters explore the business and economics of leases, others focus on lease negotiations, and still others review discrete legal issues, including a landlord’s duty to mitigate damages and some important Bankruptcy Code provisions concerning leases. Part II also explores two especially hot topics: “Tenants May Pay the Cost of Terrorism” (Chapter 23); and “Landlords Blamed for Intruders’ Crimes” (Chapter 35).

For present purposes, we will briefly review two chapters concerned with a lease topic that sometimes generates endless debates between real estate lawyers and impatient yawns from their clients. I speak, of course, of the relationship between property insurance and waivers of damage claims. Both chapters consider the issue with reference to losses resulting from a negligently caused fire, although the principles involved extend beyond fire casualty.

Chapter 34 considers the relatively rare instance (at least in the commercial context) in which the lease does not expressly address the issue. In that situation, according to *Real Estate Lore*, there are two possibilities.

**LEARNING FROM REAL ESTATE LORE**

ties. First, if the landlord carries insurance that covers the tenant as a co-insured, “the insurance company has no right to sue its own insured tenant, even though the tenant may have caused the fire.”18 A similar rule should follow when the tenant maintains an insurance policy that names the landlord as a co-insured.

When neither party provides insurance that expressly covers the other, the cases are in conflict. The chapter focuses almost exclusively on a recent Connecticut case that held in favor of an implied waiver of the right of the landlord’s insurer to proceed by subrogation against the negligent tenant.19 The majority of the modern cases seem to protect the tenant "based on the concept that the tenant is presumed to be a co-insured party under the landlord’s insurance policy even if not specifically named, because the tenant’s rent presumably includes some calculation of the landlord’s fire insurance premium."20 The Connecticut Supreme Court offered a somewhat different rationale for the same result.

Our decision is founded, in large part, upon the principle that subrogation, as an equitable doctrine, invokes matters of policy and fairness. One such policy implicated by the issue presently before us is that disfavoring economic waste. This strong public policy convinces us that it would be inappropriate to create a default rule that allocates to the tenant the responsibility of maintaining sufficient insurance to cover a claim for subrogation by his landlord’s insurer. Such a rule would create a strong incentive for every tenant to carry liability insurance in an amount necessary to compensate for the value, or perhaps even the replacement cost, of the entire building, irrespective of the portion of the building occupied by the tenant. That is precisely the same value or replacement cost insured by the landlord under his fire insurance policy. Thus, although the two forms of insurance would be different, the economic interest insured would be the same.21

Ominsky approves of this economic analysis on the logical ground that “an implied waiver of subrogation seems to make sense in light of the parties’ expectations and the economics of insurance coverage.”22 The apparent insignificance of the implied waiver to insurers also seems to validate the result because “in most cases insurance policies permit parties to release or to waive subrogation rights without any change in premium.”23

Because most commercial leases include express waivers bearing on the insurer’s subrogation rights, the more important question is how courts apply those waivers. That is the subject of Chapter 33. The lesson to be learned appears succinctly in the chapter’s title: “Mutual Waiver of Casualty Claims may Not Protect Parties.” The discussion begins with this summary of the usual situation.

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19. DiIulio v. Joseph, 792 A.2d 819 (Conn. 2003). The chapter also notes, but does not discuss at length, a recent Massachusetts case, Seaco Insurance Co. v. Barbosa, 761 N.E.2d 946 (Mass. 2002) that would permit the landlord’s insurer to proceed against a commercial tenant when the lease is silent on the point.
21. *Id.*, 792 A.2d at 822-23 (citations omitted).
23. *Id.*
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Many commercial leases provide for mutual waivers of subrogation in the event of a casualty loss. Essentially, both landlords and tenants agree to surrender certain rights their insurance companies might have to step into their shoes and sue each other for negligence or other misconduct. They accept these limitations on their right to sue because they believe they can rely on their own insurance policies to cover their property damages if there is a fire or other casualty.  

The problem is that some common waiver provisions do not adequately address all circumstances that might develop. The brief chapter is a reflection on one recent New York case that illustrates the problem and that “should serve as a drafting lesson for both landlords and tenants who are seeking to limit their exposure to liability.” The case involved two retail tenants who suffered losses from a fire that started in another tenant’s space. The lease of one tenant, The Gap, Inc., waived all claims for property damage “caused by any risk insured against.” The lease of the other tenant, Rite Aid Corporation, required each party to “look first to any insurance in its favor” and limited the mutual waiver “to the extent that such insurance is in force and collectible.” The tenants brought claims against the landlord to recover for property damage and business interruption on the basis that the landlord had negligently failed to provide adequate fire protection equipment. The landlord raised the waiver clause in each lease as a defense. The court held that neither lease waived the tenant’s claims, which included losses within the deductible of each tenant’s policy ($10,000 for one tenant and $1,000,000 for the other) and uninsured business interruption losses.

It is impossible to determine whether either lease was applied exactly as the parties originally intended or whether the landlord could have successfully negotiated broader waivers. But note that because the waivers were mutual, under different circumstances, the failure of the clauses to waive claims within an insurance deductible could just as easily have left the tenants liable to the landlord.

**Purchase and Sale Lore**

Part III of *Real Estate Lore* includes 10 relatively short essays on discrete issues that arise in purchase and sale transactions. Some explore troubling issues on fundamental topics. These include: how courts apply pricing terms that refer to fair market value (Chapter 44); the advantages and risks of letter of intent (Chapter 45); the importance to the buyer of a proper financing contingency (Chapter 46); and the enforceability of liquidated damage clauses (Chapter 47). Others concern issues that come up less frequently or only in special contexts, such as the use of purchase money and wraparound financing (Chapter 48), installment sale agreements (Chapter 49), and the risks a lawyer faces when serving as an escrow agent (Chapter 51). Two others consider important topics as applied to extremely narrow circumstances: the tax-free exchange of partnership interests (Chapter 50); and successor liability in mortgage foreclosure sales (Chapter 52). Chapter 53 provides a helpful introduction to a timely topic: “USA Patriot Act Affects Real Estate Closings.”

In addition to those 10 brief chapters, Part III also includes Chapter 54, “Real Estate Options: Using Them and Losing Them,” which is far more extensive than any other chapter in Part III. Chapter 54 caught my attention because it deals with an especially challenging area of real estate law that receives far less attention than it merits. Although it is located in Part III, which bears the title “Buying and Selling,” the chapter considers issues relevant to most preemptive rights affecting real estate, including renewal options in leases.

The chapter explores some recurring and nettlesome questions that arise from the peculiar nature of a preemptive right to acquire property, whether created in a free-standing contract or as part of a lease or other agreement. Any one of these issues could occupy experienced real estate lawyers for hours, and each of them helps explain the extraordinary care that experienced real estate lawyers take in drafting and negotiating option agreements. This overview of the issues Ominsky presents in *Real Estate Lore* provides ample material for a seasoned mentor’s war stories:

**Triggering a first right of refusal.**

What circumstances, other than a direct offer to purchase, authorize exercise of a right of first refusal? Does the right apply if the owner proposes to give away the property, to contribute it to a new investment entity, or to transfer it in a transaction with a related party? Does it apply if a third party offers to purchase the option tract as part of a package deal that involves several other tracts or an entire enterprise? Will a merger, corporate acquisition, or other entity transaction trigger the right? How about a foreclosure sale?

**Applying the terms of a first refusal right in special situations.** How should a first refusal right apply to an offer that includes features peculiar to a particular offeror or set of circumstances? How does the holder of the right match an offer to exchange other land for the tract subject to the offer? If the offeror is an especially creditworthy entity that proposes seller financing, does the holder have the right to purchase the property on the same financing terms? What if the offeror is negotiating for the owner to build improvements or to provide services that have no value to the option holder? If the right applies when the owner receives an offer that includes other properties, what portion of the offer price should be attributed to the property subject to the first refusal right?

**Determining the option price.** Many options refer to fair market value or pricing formulas to establish the sale price. How definite must the option price be? How much detail should the agreement include on the process for establishing fair market value? Under what circumstances is it sensible to use arbitration to establish the value, and when the agreement calls for arbitration, what is the best arbitration process to follow? What qualifications should the arbitrators have? When a tenant under a long term lease holds an option to purchase the leased property for its fair market value, should an appraisal consider the rent payable by that tenant for the balance of the lease term?
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Survival of preemptive rights. If an intervening transaction (such as a package deal, a merger, or a foreclosure) does not trigger a right of first refusal, does the right continue to exist following that transaction?

Miscellaneous circumstances and issues. What becomes of a preemptive right when one of the parties dies or the owning entity dissolves? What is the value of a preemptive right as security for a debt or other obligation, and how does a secured party perfect its security interest? Does a long-term option constitute an unenforceable restraint on alienation? How might a court's perspective on a preemptive right be affected by changes in the surrounding circumstances (such as extraordinary appreciation in the value of option property)? How are preemptive rights affected when either the owner or the holder of the right becomes a debtor in bankruptcy?

Preemptive rights from the owner’s perspective. The extensive wisdom here is the stuff of which real estate lore is made. For an owner, “an option of first offer is better than an option of first refusal. In that way the owner can test the market with an offer to the option holder before the owner tries to get an offer from an outsider. . . . In addition, the option of first refusal is more of an obstacle to making a sale. Some prospective purchasers will not want to make an offer when they know they are only being used as a ‘stalking horse’ and an insider may ‘trump’ them.” Indeed, many real estate professionals question whether it ever makes sense to grant an option. “Conventional wisdom tells us that it never hurts to receive an option, and there are no benefits from giving one.” Ominsky endorse this perspective as a general matter, but he also discusses three exceptions:

- If a seller gives a buyer an option to purchase instead of an agreement of sale, the seller bolsters its rights to retain the buyer's deposit if the buyer defaults.
- Giving an option of first refusal may undercut an option holder's right to implement an alternate option. For example, what happens to the buyer's fixed-price option after the owner receives a higher offer from a third party?
- A seller can save income taxes if it gives a potential buyer an option to purchase instead of arranging an installment sale.

Transactional lawyers will find only limited comfort in the knowledge that careful drafting can resolve every one of the issues raised in Chapter 54. The seasoned mentor knows that the challenge is to anticipate the issues and craft transactional structures and contractual terms that are sufficiently comprehensive and unambiguous to survive the novel situations and constantly changing circumstances in which clients choose preemptive rights.

Real Estate Broker Lore

Although Part IV includes only two short chapters, both of them are fundamental to any discussion of the lore of real estate transactions. Chapter 55 is a good, short introduction to brokerage agreements that should be especially useful to novice real estate lawyers. In that sense, it lives up to its ambitious title: “Everything You Wanted to Know About Real Estate Brokerage Agreements.” Chapter 56 touches lightly on a much narrower topic on which the law is not yet sufficiently settled. It analyzes Lombardo v. Albu, in which the Arizona Supreme Court “held that both a buyer and a buyer’s broker have a common-law duty to disclose adverse, financial information about the buyer’s ability to perform, even if such information is publicly available.” That discussion could stimulate a much broader one about evolving disclosure obligations in real estate sale transactions.

The chapter ends with an observation that could produce lawyerly-nightmares.

If agents are required to disclose everything that may seem relevant, buyers will be reluctant to confide in their agents, and as a matter of policy, that could thwart transactions more than a rule that honored loyalty and confidentiality. Also, if the Lombardo doctrine can impose tort liability on a buyer’s broker, can liability of buyers’ attorneys be far behind?

Land Use and Title Issues Lore

The fact that Part V includes both of these two distinct topics provides the reader some advance warning of the miscellaneous nature of the issues addressed. The coverage of land use mainly concerns takings issues. One chapter reports on a few adverse possession cases. Another, Chapter 62, “When Is a Pig a Pet?” is mostly for fun, although Vietnamese potbellied pig lovers might take it more seriously than other readers will. Chapter 63 provides a brief introduction to the federal law providing protection for communications towers from local land use regulation. The two title insurance chapters address issues of limited application: “Title Policy Protects Against Purchaser’s Own Tax Lien” (Chapter 60); and “Title Company Not Liable for Failing to Insure Title” (Chapter 61). Even though those two chapters are narrow in scope, they serve to remind us that a lawyer should always consider whether a client might have a claim against the title company for problems that concern title defects. Title insurance companies are, after all, subject to the same judicial bias that affects all other insurance companies.

29. Real Estate Lore, supra note 1, at 334-35.
30. Id. at 336.
31. Id. at 337.
33. Real Estate Lore, supra note 1, at 357.
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The risk seems remote: a lawyer in a real estate transaction might have an obligation to disclose to an adverse party information about the lawyer’s client. But at the urging of a trusted mentor, one can begin to envision situations involving residential closings or transactions between related parties that could raise that specter.

Land Use and Title Issues Lore

The fact that Part V includes both of these two distinct topics provides the reader some advance warning of the miscellaneous nature of the issues addressed. The coverage of land use mainly concerns takings issues. One chapter reports on a few adverse possession cases. Another, Chapter 62, “When Is a Pig a Pet?” is mostly for fun, although Vietnamese potbellied pig lovers might take it more seriously than other readers will. Chapter 63 provides a brief introduction to the federal law providing protection for communications towers from local land use regulation. The two title insurance chapters address issues of limited application: “Title Policy Protects Against Purchaser’s Own Tax Lien” (Chapter 60); and “Title Company Not Liable for Failing to Insure Title” (Chapter 61). Even though those two chapters are narrow in scope, they serve to remind us that a lawyer should always consider whether a client might have a claim against the title company for problems that concern title defects. Title insurance companies are, after all, subject to the same judicial bias that affects all other insurance companies.
Operations and Ownership Lore

It would be fascinating to read the diverse ruminations of a veteran real estate lawyer about real estate operations and ownership. Part VI, however, includes only one chapter and leaves much ground uncovered. Chapter 65 discusses a Third Circuit case that interpreted the provisions of a partnership agreement in a way that imposed proportionate liability for a partnership obligation on limited partners who had received distributions from the partnership. For our purposes, we need not explore the facts of the case or the court's specific interpretation of the Uniform Limited Partnership Law as then in effect in New Jersey. What is worth noting here, is that this concluding chapter, like many others in Real Estate Lore, serves to remind real estate lawyers that we cannot rely on general legal concepts, and we must always be alert to complexities and nuances.

Reflecting on Lore

In the end, three primary practical lessons emerge from Real Estate Lore, none of which will surprise experienced real estate lawyers.

First, routine issues continually spawn real estate litigation upon which courts in different jurisdictions often reach conflicting results. Second, except for situations governed by the Bankruptcy Code, careful drafting is often the most effective way to avoid real estate litigation. Third, because unique facts and circumstances often dominate, the process of structuring, negotiating, and drafting real estate transactions requires extraordinary perception, attention to detail and nuance, judgment, and creativity. These, of course, are the stock-in-trade of veteran real estate lawyers who contribute richly to the lore from which we learn so much.

In their busy, intense practices, real estate lawyers have too few opportunities for professional conversations with colleagues. Real Estate Lore provides that opportunity. The value of this concise book is not simply that it offers a veteran real estate lawyer's observations on a wide array of interesting and practical issues. What is more important is that many of these brief, targeted chapters offer readily accessible opportunities for busy real estate lawyers to rediscover "the excitement of exploring and discovering."

The Forum Defendant Rule in Arkansas

Scott Dodson

For those of us interested in or practicing in commercial civil litigation, removal of a case from state court to federal court is a regular event. It also is an important strategic event for defendants because of perceived tactical advantages of a federal forum, such as the following: (a) a more defendant-friendly jury pool; (b) more favorable jury rules; (c) greater familiarity of defendant's counsel's with federal court and greater familiarity of plaintiff's counsel with state court; and (d) a perceived higher cost of federal court that defendants may be able to bear more easily than in state court. But what happens when a defendant who is a citizen of the forum state tries to remove diversity grounded? Section 1441(b) of the removal statute prohibits removal in such a case under what has come to be known as the Forum Defendant Rule. Under this rule, removal to federal court on diversity grounds is prohibited if any one of the defendants in the action is a citizen of the state in which the action was filed. The reason for the rule is obvious: the traditional justification for invocation of federal jurisdiction in diversity cases is to provide out-of-state litigants a forum seen as less bi-

1. Assistant Professor of Law, University of Arkansas. I thank the students in my Federal Jurisdiction (fall 2006) and Civil Procedure (fall 2008) classes for their insights on this issue in class discussion. A more robust discussion of the issues in this article focusing generally on the jurisdictional/procedural character of removal will appear in Scott Dodson, In Search of Removal Jurisdiction, 102 Nw. U. L. Rev. (forthcoming 2008).
2. Compare Fed. R. Civ. P. 48(1) (requiring unanimous jury verdicts) with Alaska R. Civ. P. 48 ("Where as many as nine out of twelve jurors in a civil case agree upon a verdict, the verdict shall be returned as the verdict of such jury. The parties may, however, stipulate that a jury shall consist of any number less than twelve and that a verdict or finding of a stated majority thereof shall be taken as the verdict or finding of the jury.").
5. 28 U.S.C. § 1441(b).