the FEE SIMPLE

The Newsletter of the Virginia State Bar Real Property Section

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WILLIAM L. NUSBAUM
2013-14 Chair, Virginia State Bar Real Property Section

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The Fee Simple *is published semiannually for distribution to members of the Real Property Section of the Virginia State Bar. Anyone interested in publishing an article in the* Fee Simple *is invited to contact the Editor. Articles should be submitted by email as Microsoft Word documents. Your submission will also be your consent to the posting of the article on the Real Property Section website,* ***http://www.vsb.org/site/sections/realproperty/newsletters****. The* Fee Simple *has the authority to edit materials submitted for publication. Authors are responsible for the accuracy of the content of their article(s) in the* Fee Simple *and the views expressed in them are solely the views of the author(s).*

The Board of Governors gratefully acknowledges the dedication and the hard work of the Assistant to the Editors, Felicia A. Burton ((757) 221-3813, (email) faburt@wm.edu), of the College of William and Mary School of Law.

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SPRING SUBMISSION DEADLINE: APRIL 11, 2014

The next meeting of the Board of Governors and Area Representatives of the Real Property Section of the Virginia State Bar will be held on Friday, January 24, 2014 at 2:00 p.m. in Williamsburg, VA (in conjunction with the VBA's Winter Meeting).
A confirming e-mail will be sent to all members of the Board of Governors and all Area Representatives.

Real Property Section member resources website login:
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for articles from the FEE SIMPLE and a whole lot more!

CHAIRPERSON'S MESSAGE

by William L. Nusbaum*

With the new State Bar year, which began July 1, our Section once again has a new Chair. I am humbled to follow in the footsteps of such outstanding real estate lawyers and Section Chairs as (to name just a few) Court Traver, Larry McElwain, Susan Pesner, my partner Howard Gordon and my most immediate predecessors, Paul Melnick and Phil Hart. I have learned a great deal from observing and working with many of those who have preceded me as Chair, and I look forward to continuing to collaborate with them, and with Vice Chair Cooper Youell, Secretary-Treasurer Susan Walker and the Board of Governors and Area Representatives, to ensure a productive year for the Section.

When not attending to the details of the Section's operations (our State Bar staff—especially Dolly Shaffner—and our Section Committees greatly facilitate this duty!), I will focus on three goals this year, each of which is meant to provide Section members added value for their dues:

1. Reduce cost to Section members of attending Seminars. Recently, as a result of prudent stewardship and the cost savings realized by changing distribution of the FEE SIMPLE from print and U.S. mail to electronic format and e-mail, our Section generated surplus revenues. After careful consideration about how this surplus could serve the greatest good of the Section, your Board decided, at its September 2013 meeting, to extend (a) a $50 discount to all Section members who attend the Advanced Real Estate Seminar in Kingsmill on March 7-8, 2014 and (b) a $40 discount to all Section members who attend the Annual Real Estate Practice Seminar in May 2014, at any of the Seminar locations throughout the Commonwealth. Given that Section dues are only $25, we think this will also serve our third goal—growing the Section—by encouraging real estate lawyers who are not currently Section members but who are considering attending either of these programs to do the math and join (or rejoin, as many Section members dropped their membership during the recent recession in an effort to reduce costs).

2. Develop a service by which Section members may exchange knowledge and guidance among themselves. Many of our Section members practice in small firms or are the only member of their firm who practices a particular real estate specialty; as a result, they often lack knowledgeable colleagues from whom they can seek guidance. Over the years, an occasional practice has developed within the Board of Governors and Area Representatives by which a Board member or Area Representative who had a difficult or rare question could forward it to the Chair, who would then present the question by e-mail to the Board and Area Representatives. But this approach does not help the other, 1700-plus members of our Section. Since Paul Bellegarde held the Chair, the Board has struggled to develop a service that could be made available to all interested Section members while still abiding by the State Bar's Social Media Policy and remaining attentive to its other concerns. I have already discussed this issue with VSB President Sharon Nelson and am hopeful that this will be the year that we finally implement a viable open service (or at least make substantial progress toward doing so).

3. Ironically, a third way to provide greater value to Section members for their dues is simply to grow the Section. State Bar Sections retain 80% of their Section's dues for each year's budget, so the more dues revenue our Section receives, the more services and benefits we can provide to our members. As real estate continues to recover from the Great Recession, this is a prime opportunity to expand the ranks of our Section. If you, the reader, recruit additional members to join the Real Property Section, not only will *they* benefit from belonging, but with enough new

* William L. (Bill) Nusbaum is a shareholder at Williams Mullen, practicing in its Norfolk office. His practice focuses on commercial real estate and brokerage, economic development, municipal bonds and alcoholic beverage licensing. He graduated with an A.B. from Harvard College in 1977 and received his J.D. from the University of Virginia School of Law in 1980.

members, *you* can expect to enjoy additional benefits of membership in the coming years. When that comes to pass, we Virginia real estate practitioners will be even better informed, even better prepared for the work that comes our way, even better able to provide a first-rate work product, and (we all hope and expect) even better rewarded for that superior work product.

Lastly, I must recognize a "changing of the guard" in the leadership of several of our committees. For many years, Susan Pesner has chaired our Ethics Committee, Barbara Goshorn has co-chaired our Residential Real Estate Committee, Brian Dolan has chaired our Title Insurance Committee, Larry McElwain has co-chaired our Membership Committee, and Doug Dewing has chaired our Technology Committee. Each has sought to be relieved of his or her duties, and each has earned a well-deserved respite, along with our heartfelt thanks for their service. The departing Chairs' successors are listed in the final pages of the Section roster, at the end of this issue of the FEE SIMPLE, except that we continue to search for a self-described "real estate geek" to serve as the new Chair of the Technology Committee. The Technology Committee focuses on the intersection of technology and real estate practice management, and the Chairperson's duties include conducting a few committee meetings by conference call each year and filing a Committee report in each issue of the FEE SIMPLE. Anyone interested in the position should call me at (757) 629-0612 or e-mail me at wnusbaum@williamsmullen.com.

I thank each of you for this opportunity to serve our Section. If you have any ideas on how the Section can better serve you and meet your needs, please let me know.

FROM THE CLUTTERED DESK (AND MIND) OF THE EDITOR

by Stephen C. Gregory

Looking back over a career that started seemingly so long ago, I recall how cyclical real estate practice has been. The boom of the 70s gave way to an epic slowdown as interest rates hit double digits and stayed there. (Remember the creative financing of the 80s? Wrap-around mortgages, assumptions, multi-level financing…) The fever broke in the early 90s, and refinancing to lower rates became *de rigueur,* for a brief few years. A short-lived recession in '94 was followed by a decade of prosperity, until everything came crashing down during 2007-08.

As this is being written, the federal government is closed and the United States' ability to pay its bills is still in question. What are the consequences to a real estate practitioner if there is a default?

[Update: Thanks to an eleventh-hour agreement, the federal government has reopened and default has been averted—for now. However, there's a good chance that the crisis may recur in a few months, when the temporary accord expires.[1]]

The answer seems to be that, although no one knows what consequences may arise, there is general consensus that they *could* be dire. We have seen a slow but steady growth in our industry since the dark early days of the recession; the government's failure to pay its debts in full could reverse the recent gains in real estate.

Many lawyers with a concentration in real estate suffered during the most recent recession. Some cut personnel, some diversified into other practice areas (bankruptcy?), and still others abandoned real estate entirely. Did we learn anything? If you have made contingency plans in anticipation of another economic downturn, we'd like to hear from you. Let us know what you did last time; what worked, and what did not; what you have planned for the next (inevitable) drop-off in business, whether it's this month or years away.

Kay Creasman, in her report from the Title Insurance Committee (elsewhere in this issue), suggested a "round table"[2] of sorts as a recurring column for this magazine. We, or readers, would suggest a question, issue, or topic for discussion, and responses from the section members would be published in the following issue of this magazine. We think this is an idea worth trying; in addition to providing information to our readers, we may be able to influence the legislature to make changes in the law that would benefit both our industry and the public.

With that lofty goal in mind, let's begin our first "round table" with the topic of rate regulation. At last inquiry, Virginia was one of only about eight states that do not have some form of title insurance premium control—filed rates, promulgated rates, rating bureaus, etc. What are your thoughts on whether or not Virginia should join the ranks of those states that regulate title insurance rates? Send me your comments; we will publish as many as we can within our space constraints. Your responses should be emailed, in Word format, to 75cavalier@gmail.com.

In our previous issue, we we bid a fond farewell to Cari LaSala, our student editorial assistant from William & Mary Law. At the time, we were afraid that Cari had set the bar so high, her successor would be unable to achieve her exemplary standards.

[1] One might wish that the Senate—House of Representatives accord would have the longevity of Honda's Accord.

[2] Your editor (wistfully) wishes for a "round table" of Algonquin ilk, with yours truly assuming the role of a latter day FPA. (If you understand this reference without an internet search engine, you, like the editor, are older than dirt.)

Oh, but not so. With this issue, we introduce Caitlin Cater, third-year at William & Mary Law. Caitlin has moved the bar even higher; she is an editor on the *Bill of Rights Journal*, received honors in Legal Skills II, serves as a research assistant for one of W&M's most prolific scholars, and was selected to be a legal writing instructor for W&M's LLMs. Caitlin's undergraduate awards are equally, if not more, impressive, but too numerous to list here. We are fortunate that she accepted the position with us, and grateful that she will be available not only for this issue, but also for the Spring edition.

Finally, we close with our customary plea to let us hear from you. This is *your* magazine. Tell us what you like, what you don't like, how we can we improve this magazine for you and your colleagues. We are on a constant quest to make the *Fee Simple* more relevant to our real estate practitioners. As always, thank you.

PKO VENTURES, LLC v. NORFOLK REDEVELOPMENT AND HOUSING AUTHORITY

by Brian G. Kunze*

On September 12, 2013, the Virginia Supreme Court issued its opinion in *PKO Ventures, LLC v. Norfolk Redevelopment and Housing Authority*, ("NRHA"), Record No. 121534 (2013), denying a condemnor the right to acquire private property. This is an uncommon result. The property owner raised four separate assignments of error in its appeal, but the Court addressed only one, determining that Chapter 882 and Va. Code § 1-219.1, effective as of July 1, 2007, imposed a statutory deadline of July 1, 2010, on the Housing Authority's ability to acquire non-blighted property. Therefore, NRHA's authority to acquire the property expired because it had only *initiated* condemnation proceedings prior to the statutory deadline, failing to actually acquire the property, as the statute required.

In January 1998, the Norfolk City Council adopted the Hampton Boulevard Redevelopment Project, which the NRHA had submitted in an effort to address blighted areas.[1] The City Council's approval of the Redevelopment Project was based upon a redevelopment study which determined that approximately twenty percent of the properties within the nine and one-half block area of the study were blighted. The properties within the Redevelopment Project were to be acquired for the expansion of Old Dominion University. PKO Ventures, LLC ("PKO") owned a ten-unit residential apartment building near the campus of Old Dominion University in Norfolk, Virginia located within the area of the Redevelopment Project.

In 2007, the Virginia General Assembly enacted Chapter 882, which added Va. Code § 1-219.1.[2] Passed in part as a response to the United States Supreme Court's decision in *Kelo*, Va. Code § 1-219.1 established the right to private property as fundamental and defined the term "public uses" as mentioned in Article I, Section 11 of the Virginia Constitution.[3] Relevant to PKO, Va. Code § 1-219.1 requires that property acquired by eminent domain for the elimination of blight must itself be blighted.[4]

Chapter 882 also contained two sunset provisions applicable to this case. In pertinent part, Paragraph 3 of Chapter 882 provides:

> until July 1, 2010, the provisions of this act shall not affect *the ability* of a redevelopment and housing authority organized pursuant to Title 36 of the Code of Virginia *to acquire property* pursuant to any redevelopment or conservation plan adopted prior to January 1, 2007.[5]

Paragraph 4 of Chapter 882 provides a specific exception to the limitations of Va. Code § 1-219.1 for the construction of recreational facilities by NRHA:

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[1] VA. CODE § 36-49 authorizes an authority to "adopt a redevelopment plan for a designated redevelopment area to address blighted areas…"

[2] With Chapter 882, the General Assembly also enacted Chapters 901 and 926. All three chapters are substantively the same and will be referred to as "Chapter 882."

[3] Kelo v. City of New London, 545 U.S. 469, 125 S. Ct. 2655, 162 L. Ed. 2d 439 (2005).

[4] VA. CODE § 1-219.1(A): "The right to private property being a fundamental right, the General Assembly shall not pass any law whereby private property shall be taken or damaged for public uses without just compensation. The term "public uses" mentioned in Article I, Section 11 of the Constitution of Virginia is hereby defined as to embrace only the acquisition of property where: … (v) the property is taken for the elimination of blight provided that the property itself is a blighted property."

[5] 2007 Va. Acts ch. 882, 901, 906 (emphasis added).

> [n]othing contained in this act shall prohibit the Norfolk Redevelopment and Housing Authority or the City of Norfolk to acquire property located at . . . , both located in the City of Norfolk, through the use of eminent domain for the location of a recreation facility open to the public to be owned or operated by a not-for-profit entity, *provided such acquisitions are instituted prior* to January 1, 2011.[6]

On April 21, 2010, NRHA filed a Petition for Condemnation to acquire PKO's property. Both parties stipulated that PKO's property was not blighted at the time the petition was filed. The PKO property housed college students and families until they were forced to leave by the condemnation. PKO filed an answer and grounds of defense alleging, among other things, that Va. Code § 1-219.1 precluded NRHA from acquiring the unblighted property after July 1, 2010.[7] Based upon the language of the two provisions in Chapter 882, PKO objected on the grounds that the circuit court did not have jurisdiction over the condemnation proceedings. PKO argued that because NRHA had only instituted the acquisition and had not actually acquired the property by July 1, 2010, NRHA's authority to condemn had expired. The circuit court denied PKO's defenses and objections.

Faced with an issue of statutory interpretation, the Supreme Court first recognized that, when interpreting statutes pertaining to the power of eminent domain, "every reasonable doubt is to be resolved adversely to that right."[8] Furthermore, the Court reiterated that eminent domain statutes are to be strictly construed and state agencies exercising the power of eminent domain must fully comply with all statutory requirements.[9]

The Supreme Court then applied longstanding rules of statutory construction to Chapter 882 and Va. Code § 1-219.1. The Court looked at the text of Chapter 882 as a whole to divine the General Assembly's intended meaning. It also emphasized that, when interpreting statutes, it is assumed that the General Assembly chose with care the text it used, and when different words are used when addressing a similar subject, the presumption is that the difference in the choice of language was intentional.[10]

Applying these basic tenets of statutory interpretation, the Court looked to the differences between paragraphs 3 and 4 of Chapter 882. In paragraph 4, which was not applicable to the PKO property, the NRHA was only required to *institute* condemnation proceedings by filing a Petition for Condemnation before the statutorily mandated deadline. In contrast, the Court determined that the different language of paragraph 3 required the actual acquisition of the unblighted PKO property prior to July 1, 2010.

The NRHA further argued that, even if it was required to have acquired title to the property before the July 1, 2010 deadline, it had a substantive right to acquire PKO's property that could not be impaired by the enactment of a later statute. The Court disagreed with this argument, finding that there are no vested rights in a potential result in pending litigation.[11] The Supreme Court also disagreed with

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[6] *Id.* (emphasis added).

[7] In addition to this defense, PKO also alleged that the circuit court erred when it determined that the PKO property was in a blighted area, that stare decisis did not apply to a previous ruling of the Circuit Court, and that the NRHA violated due process requirements because it had a pecuniary interest in the outcome of the acquisition of the property.

[8] PKO Ventures, LLC v. Norfolk Redevelopment and Housing Authority, Record No. 121534 (2013) at 8-9 (citations omitted).

[9] *Id.* at 9 (citations omitted).

[10] *Id.* at 10 (citations omitted).

[11] *Id.* at 13 (citations omitted).

the NRHA's contention that the limitations of Va. Code § 1-219.1 could not be applied retroactively. The Court held that the NRHA did not hold any rights to the PKO property when Code § 1-219.1 became applicable in 2007. The NRHA did not file its Petition for Condemnation until April 2010, well after the new code section was enacted.

On these grounds, [12] the Supreme Court reversed the ruling of the trial court and entered a final judgment, returning the property to PKO and barring NRHA from acquiring it. The Supreme Court's decision reaffirms the importance of private property rights and reiterates that condemning authorities must comply strictly with all statutes when attempting to exercise the power of eminent domain. [13]

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[12] Because the Supreme Court concluded that the trial court erred in permitting the NRHA to acquire the PKO property after the July 1, 2010 deadline, it declined to discuss the remaining assignments of error.

[13] In addition to the property owned by PKO, the NRHA has also sought to acquire property owned by Central Radio, Inc. and Norva Properties, LC. Both Central Radio and Norva are local businesses and, like the PKO property, neither of their properties was blighted. As a result of the Supreme Court's decision in this case, both Central Radio, Inc. and Norva Properties, LC will keep their property.

"STRIP-OFF" OF REAL ESTATE LIENS IN BANKRUPTCY

by Stephen S. Mitchell[*]

Few things are more comforting to a creditor looking for assurance of payment than a lien against real estate. Such liens are most often voluntary (e.g., a deed of trust), but are sometimes involuntary (e.g., a judgment lien or a mechanic's lien). Of course, even a seemingly solid lien is no absolute guarantee of payment—much depends on the value of the property and the possible presence of senior liens. And, sadly, sometimes the perfection of the lien may be flawed and thus unenforceable against subsequent lien creditors.

In addition to the risks secured creditors face outside bankruptcy, there are risks which are peculiar to the bankruptcy process and which can result in a nominally secured claim being treated as wholly unsecured and being paid either pennies on the dollar or, in the worst case, nothing at all. One area that has recently attracted the attention of a number of commentators and courts has to do with "lien stripping"—the removal of real estate liens unsupported by any equity in the property—in Chapter 13 individual repayment plan cases. This includes, most controversially, so-called "Chapter 20" cases, in which debtors first discharge their personal liabilities on the secured debt by filing under Chapter 7 of the Bankruptcy Code and then—sometimes while the ink on the discharge is barely dry—file under Chapter 13 to shuck the (now non-recourse) mortgage debt.[1]

BACKGROUND

Bankruptcy relief takes one of two basic forms: liquidation under Chapter 7 of the Bankruptcy Code (Title 11, United States Code), or reorganization under Chapters 9, 11, 12, and 13.[2] For individuals, "liquidation" is not a particularly apt description of Chapter 7 because, unlike companies, individuals do not cease to exist after bankruptcy. Instead, individuals get to keep certain property,[3] and they receive a discharge of most kinds of debt.[4] The discharge, coupled with the right to retain exempt property,

[*] The Honorable Stephen S. Mitchell (retired) was born in Jacksonville, Florida, in 1945, and grew up in North Carolina, Hawaii, Maine, California, and Virginia. He received a B.A. with honors in 1967 from the University of Virginia, where he was a member of Phi Beta Kappa, and an LL.B. in 1970 from Yale Law School, where he was a director of the Barristers Union. Following graduation from law school, he served on active duty for 9 years with the United States Marine Corps as a defense counsel, administrative law officer, international law advisor, and military judge. After leaving active duty in 1979, he practiced law for 15 years in Alexandria, Virginia, as a partner in the general practice firm of McKinley, Schmidtlein, and Mitchell. While in private practice, he continued to serve in the U.S. Marine Corps Reserve, from which he retired as a colonel in 1994. In that same year he was appointed as a bankruptcy judge for the Eastern District of Virginia, where he sat in the Alexandria Division until his retirement in 2011. Judge Mitchell is a frequent speaker at CLE programs.

[1] Recent discussions of the controversy include David N. Saponara, *Note: Lien-Stripping in Consumer Bankruptcy: Debtors Cannot Strip Liens Down Partially, But Can They Strip Them Off Entirely? The Answer Should Be No*, 21 AM. BANKR. INST. LAW REV. 257 (2013); J. Ellsworth Summers, Jr. & Scott St. Amand, *Serial Strippers Take National Stage: Fourth Circuit Permits Lien-Stripping in Chapter 20*, 32 AM. BANKR. INST J. 14 (2013).

[2] Individuals sometimes do not have a choice between a Chapter 7 liquidation and a reorganization case. Under the so-called "means test" added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), an individual case may be dismissed as an abuse of Chapter 7 if the debtor could afford to pay some or all of the debts in a Chapter 13 case. 11 U.S.C. § 707(b)(1).

[3] 11 U.S.C. § 522.

[4] 11 U.S.C. §727. The debts excluded from discharge are set forth at 11 U.S.C. § 523(a).

constitutes the debtor's "fresh start."[5] Although non-exempt property is subject to administration by the trustee, the vast majority of individual cases are so-called "no-asset" cases, in which no property is available to pay creditor claims.

While, for individuals, Chapter 7 is all about debt forgiveness, Chapter 13 is about debt repayment under court protection and court supervision. Although a trustee is appointed, he or she serves primarily as a payment agent, and the debtor retains control over his or her property.[6] Debtors in Chapter 13 must file a repayment plan that normally lasts for three to five years. Such plans typically require the debtor to make periodic payments to the trustee from future income during the term of the plan, with the trustee making disbursement to creditors. Long-term debts, however, such as mortgages, may be (and usually are) paid directly by the debtor rather than through the trustee.[7] Unsecured debts entitled to priority must be paid in full, as must secured debts (with interest) unless the debtor surrenders the collateral.[8] General unsecured debts, however, may be compromised as long as (1) the plan is proposed in good faith, (2) creditors receive as much as they would in a Chapter 7 liquidation, and (3) the debtor contributes to the plan his or her "projected disposable income" for the "applicable commitment period," which is three years if the debtor's income is below the state-wide median for a family of the same size, or five years if it is at or above the state-wide median.[9]

Although Chapter 13 is the preferred reorganization Chapter for individuals, Chapter 13 relief is available only to individuals with regular income whose secured debts do not exceed $1,149,525 and whose unsecured debts do not exceed $383,175.[10] An individual who exceeds the debt limits for Chapter 13 may reorganize instead under Chapter 11, which, although designed and primarily intended for business reorganizations, is nevertheless available even to individuals not engaged in business.[11] Chapter 11, however, is much more cumbersome and expensive than Chapter 13, and presents several obstacles to confirmation that do not apply in Chapter 13.[12] A trustee is ordinarily not appointed in a Chapter 11 case, and the debtor remains in control of his or her property as "debtor in possession" with most of the duties and powers of a trustee.[13] As in Chapter 13, priority and secured claims must be paid in full, but unsecured claims may be, and frequently are, paid at pennies on the dollar.

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[5] The characterization of individual bankruptcy as a "fresh start" derives from an oft-quoted passage in the Supreme Court's opinion in *Local Loan Co. v. Hunt*, that bankruptcy "gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." 292 U.S. 234, 244, 54 S. Ct. 695, 699, 78 L. Ed. 1230 (1934).

[6] 11 U.S.C. § 1303 and 1304.

[7] 11 U.S.C. § 1322(b)(5).

[8] 11 U.S.C. §§ 1322(a)(2) and 1325(a)(5).

[9] 11 U.S.C §§ 1325(a)(3), (a)(4), and (b).

[10] 11 U.S.C. § 109(e).

[11] Toibb v. Radloff, 501 U.S. 157, 111 S. Ct. 2197 (1991).

[12] Specifically, creditors get to vote on the debtor's plan and, indeed, at some point may be entitled to propose their own plan, neither of which is true in Chapter 13. Although acceptance by more than one-half in number and two-thirds in dollar amount in each class of claims will bind dissenting *members* of that class, and although in certain circumstances a plan can be confirmed over the objection of a dissenting *class* (a result commonly, if inelegantly, referred to as "cramdown"), nevertheless at least one impaired class must vote in favor of a plan. An important limitation on cramdown is the so-called "absolute priority rule," which bars confirmation over the objection of a non-accepting class if the debtor (or in a corporate or partnership case, the equity owners) retain any property.

[13] 11 U.S.C. §§ 1101(1) and 1107(a).

SECURED CLAIMS IN BANKRUPTCY

A fundamental principle in bankruptcy is that a claim is secured only up to the value of the collateral, and the remainder is treated as an unsecured claim.[14] Thus, if Acme Bank has a $1 million claim secured by a deed of trust against Blackacre, and Blackacre is worth only $800,000, then Acme is treated in bankruptcy as the holder of an $800,000 secured claim and a $200,000 unsecured claim. Of course, under those facts, any liens junior to Acme's would be treated as wholly unsecured. Importantly, a lien is "void" to the extent it secures a claim that is not a secured claim, [15]

In Chapter 7, the fact that a lender may be under-secured is normally of no consequence; a trustee cannot sell over-encumbered property except with the secured creditor's permission,[16] and the lien itself, unless avoided under one of the Bankruptcy Code's specific avoidance provisions, will pass through bankruptcy unimpaired and will not be affected by the debtor's discharge.[17] This is true even though a literal reading of the Bankruptcy Code would seemingly allow a Chapter 7 debtor to have the unsecured portion of the claim declared void (a proposition nevertheless flatly rejected by the Supreme Court in a case entitled *Dewsnup v. Timm,* on the ground that Congress, in enacting the current Bankruptcy Code in 1978, would not have effected such a radical change in existing law without making its intent plain[18]). Although the holding in *Dewsnup* prohibited only a "strip-down" of a mortgage lien to the court-determined value of the real estate, the Fourth Circuit has held that a "strip-off" of a wholly unsecured mortgage is likewise unavailable in Chapter 7.[19]

In reorganization cases, by contrast, a creditor's security interest may be (and commonly is) "stripped down" to the value of the collateral. Thus, the debtor may propose and obtain (over Acme Bank's objection) confirmation of a plan that pays the $800,000 value of Blackacre, with interest (which may, however, be less than the note rate),[20] over time, with the balance of the claim receiving whatever dividend is available for unsecured creditors. There are some limitations, however. In a Chapter 11 case, Acme Bank may elect to have its claim treated as fully secured, in which event it would be entitled to payments at least equal to the $1 million principal amount of its loan.[21] Typically, such an election would be made only if Acme Bank believed either that the current $800,000 value of Blackacre was due to a temporary drop in the market, or that the property was actually worth more but a battle of the appraisers might lead the bankruptcy court to erroneously place a lower value on it. Additionally, in both Chapter 11 and Chapter 13, a repayment plan may not (except for curing defaults) "modify" a claim secured by a deed of trust or mortgage against an individual debtor's principal residence.[22] But claims secured by real property *other* than the debtor's principal residence (for example, a vacation home or a rental property) are not protected against modification.

Lack of equity is not the only hazard to a secured claim in bankruptcy. The Bankruptcy Code contains a number of provisions that allow a trustee or reorganizing debtor to set aside, or "avoid," an otherwise fully-secured lien. The three most common grounds for avoidance are that the lien (1)

[14] 11 U.S.C. § 506(a).

[15] 11 U.S.C. § 506(d).

[16] 11 U.S.C. § 363(f).

[17] Johnson v. Home State Bank, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 66 (1991).

[18] Dewsnup v. Timm, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992).

[19] Ryan v. Homecomings Fin. Network, 253 F.3d 778 (4th Cir. 2001).

[20] For a discussion of the methodology for determining an appropriate interest rate, see *In re* Birdneck Apt. Assocs. II, L.P., 156 B.R. 499 (Bankr. E.D. Va. 1993).

[21] 11 U.S.C. § 1111(b)(2).

[22] 11 U.S.C. §§ 1123(b)(5) and 1322(b)(2).

constitutes a preference, (2) is a fraudulent conveyance, or (3) would be unenforceable against a bona fide purchaser or judgment lien creditor.

A preference is a "transfer"—which is defined to include the creation of a lien[23]—if it is (1) made within 90 days of the filing of the bankruptcy petition on account of an antecedent debt, (2) the debtor was insolvent, and (3) the transfer enables the creditor to receive more than it would have received in a Chapter 7 liquidation had the transfer not been made.[24] If the transferee is an "insider," the look-back period is one year rather than ninety days. Example: The debtor borrows $100,000 from Acme Bank in January on an unsecured basis. The debtor's financial position deteriorates, and Acme insists on a deed of trust against Blackacre as a condition of not calling the loan. The deed of trust is recorded in June, and the debtor files for bankruptcy in August. On those facts, the deed of trust can be avoided as a preference.

A fraudulent transfer—which, again, includes the fixing of a lien—is any transfer made within two years prior to the filing of the bankruptcy petition either with actual intent to hinder, delay, or defraud creditors, or, regardless of intent, for less than "reasonably equivalent value" at a time when the debtor was insolvent or became insolvent as a result of the transfer.[25] One not-uncommon scenario in which reasonably equivalent value may be found lacking is when a debtor encumbers its property to secure a loan to another person or entity. Example: Acme Bank agrees to loan the debtor's son $100,000 to start a new business, but requires security in the form of a deed of trust against Blackacre. The debtor files for bankruptcy a year later. If the debtor was solvent (and did not become insolvent) at the time the deed of trust was recorded, the Bank is safe. But if it turns out the debtor was insolvent at the time, then the deed of trust can be avoided, since the loan benefited the debtor's son, not the debtor. The same issue arises when a company allows its property to be encumbered for a loan made to a parent, shareholder, subsidiary, or affiliate.

Finally, a trustee or debtor in possession may avoid any transfer that under applicable state law would not be valid against a judgment lien creditor of the debtor or a bona fide purchaser of the debtor's real property.[26] This power—commonly referred to as the "strong-arm" power—is most commonly exercised to set aside unperfected security interests and unrecorded mortgages or deeds. Example: Acme Bank loans the debtor $100,000 to be secured by a second deed of trust against Blackacre. Although the debtor signs a deed of trust, the Bank, through error, fails to record it before the debtor files for bankruptcy. The deed of trust is unenforceable against the trustee, and the Bank has only an unsecured claim.

In addition to the avoidance powers that may be exercised by a trustee or a Chapter 11 debtor in possession, an *individual* debtor (whether in Chapter 7 or 13) may avoid a *judgment* lien (but not a deed of trust)[27] against real estate to the extent the lien impairs the debtor's exemption rights in the property.[28] The statutory test for impairment is awkwardly expressed, but amounts to this: a judgment lien can remain only to the extent that there is any equity left in the property after taking into account all other liens and the debtor's available homestead exemption. As an example, if the debtor's modest bungalow, Greenacre, is worth $250,000 but is subject to a deed of trust with a balance of $245,000 and a judgment

[23] 11 U.S.C. § 101(54)

[24] 11 U.S.C. § 547(b).

[25] 11 U.S.C. § 548(a).

[26] 11 U.S.C. § 544(a).

[27] *In re* Clark, 217 B.R. 177 (Bankr. E.D. Va. 1998).

[28] 11 U.S.C. § 522(f).

lien in the amount of $20,000, and the debtor is entitled to a $5,000 homestead exemption, then the judgment lien would be avoided in its entirety.[29]

LIEN STRIPPING IN CHAPTER 13

A deed of trust against rental real estate or a vacation home may be modified in Chapter 13 or in an individual Chapter 11 case consistent with the general rules governing treatment of secured claims in bankruptcy. Congress, however, has provided special protection for a claim secured by a mortgage or deed of trust against the debtor's principal residence.[30] Although the debtor may cure any payment arrears over time, the claim may not be "modified." The Supreme Court, in *Nobelman v. American Savings Bank*,[31] held that the prohibition against modification meant that the mortgage debt could not be bifurcated into secured and unsecured components, nor could the interest rate, loan term, or payment terms be modified. In short, there can be no "strip-down" of the mortgage to the value of the house.

The issue that has divided the courts is whether this rule also applies to a claim which, as an economic matter, is wholly unsecured because there is *no* equity to which the security interest can attach. Consider, for example, a debtor who owes $700,000 on a first deed of trust against his or her principal residence, Graylings, which has fallen in value (since the halcyon days the loan was made) to $500,000. The debtor, at the height of the housing bubble, had taken out a $100,000 home equity line of credit, which is secured by a second deed of trust. The question is whether the junior deed of trust is entitled to the statutory protection against modification. The answer is no, according the Fourth Circuit in its recent decision in *In re* Davis, in accord with decisions in most other circuits[32]—[33]— . Although the precise question in *Davis* was whether lien-stripping was available in a "Chapter 20" filing, the court necessarily had to resolve the threshold issue of whether it was available in Chapter 13. In holding that it was, the court affirmed an earlier unpublished opinion[34] that had allowed the stripping of wholly-unsecured junior mortgages in Chapter 13 and joined six other circuits that have reached the same result.[35] Accordingly—unless the Supreme Court takes up the issue and rules to the contrary—a Chapter 13 debtor, or an individual debtor in a Chapter 11 case, can obtain confirmation of a plan that "strips off" the wholly-underwater deed of trust, even against a principal residence, leaving the creditor with only an unsecured claim (which may be paid at only pennies on the dollar).

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[29] For real-life examples of the computation at work, see *In re* Canalos, 216 B.R. 159, 165 (D. Md. 1997); *In re* Fitzhenry, 1998 WL 1147929 at *9-10 (Bankr. E.D. Va. 1998).

[30] 11 U.S.C. § 1322(b)(2). Because the protection against modification applies only to "security interests" and not to judgment liens, the latter can be modified even if they encumber the debtor's personal residence. *In re* Williams, 166 B.R. 615 (Bankr. E.D. Va. 1994).

[31] Nobleman v. Am. Savings Bank, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d 228 (1993).

[32] Among the decisions espousing a minority view and concluding that § 1322(b)(2) "trumps" § 506(a) even when the claimed security interest might otherwise be thought illusory, and that under *Nobleman* a debtor is prohibited from stripping off the lien even of a wholly unsecured mortgage against a principal residence are *In re* Lewandowski, 219 B.R. 99 (Bankr. W.D. Pa. 1998); Fraize v. Beneficial Mortgage Corp. of N.H. *(In re* Fraize*)*, 208 B.R. 311, 313 (Bankr. D. N.H. 1997); Barnes v. American General Finance, *(In re* Barnes*)*, 207 B.R. 588, 593 (Bankr. N.D. Ill. 1997); *In re* Jones, 201 B.R. 371 (Bankr. D. N.J. 1996); *In re* Barnes, 199 B.R. 256 (Bankr. W.D. N.Y. 1996); and *In re* Hughes, — B.R. —, 2009 WL 661326 (Bankr. D. Minn. 2009).

[33] Branigan v. TD Bank, N.A. *(In re* Davis*)*, 716 F.3d 331 (4th Cir. 2013).

[34] First Mariner Bank v. Johnson *(In re* Johnson*)*, 407 Fed. Appx. 713 (4th Cir. 2011).

[35] McDonald v. Master Fin. *(In re* McDonald*)*, 205 F.3d 606 (3rd Cir. 2000); Bartee v. Tara Colony Homeowners Ass'n *(In re* Bartee*)*, 212 F.3d 277 (5th Cir. 2000); Tanner v. FirstPlus Fin. *(In re* Tanner*)*, 217 F.3d 1357 (11th Cir. 2000); Pond v. Farm Specialist Realty *(In re* Pond*)*, 252 F.3d 122 (2d. Cir. 2001); Lane v. W. Interstate Bancorp *(In re* Lane*)*, 280 F.3d 663 (6th Cir. 2002); Zimmer v. PSB Lending Corp. *(In re* Zimmer*)*, 313 F.3d 1220 (9th Cir. 2002).

"CHAPTER 20" LIEN AVOIDANCE

Although the issue of mortgage "strip-off" in Chapter 13 is controversial enough, the clash of views has been even greater with respect to whether such relief is available when a debtor first files under Chapter 7 and then files a second case under Chapter 13—a scenario commonly referred to as a "Chapter 20"—with a view to stripping off junior mortgages against the debtor's residence that are unsupported by any equity at all. Chapter 20 filings, although not prohibited,[36] have traditionally been viewed by bankruptcy courts with suspicion.[37] It is easy to see why: serial filings allow a debtor to accomplish a result that could not obtained by filing under either Chapter 7 or Chapter 13 alone. That is a concern that Congress, in enacting the 2005 amendments to the Bankruptcy Code, seems to have recognized as well. One of those amendments, made with the evident purpose of discouraging Chapter 20 filings, bars discharge in a Chapter 13 case filed within four years of a Chapter 7 case in which the debtor received a discharge.[38] The Fourth Circuit has held, however, that the mere fact that a debtor cannot receive a discharge in a Chapter 13 case is not a bar to obtaining confirmation of a repayment plan to address debts that were not discharged in the Chapter 7 case or liens that survived the Chapter 7 case, but is simply one factor to be considered in determining whether the debtor's plan has been proposed in good faith.[39] Thus, inability to receive a discharge does not bar at least some forms of Chapter 13 relief. However, another of the amendments made by the 2005 Act arguably provides an insurmountable hurdle to "strip-off" by providing that a secured creditor under a plan retains its lien until either the underlying debt is paid in full or the debtor receives a discharge.[40]

It was against this backdrop that the Fourth Circuit in its recent 2-to-1 decision in *In re* Davis affirmed bankruptcy court rulings confirming a Chapter 13 plan in two cases (consolidated on appeal) in which the debtors, because of their discharge in a prior Chapter 7 case, were not eligible for a discharge in the Chapter 13 case. In the first of the two cases, the wife was unemployed when the Chapter 7 case was filed. The Chapter 13 case was filed approximately a year after the discharge in the Chapter 7 case; by this time, both debtors were gainfully employed, and the bankruptcy court specifically found that the second case had been filed in good faith based on changed circumstances. The debtors' house was valued at $270,000, and was subject to a $275,373 first deed of trust and a $115,138 second deed of trust. On those facts, the bankruptcy court allowed the strip-off of a third deed of trust on which $117,603 was owed.

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[36] Johnson v. Home State Bank, 501 U.S. 78, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991).

[37] See, e.g., *In re* Cushman, 217 B.R. 470 (Bankr. E.D. Va. 1998) which denied confirmation of a plan in a Chapter 20 case that was filed for the sole purpose of reducing the debtor's car payment. In so ruling, the court noted the following factors as relevant to a good faith determination in the Chapter 20 context:

> 1. The proximity in time of the Chapter 13 filing to the Chapter 7 filing.
>
> 2. Whether the debtor has incurred some change in circumstances between the filings that suggests a second filing was appropriate and that the debtor will be able to comply with the terms of a Chapter 13 plan.
>
> 3. Whether the two filings accomplish a result that is not permitted under either Chapter standing alone.
>
> 4. Whether the two filings treat creditors in a fundamentally fair and equitable manner or whether they are rather an attempt to manipulate the bankruptcy system or are an abuse of the purpose and spirit of the Bankruptcy Code.

Id. at 477.

[38] 11 U.S.C. § 1328(f)(2).

[39] Branigan v. Bateman *(In re* Bateman*)*, 515 F.3d 272 (4th Cir. 2008).

[40] 11 U.S.C. § 1325(a)(5)(B)(i)(I).

In the second case, the debtor filed her Chapter 13 case only one week after receiving her Chapter 7 discharge. The opinion does not discuss whether there were any changed circumstances; it laconically notes only that the Chapter 13 trustee "never contended" that the second case was not filed in good faith.

The opinion in the consolidated cases begins its analysis by observing that § 506(a), which classifies valueless liens as unsecured claims, operates with § 1322(b)(2) to permit a bankruptcy court in a Chapter 13 case to strip off a valueless lien against a primary residence. The opinion reasoned further that the debtors' ineligibility for a discharge based on the prior Chapter 7 discharge does not change the result, since the provision in § 1325(a)(5)(B)(i)(I) for lien retention until discharge only applies to secured claims, and a valueless lien is not a secured claim. The opinion does caution that "bankruptcy courts are bound to carefully scrutinize filings for good faith and dismiss cases where the debtor attempts to use a Chapter 20 procedure solely to strip off a lien." However, based on the bankruptcy judge's express finding of good faith on the part of the married debtors, and the lack of any challenge to the debtor's good faith in the other case, the court concluded that confirmation of the plans was not improper.

Davis is the first court of appeals decision to address strip-off in the Chapter 20 context, although a number of lower courts have permitted it.[41] The issue, however, is currently pending before the Eleventh Circuit on direct appeal of a bankruptcy court decision from the Middle District of Florida that, like *Davis*, had allowed strip-off in a Chapter 20 case.[42] If the Eleventh Circuit rules contrary to the Fourth, the stage may be set for Supreme Court consideration of the issue. Unless the Supreme Court ultimately rules to the contrary, individual debtors filing in Virginia will be able to discharge their personal liabilities and still strip off mortgages against their personal residence unsupported by any equity through coordinated Chapter 7 and 13 filings—provided, of course, that the bankruptcy court determines that the second case was filed in good faith.

Editor's Note: On October 23, 2013, the U.S. Court of Appeals for the Fourth Circuit issued its opinion in *Alvarez v. HSBC Bank USA*, 2013 BL 293249, 4th Cir. No. 12-1156.

Jose Alvarez and his wife, Meyber L. Alvarez, owned their residence in Maryland as tenants by the entirety. The property, valued at $442,400.00, was encumbered by a first mortgage lien with a balance in excess of $447,000.00, and a second mortgage lien with a balance in excess of $75,000.00. Mr. Alvarez filed a voluntary Chapter 13 bankruptcy petition and identified his interest in this property. Mrs. Alvarez was not a party to this petition, nor did she file a separate petition. In his Chapter 13 proceeding, Mr. Alvarez moved the court to "strip off" the second mortgage lien as being totally unsecured based upon the property value and first lien.

The Court of Appeals affirmed the Bankruptcy Court's holding that, because the property was held in tenancy by the entirety and Mrs. Alvarez did not join in the bankruptcy petition, the valueless lien could not be stripped. The Court of Appeals emphasized that Mr. Alvarez did not sever the tenancy by the entirety when he filed his bankruptcy petition, and that only the *debtor's* interest in the entireties property—not the whole owned by the marital unit—was under the jurisdiction and control of the Bankruptcy Court. The Court of Appeals cited favorably to *In re* Hunter, 284 B.R. 806 (Bankr. E.D. Va. 2002) (applying Pennsylvania law and holding that an individual debtor spouse cannot strip off a lien on property in tenancy by the entirety), while noting that other Bankruptcy Courts have reached different conclusions.

[41] *See, e.g., In re* Fisette, 455 B.R. 177 (8th Cir. BAP 2011); *In re Dang*, 467 B.R. 227 (Bankr. M.D. Fla. 2012); *In re* Okosisi, 451 B.R. 90 (Bankr. D. Nev. 2011); and *In re* Tran, 431 B.R. 230, 237 (Bankr. N.D. Cal. 2010). Decisions holding to the contrary include *In re* Gerardin, 447 B.R. 342 (Bankr. S.D. Fla. 2011); *In re* Victorio, 454 B.R. 759 (Bankr. S.D. Cal. 2011); *In re* Fenn, 428 B.R. 494 (Bankr. N.D. Ill. 2010); *In re* Jarvis, 390 B.R. 600 (Bankr. C.D. Ill. 2008).

[42] Wells Fargo Bank, N.A. v. Scantling, No. 13-10558 (11th Cir. appeal granted)

CFPB COMPLIANCE MYTHS THAT DESERVE DEBUNKING

by Jonathan L. Pompan[*]

When it comes to the Consumer Financial Protection Bureau's ("CFPB" or the "Bureau") compliance expectations, it is important to separate myth from fact. These days, the CFPB is moving full-steam ahead on examining non-banks and banks, dozens at a time, and is not leaving any stone unturned for potential unfair, deceptive or abusive acts or practices in violation of the Consumer Financial Protection Act or other consumer financial laws that fall under its scope.

Myth #1: Only large financial institutions are subject to CFPB supervision and examination.

No provider of consumer financial products and services, or their service providers, should assume they are beyond the reach of the CFPB. The CFPB can examine any entity, regardless of size, based on regulatory authority to supervise "risky" financial products and services that it believes are causing harm to consumers. This authority is in addition to the CFPB's ability to supervise larger market participants in the debt collection, credit reporting, and student loan servicing markets, as well non-bank businesses in the private student loan, mortgage, and small dollar loan markets. (The CFPB also supervises banks with over $10 billion in assets).

Myth #2: An audit program is sufficient to catch non-compliance.

The CFPB expects a proactive approach to compliance. This means not only having a detailed audit program, but also a system for proactively preventing and detecting potential non-compliance with the law before a consumer harm occurs.

The CFPB examines: Board of Director and management oversight; compliance programs; consumer complaint responses; and compliance audits. In addition, the CFPB reviews such areas as operations, marketing and lead generation, third party relationships, internal controls, consumer interaction, information sharing and privacy, and payment processing.

Myth #3: The CFPB only cares about policies and procedures.

Wrong. The CFPB expects written policies and procedures that institutions will design and offer consumer financial products in accordance with federal consumer financial laws and maintain effective systems and controls to manage compliance responsibilities. This means the CFPB will focus both on policies and procedures and actual acts and practices, including consumer level transactions. The CFPB has released a comprehensive Supervision and Examination Manual, and several additional guidance documents and bulletins that shed light on all of the different ways their examiners oversee companies.

Myth #4: Companies are not responsible for the actions of their service providers.

As the CFPB stated in its Bulletin 2012-03, the CFPB expects non-banks and banks to "oversee their business relationships with their service providers in a manner that ensures compliance with Federal consumer financial law." The CFPB considers a "service provider" to be "any person that provides a material service to a covered person in connection with the offering or provision by such covered person

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of a consumer financial product or service." For more information about the CFPB expectations for effective vendor management, see "CFPB Warns of Service Provider Scrutiny."

Myth #5: The CFPB will give companies that are supervised and licensed by other regulators a pass.

Wrong. All of the CFPB administrative proceedings brought about by the CFPB to date have been against entities that were already regulated on the Federal or state level prior to the creation the Bureau. For example, the CFPB has entered into consent orders with several banks regulated by the OCC, and mortgage related providers regulated by states. In addition, the CFPB has brought lawsuits against licensed attorneys, debt relief providers, mortgage assistance relief service providers, and others. The Bureau also has stated it is in the process of investigating companies and service providers in virtually all consumer product and service markets.

* * * * *

This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to a specific fact situation.

ENCRYPTION MADE SIMPLE FOR LAWYERS

by David G. Ries and John W. Simek*

Encryption is a topic that most attorneys don't want to touch with a ten-foot pole, but it is becoming a more and more important part of security. Encryption is an electronic process to protect data. It has now reached the point where all attorneys should generally understand encryption, have it available for use when appropriate, and make informed decisions about when encryption should be used and when it is acceptable to avoid it. Fortunately, easy-to-use options are available today for encryption. Most attorneys will need technical assistance to install and set up encryption, but it's generally easy from there.

Encryption uses a formula to transform readable data into unreadable data. The formula is an algorithm (called a *cipher*), the readable data is called plaintext, and the unreadable data is called *ciphertext*. Decryption is the reverse process that uses a key to transform the encrypted data back to readable data. As long as the decryption key is protected, the data is unreadable and secure. Although the technical details of how encryption works are complex, it is not necessary for attorneys who use encryption to understand them.

Encryption can be used to protect data at rest (on desktops, laptops, servers, or portable media) and data in motion (over wired or wireless networks and the Internet). Anyone who has access to encrypted data cannot read or use it without access to the decryption key.

Attorneys have ethical and legal duties to protect information relating to clients. Encryption is an important consideration in addressing these duties.

Laptops and Portable Media

The attributes that make laptops and portable devices useful also make them very dangerous from a security perspective: They're compact and portable. Add to that the fact that their costs have been decreasing over the years, their capacities have been dramatically increasing, and they have become more and more compact. Laptops are available with 1 TB (terabyte) and larger hard drives. USB thumb drives with capacities of 256 GB or more are now available. Portable hard drives of 1 TB or more, the same as desktop computers, are now available. A massive amount of data, in compact media, can be easily lost or stolen. With these devices, attorneys and employees can lose or steal the equivalent of a truckload of paper pages or more.

Not properly protected, laptops and portable media can be recipes for a security disaster. One survey reported that 70 percent of data breaches resulted from the loss or theft of off-network equipment (laptops, portable drives, PDAs, and USB drives). Strong security is a must. Encryption in now a standard security measure for protecting laptops and portable devices—and attorneys should be using it.

In fact, a joint U.S./UK research team has written that full disk encryption is so effective that law enforcement and federal agencies are complaining that they are unable to retrieve encrypted data in criminal investigations. Federal courts are struggling with the issue of whether compelled disclosure of passwords and pass phrases for decryption is prohibited by the Fifth Amendment.

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After the high-profile theft of a Department of Veterans Affairs laptop and external hard drive containing personal information on more than 28 million veterans in 2006, security guidelines for federal agencies added the requirement of encryption of all data on laptops and portable devices, unless it is classified as "non-sensitive." This was six years ago.

In January 2007, 18 laptops were stolen from the offices of a law firm in Orlando, Florida. The laptops were reportedly protected by encryption, and the incident received very little publicity. In discussing this incident, the SANS Institute, a leading information security organization, noted, "[l]aptop thefts aren't going away, but by this time next year, this type of item (laptop stolen, but the data was protected) shouldn't be newsworthy." That was more than five years ago.

In a recent data breach report, a Maryland law firm lost an unencrypted portable hard drive that contained medical records of patients in a lawsuit against its client hospital. One of the law firm's employees took home the hard drive containing backup data. This was the firm's method of ensuring that it had an off-site backup. She took the light rail system home and left the drive on the train. When she came back a few minutes later, it was gone. Backup is a good practice, but not if it exposes confidential data. If the drive had been encrypted, it would have had a strong level of protection. As it was, it had little or none. It is not uncommon for backup software to have the ability to encrypt the backed-up information. Generally, it is just a simple matter to check an option for the backup to be encrypted.

As these examples demonstrate, encryption is particularly important for laptops and portable media. A lost or stolen laptop or portable device that is encrypted is protected unless the decryption key has been compromised.

Encryption basics. There are two basic approaches to encrypting data on hard drives: full disk encryption and limited encryption. As its name suggests, full disk encryption protects the entire hard drive. It automatically encrypts everything and provides decrypted access when an authorized user properly logs in. Limited encryption protects only specified files or folders or a part of the drive. With limited encryption, the user has to elect to encrypt the specific data.

There are also three kinds of encryption for protecting laptops and portable devices: hardware encryption, encryption in operating systems (such as Windows and Apple OS X), and encryption software.

Hardware full disk encryption. All hard drive manufacturers now offer drives with hardware full disk encryption built in. The major laptop manufacturers all offer models with these drives. Hardware encryption is generally easier to use and administer than encryption software. Some examples are Seagate Secure (www.seagate.com) and Hitachi Self-Encrypting Drives (www.hgst.com). Secure use simply requires enabling encryption and setting a strong password or pass phrase. The contents of the drive are automatically decrypted when an authorized user logs in. It is automatically encrypted when the user logs off or the laptop is turned off.

Because most encryption programs are tied to a user's password, secure passwords or pass phrases are essential, and a forgotten password can lead to lost data. Automatic logoff, after a specified time, is critical so that unencrypted data will not be exposed if a user goes away from a computer or forgets to turn it off. In an enterprise environment, like a law firm, access by an administrator, ability to reset passwords, backup, and key recovery are essential. Installing encryption and administering it, particularly in a large enterprise, can be a challenge.

Encryption in operating systems. Current business versions of Windows and current versions of Apple OS X have built-in encryption capability.

Windows Vista Enterprise and Ultimate and Windows 7 Enterprise and Ultimate include an encryption feature called BitLocker. BitLocker works below the operating system and encrypts an entire volume on the hard drive. BitLocker requires either a computer that is equipped with a Trusted Platform Module (TPM) chip on the motherboard or use of an external USB drive to hold the decryption key. If an intruder gains access to a USB key, the encryption can be defeated.

The business versions of Windows also include an encryption function called Encrypted File System (EFS). It allows encryption of files and folders. An authorized user who is logged in has access to decrypted data. It is encrypted and unreadable to anyone else (unless they can defeat the login process). EFS is considered a fairly weak encryption method that is easily cracked using forensic tools. You are better off using BitLocker or one of the other third-party encryption products discussed below.

Setup of both EFS and BitLocker is fairly technical. For most attorneys, it will be necessary to obtain technical assistance to implement them.

OS X has built-in file encryption in FileVault. Newer versions have full disk encryption available in FileVault 2. Follow Apple's instructions for turning it on. After a password is set, it just requires turning on the FileVault button in System Preferences. Recent advances have attacked Apple's encryption scheme, and the Passware software suite claims to be able to defeat FileVault 2 in less than an hour.

Third-party encryption software. Some commonly used third-party encryption software products for hard drives include those offered by Symantec (PGP and Endpoint; www.symantec.com), McAfee (Endpoint Encryption; www.mcafee.com), Check Point (ZoneAlarm DataLock; www.zonealarm.com), WinMagic (SecureDoc; www.winmagic.com), and Sophos (SafeGuard; www.sophos.com). A common open-source encryption program that is free and relatively easy to use (after setup) is TrueCrypt (www.truecrypt.org).

Hardware-encrypted drives and encryption software are available for USB drives and portable hard drives. Microsoft's BitLocker to Go can be used to encrypt portable devices. Individual USB drives with built-in encryption capability are also available, such as the IronKey (www.imation.com), Kanguru Micro (www.kanguru.com), Kingston (www.kingston.com), and SanDisk Cruzer Professional and Cruzer Enterprise (www.sandisk.com). The IronKey (store.imation.com/security) is a favorite of the authors. It includes strong encryption, wiping if the wrong credentials are entered too many times, and has strong physical construction. As an added bonus, several of the models contain a password management application called Identity Manager, which stores all your 12+ character passwords in a secured, encrypted "vault." Of course you can store any length password, but the current recommendation is 12 or more characters.

To avoid the loss of data, it is important to understand how the encryption works, to back up data that is encrypted, and to keep a copy of the recovery key in a secure place. Enterprise controls are available to centrally manage encryption.

Smartphones and Tablets

Smartphones and tablets are basically small computers, with substantial computing power and high storage capacity. Like laptops and other mobile devices, they can be easily lost or stolen and should be protected with encryption.

BlackBerry devices (www.blackberry.com) have long been the "gold standard" for secure cell phone communications. If you use the BlackBerry Enterprise Server (BES), the communications are automatically encrypted. Encrypting the device itself is accomplished by enabling Content Protection. You can find that choice by navigating to Options > Security Options > Encryption. This is where you will set encryption for the device memory, encryption strength, contacts, media files, and expansion memory card. In addition, you will need to set a password for the phone as well as the inactivity timer to lock the phone. The password and time-outs are set by going to Options > Password. A lot of law firms use BES to manage their BlackBerry devices. This centralized management will push the desired security settings to the phones with no user interaction.

For iPhones and iPads (www.apple.com), hardware encryption was implemented in iOS 4. All files are automatically encrypted when a lock code is set and decrypted when the device is unlocked. It provides little protection unless Simple Passcode is turned off, Require Passcode is turned on, and a strong pass code is selected. Require Passcode should be set for a short time and Erase Data should be turned on. iOS also includes a feature called Data Protection. It secures e-mails and attachments stored on the device and data in other apps that are designed to work with it.

Android OS (www.android.com) has included encryption for tablets (starting with Honeycomb) and for phones (starting with Ice Cream Sandwich). Earlier versions require third-party apps for encryption, such as WhisperCore (http://whispersys.com), Droid Crypt (tinyurl.com/9m3d598), or AnDisk Encryption (tinyurl.com/8no7qsh). Also, Motorola (www.motorola.com) and Samsung (www.samsung.com) market enterprise phones with built-in encryption capability. Follow the device manufacturer's instructions for turning on encryption. It generally requires touching the Encrypt or Encrypt Tablet button in Settings. A strong PIN or password and automatic logoff after a set time are also important to keep the data encrypted.

Again, it is important to follow the manufacturer's instructions when setting up encryption. Get help if you need it. First-time encryption takes some time when a device has already been in use, so make sure that the battery is fully charged before starting.

Weaknesses have been reported in the encryption for both iOS and Android, so it is important to consider multiple levels of security. Despite some limitations, smartphones and tablets are more secure with encryption, and attorneys should be using it.

It is also important to make sure that secure methods are used for getting files on and off smartphones and tablets and for sharing files. There is substantial concern about the security of services such as Dropbox (www.dropbox.com) and iCloud (www.icloud.com). Their terms of use provide limited protection and they control the encryption—so their employees can get access, and protection from unauthorized third parties depends on how well they protect the decryption keys. Use of alternatives such as Box (www.box.com) or SpiderOak (https://spideroak.com) or using add-on encryption such as BoxCryptor (www.boxcryptor.com) with Dropbox or another vendor provides stronger security because the end user controls the decryption keys.

Wireless Networks

Communication via wireless connections needs to be secured as well in order to protect the transmission. Encrypting the wireless network will protect the data from being intercepted and viewed. There are many free "sniffer" applications that can be used to view the contents of unencrypted data streams. Essentially, there are three commonly available types of encryption schemes for your wireless network: WEP (Wired Equivalent Privacy), WPA (Wi-Fi Protected Access), and WPA2 (second-generation WPA). These encryption methods can be used on all currently available wireless access points. WEP is very weak encryption and is fairly easy to crack. There are plenty of free tools available that can crack WEP in a matter of minutes. WEP should not be used in any wireless network because of its insecurity. WPA is a stronger form of encryption, but it has also been cracked. Therefore, WPA is not recommended either. WPA2 is secure and should be the encryption method of choice for wireless networks. As with other forms of password management, the WPA2 pass phrase should be long and complex.

In addition to making sure that their wireless networks are secure, attorneys should ensure that third-party wireless networks that they use for client matters are protected by encryption. They should be protected by WPA2 and require a user name and password for access. This is particularly the case for public networks. Many security professionals and US-CERT (United States Computer Emergency Readiness Team) have recommended that public networks should not be used for confidential communications. If public networks are to be used, attorneys should obtain technical assurance that they are being securely used through protection such as a secure (https) connection to a trusted website or a virtual private network (VPN). A recent ethics opinion concluded that an attorney has an ethical duty to evaluate the security of a wireless network, home or public, before it is used for client communications and to take appropriate precautions in using it. California Formal Opinion No. 2010-179.

E-Mail

Particularly important to attorneys is the confidentiality and integrity of e-mails. Respected security professionals have for years compared e-mail to postcards or postcards written in pencil. They can be viewed or altered by third parties. While some ethics opinions have been incorrectly interpreted as saying that e-mail encryption is never required, current ethics opinions continue to stress the requirement of reasonable and competent safeguards. For example, California Formal Opinion No. 2010-179 states, “encrypting email may be a reasonable step for an attorney to take in an effort to ensure the confidentiality of such communications remain so when circumstance calls for it, particularly if the information at issue is highly sensitive and the use of encryption is not onerous.” Encryption is increasingly required in areas such as banking and health care and by new state data protection laws. As these requirements continue to increase, it will become more and more difficult for attorneys to justify their avoidance of encryption.

For e-mail, the term *encryption* is generally used to mean both encryption and the authentication process that are used, in combination, to protect e-mail. Encryption protects the confidentiality of e-mail. Authentication identifies the sender of an e-mail and verifies its integrity.

Encryption is a process that translates a message into a protected electronic code. The recipient (or anyone intercepting the message) must have a key to decrypt it and make it readable. Although it still takes some technical knowledge to set up, e-mail encryption is now easier to use than it once was.

Encryption generally uses a pair of keys to encrypt the e-mail. The sender uses the recipient’s public key to encrypt the e-mail and any attachments. Since the public key only encrypts the e-mail, it does not matter that it is available to the public or to various senders. The recipient then uses his or her private key to decrypt the e-mail. It needs to be safeguarded because anyone who has access to it can use it for decryption.

The process is easy to use once the keys are set up in an e-mail program such as Outlook (www.microsoft.com). The most difficult process is getting the keys (digital IDs) and making the public key available to senders. Once it is set up in Outlook, the sender just has to click on the Message tab in the Options group and click the Encrypt Message Contents and Attachments button. At the recipient’s end, the message will automatically be decrypted if his or her private key has been installed.

Digital authentication of e-mail also generally uses a key pair. The sender uses his or her private key to digitally sign the e-mail. The recipient then uses the sender’s public key to verify the sender and integrity of the message. In Outlook, after installation of the private key, the sender clicks the Options tab in the Permission group and clicks Sign Message. After the sender’s public key has been installed in the recipient’s compatible e-mail program, the recipient will receive an automatic notice of verification of the sender and integrity.

For protection of confidentiality and authentication, the sender’s and recipient’s key pairs are used in combination. The sender uses both the Encrypt Message and Attachments command button (that uses the recipient’s private key) and the Sign Message command (that uses the sender’s private key). At the receiving end, the e-mail program automatically uses the recipient’s private key to decrypt the messages and automatically uses the sender’s public key to verify authenticity and integrity.

Again, the challenging part is obtaining key pairs, exchanging public keys, and setting them up in the e-mail program for encryption. Keys are available from commercial public key authorities such as Verisign (now part of Symantec; www.verisign.com). Public key authorities have online directories where their customers’ public keys are available.

Another form of e-mail encryption is Transport Layer Security (TLS) encryption. It automatically encrypts e-mail between two e-mail gateways. If a law firm and client each have their own e-mail gateways, TLS can be used to encrypt automatically all e-mails between them. TLS encryption protects e-mails between e-mail gateways only. It does not protect e-mails within the sender's and recipient's networks and does not protect e-mail that is misaddressed or forwarded through other e-mail gateways.

Secure e-mail is also available from managed messaging service providers such as Zixcorp (www.zixcorp.com), Mimecast (www.mimecast.com), and DataMotion (www.datamotion.com). They provide e-mail encryption without the complexity of setting up and exchanging keys.

As an alternative to e-mail, confidential information can be exchanged by using secure file sharing and transfer options such Biscom (www.biscom.com) or Accellion (www.accellion.com) or by using add-on encryption (e.g., BoxCryptor with Dropbox or another cloud vendor).

Another alternative to encryption of e-mail is to give confidential information a basic level of protection by putting it in a password-protected attachment rather than in the body of the e-mail. File password protection in some software, such as current versions of Microsoft Office, Adobe Acrobat (www.adobe.com), and WinZip (www.winzip.com), uses encryption to protect security. It encrypts only the document and not the e-mail, so the confidential information should be limited to the attachment. It is generally easier to use than complete encryption of e-mail and attachments. However, the protection can be limited by the use of weak passwords that are easy to break or "crack." In addition, it should be obvious not to include the password for the attachment in the body of the e-mail message.

Electronic communications have now reached the point that most attorneys should have encryption available for use in appropriate circumstances. In addition to complying with any legal requirements that apply, the most prudent approach to the ethical duty of protecting confidentiality of electronic communications is to have an express understanding with clients about the nature of communications that will be (and will not be) sent by e-mail and whether or not encryption and other security measures will be utilized.

Conclusion

Encryption is now a generally accepted practice in information security for protection of confidential data. Attorneys should understand encryption and use it in appropriate situations. All attorneys should use encryption on laptops, portable storage media, smartphones, and tablets that contain information relating to clients. They should make sure that transmissions over wireless networks are secure. Attorneys should have encryption available for e-mail or secure file transfer and use it when appropriate. Although most attorneys will need technical assistance to install and set up encryption, use of encryption after that is generally easy.

IT IS BETTER TO ASK FOR PERMISSION THAN TO SEEK FORGIVENESS: *NICKSOLAT V. GHARAVI* AND THE EFFECT OF FAILING TO OBTAIN MORTGAGEE CONSENT IN THE REASSIGNMENT OF LIMITED COMMON ELEMENTS PURSUANT TO VIRGINIA CODE § 55-79.57

by John C. Altmiller*

The Circuit Court of Fairfax County has issued an opinion addressing the effect of the failure to obtain lender consent for the reassignment of a condominium parking space pursuant to Virginia Code § 55-79.57. The case, *Nicksolat v. Gharavi*, Case No. CL-2013-1659 (Fairfax County Circuit Court, Sept. 16, 2013), involved a dispute over a parking space that arose subsequent to a foreclosure sale. Applying the Condominium Act, the Court, found that the failure to obtain consent of the mortgage lender prior to the reassignment of the parking space rendered the reassignment a nullity.

FACTS

The facts in this case were almost entirely undisputed. The Plaintiff, Mandona Nicksolat ("Nicksolat"), purchased a unit (the "Unit") in the Rotonda Condominium (the "Rotonda") at a foreclosure sale conducted pursuant to a default under a valid deed of trust (the "Deed of Trust") encumbering the Unit at that time. The notice of the foreclosure sale stated that the Unit included the use of the limited common element known as Parking Space Number 145 (the "Parking Space"). In addition, both the memorandum of sale signed by the parties at the foreclosure and the deed into Nicksolat stated that the Unit included the exclusive use of the Parking Space. However, Nicksolat soon realized that the Parking Space was being used by another unit owner, Mohammad Gharavi ("Gharavi").

Gharavi claimed that he had purchased the Parking Space from the former owner of the Unit, Ali Vaezi ("Vaezi"), and that he had a reassignment of the Parking Space recorded in the land records to support his position. The evidence showed that Vaezi had sold the Parking Space to Gharavi, less than a year before his condominium unit was foreclosed upon. Because the sale of a parking space involves the reassignment of a limited common element, an amendment to the Rotonda's Declaration was required. Although the amendment reassigning the Parking Space had been duly executed by the condominium association and recorded among the Fairfax County land records, no one had contacted the mortgage lender to obtain its approval for the reassignment. When Gharavi was unwilling to relinquish the Parking Space, Nicksolat filed suit in Fairfax County Circuit Court.

THE LAWSUIT

The Complaint filed by Nicksolat against Gharavi and the Rotonda contained three counts. In the first count, Nicksolat sought a declaratory judgment determining that she was entitled to exclusive use of the Parking Space based upon her purchase of the Unit at the foreclosure sale. The second count was a claim for unlawful detainer, which sought the fair market rental value of the Parking Space during the time that Gharavi refused to deliver possession. Finally, Nicksolat sought relief pursuant to Virginia Code § 55-79.53, based upon Gharavi's failure to comply with the condominium instruments.

The claims for declaratory relief and rent were based upon the theory (i) that Vaezi lacked the authority to convey the Parking Space to Gharavi, or, alternatively, (ii) that the reassignment of the Parking Space was made subject to the Deed of Trust. In either event, Nicksolat claimed, the Parking

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Space was conveyed to her when she purchased the Unit. Nicksolat also sought money damages in the amount of the fair market rental value of the Parking Space pursuant to Virginia Code § 8.01-128.

In her claim for relief pursuant to § 55-79.53, Nicksolat asserted that the Rotonda's Declaration by its terms reserved the right to assign parking spaces "for the exclusive use of certain Unit Owners to whose Units these parking spaces shall be appurtenant." The Declaration further explicitly assigned the Parking Space to the Unit. By defeating her exclusive use of the Parking Space, Nicksolat claimed, Gharavi was in violation of the Declaration. Virginia Code § 55-79.53 allows an aggrieved unit owner to sue for injunctive relief and other remedies available at law or in equity against a unit owner failing to comply with the condominium instruments. The statute also permits recovery of attorney's fees for the prevailing party in such a suit.

THE PRIOR CASE: *SHEDADEH V. FOUNTAINS AT MCLEAN*

Supporting Nicksolat's position was a prior case decided in the Fairfax County Circuit Court. In *Shedadeh v. Fountains at McLean Condominium Unit Owners Association*, 79 Va. Cir. 103 (Fairfax County Circuit Court, 2009), the Court addressed the same issue upon virtually identical facts. The Plaintiffs in *Shedadeh* had purchased a condominium unit from Bank of America after the lender had foreclosed on the unit pursuant to a deed of trust. As in *Nicksolat*, the exclusive use of assigned parking spaces had been conveyed to the trustee under the deed of trust by the former owner of the unit but, prior to the foreclosure, the parking spaces had been reassigned. The positions taken by the parties in *Shedadeh*, and the trial court's analysis in that case, are instructive.

In *Shedadeh*, the Plaintiffs' arguments were essentially the same as those in *Nicksolat*. The Plaintiffs contended that:

- "[A]fter the deed of trust was recorded, [the former owner] retained only his right to use the parking spaces subject to the deed of trust. As a result, this right of use, subject to the deed of trust, was all that [the former owner] could transfer, assign or convey to Defendants."
- "[W]hen property subject to a deed of trust is purchased, the deed of trust operates to give the trustee priority over the purchaser. Thus . . . [the] trustee has the superior claim, and any subsequent purchasers have an inferior claim against the trustee."
- "[B]ecause [the trustee] recorded his deed first, prior to Defendants' recordation of the amended parking space assignments, [trustee's] deed of trust takes priority."
- "[O]nce the deed of trust was filed among the land records . . . the public had constructive notice that the condominium unit and the parking spaces were subject to the deed of trust," and "Defendants acted at their own peril by purchasing the right to use the parking spaces without first conducting a title search . . . [I]f Defendants had conducted a title search, they would have been aware of the fact that parking spaces could only be purchased subject to [the trustee's] deed of trust."
- "[W]hen the valid deed of trust was foreclosed on, the foreclosure extinguished any rights that were later transferred to Defendants."

The Plaintiffs' position, in summary, was that the parking spaces at issue were encumbered by the deed of trust, as would be the case with any property conveyed to a trustee pursuant to a deed of trust. Since the deed of trust was duly recorded, all subsequent purchasers of an interest in the parking spaces would be on notice of the trustee's superior interest. The Defendants' interest in the parking spaces was therefore subject to the trustee's right of foreclosure.

The Defendants argued that the trustee under the deed of trust had not received legal title (or any other rights) to the parking spaces at issue in that case, or that the trustee was subsequently divested of its interest in the parking spaces. Specifically, the Defendants claimed that:

- "[The owner] was not in a position to convey more than he owned in the deed of trust, and while he owned the unit, *he did not own the parking spaces*. The Association owns all limited common elements, including the parking spaces, and can assign or reassign them at their discretion. Thus, . . . while [the owner] could convey the unit in the deed of trust, he could not convey the limited common elements." [emphasis added]

- "[T]he parking spaces were only appurtenant to [the] condominium unit, unless and until they were detached from that unit in accordance with Virginia Code § 55-79.57. [T]he amendments to the condominium instruments signed by [the former owner], Defendants, and the Association followed the procedure outlined in [Virginia] Code § 55-79.57. [T]hese amendments became effective when recorded, before the foreclosure occurred. Therefore . . . the parking spaces had been reassigned to their units and could not be foreclosed on under the deed of trust because they were no longer appurtenant to the conveyed unit."

The Defendant's position, in summary, was that (i) the former owner could not have validly conveyed the appurtenant interest in the limited common element because the former owner did not possess fee simple title in the parking spaces, and (ii) even if such a conveyance would be validly made, that property interest could be defeated by a reassignment made in compliance with the procedures set forth in § 55-79.57.

The trial court recognized that the question of "whether the parking spaces or the right to use the parking spaces could be conveyed . . . in the deed of trust" was a matter of first impression in Virginia. After observing that the property conveyed to the trustee was described exactly as it was described in the deed into the former owner of the unit, including the reference to the parking spaces, the trial court held that "persuasive authority" supported the conclusion that the former owner could convey the right to use the parking spaces in the deed of trust. The trial court cited *15A Am. Jur. 2d Condominiums and Cooperative Apartments §30 (2009)*, which states that "limited common elements become appurtenant to unit and are conveyed with that unit." Essentially, if a unit owner has the power to convey the unit and the appurtenant interest in the limited common element to a subsequent purchaser, then he or she has the power to convey the unit in the appurtenant interest to a trustee pursuant to a deed of trust. In taking this approach, the trial court observed:

> Had [the former owner] discharged his debt, each defendant would have possessed the exclusive right to use the parking spaces. However, until [the former owner's] debt was discharged, Defendants' claims to the parking spaces were inferior to [the trustee's] claim. Given that [the trustee] had the superior claim to use of the parking spaces, when the deed of trust was foreclosed on, Defendants' rights to the parking spaces were likewise foreclosed on and extinguished. As of the date of foreclosure, Defendants were divested of their interest in the parking spaces, and [the trustee] acquired the exclusive right to the use of the parking spaces.

Shedadeh, pp. 9-10. Again, the court simply treated the appurtenant interest in the parking spaces as it would treat any property subject to a deed of trust. That is, subsequent transfers of the property *are not invalid*, but they *are subject to* the trustee's right of foreclosure under the deed of trust. This is an important distinction in light of how the Court ultimately ruled in *Nicksolat*.

Interestingly, the court in *Shedadeh* did not address the apparent argument made by the Defendants that compliance with § 55-79.57 as a matter of law detaches the parking spaces from the unit, and therefore *per se* defeats any subsequent foreclosure.

THE TRIAL

Trial in *Nicksolat* was held on August 7, 2013. After Plaintiff's opening statement, it became clear that most of the pertinent facts were being stipulated by the parties. During Gharavi's opening statement, the Court engaged counsel in a colloquy regarding the legal issues at the heart of the case. At that point, the parties presented their legal arguments concerning the validity of the reassignment and whether the Parking Space was subject to the Deed of Trust.

Unlike the defendants in *Shedadeh*, Gharavi stipulated that the conveyance under the Deed of Trust was valid. Rather than arguing the validity of the conveyance to the trustee, Gharavi contended that compliance with the procedures and terms set forth in § 55-79.57 had the legal effect of separating the Parking Space from the Unit, thereby defeating the trustee's interest in the Parking Space. Gharavi pointed out that this section sets forth the specific procedure for amending the Declaration to reassign the Parking Space, and that consent of the lender or trustee under a deed of trust is not required. Gharavi argued that the section's unequivocal statement that the amendment "shall become effective when recorded" further supported his interpretation of the statute.

Nicksolat's analysis was substantially the same as that of the court in *Shedadeh*. The reassignment of the Parking Space was valid, she claimed, subject to the rights of the trustee under the Deed of Trust. Under this analysis, there was no dispute that the amendment "became effective when recorded." In fact, it was not essential to the success of Nicksolat's claim that the amendment be deemed void or ineffective; rather, all that was necessary was a recognition by the Court that any such amendment was made subject to the rights of the trustee.

The Rotonda supported Gharavi's position. Apparently, as a matter of procedure, the Rotonda did not inquire as to whether there were any existing deeds of trust prior to executing and recording an amendment reassigning a parking space, nor did it require any representation from the unit owner regarding such deeds of trust. The Rotonda contended that the law required no such inquiry, and certainly did not require any lender or trustee consent. Specifically, the Rotonda called the Court's attention to the fact that, under Virginia Code § 55-79.57(B), an amendment to the Declaration reassigning a limited common element involves no discretion on the part of the condominium association. Further, it noted that that other sections in the Condominium Act require mortgagee consent, while no such consent is required for the reassignment of a limited common element pursuant to § 55-79.57.

The Court took the matter under advisement in order to analyze the effect of any other sections in the Condominium Act requiring mortgagee consent. Nicksolat and Gharavi had each prepared a trial memorandum setting forth their respective positions; however, neither memorandum addressed this issue raised by the Rotonda. Because the outcome of the Court's analysis might have rendered Nicksolat's claims for rent and attorney's fees moot, the Court deferred the presentation of evidence on those matters until ruling had been issued regarding the parties' respective rights regarding the Parking Space.

After trial, the Court requested that the parties submit briefs regarding the applicability of Virginia Code § 55-79.73:1, the only section of the Condominium Act which addresses mortgagee consent. On September 16, 2013, after all parties had submitted briefs on this issue, the Court issued its memorandum opinion.

THE OPINION

The Court's analysis focused on § 55-79.73:1. Subsection A of this section applies to circumstances in which consent of the mortgagee is required by the condominium instruments, and provides a procedure for obtaining implied consent. Since the Rotonda Declaration did not require written consent from the mortgagee, this subsection is not applicable. Subsection B provides an exception to the procedures set forth in subsection A, and is similarly inapplicable. Subsection C, however, would determine the outcome of the case.

Subsection C states: "Where the condominium instruments are silent on the need for mortgagee consent, no mortgagee consent shall be required if the amendment to the condominium instruments does not specifically affect mortgagee rights." The Court reasoned:

> This subsection uses a double negative: if written consent is not required by the instrument, consent is not needed *unless* the instrument affects mortgagee rights. But if mortgagee rights *are* "specifically affect[ed]," then written consent *is* required.

Nicksolat, p. 5. There was no dispute that the reassignment of the Parking Space, if given the effect claimed by Gharavi and the Rotonda, would have significantly affected the mortgagee's rights. As the Court observed, "[a]s this litigation proves, Defendant Gharavi has interfered with the interest that Plaintiff bought in the Parking Space by maintaining that it is his parking space per the agreement with Mr. Vaezi."

Having established the applicability and effect of Virginia Code § 55-79.73:1, the Court proceeded to address the two arguments advanced by Gharavi and the Rotonda: (i) that § 55-79.57 provides the exclusive method through which limited common elements are assigned, and (ii) that the condominium instruments do require mortgagee consent in some circumstances but not in others, such that § 55-79.73:1(C) is inapplicable.

The Defendants pointed out that § 55-79.73:1 is a generally applicable statute (having no specific application to the reassignment of limited common elements), while § 55-79.57 is a more specific provision. As such, the Defendants argued, the specific provisions of § 55-79.57 supplant the general rule stated in § 55-79.73:1. Although the Defendants' argument focused on the procedures set forth in subsection B of § 55-79.57, the Court found the answer to this question in subsection A, stating:

> However, Defendants take an overly narrow view of the procedures applicable to assigning a limited common element under § 55-79.57. The explicit language of that Code section requires that "[n]o limited common element shall be assigned or reassigned except in accordance with the provisions of this chapter." Va. Code § 55-79.57(A). The text does not say *section;* instead, it says *chapter;* section 55-79.73:1 is a provision within the same chapter, and it is precisely because it is a generally applicable section that it must be read in concert with § 55-79.57.

Nicksolat, p. 5. Further, since there is no reference in § 55-79.57 as to the requirements of mortgagee consent, there is no specific rule supplanting the general rule regarding mortgagee consent contained in § 55-79.73:1(C). Finally, in response to the argument that the Rotonda lacked discretion under the statute to wait until mortgagee consent before executing and recording the amendment, the Court stated:

> When Mr. Vaezi failed to obtain the consent of the Trustees before reassigning the Parking Space, he violated § 55-79.73:1(C), which waived his right under § 55-79.57(8) to assign the Parking Space. *This rendered the subsequent assignment a nullity.* Nothing in § 55-79.57—which itself requires assignment to occur "in accordance with the provisions of this chapter'"—suggests that the strict requirements of § 55-79.73:1 can be ignored.

Nicksolat, p. 5 (emphasis added).

DISCUSSION

The opinion in *Nicksolat* is notable not so much for the outcome but for the reasoning of the Court and the logical conclusions that flow from that reasoning. Although Nicksolat had pleaded alternatively that the reassignment of the Parking Space was either ineffective *ab initio* or merely subject to the foreclosure rights under the Deed of Trust, her argument at trial focused primarily on the second approach. Since Gharavi had conceded that the appurtenant rights to the Parking Space had been validly transferred to the trustee, the argument at trial ultimately came down to whether or not the provisions of § 55-79.57 could act to unilaterally divest the trustee of those rights.

The appeal of making the "subject to" argument, as opposed to the "void *ab initio*" argument, was that it took almost all of the punch out of Gharavi's contentions regarding § 55-79.57. Gharavi was asserting that the statute, by its language, granted special powers to a unit owner to sell his parking space at any time, despite it being subject to a deed of trust, without any repercussions. In fact, he argued that the trustee of the deed of trust received the appurtenant rights to a parking space with full knowledge that it might subsequently be unilaterally divested of those rights under the statute.

By taking a more conservative approach, Nicksolat granted the Defendants most of their points without granting them their outcome. Yes, the Rotonda had no discretion except to sign and record the amendment once the interested unit owners requested that it do so. Yes, that amendment became effective upon its recordation. Yes, if Vaezi's loan had been paid off and the Deed of Trust released, Gharavi would have an unencumbered appurtenant right to use the Parking Space. But the transfer still remained subject to the Deed of Trust. Further, there is nothing controversial or revolutionary about such a position. For example, I may sell my house even though it is subject to a mortgage; the deed to the new owner, having been recorded among the land records, will be effective. In the event of a default on that mortgage, however, the new owner's interest in the house will be subject to the right of the trustee to foreclose. This was the conclusion of the trial court in *Shedadeh*.

Because the Rotonda raised at trial the applicability of other provisions of the Condominium Act relating to mortgagee consent, the Court in *Nicksolat* determined that § 55-79.73:1 was not merely relevant to the analysis of the case, it was dispositive. Neither Nicksolat nor Gharavi asserted the relevance of that statute in their pleadings or trial memoranda, and the statute was nowhere addressed in the *Shedadeh* opinion. Furthermore, if the reassignment in this case was a nullity as a result of the failure to obtain mortgagee consent pursuant to § 55-79.73:1, this would also be true even if the foreclosure sale had never occurred. In other words, even if the loan was paid off and the Deed of Trust released, Gharavi would never have had an interest in the Parking Space.[1]

More important, the same result would appear to obtain for any reassignment of a limited common element (i) occurring in Virginia (ii) during the applicability of the relevant statutes (iii) in which the limited common elements being transferred was subject to a deed of trust, and (iv) for which consent from the mortgagee was not obtained. Therefore, the ruling in *Nicksolat* would appear to cast doubt upon the validity of all transactions meeting the above criteria. It is also unclear whether such transactions could be rendered valid after the fact, and, if so, by what procedure this could be

[1] The editor, like the author, is troubled by this language of the opinion. Let's try a little *reductio ad absurdum*: A owns Blackacre, which borders on a public way. A grants B, owner of Whiteacre, an easement across Blackacre to reach B's property, situated behind A. B encumbers Whiteacre with a deed of trust that includes the language "together with" the easement. A then sells C Greenacre, to the rear of Whiteacre, and grants C the right to use, in common with B, the aforesaid easement. B joins in the grant to C. The access easement is entirely on Blackacre, forming the western boundary of Blackacre, Whiteacre, and Greenacre. B then defaults, and the bank forecloses. Because C's "right to use" was recorded after the deed of trust, by the language of the *Nicksolat* opinion, C would have no right of access over that portion of the easement that bordered Whiteacre without the consent of B's foreclosure purchaser (and presumably, the subsequent lender).

BTW, for those of you who had forgotten about Blackacre and Whiteacre since passing the bar exam, well, you're welcome. And no, this isn't the same Green Acres owned by Oliver Wendell Douglas. (The rest of you can look it up when you get home.)

accomplished. This is one of those times when it is better to be a trial attorney than a transactional attorney.

EPILOGUE

After the opinion in *Nicksolat* was issued, an evidentiary hearing was held with regard to the claims for rent and attorney's fees. After hearing evidence regarding the fair market monthly rental value of the Parking Space, the Court awarded damages on Nicksolat's claim with regard to unlawful detainer. At the conclusion of the Plaintiff's evidence, Gharavi made a motion to strike with regard to the claim for attorney's fees, arguing that Nicksolat's claim was for declaratory relief and unlawful detainer, rather than a violation of the condominium documents.

Nicksolat argued that it was the Declaration that granted her exclusive use of the Parking Space, and that this action rested entirely upon her rights under the Declaration and the Condominium Act. She further asserted that Gharavi's actions in depriving her of that exclusive use constituted a violation of the parties' respective rights and obligations under the Declaration. Because Nicksolat's right to exclusive use of the Parking Space, and her right to fair market rent, arose solely from the Declaration, the lawsuit necessarily involved enforcement of her rights thereunder. However, the Court concluded that Nicksolat's claims were not for violations of the Declaration, and that attorney's fees were therefore not recoverable.

**INTERNET BANKING, EMPLOYEE EMBEZZLEMENT,
AND BANK SECURITY PROCEDURES**

by Vincent I. Holzhall*

Back in the "old days," when dishonest employees pilfered paper checks from their employers' safes, lockboxes and desk drawers, courts considered a list of factors to determine who, as between the bank and the employer-consumer, should bear the risk of loss for that embezzlement. For example, evidence that an employer kept blank paper checks in an unlocked desk drawer might lead the court to conclude that the employer failed to exercise sufficient financial controls, and that he—rather than the bank—should bear the risk of loss. Thus, where paper checks are at issue, attorneys and judges have a number of classic examples, set forth in the Official Comments of the Uniform Commercial Code ("UCC"), case law and treatises, to guide their analyses as to where the risk of loss might lie.

With the rise of Internet banking ("e-banking"), bank customers are increasingly transferring funds electronically. For the most part, electronic transactions pass through the Automated Clearing House ("ACH") network and are governed by rules and guidelines adopted by the National Automated Clearing House Association ("NACHA"). While the relationships between and among the various regional payment associations and financial institution members are governed by NACHA rules and guidelines, the relations between banks and their customers are governed by federal and state law. Generally, issues between consumer customers and their banks regarding electronic fund transfers are governed by the federal Electronic Fund Transfer Act ("EFTA"), 15 U.S.C. § 1693 *et seq.*, while issues between commercial customers and their banks are governed by Article 4A of the UCC (funds transfers), as adopted by the various states.

Because most dishonest employees embezzle funds from the bank accounts of their commercial-entity employers, Article 4A of the UCC will likely apply to those employers who find themselves in a dispute with their bank concerning funds embezzled by electronic means. In a recent case decided by the U.S. Court of Appeals for the First Circuit, *Patco Construction Company, Inc. v. People's United Bank*, 684 F.3d 197 (1st Cir. 2012), the court examined the kinds of "commercially reasonable security procedures" offered by a bank to protect its customers' electronic transactions. *Id.* at 209 (quoting U.C.C. § 4-1202(3) cmt. 3). Ultimately, the First Circuit found the bank's security to be lacking.

While a First Circuit decision is law only within the First Circuit, the *Patco* decision is worth analyzing because it is one of the first to examine e-banking security in depth. As such, the decision provides helpful guidance to banks and employers.

In *Patco*, the court began by examining the security authentication methods for Internet-based financial transactions identified by the Federal Financial Institutions Examination Council ("FFIEC") in its October 2005 guidance document, "Authentication in an Internet Banking Environment" ("FFIEC Guidance"). The court relied on the FFIEC Guidance and found that single-factor authentication tools such as passwords and PINs are inadequate where those tools are the only control mechanism for "high-risk transactions involving access to customer information or the movement of funds to other parties." *Patco*, 684 F.3d at 202. The court then examined the bank's security procedures as they related to its customer, Patco Construction Company.

The court found that the bank's internal security procedures had indeed identified the fraudulent electronic transfers at issue as "high risk" because:

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(1) the transfers were initiated from a computer never previously used by Patco for electronic transfers;

(2) the funds were transferred to accounts to which Patco had never sent funds electronically in the past;

(3) the amount of each fraudulent transfer was in a range higher than Patco's normal third-party transactions; and

(4) the transactions generated high risk scores by the bank's risk-scoring engine.

The court was troubled by the finding that, although the bank had established certain security procedures beyond passwords and PINs for a flagged high-risk transaction, it nevertheless "neither monitored that transaction nor provided notice to customers before allowing the transaction to be completed." *Id.* at 211.

In addition, the court noted the bank had actual knowledge that, in 2008, other banks had experienced a substantial increase in Internet banking fraud involving keylogging malware. Also, in 2009, the bank itself was the victim of two incidents of electronic banking fraud. Although these incidents did not involve the bank customer at issue (Patco Construction Company), the court found that these incidents made it "especially unreasonable" for the bank to do nothing in response to the identified high-risk transactions on Patco's account involving the movement of funds to other parties. *Id.* at 213. In light of all the problems identified, the court concluded that the bank's failures, taken as a whole, rendered the bank's electronic security procedures commercially unreasonable.

As the commercial world moves away from paper check transactions and embraces electronic fund transfers, banks will need to keep pace with commercially reasonable security procedures. Although security procedures involving electronic fund transfers will undoubtedly need to be updated and refined as technology advances, one overarching theme articulated by the court in *Patco* was that banks should follow its security measures already in place and act upon information within the bank's systems.

EB-5 CAPITAL FOR COMMERCIAL REAL ESTATE DEVELOPMENT

by Richard B. Chess [*] and Shae Armstrong [**]

A. WHY EB-5?

Do your clients need a new source of capital for their commercial real estate developments? Under the federally-administered Immigrant Investor Program, (also known as the "EB-5 Investor Program"), if a foreign national invests in new commercial development that creates at least ten permanent jobs, he or she may be eligible for $500,000.00 to $1,000,000.00 of capital for each block of ten new permanent jobs created. Although the process of accessing this source of capital is lengthy and in some cases complicated, the capital itself may be used more flexibly than that which is typically available in the investment market. The EB-5 Investor Program is underutilized; not once since the Program's inception in 1990 has the U.S. Citizenship and Immigration Service ("USCIS") reached its 10,000 annual maximum EB-5 visa allocation.

B. HISTORY

In 1990, Congress created the Immigrant Investor Program in an effort "to stimulate the U.S. economy through job creation and capital investment by foreign investors." "EB-5 Immigrant Investor," U.S. CITIZENSHIP & IMMIGRATION SERVS.[1] The EB-5 Investor Program permits a foreign national to obtain U.S. permanent resident ("green card") status by investing in a new commercial enterprise. The foreign investor's spouse and unmarried children under the age of 21 may also be eligible for green cards, under derivative status. USCIS, a component of the U.S. Department of Homeland Security ("DHS"), oversees the EB-5 Investor Program. EB-5 investors may be eligible for an EB-5 immigrant visa if they have invested—or are actively in the process of investing—the required amount of capital into one of the following for-profit business-types:

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[1] http://www.uscis.gov/working-united-states/permanent-workers/employment-based-immi gration-fifth-preference-eb-5/eb-5-immigrant-investor.

- A new commercial enterprise (defined as a commercial enterprise created after November 29, 1990);
- An enterprise which will expand to 140 percent of pre-investment net worth or number of employees; or
- A troubled business in which jobs will be preserved.

Because the vast majority of these investments are in new commercial enterprises, this overview of the EB-5 Investor Program will examine only this particular path to EB-5 eligibility.

The EB-5 Investor Program features two key requirements. First, the foreign investor must make a minimum investment of $1,000,000.00. Importantly, the minimum investment amount may be reduced to $500,000.00 if the new commercial enterprise is located within a "targeted employment area" (TEA). An area is designated a TEA if its unemployment rate is at least 150 percent of the national average or if it is located within a rural area. For EB-5 purposes, a rural area is any area outside either a metropolitan statistical area ("MSA") or the boundary of any municipality that has a population above 20,000.

The Virginia Employment Commission ("VEC") is the state authority charged with certifying which geographic areas or political subdivisions qualify as TEAs, as defined by 8 C.F.R. § 204.6(e)(i), (e)(ii), f(2), f(3). The VEC website[2] provides a map showing areas in Virginia that are currently designated as TEAs, as well as a downloadable spreadsheet which identifies by census tract those locations which qualify as TEAs.

The second key requirement of the EB-5 Investor Program is that the investment must create full-time employment for not fewer than ten individuals who are either United States citizens, aliens lawfully admitted for permanent residence, or other immigrants lawfully authorized to be employed in the United States (excluding the immigrant investor and the immigrant investor's spouse and children).

C. THE EB-5 IMMIGRATION PROCESS

The EB-5 immigration process informally commences when a foreign investor deposits the requisite funds into the escrow account of a "regional center" or direct investment project. Subsequent to the escrow of investment funds, the petitioning immigrant investor applies for conditional permanent residency status by submitting Form I-526, *Immigrant Petition by Alien Entrepreneur*, to USCIS. Conditional permanent resident status permits the immigrant investor and qualified family members to reside in the United States during the pendency of the investor's petition. As of the date of this article, processing times for I-526 petitions range from eight (8) to sixteen (16) months. Once the I-526 petition is approved, the petitioner proceeds in one of two ways. If the investor is presently in the United States because of other nonimmigrant status, then he must apply to adjust his status by submitting Form I-485, *Application to Register Permanent Residence or to Adjust Status*, to USCIS. Alternatively, if the investor resides outside the United States, he must submit Form DS-230, *Application for Immigrant Visa and Alien Registration*, to the U.S. Department of State for consular processing. Consular processing is the more elaborate of these two paths as it requires an in-person interview at a designated U.S. consulate or embassy in the investor's country of origin.

Following Form I-526 approval and grant of lawful entry into the United States, the investor is accorded two years of conditional permanent resident status. During this period, the investor must demonstrate an actual intent to immigrate, through such actions as opening a U.S. bank account, obtaining a driver's license or social security number, paying state and federal income taxes, and renting or buying a home.

Ninety days prior to the end of the two-year conditional status period, the investor must submit Form I-829, *Petition by Entrepreneur to Remove Conditions*, requesting that the conditions on his residency be

[2] https://www.vawc.virginia.gov/gsipub/index .asp?docid=465

removed. If USCIS determines that the investor has satisfied the EB-5 requirements discussed in this section, then the conditions are removed and the investor obtains permanent resident status. Processing times for Form I-829 petitions are far shorter than those for Form I-526 processing.

After maintaining five years of U.S. permanent resident status, an investor may be eligible to petition for U.S. citizenship.

Additionally, for an investor to be eligible for immigration through EB-5 investment, his investment must satisfy the following requirements:

1. New Commercial Enterprise: The enterprise in which the investor invests must have been established after November 29, 1990;
2. Minimum Investment Amount: The investor must personally invest $1 million dollars into the new commercial enterprise, unless (as previously discussed) the investment is located in a "targeted employment area," in which case the minimum investment is lowered to $500,000, 8 C.F.R. § 204.6(j)(6);
3. Evidence of Investment: The investor must demonstrate that he has invested the full amount of his capital into the new commercial enterprise, 8 C.F.R. § 204.6(j);
4. Creation of Not Fewer than Ten EB-5 Qualifying Jobs: USCIS requires that each EB-5 investment result in the creation of no fewer than ten full-time (35 hours per week) jobs at the minimum wage level for qualified U.S. workers;
5. Capital Available to Employment Creating Activity Requirement: USCIS has emphasized the requirement that all of the Petitioner's capital must be available to the job creating entity, 8 C.F.R. § 204.6(e);
6. Capital "At Risk" and "For Profit": The investor must demonstrate that the full amount of the capital invested into the new commercial enterprise is "at risk" for the purpose of generating a return on that capital, 8 C.F.R. § 204.6(j);
7. Lawful Source of Funds: The investor must demonstrate that the investment funds have been gained from lawful sources, 8 C.F.R. § 204.6(j); and,
8. Active Management: "To show that the petitioner is or will be engaged in the management of the new commercial enterprise, either through the exercise of day-to-day managerial control or through policy formulation, as opposed to maintaining a purely passive role in regard to the investment. However, if the petitioner is a limited partner and the limited partnership agreement provides the petitioner with certain rights, powers, and duties normally granted to limited partners under the Uniform Limited Partnership Act, the petitioner will be considered sufficiently engaged in the management of the new commercial enterprise," 8 C.F.R. § 204.6(j)(5).

D. DIRECT VS. REGIONAL CENTER INVESTMENT

An investor may use either of two models for his EB-5 investment:

1. Basic EB-5 Investor Program: Requires direct investment into a new commercial enterprise.

2. Immigrant Investor Pilot Program ("Regional Center Program"): The investor makes an investment through a USCIS-approved "regional center" that in turn funds various projects underwritten by the regional center.

Congress created the Regional Center Program in 1992, *see* Pilot Immigration Program, Pub. L. No. 102-395, § 610 (October 6, 1992), and recently extended the program through September 30, 2015.[3]

A regional center is not merely a defined geographic area; rather, it is a business entity that coordinates foreign investment within its USCIS-approved geographic area. EB-5 requirements for an investor in the

[3] Notably, this law received unanimous approval in the U.S. Senate and passed in the U.S. House by a vote of 412 to 3 (nays included two Texas Representatives, Rep. Louie Gohmert and Rep. Ron Paul).

Regional Center Program are essentially the same as those for an investor in the basic EB-5 investor program, except that the Regional Center Program's job creation requirement for investment eligibility accounts for "indirect" and "induced" jobs as well as ordinary "direct" jobs, and is thus less restrictive.

Direct jobs are actual, identifiable jobs for qualified employees generated by the new project in which the investor has invested his or her capital. Indirect jobs are jobs within the same industry as the new project that are created as a result of the investor's capital investment in the project. Induced jobs are those created when employees associated with the new project spend their salaries in the local economy (for example, by purchasing real estate or consumer goods and services).

The number of indirect and induced jobs created through an EB-5 investor's capital investment is estimated based upon a business plan and a detailed economic analysis. USCIS evaluates this information when reviewing an EB-5 investor's petition for conditional residency status pursuant to his investment in a regional center. Because a regional center's job creation figures account for indirect jobs and induced jobs as well as direct jobs, investing in a regional center increases the total investment offering available per project. (By contrast, non-regional center direct investment may only account for direct jobs; this limits the amount of EB-5 capital that can be raised.)

Regional centers must submit annual filings with USCIS and are required to maintain audited financials; such compliance measures encourage transparency with respect to regional centers' financials and operations.

Currently, eight EB-5 regional centers are authorized to operate in portions of the Commonwealth of Virginia. An updated list is available at www.uscis.gov/eb-5centers.

The Association to Invest In USA ("IIUSA") is the largest trade group for regional centers. The IIUSA has recently published a document recommending best practices for EB-5 regional centers. *Recommended Best Practices*, IIUSA, *available at* http://iiusablog.org/milestones/iiusas-newly-recommended-practices-eb5-regional-centers/. This guide is useful for determining which EB-5 regional center in a given market best suits the needs of your particular client.

E. SECURITY ISSUES RELATED TO EB-5

1. Securities 101: Securities transactions in the United States are regulated at the federal *and* the state level (at the state level, these are referred to as "blue sky" laws or regulations). Section 5(a) of the Securities Act of 1933 (the "Securities Act"), as amended, states that *all* securities offered in *interstate* commerce must be registered with the Securities and Exchange Commission ("SEC") unless an exemption to registration applies. Key to the regulation is *disclosure of material information*, with registration (at the state or federal level) being the primary means of ensuring disclosure. As with any offering, issuers must comply with the antifraud and civil liability provisions of the Securities Act as well as the Securities Exchange Act of 1934, as amended, which require disclosure of material information related to the investment.[4]

2. Regulation D: Regulation D is promulgated under Section 4(2) of the Securities Act, which provides an exemption from registration for "transactions by an issuer not involving any public offering." Regulation D offerings are sold primarily to accredited investors. The definition of accredited investor has been adjusted, such that the value of an investor's primary residence is no longer considered part of the investor's net worth (which still must be at least $1 million). The accredited investor standard can also be met if the investor has an annual income of $200,000 or, with his spouse, a combined annual income of $300,000. It can be challenging to ascertain the accredited status of foreign nationals when their assets and the sources thereof are not subject to the same confirmation processes applicable in the United States.

[4] See http://www.sec.gov/info/smallbus/qasbsec.htm for a good overview of SEC issues and options, and http://www.scc.virginia.gov/srf/bus/smbus.aspx for a similar overview by the Virginia SCC.

When a Regulation D Section 506 offering is to be distributed in Virginia, a notice must be submitted to the State Corporation Commission ("SCC"). A Regulation D offering can be used to raise capital in multiple states, subject to relevant "blue sky" rules, and is not limited in size. Regulation D offerings are permitted to have up to thirty-five non accredited investors. However, non-accredited investors must be "sophisticated," either alone or in conjunction with a "purchaser representative." The JOBS Act allows for public advertising and general solicitation of investors in a Regulation D offering if all investors are accredited. Securities offered and sold under the Regulation D exemption are highly restricted in their ability to be resold without registration or an exemption—so if ease of transfer of interests is important, other options may be more attractive.

3. Regulation S: The SEC has no jurisdiction over sales of securities which occur outside the United States. This exemption to the Securities Act is codified in Regulation S. It is possible that the SCC, focused on the mere fact that a sponsor is organized as an entity in the Commonwealth, could claim jurisdiction over a Regulation S securities offering.

An issuer can rely on exemption from registration based on use of either Regulation D or Regulation S. The difficulty in crafting your approach will be determined largely by the manner in which the sponsor markets the offering. Rule 902(c)(3) of the Securities Act specifies what marketing is permitted in the United States under Regulation S (virtual access to marketing events occurring outside the United States and visits to the subject development in the United States).

4. Broker Relations: All securities broker dealers ("BDs") operating in the United States must be members of the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization which is required to have all of its major rules approved by the SEC. FINRA has issued guidelines as to what BDs should consider in their analysis regarding investor suitability.[5]

5. JOBS Act Implications: On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act ("JOBS Act"). In September 2013, the SEC enacted seventy-two pages of regulations covering the general solicitation of investors for Regulation D offerings. FINRA and the North America Securities Administrators Association ("NASSA") – of which the SCC is a member— have not issued their regulations regarding general solicitation of a Regulation D offering. While general solicitation of a Regulation D offering is now legal, it is recommended that one not rely on this exemption until all regulatory entities with an impact on the process have issued their final positions.

F. STATISTICS

The number of regional centers has more than doubled over the last few years; presently, there are over 300 USCIS-approved regional centers in the United States. Approximately 10,000 Form I-526 and I-829 filings are allocated for EB-5 investment. As of the fourth quarter of 2013, USCIS disclosed that over 6,000 Form I-532 petitions and about 1,000 Form 1-829 petitions were pending review. According to USCIS, historically around eighty percent of Form I-526 petitions and around ninety percent of Form I-829 petitions, have been approved.

Immigrant investors originating from the People's Republic of China consistently account for the vast majority of EB-5 visa applicants. In recent years, however, increasing numbers of EB-5 investors have come from other countries, including Brazil, Iran and Mexico.

[5] For details, see: http://iiusablog.org/government-affairs/finra-issues-guidance-suitability-rule-eb5-securities-transactions/ and http://www.eb-5lawblog.com/2013/09/19/finra-raises-the-bar-on-due-diligence-by-broker-dealers-involved-in-eb-5/

G. EB5 ROLE IN REAL ESTATE FINANCE

EB-5 capital can be structured as either debt or equity. Most structures position the EB-5 capital as unsecured debt; this affords the developer maximum ownership of the development. Moreover, because it is non-secured, some primary lenders will allow this additional debt as long as the total debt percentage does not exceed a certain negotiated amount. The EB-5 investor receives a return in the low single-digit range (typically two to four percent), paid on the back end (typically after five years), with the fully loaded cost to the developer in the high single-digit range (currently around nine percent). In today's market, there is no upside participation required for the investor.

H. UTILIZING EB-5 CAPITAL AND REGIONAL CENTERS.

EB-5 is uniquely well-suited for situations where there is a gap in the capital stack for a proposed commercial real estate development between the equity the developer has available and the level of debt offered by the prospective lender. The proposed development needs to meet the criteria detailed above for permanent job creation, so it works best on high-head count business uses, such as full service hotels, restaurants and hospitals. Locating the development in a TEA allows for smaller size investments. A development with a known "flag" (e.g., Marriott, McDonalds, Mayo) encourages quicker acceptance by off-shore investors. A development located where there is a significant population of first-generation Americans is also valuable, as that population can promote the new development opportunity to their friends in the old country.

I. EB-5 AND VIRGINIA

To date, the EB-5 Investor Program has not been a major source of capital for real estate developments in Virginia. Assigning the VEC responsibility for the TEA designation process will likely increase use of the Program as a vehicle for economic development, but this transition has occurred only in the last year. Information about the EB-5 Investor Program is not featured in the marketing materials for most jurisdictions in Virginia; based on a random survey of municipalities, it appears that lack of knowledge about the Program is the primary reason for this. Nonetheless, several new EB-5 projects in Virginia have been announced this year, so acceptance of EB-5 capital appears to be increasing in the Commonwealth.

J. HOW TO FIND A REPUTABLE REGIONAL CENTER

Prospective immigrant investors searching for regional center opportunities should first consider a given regional center's reputation. An investor should inquire about a regional center's previous projects, success rates of both EB-5 projects and non-EB-5 projects, the regional center's history and background, the number of EB-5 related petitions approved and denied, and the project's key management. Further, investors should be wary of EB-5 information published on the Internet through blogs and websites, as much of this information is inaccurate and misleading.

Before investing, investors should consider hiring a third party contract lawyer (one not associated with a regional center) in order to thoroughly review the private placement memorandum and associated investment documents, and to ensure that they fully understand the duties and obligations of all parties involved. Additionally, an investor should properly vet any attorney before retaining their services for EB-5 immigration. Because EB-5 immigration accounts for an extremely small portion of overall U.S. immigration, even many experienced immigration lawyers have never handled a single EB-5 file. Thus, EB-5 investors should inquire about an attorney's prior EB-5 legal experience before formally retaining him or her.

K. CONCLUSION.

EB-5 may be "the right answer at the right time" for commercial real estate development clients seeking a new source of reasonably priced capital.

CUT THE (RECORDING) LINE: eRECORDING IN FAIRFAX COUNTY, VIRGINIA

by Mark W. Graybeal[*]

In 2006, the Virginia Legislature enacted the Uniform Real Property Electronic Recording Act,[1] thereby providing the legislative framework for Virginia courts to implement their own eRecording Systems. In Northern Virginia, Circuit Courts in two counties implemented eRecording Systems: Fairfax County and Loudoun County. This article will focus exclusively on the Fairfax County eRecording System—in particular, how real estate practitioners electronically record documents in the Fairfax County Circuit Court Land Records.

THE SETUP

One of the most surprising aspects of the eRecording System is that its use requires minimal hardware and software. According to Fairfax County, the system requires only the following:

- A document scanner that can produce scanned images in 300 DPI and save those images in .TIF format; and
- A computer with access to the Internet and with Adobe Reader, Adobe Flash Player, and AlternaTIFF (which is a TIFF image viewer for Windows) installed.[2]

Once you have the above configuration, the next step is to apply for a free eRecording account with Fairfax County. Title companies, law firms, mortgage companies, and lenders are all eligible to sign up for the service. Companies must sign a Business Subscriber Agreement and each individual user must complete an Individual Subscriber Application. Anyone interested in applying for an account can obtain the necessary application forms at http://www.fairfaxcounty.gov/courts/circuit/efs.htm .

After the application is submitted and approved, the Fairfax County Circuit Court IT Department will assign a username, a login password and a VeriSign ID Protection (VIP) Token. This token, similar to other security key fobs, generates a randomized passcode each time the user logs in to the system, creating a two-factor authentication system.

With both the hardware and the software in place, practitioners are ready to record documents electronically. But how is that done?

THE PROCESS

The basic document requirements are the same for eRecording as they are for physical document recordings: A document must be a signed original, be in a recordable format, and have the proper notarial acknowledgment. However, unlike a traditional recording, a signed, notarized document submitted via the eRecording system never has to leave your office; as part of your agreement with the court, you certify that you have the original document in your possession each time you eRecord.

The first step in eRecording is to scan the document to a computer During the scan, each page is separated into its own individual file. (Thus, if the Deed is three pages, there will be three files, each containing one page of the Deed. Each file is then saved (or converted, depending on the equipment) into a .TIF image file. Next, log in to the eRecording website for Fairfax County, using the assigned username, password and VeriSign Token passcode. Once into the system, upload each image to the

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[1] VA. CODE ANN. § 55-142.10 et seq.

[2] http://www.fairfaxcounty.gov/courts/circuit/pdf/hardware-software-requirements-efs.pdf

website. Reorder the pages if necessaryto ensure they are in the proper order. Then create a cover sheet for the document (cover sheets are required in Fairfax County), and, finally, submit the electronic document to an eRecording clerk at the Fairfax County Courthouse. The clerk will review the document and coversheet and either 1) accept the document and issue a recording receipt, or 2) reject the document, indicating the reasons for its rejection. On an average business day, the entire process, from submission to approval (or rejection), takes about 30 minutes.

As indicated above, there is no additional cost for subscription to the eRecording service. The only charges incurred are the normal Clerk's fees and recording taxes that would be paid on any document, regardless of how it was recorded. For eRecordings,those fees are paid by direct debit from a bank account that set uplinked with Fairfax County.

Many of the most common documents for any real estate practice, including Deeds, Deeds of Trust, Powers of Attorney, Affidavits, and Certificates of Satisfaction, can be electronically recorded. The full list of eligible documents can be found at http://www.fairfaxcounty.gov/courts/circuit/pdf/documents-and-limitations-for-efs.pdf.

THE IMPACT

Our firm has been using the Fairfax County eRecording System since March 2011. eRecording has benefited all areas of our real estate practice. Many clients are amazed that they can sign their Deeds and Deeds of Trust and have them recorded before they finish signing the remainder of their loan documents. And because the Wet Settlement Act requires recordation prior to disbursement[3], sellers and realtors need to wait only briefly for their funds.

For our estate planning clients, the eRecording process allows us to move real property into Trusts immediately upon the signing of a Trust Agreement. Clients thus leave our office knowing that their property is already safely in their newly formed Trust.

Considering the expediency of Fairfax County's eRecording system, it is our hope that other jurisdictions across the Commonwealth will adopt similar systems for recording documents electronically.

[3] VA. CODE ANN. § 55-525.11.

AMERICAN LAND TITLE ASSOCIATION OFFERS VARIOUS MEMBERSHIP OPTIONS, TOOLS FOR ATTORNEYS

by Jeremy Yohe[*]

With attorney agents facing new demands from lenders, and an uncertain role in the closing process pending the Consumer Financial Protection Bureau's ("CFPB") final rule on new mortgage disclosures, membership in the American Land Title Association ("ALTA") has never been more important.

Earlier this year, ALTA released its "Title Insurance and Settlement Company Best Practices,"[1] a treatise on industry procedures which protect consumers and lenders while also ensuring a positive real estate settlement experience. Today, regulators are holding lenders responsible for their service providers' acts and, due to an increase in consent orders and settlements, lenders want to know more about the entities with which they work, including attorneys who facilitate real estate transactions. To meet these demands, ALTA members have exclusive access to resources, such as an Assessment Preparation Workbook and a policy-building tool, showcasing policies and procedures which help protect clients' money and personal information.

The CFPB is expected to release its new, integrated mortgage disclosures before the end of the year, replacing the current TIL, GFE and HUD-1 disclosures with a new Loan Estimate and Closing Disclosure ("Closing Disclosure"). The accompanying proposed rule requires that the lender provide consumers the Closing Disclosure at least three business days before the consumer closes on the loan. Generally, if changes occur between the time the Closing Disclosure is presented and the closing itself, the consumer must be provided a new form. In such event, the consumer must be given an additional three business days to review the new Disclosure prior to the closing date. Thanks to ALTA's efforts, however, the CFPB included in its proposed rules a number of exceptions to the three-day requirement for some common changes.

The proposed rule also addresses distribution of the new Closing Disclosure forms to consumers. Currently, attorneys and settlement agents are required to provide the HUD-1, while lenders must provide the revised TIL disclosure. Under the proposed rule, there are two options for providing consumers the new Closing Disclosure form: option one requires the lender be responsible for delivering the Closing Disclosure form to the consumer; under the option two, the lender may rely on the attorney or settlement agent to provide the form, although. the lender would remain responsible for the form's accuracy.

ALTA will provide guidance on the new rule and explain how it will affect both the closing process and attorney agents' relationships with lenders and consumers. For more information, visit www.alta.org/cfpb.

To keep its members informed, ALTA publishes a monthly magazine, TITLENEWS, along with weekly email updates and monthly webinars about industry developments. (ALTA is launching a digital version of TITLENEWS in November, to complement the print version.) Additionally, membership in ALTA includes a license, renewable annually, to use ALTA policy forms, plus and discounts on ALTA meetings and other educational materials. Members also have the opportunity to connect with key professionals in the industry and to serve on committees, thereby establishing themselves as experts in their local markets. Of note is ALTA's Title Counsel Committee, whose members review case law affecting the land title industry and address developments in real property law that affect title insurance.

[*] Jeremy Yohe is Director of Communications for the American Land Title Association. He can be reached at jyohe@alta.org.

[1] Available at http://www.alta.org/bestpractices/. *See also* the FEE SIMPLE, Spring 2013, at 20 (describing how implementation of ALTA's best practices can prove professionalism and grow business).

Participants are requested and encouraged to write summaries of lawsuits relevant to title professionals, which are then published in ALTA's various publications.

In 2013, ALTA membership reached a record level for the third consecutive year, and now stands at nearly 5,000 companies. ALTA's diverse membership includes title agents, title insurance companies, abstractors, and real estate attorneys. The majority of these members are small business owners who routinely rely on the variety of services and benefits that ALTA provides.

Here is a review of the various membership/licensing options available:

- **Active Membership:** Active membership is restricted to business entities that primarily engage in, and are legally qualified to engage in, the business of land title evidencing as an abstractor, title insurance agent or title insurance underwriter.

- **Associate Membership:** This membership is for individuals or firms engaged in providing services to the land title industry. Examples include attorneys, surveyors, automation vendors, counsel to lenders or life insurance companies, and governmental agencies.

- **Real Estate Attorney Membership:** This *individual* membership is for real estate attorneys who do not primarily engage in the business of land title evidencing or insuring. It is designed to specifically meet the needs of individual real estate attorneys who practice real estate law and provide title, closing and settlement services.

- **Emeritus Membership:** This membership is open to retired members of the title industry, provided that they are not eligible for any other type of membership.

- **Policy Forms License:** All attorney agents who issue title insurance must hold a policy forms license with ALTA ($195 per year). A policy forms license grants use of ALTA's Policy Forms. (Those who hold only the policy forms license do not receive membership benefits.)

- **Waiver:** An occasional-use waiver is available to attorneys who signed policies for fifty or fewer title transactions in the previous calendar year. If approvedthe attorney receives a policy forms license at no cost. (Holders of a waiver do not receive membership benefits.)

Apply today to become a member at www.alta.org/membership, or contact us at membership@alta.org or 800-787-2582.

REPORT OF THE COMMERCIAL REAL ESTATE COMMITTEE

by Whitney Jackson Levin

REPORT AND MINUTES OF A MEETING OF THE COMMERICIAL REAL ESTATE COMMITTEE OF THE VIRGINIA STATE BAR REAL PROPERTY SECTION

HELD BY CONFERENCE CALL ON SEPTEMBER 10, 2013 AT 12:00 P.M.

by Whitney Jackson Levin, Chair

Pursuant to e-mailed notice to members of the Commercial Real Estate Committee, a conference call meeting of the Committee was convened by Committee Chair, Whitney Jackson Levin (Philip H. Miller, PC), on September 10, 2013 at 12:00 p.m. Also participating in the call were Jean Mumm (LeClairRyan), Mark Williamson (McGuire Woods LLP), Ray King (LeClairRyan), Paul Bellegarde (Paul Bellegarde) and Grice McMullan (Thompson McMullan).

The meeting opened with a plea from the Chair for commercial real estate articles for the Fall issue of the FEE SIMPLE:

- The Chair informed the group that Rick Chess had agreed to write an article on EB-5 for the Fall issue.
- Grice McMullan said that he would help draft an article on a recent fraudulent cashier's check scheme in Virginia in which a Virginia attorney and his client were harmed. This article would potentially be for the Spring issue.
- Mark Williamson suggested that a colleague at his firm may be able to draft an article on the recent Virginia Supreme Court case *Koontz v. St. Johns River Water Management District*, which held that a taking occurred when the government required, as a condition of rezoning a particular part of a landowner's property, that the landowner have environmental work done on a different part of his property.

The meeting continued with a plea from the Chair for seminar topics for the Advanced Real Estate Seminar:

- Grice McMullan suggested that the fraudulent cashier's check scheme would be a good topic for the Advanced Seminar as well. The group discussed inviting a panel of speakers from different backgrounds, including possibly the Bar President, Sharon Nelson of Sensei Enterprises.
- Grice McMullan also suggested the possibility of a break-out session at the Advanced Seminar on Series LLCs, and suggested Allen Donn of Willcox Savage as a possible speaker.
- Jean Mumm and Ray King suggested a break-out session on lender requirements for UCC opinions in real estate transactions.

The Chair reminded everyone that the next meeting of the Board of Governors and Area Representatives will be in Richmond on September 13. The next meeting of this Committee will be held in January 2014 on a date to be determined by the Chair.

There being no other business to come before the Committee, the meeting was adjourned.

REPORT OF THE CREDITORS' RIGHTS AND BANKRUPTCY COMMITTEE

by F. Lewis Biggs

CREDITORS' RIGHTS AND BANKRUPTCY COMMITTEE OF THE VSB REAL PROPERTY SECTION

SEPTEMBER 11, 2013 COMMITTEE REPORT

Submitted by F. Lewis Biggs, Chairman

The Creditors' Rights and Bankruptcy Committee of the VSB Real Property Section met by teleconference on September 11, 2013. In attendance were the following Committee members:

F. Lewis Biggs
John Maddock
J. Philip Hart
Richard C. Maxwell
Stephen B. Wood
Chris Jones

The Committee discussed the draft of an article prepared by the Honorable Stephen S. Mitchell, with the assistance of Mr. Maxwell, entitled *"Strip-Off" of Real Estate Liens in Bankruptcy*. The article, which is almost in final form, had previously been submitted to Committee members for review and discussion. It will be submitted for inclusion in the Fall 2013 issue of the FEE SIMPLE. The general consensus of the Committee is that the article is excellent and will be a valuable addition to the Section's publication. The Committee believes the article covers an important topic and is presented in terms that non-bankruptcy attorneys will understand.

The Committee expressed significant praise for and thanks to Judge Mitchell.

Mr. Wood stated that Robert Michael, an attorney with his firm, had volunteered to author an article to be submitted to the FEE SIMPLE by this Committee for the Spring 2014 issue. The article will be on a lien-related topic, and Mr. Michael will provide additional information about the topic prior to submission.

The Committee discussed upcoming seminars. Committee members articulated the following points:

1. Judge Mitchell would be an outstanding and dynamic speaker on many topics within this Committee's coverage and would be at the top of the Committee's list of potential speakers for seminars, particularly in Northern Virginia (subject, of course, to his availability and willingness).

2. We do not know whether a topic has been selected for the joint seminar at the summer meeting. Mr. Biggs will inquire about that at the upcoming Board of Governors meeting. The Committee does not yet have a topic in mind, but is willing to brainstorm as needed.

3. The Committee believes that the lien-strip issue covered by Judge Mitchell's article would be a good topic for the advanced seminar in March of 2014.

Finally, the Committee discussed new membership. The Committee lacks representation from attorneys in Tidewater and would like to add one or more from that area. Several potential candidates were discussed, one of whom is from Tidewater; Committee members will extend invitations to those potential members.

Respectfully submitted,

F. Lewis Biggs

REPORT OF THE ETHICS COMMITTEE

by Paul H. Melnick

The Ethics Committee met by conference call on September 11, 2013, at 10:30 A.M. In attendance were Paul Melnick, Susan Pesner, Christina Meier, Jim McCauley and Page Williams. The Committee discussed at length report[1] of a recent class action lawsuit alleging that Google violates the privacy of Gmail users. Google has filed a motion to dismiss the action, arguing that individuals who send email to any of Google's 425 million Gmail users have no "reasonable expectation" that those communications are private.[2] Google's assertion raised questions among Committee members about state privacy laws, email encryption, and the possible need for disclosures informing clients of email privacy issues. The Committee discussed preparing an article on email privacy for an upcoming issue of the FEE SIMPLE and considered potential authors. The Committee will follow up on this at a later date.

Also discussed was lay settlement companies' practice of preparing deeds and other legal documents. Jim McCauley stated that such actions raise concerns about the unauthorized practice of law on the part of the lay settlement company, and added that an attorney who aids in the unauthorized practice of law may violate state ethics rules.

Turning to another matter, the Committee discussed a trust account scam involving earnest money deposits paid for real estate purchases. The scam is perpetuated by the purchaser who, after paying the deposit with a fake cashier's check, backs out of the deal and demands that the deposit be returned. After "returning" the purchaser's deposit, the settlement attorney learns the earnest money check has been dishonored, resulting in a major loss in the attorney's real estate escrow account.

[1] From the August 14, 2013, issue of *The Guardian.*

[2] The reporter for *The Guardian* uses the term "confidential," but the Editors feel that the appropriate term is "private," based upon opinions in other cases that address expectations of privacy.

REPORT OF THE LAW SCHOOL LIAISON COMMITTEE

by Paul A. Bellegarde

REPORT OF THE REAL PROPERTY SECTION LAW SCHOOL LIAISON COMMITTEE (Fall – 2013)

by Paul A. Bellegarde

Law School Liaison Committee Chair

The Law School Liaison Committee, now in its third year, continues to advance its mission of establishing working support relationships between this Section and Virginia's eight law schools,[1] promoting real estate as a potential area of practice.

The Committee is currently comprised of the following Section members:

Chair - Paul Bellegarde
Kay M. Creasman
Kenneth L. Dickenson
Mark W. Graybeal
Charles M. Lollar
Larry J. McElwain
Mark Williamson
J. Page Williams
Charles Cooper Youell, IV
Eric V. Zimmerman

Again this year, the Committee will offer the Section's "Day in the Life" panel discussions, during which a group of three real estate practitioners from diverse backgrounds describe their respective real estate practices and career paths. The goal of these panels is to provide insight on opportunities in real estate practice and to provide general insight (through "war stories" or other anecdotal experience) into the challenges that new lawyers can expect to confront in a range of workplace environments (big firm, small firm, clerkship, government, in-house, etc). Because Virginia's eight law schools are spread throughout the entire state, practitioners' geographic locations will determine the composition of these panels. For example, the Section's current Co-Chair, Cooper Youell, has volunteered to participate on the panel for Appalachian School of Law because the school is in his "neck of the woods."

Another of the Committee's goals for this year is to work with the law schools to explore the possibility of our Section's practitioners delivering subject-matter presentations in faculty members' courses. We believe that such presentations would benefit the Section as well as the law schools and their students. As with the panel discussions mentioned above, the availability of subject-matter presenters will be determined by practitioners' geographic locations.

The Committee will continue its efforts to schedule dates for the panel discussions with all eight law schools. The Committee has conducted its presentations at George Mason (twice), William & Mary and the University of Virginia; another presentation scheduled for last spring at Washington & Lee was cancelled at the last minute. Our goal is to secure commitments from those schools at which we have not

[1] Eight law schools are accredited in Virginia. They are: Appalachian School of Law; George Mason University School of Law; Liberty University School of Law; Regent University School of Law; University of Richmond School of Law; University of Virginia School of Law; Washington & Lee University School of Law; and William & Mary Law School.

yet presented—Washington & Lee, University of Richmond, Regent, Liberty and Appalachian—for at least one panel discussion during the 2013-2014 academic year.

REPORT OF THE MEMBERSHIP COMMITTEE

by Philip Hart

Virginia State Bar
Real Property Section
Membership Committee

Report

The Membership Committee of the Real Property Section held a meeting by telephone on Tuesday, September 10, 2010, beginning at 11.30 a.m. Philip Hart (Co-Chair) presided; Randy Howard and Harry Purkey were in attendance.

Three agenda items were discussed: the Board of Governors and Area Representative Handbook, membership recruitment ideas, and Area Representatives.

Philip reminded the Committee that one of its responsibilities is to update the Handbook every year and distribute it to the Board of Governors and the Area Representatives around the time of the Fall Meeting of the Board (held this year on Friday, September 13). Philip had distributed a draft of the revised Handbook, prepared by Co-Chair Larry McElwain, prior to the meeting. A few items were discussed. Philip agreed to make a few revisions to the Handbook and asked the Committee members to follow up with him if they had any additional comments.

The Committee then discussed the following membership recruitment ideas put forward by Philip (and resulting from an earlier telephone conversation with Larry McElwain): Section participation in the Virginia State Bar's annual "First Day of Practice" seminar; waiver of Section dues for the first year of Section membership; Section seminar discounts; coordination of recruiting efforts with the law school liaison committee; law student vouchers for attendance at the Section's seminars; and focused recruitment efforts at the Section's seminars. Following discussion among the Committee members, Philip agreed to present these ideas to the Board of Governors.

The Committee also discussed the Area Representatives. It was agreed that the Committee's forthcoming letter to the Area Representatives, distributed with the 2013 Handbook, should remind them of their duties and encourage them to mentor the new Area Representatives whom they may have sponsored. Philip said he would monitor Area Representative attendance at this year's meetings.

The meeting concluded at 12.00 p.m.

The members of the Committee are:

Lewis Biggs
Wayne Glass
Philip Hart (co-chair)
Randy Howard
Larry McElwain (co-chair)
Harry Purkey
Chip Royer
Susan Siegfried

REPORT OF THE PROGRAMS COMMITTEE

by Paul A. Bellegarde

REPORT OF THE REAL PROPERTY SECTION PROGRAMS COMMITTEE (Fall 2013)

by Paul A. Bellegarde
Programs Committee Co-Chair

The Real Property Section Programs Committee, with the able assistance of Nancy Kern, Seminar Director of Virginia Continuing Legal Education, will present the 18th Annual Advanced Real Estate Seminar on March 7-8, 2014, at Kingsmill Resort in Williamsburg. As with prior Advanced Real Estate seminars, the 2014 seminar will focus on both commercial and residential transactions, and include topics related to the present business and economic climate.

The Section will also present the 31st Annual Real Estate Practice Seminar, offered live in May 2014 at three locations (Fairfax, Lexington and Williamsburg) and via recorded replay at dates and locations to be determined. This seminar features timely topics of interest to both commercial and residential real estate attorneys, including the annual real estate case law and legislative updates.

The Section's final offering for 2013-2014 will occur in conjunction with the 76th Annual Meeting of the Virginia State Bar at Virginia Beach. This year, the Section is partnering with the Local Government and Construction Law Sections to present a panel discussion on one of the Annual Meeting's suggested showcase topics: *Private Property Rights and Public Private Partnerships: A Tangled Web of Competing Rights and Opportunities.* The program will run from 9:00 to 11:00 A.M. on Friday, June 13, 2014, at the Hilton Virginia Beach Oceanfront Hotel, 3001 Atlantic Avenue, Virginia Beach, VA, 23451.[1]

As always, the Section asks its constituency to suggest topics for these programs. The Section's Standing Subcommittees are obliged to propose at least one topic, along with speaker recommendations, for the Annual or Advanced Seminars; from these recommendations, the Programs Subcommittee works with Virginia CLE to plan the final slate of topics. A similar obligation is imposed with respect to topic proposals and article submissions for each issue of the FEE SIMPLE, published semi-annually. Although this process currently functions quite smoothly, the Section nonetheless encourages its members to submit seminar topic ideas, and invites submissions from any other readers of this Report.

[1] Editor's Note: The Cavalier Hotel on the hill is unavailable, thus necessitating use of other facilities in Virginia Beach. If you plan to attend the Annual Meeting, please read carefully the Bar announcement of programs and locations when the same becomes available in early Spring.

REPORT OF THE TECHNOLOGY COMMITTEE

by Douglass W. Dewing

To: Real Property Section
From: Technology Committee

On September 10, Apple launched its iPhone 5s, touting, among other highlights, an enhanced biometric-based security feature. The press release trumpeted: "iPhone 5s sets a new standard for smartphones, packed into its beautiful and refined design are breakthrough features that really matter to people, like Touch ID, a simple and secure way to unlock your phone with just a touch of your finger."[1]

Less than 48 hours later, a low-tech hack reminiscent of a child playing with a "junior detective" kit was also announced. OK, I exaggerate a bit. "First you need some kind of colored powder or superglue to lift the fingerprint. Then you have to scan the fingerprint, invert it and print it with a resolution of 1200dpi or more onto a transparent sheet. … If somebody is willing to go through all of this to break into your phone, chances are you have bigger issues than fingerprint security."[2]

All of which brought to mind certain theatrical tropes that have recurred in higher-tech movies through the years, portraying biometrics as a threat to someone with access to secured data (typically because they provoke removal of body parts in order to gain access to that data). No need to go into the details, but if you are a movie buff, the following link may bring back memories.[3]

For an overview of biometric security systems in the real world, see "Biometric authentication is reality not fiction,"[4] a recent article from *Engineering and Technology* magazine that discusses some of the strengths and weaknesses of various types of systems available today.

Perhaps an alternative to biometric authentication would be data encryption, so that even if someone were to gain access to sensitive data, he or she could not actually read it. John Simek, with Sensei Enterprises, in Fairfax, co-presented the American Bar Association's continuing legal education program, "Encryption Made Simple for Lawyers." He stated, "the real reason for encryption is to protect data: protect it from data breaches, protect it from folks getting access to that information who shouldn't have access."

Co-presenter Dave Ries, an attorney at Clark Hill Thorp Reed in Pittsburgh, added that many lawyers avoid encryption for two reasons. "First, most attorneys think that encryption is too difficult. They don't want to go through the time to have to understand it. A lot of attorneys also think that they never need it. Both of those assumptions are wrong." In addition, Ries pointed out that attorneys do not need to understand the underlying technology—which is getting easier to use—because recent modifications to the ABA ethics rules merely make explicit that the existing duty of confidentiality applies equally in the context of new technology. The seminar is available for purchase from the ABA.[5]

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[1] http://www.apple.com/pr/library/2013/09/10Apple-Announces-iPhone-5s-The-Most-Forward-Thinking-Smartphone-in-the-World.html

[2] http://www.abajournal.com/news/article/fingerprint-id_system_for_new_apple_smartphone_has_been_hacked/?utm_source=maestro&utm_medium=email&utm_campaign=tech_monthly

[3] http://tvtropes.org/pmwiki/pmwiki.php/Main/BorrowedBiometricBypass?from=Main.BloodyBiometric

[4] http://eandt.theiet.org/magazine/2013/08/bodies-of-evidence.cfm

[5] http://www.americanbar.org/newsletter/publications/youraba/201310article08.html

Now the only thing to worry about is the equally old movie trope of the protagonist's family members being kidnapped in order to compel the protagonist to do that which he would not do if threatened himself…

REPORT OF THE TITLE INSURANCE COMMITTEE

by Kay M. Creasman

Title Insurance Committee
Of the VSB Real Property Section
September 3-10, 2013 Committee Report
Submitted by Kay M. Creasman, Chairman

The Title Insurance Committee of the Virginia State Bar Real Property Section held a meeting via email September 3-10, 2013. The following members indicated that they would like to remain on the Committee for the 2013-2014 year:

Michael E. Barney
Paula Caplinger
Kenneth L. Dickinson
Rosalie K. Doggett
Brian O. Dolan
Stephen C. Gregory
Randy C. Howard
Cynthia A. Nahorney
Ed Waugaman
Ronald D. Wiley, Jr.

Over the course of the meeting, the Committee members listed above also contributed suggestions for possible seminar topics and speakers as well as possible topics and authors for FEE SIMPLE articles.

1. Possible seminar topics and speakers:
    a. Right now, the most prominent issues in the residential real estate arena concern ALTA's Best Practices guidelines and the impending changes to Consumer Financial Protection Board (CFPB) regulations. Dodd-Frank's impact on residential real estate practices cannot be overstated. Anne Anastasi, a former ALTA president who is a passionate and articulate speaker on these subjects, would make an excellent presenter for the 2014 Advanced Real Estate Seminar but she is already committed for the weekend of March 7-8. However, Anne recommended Alison Gareffa as a possible speaker; Alison and I are in contact regarding her availability for March 7-8.
    b. The Committee suggested that the aforementioned topics would also be appropriate for the Annual Seminar. Of particular interest might be a one-hour seminar on privacy issues after Dodd-Frank, such as how to screen staff, computer repair people, replacing computers, storage facilities, shredding facilities.
    c. Topics concerning real property passing through estates. For example, power of sale versus direction to Executor to sell; implications when beneficiaries want to take title instead of selling the real estate; powers of the Commissioner of Accounts; Transfer on Death statute; effects of *U.S. v. Windsor* and I.R.S. Revenue Ruling 2013-17 on real estate practice in Virginia.
    d. Topics related to Insured Closing Letters (ICLs) and Seller's counsel. What does an ICL really do for lender's counsel? Should Seller's counsel order an ICL for the Seller where either an attorney, CRESPA closing agent or other settlement firm is responsible for disbursement of the funds to Seller's lienholders or the client/Seller, even when the buyer is not obtaining insurance?
    e. Conservation easements and windmill projects.
    f. Nature and scope of the CFPB regulations published in October 2013.

2. Possible FEE SIMPLE topics:
    a. ALTA Best Practices as they relate to residential real estate practice in Virginia.
    b. Problems with releases, such as unreleased Deeds of Trust (DOTs), clerical errors in DOTs, contact information for major lenders to use to obtain releases, and the status of the $500 fee borrowers must pay to obtain releases.
    c. In lieu of an article, a column that addresses unresolved “issues.” The Committee would edit responses.
    d. A regular series under the headline, “Think About It.” Each issue, the series would identify a topic and invite readers to submit their thoughts with respect to the topic, The following issue would analyze and summarize readers’ comments and propose a new topic for the next issue. Such a series would make the FEE SIMPLE more interactive while we work to establish a functional blog or web forum. Suggested topics:
        1. How many years should a title search cover? Commercial versus residential?
        2. Insurability versus marketability and your client’s best interest?
        3. What to do about unreleased deeds of trust?
        4. Negotiated rates—should they be requested on a regular basis?
        5. Powers of attorney in the real estate process

Respectfully submitted,

Kay M. Creasman

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