THE LAW OF PROPERTY

SUPPLEMENTAL READINGS

Class 12

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PROPERTY

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CHAPTER 6

TRANSFERS OF REAL PROPERTY

ChapterScope

This chapter examines transfers of real property, including the contract of sale, the deed by which title is transferred, and the financing devices that enable the sale to occur. Here are the most important points in this chapter.

- To be enforceable, a contract to convey real property must be in writing and signed by the party against whom it is sought to be enforced. Exceptions occur when there has been part performance and when equitable estoppel applies.
- Implied in any contract to sell real property is an obligation of good faith and timely performance, as well as an obligation to deliver marketable title. In order for a defect in title to make title unmarketable it must be substantial and likely to injure the buyer. Such defects include recorded encumbrances but not zoning restrictions unless the property actually violates them.
- Remedies for default of a contract of sale include specific performance, rescission, or damages.
- Sellers may not intentionally misrepresent the property, and they must disclose all seller-created conditions that materially impair value and which are not likely to be discovered by an ordinarily prudent buyer. The trend is to require sellers to disclose all latent defects known to the seller — defects that materially impair value and which could not be discovered by a reasonably prudent buyer. Builders are generally held to make an implied warranty of quality.
- Deeds must be in writing and signed by the grantor. To be recorded the grantor's signature must be acknowledged before a notary and that fact memorialized on the deed by a notarial seal and signature. A deed must contain an adequate description of the grantee and the property conveyed.
- Deeds may be a general warranty deed, a special warranty deed, or a quit claim deed. The difference inheres in the scope of the warranties of title made by the grantor.
  - A general warranty deed contains six warranties of title, three of which are promises about present conditions, and three of which are promises about future action. In substance, the present covenants are that the seller owns the property, has the right to convey it, and there are no encumbrances except those disclosed. The future covenants are that the seller will defend the buyer's title against lawful claims of superior title, the buyer will not be disturbed by such claims and the seller will do whatever is reasonably necessary to perfect title.
  - A special warranty deed contains the same six warranties, but only as to the time the seller owned the property.
  - A quit claim deed contains no warranties of title at all, but is effective to transfer whatever interest the seller happens to have in the subject property.
- To be effective a deed must be delivered to the grantee. This often becomes a problem when a grantor executes a deed with the intention that it become effective at his death.
- Purchase of real estate is usually financed in large part by a commercial loan of much of the purchase price to the buyer. The lender secures repayment of that loan by either a mortgage of

or deed of trust to the property. A mortgage is a lien on the property that can produce a transfer of title upon the borrower's default. A deed of trust is a transfer of title of the property to a trustee for the purpose of conveying it to the lender if the borrower defaults or back to the borrower if he does not default. In practice, both devices are treated as liens until title is transferred after borrower default.

- Sometimes sellers lend the buyer a portion of the purchase price by taking the buyer's note. Sellers may secure payment of the note by taking a mortgage or deed of trust, but sometimes they use an installment sale contract, under which title is not transferred until the buyer has paid the entire price. When a buyer defaults under such a contract, virtually every state treats the contract as functionally identical to a mortgage or deed of trust and requires the seller to act as would any other mortgage lender.
  - Mortgages usually involve a foreclosure sale, at which the property is sold to pay off the unpaid balance of the loan. Deeds of trust usually involve a private sale for the same purpose. Under either mechanism, the borrower usually has some statutorily defined period of time in which to redeem his property following sale, unless that right has been cut off by judicial decision. Some states impose on lenders the obligation to act in a commercially reasonable fashion when conducting a foreclosure sale or private sale, in order to realize fair value for the property.

I. CONTRACTS OF SALE

A. **Introduction:** All arm's length transfers for consideration will involve a contract for the sale of the land involved. Much of the law pertaining to that contract is the domain of your Contracts course. This discussion focuses on aspects of the contract for sale that are peculiar to the fact that land is the subject matter.

1. **Brokers:** Brokers are ubiquitous. Very few transfers of houses occur without the involvement of one or more brokers, and many transfers of commercial real estate involve a broker. In the typical arrangement, a seller hires a broker (the ***listing agent***) to sell the property on terms and for a commission specified in the ***listing agreement.*** In most states the commission is earned when the broker has produced a buyer ***ready, willing, and able*** to purchase on the terms of the listing agreement or other terms acceptable to the seller. Unless the listing agreement provides otherwise, most courts find that the broker is entitled to his commission if the deal fails regardless of seller's or buyer's default. The minority view is that if the deal falls through because the ***seller defaults*** or the ***seller refuses to sell on the terms of the listing agreement*** the broker is entitled to the commission anyway; but if the ***buyer defaults,*** no commission is earned.

   a. **Brokers' fiduciary duties:** A listing agent is the seller's agent and owes to the seller all of the fiduciary duties that come with an agency relationship. Reduced to the essentials, the broker must put his principal's interests ahead of his own and exercise diligence to obtain the best result.

   ★**Example:** Six siblings lacking knowledge of real estate transactions retained a broker to sell the Connecticut property they had inherited. The broker enlisted the services of another broker to assist in marketing the property. Less than 24 hours after a listing agreement was

signed in which the property was offered for sale for $125,000, the defendant broker offered to purchase the property for $115,000. The broker's offer was accepted. Six days after the closing the broker resold the property for $160,000, making a profit of $45,000 on a cash investment of $11,500. In ***Licari v. Blackwelder***, 539 A.2d 609 (Conn. App. 1988), a damage award of $45,000 against the broker was upheld. The broker had withheld from his client the fact that he was negotiating the sale of the property to a third party even before he purchased it; failed to exercise his best efforts to obtain the best price for his client; and misrepresented other facts.

Because the listing broker shares the commission with other brokers who are working with buyers, the ostensible buyer's broker is actually a subagent of the listing agent; thus, while the buyer may think "his" agent is representing him, in fact the broker is representing the seller. Some states require disclosure of this fact. Although true buyers' brokers have begun to exist, such brokers have no contractual right to share the listing agent's commission, thus presenting economic obstacles to the proliferation of buyers' brokers.

2. **Lawyers:** Most residential sale transactions are done via a standard, preprinted contract, with critical terms (e.g., price, financing, closing costs) to be supplied by the parties. Often brokers fill in these gaps and lawyers are not involved. Brokers must be careful not to do much more than "fill in the blanks" lest they be deemed to be practicing law. Of course, the choices made or advised by brokers have large legal consequences. Buyers and sellers are well-advised to consult lawyers in the making of the contract, but most don't. In some states, lawyers are engaged to prepare a ***title abstract*** — a history of the chain of title — and an opinion as to the state of title that would pass from seller to buyer. In other states, title insurance companies perform this chore and insure that the buyer receives good title. See Chapter 7. In more sophisticated transactions, lawyers will draft the sales contract, draft the deed, examine title or obtain title insurance, and oversee the closing.

3. **Mortgage lenders:** Very few people buy real property without borrowing a substantial portion of the purchase price. Key portions of any sales contract deal with the seller's existing and the buyer's proposed mortgage. The mortgage lender is usually a third party but sometimes the seller will become a mortgage lender by agreeing to receive a portion of the purchase price in the form of the buyer's promissory note secured by a mortgage to the property. See III, below.

4. **Closing:** Real estate sales are two-step transactions. The nature of a real estate sales transaction is that some time will elapse between execution of the sales contract and the closing — the actual exchange of title and purchase price. Time is needed for the buyer to arrange financing, for a proper examination of title, and for various inspections and other acts to occur as called for under the sale contract or as required by law. Closings are usually conducted through an independent ***escrow agent.*** The critical items are deposited into escrow — the executed deed, the purchase price, the mortgage (if any) executed by the buyer. The escrow agent makes various adjustments of the purchase price to reflect pro rata apportionment of taxes and other prepaid expenses, and then disburses a portion of the purchase price to extinguish the seller's old mortgage, records the deed and buyer's new mortgage, and finally delivers the balance of the purchase price to the seller.

B. Statute of Frauds: The Statute of Frauds, adopted in some form by every state, requires that, unless there is some exception available, a contract for the sale of land ***must be in writing*** and ***must be signed by the party against whom it is sought to be enforced.*** Because both parties wish to

enforce the agreement, if necessary, against the other, this means in practice that ***both parties must sign the contract for sale.***

1. **Formal contract not necessary:** A binding contract can be quite informal. So long as the key terms are present — price, description of the property, and the parties' signatures — an enforceable contract may exist. Parol evidence — evidence extrinsic to the document — is permissible to remove ambiguities.

   Example: George agrees to sell his beach house to Martha for $100,000. On a cocktail napkin, George writes "My Malibu beach house to Martha for $100,000 as soon as practical. [signed] George." Martha writes "OK. [signed] Martha." This contract is sufficient. As they part, George and Martha orally agree to close the transaction 90 days later. Parol evidence concerning this oral clarification of the closing date is admissible to clear up the contractual ambiguity of what is "as soon as practical."

2. **Single instrument not necessary:** The contract need not consist of a single document, so long as the multiple writings are consistent, embody the essential terms (price, parties, and property description), and are signed by the parties.

   Example: Martha sees her friend George in a bar and passes George a note, "George, will you sell me your Malibu beach house for $100,000 cash? Martha." George passes a separate note back to Martha: "Martha, I wouldn't sell my beach house to anybody but you and I'm happy to take $100,000 cash for it. George." The two notes, taken together, constitute an enforceable contract. See, e.g., *Ward v. Mattuschek*, 134 Mont. 307 (1958).

3. **Conditions:** Real estate sale contracts often make the buyer's obligation subject to financing conditions — that the buyer obtain loans in an amount sufficient to meet the purchase price and on terms acceptable to the buyer — or some other condition (e.g., the property is acceptable to the buyer's structural expert, or the issuance of a building permit to enable the buyer to build an intended structure). Financing conditions are usually spelled out carefully and precisely. If not, two problems can occur. If the financing conditions are vague, and there is no parol evidence to clarify the ambiguity, the contract may be void for want of an essential term. If the financing conditions are "to the buyer's satisfaction," an obligation is implied on the part of the buyer to use reasonable efforts to obtain the necessary financing on commercially reasonable terms. Failure to do so will result in buyer's default. The same obligation of good faith is implied with respect to other conditions that are "to the buyer's satisfaction."

4. **Electronic transactions:** The ubiquity of the Internet caused Congress to enact the "E-sign Act," which provides that an electronic contract is as fully enforceable as its paper equivalent. The E-sign Act defines an electronic signature as any electronic "sound, symbol, or process" that is "attached to, or logically associated with" the putative contract and which is created with "intent to sign." Some courts find an exchange of e-mails adequate to form a contract for the sale of realty, so long as their substance covers all the requisite points necessary to establish the contract. Other courts and some commentators are more wary. They fear that the cautionary and memorializing functions of traditional written contracts will be undermined by giving effect to electronic contracts. The virtue of the paper deal is that it takes longer, and that fact gives all sides more time to contemplate the significance of their actions. Also, the prospect of forged electronic contracts may be significantly greater. Are these objections weighty enough to reconsider E-sign?

5. **Exceptions to the Statute of Frauds:** There are two major exceptions to the Statute of Frauds — ***part performance*** and ***equitable estoppel.*** Each is an ***equitable doctrine*** and thus is generally available only when a buyer seeks ***specific performance*** of an otherwise unenforceable contract of sale.

   a. **Part performance:** The elements necessary to establish part performance vary among the states. Every state requires proof of an oral contract. The differences occur with respect to the additional elements.

      i. **Unequivocal evidence of contract:** Some states insist that the acts constituting part performance must be of the sort that would not occur but for the existence of a contract — often labeled as actions of ***unequivocal reference to a contract.*** These acts consist of ***payment of all or a part of the purchase price,*** taking ***possession,*** and making ***improvements.*** None of these things are likely to be done if there were not a contract. Some states require all of these elements to establish part performance, but others are satisfied if possession alone is proven.

      ii. **Reasonable reliance:** The modern trend is to require proof of (1) an ***oral contract*** and (2) ***reasonable reliance*** on the contract — enough reliance that it would be inequitable to deny specific performance.

      ★**Example — Reliance:** Mrs. Green orally agreed to sell Hickey a building lot for $15,000 and accepted but did not deposit Hickey's check for part payment. Hickey then sold his house, expecting to build a new house on the lot. Mrs. Green refused to complete the sale. In ***Hickey v. Green,*** 14 Mass. App. Ct. 671 (1982), the Massachusetts Appeals Court held that Hickey's reliance was reasonable and that equity required specific performance of the oral sale contract.

      Example — No reliance: Ireton orally agreed to sell his farm to Walker for $30,000. Although a written contract was discussed, none was prepared. When Walker asked for a written contract Ireton assured Walker he was honest and none was needed. Walker gave Ireton a $50 check as part payment and Ireton accepted but did not cash the check. Walker then sold his own farm without ever mentioning to Ireton his intention to do so. Ireton then refused to convey and, in *Walker v. Ireton,* 221 Kan. 314 (1977), the Kansas Supreme Court ruled for Ireton. Walker's sale of his own farm was not reasonable reliance on the oral contract because the parties had neither discussed that action nor was it foreseeable by Ireton.

      iii. **Enforceable by seller:** The part performance doctrine is a two-way street, available to both buyers and sellers. In most states a seller may invoke the part performance doctrine to compel specific performance by the buyer, if the buyer's acts are sufficient to constitute part performance and the buyer has acted to diminish the value of the property in the hands of the seller. A few states do not require any proof of diminished value. In those states the principle of mutuality reigns — if the buyer can compel specific performance, mutuality of remedies requires that the seller have the same opportunity.

   b. **Equitable estoppel:** The familiar doctrine of equitable estoppel may be used to enforce an oral sale contract if the seller has caused the buyer reasonably to rely significantly to his detriment upon the seller's oral agreement to sell. This is not much different from the reasonable reliance branch of part performance.

Example: Cities Service orally agreed to sell Newman two building lots and to convey title when "construction was well under way." Cities Service reaffirmed this promise to Newman's construction lender, inducing a $55,000 loan to Newman. After the foundation was constructed. Newman ran out of money and assigned his contract to Baliles. Cities Service refused to convey and the Tennessee Supreme Court ruled that Cities Service was equitably estopped from asserting the Statute of Frauds as a defense. *Baliles v. Cities Service Co.*, 578 S.W. 2d 621 (Tenn. 1979).

Example: Ireton orally agreed to sell his farm to Walker and, when Walker asked for a written contract to evidence the deal, Ireton told Walker that he was honest and that no written contract of sale for the farm was necessary. Should that statement, coupled with Walker's later sale of his own farm, be sufficient to trigger equitable estoppel? In *Walker v. Ireton*, 221 Kan. 314 (1977), the Kansas Supreme Court thought that Walker's reliance, in the form of selling his own farm, was "purely collateral" and thus found equitable estoppel inapplicable.

6. **Revocation of contracts:** Most states do not apply the Statute of Frauds to revocation of a contract for sale of realty. Thus, if both parties agree orally to revoke a contract, the oral agreement is sufficient to do so. A few states reason that the original contract vested equitable title in the buyer and that a revocation amounts to a transfer of title back to the seller. In those states, the Statute of Frauds applies to revocations.

C. **Implied obligations:** There are a number of obligations implicit in every contract for the sale of realty. The principal ones are considered here.

1. **Good faith:** Each party is required to act with good faith in discharging the express duties of the contract. This has particular force when the obligation to complete the transaction is expressly conditioned upon future events that are subject to influence by the parties. These conditions often refer to buyer's obtaining financing, or public approval of an intended use, or buyer's satisfaction with some unknown aspect of the property. A party must exert reasonable efforts to discharge such conditions. Failure to do so will result in default. See, e.g., *Bushmiller v. Schiller*, 35 Md. App. 1 (1977).

   Example: Buyer agrees to purchase Blackacre "if Blackacre yields a well for potable water of at least 10 gallons per minute." Buyer makes no effort to determine whether Blackacre has any ground water. Buyer will be in default if he fails to complete the purchase. By contrast, if Buyer drills a well in the location recommended by a professional well driller, but it only yields 3 gallons per minute, Buyer has used reasonable efforts. Buyer need not drill in another location and may refuse to close without incurring liability.

2. **Time of closing:** Most contracts state a date for the closing — the completion of the transaction. But if the closing does not occur on the specified date, it still may be enforced in equity if full performance is tendered within a reasonable time after the closing date. Courts reason that a particular closing date is not an essential term on the contract. To avoid this lingering uncertainty, sale contracts often stipulate that ***time is of the essence*** of the agreement. By expressly making the time of performance an essential term of the agreement, a party able and willing to perform on the closing date is relieved of any future obligations under the sale contract if the other party fails to perform on the required closing date. On the other hand, if some unforeseen event occurs that makes timely closing impossible, such a clause may be more harmful than helpful.

3. **Marketable title:** Every contract for sale of realty contains an implied duty of the seller to deliver ***marketable title*** to the buyer. This obligation can be expressly disclaimed by agreement between buyer and seller. Marketable title is a title a prudent buyer would accept, one reasonably free of doubt that there is any other rival to title or any portion of it. Any defect in title must be ***substantial*** and likely to result in injury to the buyer.

   a. **Proof of marketable title:** A seller can deliver marketable title by either (1) producing ***good record title*** — a recorded chain of title, showing an unbroken transfer of title from some original root of title in the past to the seller, with no recorded encumbrances (e.g., mortgages, easements, or servitudes) — or (2) proving ***title by adverse possession*** — either through a successful quiet title action or evidence sufficient to establish that the rival claim to title would not succeed if asserted and "that there is no real likelihood that any claim will ever be asserted." A careful buyer may well insist on a contractual term obligating the seller to deliver ***good record title,*** thus depriving the seller of the ability to deliver marketable title by proof of adverse possession.

      i. **Root of title:** To deliver good record title it is usually ***not necessary*** to trace the chain of title back to the original possessor of the property. About 20 states have ***marketable title acts,*** which provide that a deed at some distance in the past (typically, older than 20, 30, or 40 years) is a ***root of title,*** and cuts off any claims to title founded on earlier instruments. See Chapter 7. Even in states without marketable title acts, good record title may be produced by a title search that goes back to the point that is deemed acceptable under local practice. The rationale is that a search of the records for the preceding 80 years, for example, is adequate to reveal virtually all present claims to title and, if there is any claim founded on some earlier instrument it is likely barred by the limitations statute. Even though this may not always be so, the risk of such claims is so low that the courts regard the record title thus produced as "marketable." This risk to the buyer may be even further reduced or eliminated by title insurance (see Chapter 7) or reliance on the seller's warranties of title in the deed (see section II.C, below).

   b. **Defective title:** To be unmarketable, the defect in title must be ***substantial*** and likely to injure the buyer. Defective title does not always prevent the transaction from taking place. Buyers can and often do waive certain defects (e.g., easements, or a mortgage that can be assumed by the buyer) and other defects can be removed prior to or at the closing (e.g., an existing mortgage may be paid off by the sale proceeds so that the buyer receives unencumbered marketable title). Common defects in title are discussed in this section.

      i. **Defective chain of title:** The chain of title may have a faulty or nonexistent link. If a deed describes the wrong land, for instance, it is a faulty link. If there is no record evidence of a deed from *B* to *C* in a chain of title purportedly from *A* to *B* to *C* to *D,* the nonexistent link makes *D*'s title unmarketable. Because a chain is only as good as its weakest link, such defects make title unmarketable unless there is adequate proof of adverse possession sufficient to create a new, valid, and marketable title. See, e.g., *Conklin v. Davi,* 76 N.J. 468 (1978).

      ii. **Encumbrances:** Generally an encumbrance makes title unmarketable. An encumbrance is a burden on the title, such as mortgages, judgment liens, easements, or covenants.

      ★**Example:** Bower and Lohmeyer entered into a written agreement by which Bower agreed to sell and Lohmeyer agreed to purchase a one-story wood-frame house in

Emporia, Kansas. The lot was burdened by a covenant requiring all residences constructed on the land to be two stories tall. In ***Lohmeyer v. Bower,*** 170 Kan. 442 (1951), the Kansas Supreme Court opined that the mere *existence* of a covenant restricting use is an encumbrance making title unmarketable. Only because Lohmeyer had agreed to take title "subject to all encumbrances of record" did the mere existence of the covenant not make title unmarketable; however, Lohmeyer had not agreed to accept *existing* violations of the covenant. Those existing violations made title unmarketable. There are two exceptions to the general rule. (1) An easement that ***benefits the property*** (e.g., a utility easement) is regarded by some courts as ***not an encumbrance*** so long as the easement is ***known to the buyer*** before entry into the contract. (2) Covenants restricting use are encumbrances, but some courts treat them as not making title unmarketable ***if the sale contract specifies a particular use that is permitted by the restrictive covenants.*** The rationale for the second exception is that the buyer has bargained for a specific use, not all possible lawful uses.

iii. Zoning restrictions: Use limits imposed by public authority through zoning laws are not regarded as encumbrances upon title. The rationale is that all property is subject to the lawful regulation of public authority, and that all land titles implicitly incorporate such use limits. However, if the existing use of the property violates a zoning ordinance the title will be held unmarketable on the theory that the buyer could not possibly have intended to purchase a violation of law and consequent liability.

★**Example:** In the prior example, an Emporia zoning ordinance prohibited the location of any frame structure within 3 feet of any lot line. The house that Lohmeyer had agreed to buy from Bower was located 18 inches from one lot line. In ***Lohmeyer v. Bower,*** 170 Kan. 442 (1951), the Kansas Supreme Court held that the mere existence of the zoning law did not constitute an encumbrance making title unmarketable but that the present and continuing violation of the ordinance sufficiently exposed Lohmeyer "to the hazard of litigation" to make the title unmarketable.

D. Default and remedies: Default occurs when one party has tendered performance in time, demanded timely performance from the other party, and reciprocal performance is not forthcoming. Remedies for breach are ***damages, rescission,*** and ***specific performance.*** The plaintiff may choose the remedy.

1. Specific performance: Because land is unique damages are thought to be inadequate compensation for breach, but because specific performance is an equitable remedy the defendant may assert the usual equitable defenses (e.g., if specific performance would work an undue hardship upon the defendant it will be denied).

a. Sought by buyer: Buyers are generally able to demand specific performance. If the seller's title is defective (e.g., an easement) and the buyer still wants the property, the buyer is entitled to an abatement of the price to reflect the diminution in value attributable to the defect.

b. Sought by seller: Sellers have traditionally been able to demand specific performance from the buyer, but the emerging trend is to deny sellers specific performance if they are still able to sell the property at a commercially reasonable price. A seller entitled to specific performance will be required to reduce the price if there is an ***insubstantial defect in title.***

Of course, if the title defect is substantial, the title is not marketable and the seller would not be entitled to specific performance.

c. **Equitable conversion:** If a contract for the sale of realty is specifically enforceable, the doctrine of equitable conversion operates to treat the buyer as the equitable owner from the moment the contract becomes effective, even if title passes later, as it almost always will. Traditionally, this meant that the risk of casualty loss (e.g., fire, earthquake) was on the buyer from that moment forward. See, e.g, *Paine v. Meller*, 31 Eng. Rep. 1088 (Ch. 1801). The traditional view, while still probably the majority view, is being eroded. The Uniform Vendor and Purchaser Act puts the risk of loss on the party in possession until title has passed. Other states place the risk on the seller if the loss is substantial and central to the contract. Of course, the parties should explicitly agree who bears the risk of loss until title passes and express that agreement clearly in the sale contract. See section I.F. below, for a fuller discussion.

2. **Rescission:** The polar opposite of specific performance is rescission. If the seller breaches, the buyer may elect to rescind, recover his partial payments already made, and "walk away" from the deal. If the buyer breaches, the seller may elect to rescind the contract and sell the property to another party. The rescission right does not ripen until the closing date, however, because either party has until then to tender performance. An attempted rescission prior to the closing date is not only ineffective but is a breach of the contract.

3. **Damages:** If the plaintiff does not want (or cannot obtain) specific performance she may obtain money damages. The measure of damages is usually the ***benefit of the bargain***, but a frequently employed alternative for the buyer's breach is ***retention of the buyer's deposit***. Under some circumstances damages are limited to recovery of ***money out of pocket***, and damages may be defined by the contract's ***liquidated damages*** provisions.

   a. **Benefit of the bargain:** This measure of damages gives the aggrieved party the difference between the contract price and the fair market value of the property at the time of breach.

   Example (seller's breach): Seller agrees to sell Blackacre for $50,000, but refuses to convey at the closing date because she is aware that in the interim the value of Blackacre has risen to $90,000. Buyer is entitled to $40,000 damages — the value of which she is deprived by Seller's breach. Buyer thus gets the benefit of the bargain as of the date of breach. It would not reduce the damages if Seller were to sell the property later to another party for $80,000. The value of the bargain to Buyer on the date Buyer was entitled to it was $40,000.

   ★**Example (buyer's breach):** Mr. and Mrs. Lee entered into a contract to purchase Jones's home for $610,000, and then unjustifiably refused to perform. Jones later sold the house for $540,000 and sought to collect the $70,000 difference from the Lees. The trial court awarded Jones that amount as damages, together with another $87,000 in punitive damages and special damages for certain out-of-pocket expenses made by Jones in reliance upon the pending sale. In ***Jones v. Lee***, 971 P.2d 858 (N.M. App. 1998), the award of special and punitive damages was upheld, but the award of compensatory damages was vacated and the case remanded to determine whether the fair market value of the house on the date of the Lees' breach had declined to $540,000. The New Mexico appellate court instructed the trial court that, in making that determination, the later sale for a lesser price "may be considered evidence of the market value at the time of breach" and should be considered with all other

relevant evidence on that point. Note that even if no compensatory damages were proven, the Lees remained liable for the out-of-pocket losses incurred by Jones and for punitive damages because of the Lees' "wanton, utterly reckless" actions "in utter disregard of their contractual obligations."

b. Deposit retention: The venerable common law rule is that a seller may elect to retain the entire deposit made by the buyer in the event of buyer's breach, even if the deposit exceeds the actual damages to the seller. This rule has been criticized as unfair and inefficient. It is unfair because it gives the seller a windfall. It is inefficient because it deters efficient breaches — those that would be more economically beneficial than performance — by making the cost of the breach to the breaching party greater than the loss to the victim. See Richard Posner, Economic Analysis of the Law §4.10. Accordingly, a minority of courts limit retention of the buyer's deposit to the actual damages incurred by the seller, unless the parties have agreed to retention as liquidated damages.

★**Example:** Mr. and Mrs. Pirnie agreed to purchase the Kutzins' house and deposited $36,000 toward the purchase price. The contract contained no liquidated damages provision. After the Pirnies unjustifiably failed to perform the Kutzins sought to retain the entire deposit. A trial court ordered the Kutzins to return about half the deposit, but a New Jersey appellate court reversed that decision, applying the common law rule. In ***Kutzin v. Pirnie***, 591 A.2d 932 (N.J. 1991), the New Jersey Supreme Court abandoned the common law rule and adopted the rule in Restatement (2d) Contracts §374(1) that the party in breach is entitled to restitution of any portion of his deposit that is "in excess of the loss he has caused by his own breach." Principles of unjust enrichment and economic efficiency dictated the result. The court placed the burden of proof upon the party in breach and stressed that the rule was limited to realty sale contracts that did not dispose of the deposit as liquidated damages.

c. Out of pocket: This rule is primarily designed to limit the exposure of the seller who breaches innocently — whose breach is in good faith. About half the states limit damages awarded against a seller who has breached in good faith to the actual money that the buyer has expended in reliance on the contract, which means that the buyer is able to recover any part payments, expenditures on experts (e.g., engineers, lawyers, title insurers), and interest and fees incurred with respect to loans obtained in connection with the prospective purchase. The other half of the states make the good faith seller in breach liable for the entire benefit of the bargain.

Example: Seller agrees to sell Blackacre for $50,000 but cannot deliver marketable title due to a title defect previously unknown to Seller. At the closing date, Blackacre is worth $90,000. Buyer has paid $5,000 to Seller, and has incurred another $5,000 in lawyers' fees, appraisals, loan fees, and title examination costs. Seller's default is not the product of bad faith. In an ***out of pocket*** state Buyer is entitled to $10,000 damages. In a full ***benefit of the bargain*** state Buyer will be able to recover $40,000 damages.

d. Liquidated damages: Sellers typically protect themselves against a buyer's breach by stipulating in the contract that the buyer's deposit may be retained as ***liquidated damages*** in the event of buyer's breach. Such provisions are enforceable so long as there is some ***reasonable relationship*** between the deposit amount and the actual damages suffered by the seller.

Example: Seller and Buyer agree to transfer Blackacre for $50,000, and Buyer gives Seller a deposit of $5,000 which the contract recites may be retained by Seller as liquidated damages if Buyer should breach. Buyer breaches. Seller will assert that his actual damages consist of (1) the added cost of reselling the property (e.g., advertising and promotion), (2) the delay in consummating another sale and consequent reduction in the present value of a later sale at the same price (or, phrased differently, the loss of interest on the sale proceeds until the later sale is completed), (3) the uncertainty that any replacement sale will actually be for that price or better, (4) the loss of other prospective buyers, and (5) any expenditures made in reasonable reliance on Buyer's performance. Seller will probably be able to keep the $5,000 deposit as liquidated damages.

Example: Seller and Buyer enter into an ***installment sale contract*** for Blackacre, under which Buyer takes possession and pays Seller monthly installments of the $50,000 purchase price. Seller promises to deliver title after the entire purchase price has been paid. The contract recites that Seller may keep all payments as liquidated damages in the event of Buyer's breach. Buyer pays a total of $49,000 and then breaches. Almost no state will permit Seller to keep the $49,000 as liquidated damages. The installment sale contract will be treated as a mortgage (see section III, below) or the Seller will be required to refund to Buyer all payments in excess of Seller's actual damages. Otherwise, Seller gets $49,000 from Buyer and continued ownership of Blackacre.

E. Duties of disclosure and implied warranties: This section deals with the duties imposed by law on sellers to disclose known defects and the warranty, implied by operation of law, of quality in the construction of buildings. Warranties of title, which may be contained in the deed, are covered in section II, below.

1. **Duties of disclosure:** The traditional common law rule is that, absent a fiduciary relationship, a seller has no duty to disclose known defects in the property. The seller's duty was to refrain from ***intentional misrepresentation*** — the outright lie about the property's condition (e.g., the seller says "the roof is watertight" when he knows it leaks like a sieve) or ***active concealment*** of a known defect (e.g., the construction of a fake heating system to conceal the building's lack of a furnace). This rule of *caveat emptor* was justified on the theory that buyers ought to use diligence and care to examine the property for themselves. *Caveat emptor* has been largely abandoned today.

   a. **Fiduciary relationships:** Even under *caveat emptor*, if the parties were in a fiduciary relationship — a relationship in which one party is dependent upon and reposes special trust in the other — the fiduciary was obligated to reveal all defects known to him. This duty arises from the fiduciary's obligation to place the other party's interests ahead of his own.

   b. **Disclosure of seller-created conditions:** The narrowest departure from *caveat emptor* is the rule that a seller is obligated to disclose conditions that (1) are ***created by the seller,*** (2) ***materially impair property value***, and (3) are ***not likely to be discovered by a reasonably prudent buyer using due care.***

   ★**Example:** Ackley owned a home in Nyack, New York, and repeatedly publicized various abnormal phenomena ("spectral apparitions") that had occurred in the house, encouraging the reputation of the house as haunted by ghosts. Stambovsky agreed to buy the house and

then learned "to his horror" that the house "was widely reputed to be possessed by poltergeists." He promptly sought to rescind the contract. In ***Stambovsky v. Ackley,*** 169 App. Div. 2d 254 (N.Y. 1991), a New York appellate court concluded that *caveat emptor* did not apply: The seller had promoted the property's reputation as haunted, and that reputation was not likely to be discovered by a reasonably prudent buyer ("the most meticulous inspection . . . would not reveal the presence of poltergeists . . . or unearth the property's ghoulish reputation . . ."). The court concluded, without discussion of the evidence, that the haunted reputation of the house "materially impair[ed] the value of the contract."

c. **Disclosure of latent material defects:** The emerging majority rule today is that a seller must reveal all ***latent material defects.*** A latent material defect is a defect that (1) ***materially affects the value or desirability*** of the property, (2) is ***known to the seller*** (or only accessible to the seller), and (3) is ***neither known to or "within the reach of the diligent attention and observations of the buyer."***

★**Example:** The Davises purchased Johnson's house, moved in, and learned within a few days that water leaked in around the windows and from the ceiling in two rooms. The Davises sued to rescind. In ***Johnson v. Davis,*** 480 So. 2d 625 (Fla. 1985), the Florida Supreme Court ruled for the Davises on two separate grounds. First, because Johnson had told the Davises that "the roof was sound" Johnson was liable for his fraud. Second, and quite apart from the fraud, the court concluded that Johnson was obligated to disclose any facts known to him or accessible only by him that materially affects the value or desirability of the property and which are either unknown to the buyer or cannot be learned by a diligent search.

See also *Lingsch v. Savage,* 213 Cal. App. 2d 729 (1963) and *Posner v. Davis,* 76 Ill. App. 3d 638 (1979). While courts may differ as to whether the test of materiality is ***objective*** (would the ***reasonable person*** think the defect was important?) or ***subjective*** (did the defect affect value or desirability to ***this particular buyer?***), a seller who fails to disclose all latent material defects has committed fraudulent concealment. The buyer may elect either damages or rescission. *Nystrom v. Cabada,* 652 So. 2d 1266 (Fla. App. 1995). The range of latent defects is quite broad. See *Reed v. King,* 145 Cal. App. 3d 261 (1983) (seller's failure to reveal the fact that the house had been the site of a decade-old multiple murder was actionable). Note particularly that in some statutes a seller is obligated to reveal the existence of environmental toxins known to be located on nearby property. See, e.g., *Strawn v. Canuso,* 140 N.J. 43 (1995); *Haberstick v. Gundaker Real Estate, Inc.,* 921 S.W. 2d 104 (Mo. App. 1966).

d. **Statutory disclosure obligations:** Some states have enacted statutes that require sellers to disclose a number of specified conditions. See, e.g., Cal. Civil Code §1102.6, which obligates sellers to reveal structural or soil defects, hazardous materials, underground tanks, alterations made without permits, encroachments, or neighborhood noise problems or other nuisances. This extensive disclosure obligation requires sellers to reveal the presence of annoying neighbors and possibly even barking dogs or crying infants. See, e.g., *Shapiro v. Sutherland,* 64 Cal. App. 4th 1534 (1998). California has gone from "buyer beware" to "seller tell all."

e. **Broker's disclosure obligations:** Some states impose upon the seller's broker the same disclosure duties that are imposed upon the seller. See, e.g., *McEneaney v. Chestnut Hill Realty Corp.,* 38 Mass. App. Ct. 573 (1995); *Easton v. Strassburger,* 152 Cal. App. 3d 90 (1984); Cal. Civ. Code, §2079.16.

f. Post-closing survival of causes of action for nondisclosure: The common law doctrine of merger held that upon passage of title all warranties in the sale contract were merged into the deed, and the buyer could then sue only on the warranties contained in the deed, if any. (On deed warranties, see section II, below.) This doctrine is now riddled with exceptions, the principal ones being that claims for fraud and actions based on promises collateral to the contract survive. The concept of a promise collateral to the contract can be expansive. See, e.g., *Davis v. Tazewell Place Associates*, 254 Va. 257 (1997) (promise to construct residence in "good and workmanlike manner" found to be collateral to sale of the land on which the construction was to occur).

2. Implied warranty of quality: The traditional rule was that a builder had no liability to anyone for his poor workmanship unless he had given an ***express warranty*** of quality. In time, a builder's warranty of quality was implied into the contract between builder and owner but the builder's liability for economic loss resulting from breach of this warranty was limited to those with whom he was in ***privity of contract*** — the ***immediate purchaser*** of the structure from the builder or the owner with whom the builder contracted. Recovery in tort for the builder's negligence was generally unavailable because the loss was wholly economic — neither damage to property or person. See, e.g., *Sensenbrenner v. Rust, Orling & Neale*, 236 Va. 419 (1988). In recent years, most jurisdictions have abandoned the traditional rules and now imply a warranty of quality by the builder of a new home that may be enforced by subsequent purchasers of the structure.

★**Example:** Dagenais built a garage for owners of property who then sold the property to the Lempkes. Shortly after the Lempkes took possession they noticed severe structural problems with the roof of the garage. After some fruitless attempts to persuade Dagenais to repair the garage the Lempkes sued Dagenais for negligence and breach of an implied warranty of quality. The trial court dismissed the complaint but the New Hampshire Supreme Court, in ***Lempke v. Dagenais,*** 130 N.H. 782 (1988), reversed as to the implied warranty claim. The court concluded that when a builder sells his structures a warranty of workmanlike quality is implied by law and runs for the benefit of subsequent purchasers with respect to *latent* defects that become apparent after the remote purchaser has acquired title and which could not have been discovered prior to the remote purchaser's acquisition. The court thought that abandonment of privity of contract was appropriate because in our mobile society defects often manifest themselves after a structure has changed hands, remote buyers are entitled to rely on a builder's skill even if they have not contracted with him, and because the builder already owes this duty to his immediate vendee an extension of this duty to others for a reasonable time does not unduly enlarge his liability.

a. No disclaimer: Courts generally agree that the implied warranty of quality in favor of subsequent purchasers may not be disclaimed but are divided about the rationale for that result. Some say it is grounded in tort law's implementation of public policies — protecting innocent buyers of houses from shoddy work, imposing the risk of loss on the builder (the party most able to avoid the loss by building with care), and encouraging the creation of a sound housing stock. See, e.g., *LaSara Grain v. First Natl. Bank of Mercedes*, 673 S.W. 2d 558 (Tex. 1984). Other courts contend that the warranty is based on contract, but because the builder has created a defective product that will inevitably harm others beyond the initial buyer, have ignored privity of contract as a barrier to its enforcement. See, e.g., *Redarowicz v. Ohlendorf*, 92 Ill. 2d 171 (1982). In theory, if the implied warranty is rooted

in tort it should be incapable of disclaimer but if founded upon contract its scope and existence ought to be limited by the bargain struck. Courts, however, pay no attention to theory here and generally are reluctant to permit disclaimer, perhaps because they have begun to agree that the warranty of workmanlike quality is implied by law to effect the public policies of placing the loss on the party best able to avoid it and to protect consumers from shoddy work they are illequipped to detect. See ***Lempke v. Dagenais,*** 130 N.H. 782 (1988).

b. Limitations period: Courts permit subsequent purchasers to bring suit against the original builder for a ***"reasonable time"*** — usually a period long enough for latent defects of the original construction to become apparent. Some states have enacted statutory limitations periods. See, e.g., Cal. Code Civ. Proc., §337.15 (10 years). The Uniform Land Transactions Act, §2-521, provides for a 6-year limitations period commencing with the initial sale, but that Act has not been adopted by any state.

c. Subsequent owner's liability: The owner of a home who is not the builder has no liability based on the implied warranty of quality. Only the original builder is liable on that theory, but a seller may be liable for breach of a duty to disclose a known defect.

F. Risk of loss and equitable title: During the time between making of the contract for sale and the closing various bad things can happen — the property can be destroyed or damaged, or one or both of the parties may die. The common law reacted to these possibilities by creating the notion of ***equitable title*** (or ***equitable conversion,*** as it is often called).

1. Equitable title: This doctrine holds that equitable ownership of the subject property passes to the buyer at the moment the contract of sale is made. Of course, the seller remains the legal owner until the closing, but for purposes of equity the buyer is treated as the owner. The seller's legal title is analogous to the legal title held by mortgage lenders in states that treat the mortgage as a transfer of legal title: It is retained as security for the buyer's payment of the purchase price. Because the doctrine is equitable, courts apply it in order to deliver fair results. The touchstone for its application is often whether it is necessary to carry out the parties' intentions or to avoid a palpable injustice. Note that only equitable title is passed to the buyer; unless the contract of sale permits the buyer to take possession prior to the closing, the buyer, as equitable owner, has no right to possession. If the contract does permit the buyer to take possession the buyer is obligated to avoid waste of the property, for that would impair the value of the seller's retained legal title. Equitable title does not apply to contracts giving the buyer an option to purchase until and unless the option is exercised.

a. Application to death of a party: An important effect of equitable title is that, for purposes of the seller's or buyer's death before closing, the parties are treated as having transferred the real property by entry into the contract. This means that a seller who dies after contracting but before closing leaves an estate that owns personal property — a contract right — and not real property. If the buyer dies before closing, the buyer's estate includes the real property.

Example: Opus, owner of Blackacre, enters into a valid contract to sell Blackacre to Baggins for $100,000. Before the closing, Opus dies. His will devises his real property to Bertha and his personal property to Camellia. At his death, Opus's interest in Blackacre is deemed to be personal property, which passes to Camellia. If Baggins performs, Camellia will receive the sale proceeds. If Baggins should default and equitable title should return

to Opus's estate Camellia will still receive Blackacre. At Opus's death, his interest in Blackacre was personal property; the later conversion of that interest into real property occurred after Opus's death so Blackacre represents the proceeds of the personal property. The character of Opus's property at his death is what matters. Similarly, if Baggins died before the closing his interest in Blackacre passes under his will as real property. Of course, Baggins's estate must perform at the closing for that real property to become tangible.

b. **Application to risk of loss of the property:** English law used the doctrine of equitable title to place on the buyer the risk of loss of the property from causes not attributable to either buyer or seller (e.g., fire, earthquake, storm damage). See *Paine v. Meller*, 6 Ves. 349, 31 Eng. Rep. 1088 (Ch. 1801). Most American states follow this rule, which requires the buyer to perform at the closing despite the loss. Of course, the seller must tender timely performance to perfect his choice of seeking either damages (measured by the diminution of value produced by the loss) or specific performance should the buyer default.

   i. **Entitlement to insurance proceeds:** The old English rule was that the seller was entitled to insurance proceeds, even though the buyer had the risk of loss, because the insurance policy was regarded as a personal contract right of the seller. If the buyer wanted insurance protection, he would have to secure his own. Most American states reject this rule and require the seller to credit the insurance proceeds against the purchase price in an action for specific performance or, in an action for damages, reduce the damage award by the insurance proceeds. The rationale is that the seller is maintaining insurance as much for the benefit of the buyer as himself, and thus holds the proceeds in ***constructive trust*** for the buyer. See, e.g., *Bryant v. Willison Real Estate Co.*, 350 S.E. 2d 748 (W.Va. 1986); *Heinzman v. Howard*, 366 N.W. 2d 500 (S.D. 1985). It is always a good idea, however, for the buyer either to (1) procure his own insurance or (2) insert a provision in the sale contract requiring the seller to keep the property insured for the benefit of the buyer. A buyer who procures his own insurance keeps the proceeds even if risk of loss is on the seller, because it is quite clear that the buyer's insurance is obtained solely to protect the buyer's interest. No constructive trust is created.

   ii. **Minority rule:** The minority of American courts place the risk of loss on the seller, despite the doctrine of equitable title, on the theory that an intact structure was an essential part of the bargain. See, e.g., *Caulfield v. Improved Risk Mutuals, Inc.*, 66 N.Y. 2d 793 (1985). Thus, if the loss is substantial, it falls entirely on the seller and the buyer may not be forced to perform. If the loss is insignificant, the buyer may still be forced to perform but is entitled to an abatement of the purchase price to reflect the lost value, usually measured by the insurance proceeds received by the seller. The minority rule is thus effectively the same as the majority rule in cases of ***insubstantial insured loss.*** The minority rule is different only in cases of ***substantial loss.*** In minority jurisdictions the buyer may ***not be forced to perform;*** in the majority of states the buyer ***must perform or incur liability***, though the buyer will receive ***credit for the seller's insurance proceeds.***

2. **Risk of loss goes with possession:** Many states have enacted statutes that make the risk of loss go with possession. See, e.g., Cal. Civ. Code, §1662. Thus, despite equitable title, if the seller

remains in possession he assumes risk of loss. Buyers in these jurisdictions acquire risk of loss prior to closing only if they take possession or assume that risk under the sale contract.

II. DEEDS

A. **Formal requirements and component parts:** A deed is the usual method by which title to realty is transferred. This section addresses the formal requirements for a valid deed and the elements of the instrument.

1. **Writing required:** The Statute of Frauds requires a writing signed by the grantor in order to transfer an interest in land. A deed signed by the grantor is the usual method of compliance, but other writings will suffice. Because the grantor is the only party bound by the deed (as distinguished from the contract of sale) only the grantor needs to sign the deed.

2. **Notarial acknowledgment:** A notarial acknowledgment is the act of a notary public attesting to the fact of the grantor's signature and to the identity of the grantor. A deed is valid without acknowledgment but virtually all deeds are acknowledged because notarial acknowledgment is almost universally required for recording the deed in the public land records.

3. **The grant:** The first clause in a deed is the ***granting clause,*** which recites the parties, the words effecting the grant, the consideration, and the description of the property.

a. **Words effecting the grant:** Any expression of an intent to effect a transfer of realty will accomplish the grant. No "magic words" are required.

b. **Description of the grantee:** Ordinarily the grantee is described clearly and specifically, but a grantee can be described without reference to a specific person, so long as the description is sufficient to identify an actual person. Otherwise the deed may not be valid, either because of uncertainty as to ownership or inability to deliver the deed to a nonexistent grantee.

Example: A deed to the "first born son of Diana, Princess of Wales" is sufficient to describe William. A deed to the "eldest daughter of Diana, Princess of Wales" is invalid because no such person exists or ever will exist.

i. **No grantee named:** While the traditional rule has been that a deed that mentions no grantee is void, most American states today hold that the ***intended grantee*** has ***implicit authority,*** as the ***agent of the grantor,*** to fill in the intended grantee's name at ***any later time.*** Without a grantee the deed is a legal cipher, but once the intended grantee's name is inserted it becomes effective. See, e.g., *Board of Education v. Hughes*, 118 Minn. 404 (1912).

c. **Consideration:** While consideration is ***not necessary*** to convey land, deeds often recite the ***fact of consideration*** rather than the actual amount of the consideration. Thus, the granting clause often states "for ten dollars and other good and valuable consideration" in order to establish that the buyer is a bona fide purchaser for value (which gives the grantee the protection of the recording acts; see Chapter 7) and simultaneously keeps the actual purchase price out of the public records.

d. **Description of the land:** The property conveyed may be described in any fashion that clearly and precisely identifies the parcel. Common forms of description include ***metes and***

bounds (a surveyor's description of the length and direction of the boundaries), reference to a ***recorded survey map*** or other survey, and ***street and number.*** So long as the description contains enough to identify the land, an ambiguous description will suffice if extrinsic evidence will clarify the ambiguity. If there is no ambiguity in the description extrinsic evidence is not permitted to contradict the deed except to establish a mutual mistake in the description.

i. **Rules of construction:** If a property description is internally inconsistent, plainly mistaken, or incomplete, courts strive to ***determine the intentions of the parties.*** If there are no better clues to intent, courts employ a hierarchy of rules to sort out these problems. In descending order of preference and reliability, these are as follows: (1) ***original survey markers,*** (2) ***natural monuments*** (e.g., trees), (3) ***artificial monuments*** (e.g., structures), (4) ***maps,*** (5) ***courses of direction*** (e.g., "a line running ENE" or "a line 90 degrees to the left of the baseline"), (6) ***distances,*** (7) ***common names*** (e.g., "McDonald's Farm"), and (8) ***quantity*** (e.g., 140 acres).

Example: The deed description reads as follows: "Brigham's Farm, being that tract of 40 acres encompassed by a line beginning at an iron survey marker topped with a brass ball, located 10 feet due north of Highway 1, going east 1,000 feet to an old fir tree with a circumference of 25 feet, turning northerly 82 degrees and running for 1,220 feet to a wood rail fence marked on the USGS topographical map for the region, following the rail fence in a westerly direction for 1,750 feet to Bishop's Creek, then southerly along the bank of Bishop's Creek for 1,072 feet to the intersection with an undeveloped road platted on county survey map No. 872, as recorded in the county records, then southeasterly 420 feet to the point of origin." In trying to make sense of this description, we would first prefer the original iron survey marker even if it was not 10 feet due north of Highway 1, then we would prefer the old fir tree (even if it is more or less than 1,000 feet from the survey stake), then we would prefer the 82 degree course change to the 1,220 foot distance in order to reach the rail fence. If the fence is located in some place different from that marked on the USGS topographical map we would prefer its actual location to its mapped location. Again, we will prefer the meandering fence line to Bishop's Creek rather than the described distance and the natural course of the creek to the described distance along the creek. We will also prefer the mapped location of the undeveloped road to the asserted distance to it. Finally, as a last recourse, we would prefer "Brigham's Farm" over the described quantity of 40 acres. See, e.g., *Riley v. Griffin,* 16 Ga. 141 (1854).

B. Warranties of title: A seller's warranties concerning the state of the title conveyed are expressly contained, if at all, in the deed. No warranties are implied. There are three types of deeds: the ***general warranty*** deed, the ***special warranty*** deed, and the ***quitclaim*** deed. The general and special warranty deeds contain covenants that warrant the state of title: the quitclaim deed does not.

1. **General warranty deed:** The general warranty deed usually contains six covenants concerning title. Each covenant is a promise that the title is absolutely free of the warranted defect, regardless of whether the defect arose before or during the time the grantor had title. Occasionally, a general warranty deed will contain less than these six covenants. Some states have enacted statutes that provide that use of terms of conveyance in a deed (e.g., grant, sell, convey) carries with them the six general warranties of title. Such deeds are sometimes referred to as ***statutory warranty*** deeds; they are simply a statutory form of a general warranty deed.

a. **Covenant of seisin:** The grantor promises that he owns what he is conveying by deed.

b. **Covenant of right to convey:** The grantor warrants that he has the power or authority to convey the property.

c. **Covenant against encumbrances:** The grantor warrants that there are no liens, mortgages, easements, covenants restricting use, or other encumbrances upon title to the property other than those specifically excepted in the deed.

d. **Covenant of general warranty:** The grantor warrants that he will defend against ***lawful claims*** of a ***superior title*** and will compensate the grantee for any loss suffered by the successful assertion of a superior title.

e. **Covenant of quiet enjoyment:** The grantor warrants that the grantee will not be disturbed in his possession or enjoyment of the property by someone's successful assertion of a superior title to the property. This covenant is functionally identical to the covenant of general warranty and, for that reason, is frequently omitted from general warranty deeds.

f. **Covenant of further assurances:** The grantor promises to do whatever else is reasonably necessary to perfect the conveyed title, if it turns out to be imperfect. This covenant is also frequently dropped from general warranty deeds, perhaps because of the open-ended obligation imposed on the seller, or because it adds little to the first four covenants, or because the doctrine of after-acquired title (see section II.B.6, below) has made this covenant redundant.

2. **Special warranty deed:** A special warranty deed contains the same six (or fewer) covenants of the general warranty deed. The only difference is that the grantor warrants against defects of title that arose ***during the grantor's time of holding title.*** Defects arising ***before the grantor's ownership*** are not covered. The grantor warrants, in essence, only that the grantor has not created or suffered a defect to occur during his ownership period.

3. **Quitclaim deed:** A quitclaim deed contains no warranties of title whatever, but operates to convey to the grantee whatever interest in the property the grantor may own. If the grantor owns the Brooklyn Bridge, a quitclaim deed is sufficient to transfer ownership; but if the grantor owns no interest whatever in the Brooklyn Bridge, nothing is transferred by a quitclaim deed, nor is the grantor liable for breach of any covenants of title because none were made. The usual function of a quitclaim deed is to remove apparent and uncontested defects in title without resort to litigation.

4. **Merger doctrine:** The traditional rule is that any promises in the contract of sale ***with respect to title*** are "merged" into the deed once the buyer accepts the deed. This means that the buyer can only sue for breach of the deed covenants of title and may not rely on the contract of sale's provisions with respect to title. The justification for this rule is that buyer's acceptance of the deed is conclusive evidence that the buyer was satisfied that the deed fully conformed to the seller's obligations under the sale contract with respect to title. If the buyer was not satisfied that the deed conformed to the contract he should not have accepted the deed. The merger doctrine does not extinguish those portions of the sales contract that are ***independent of or collateral to the transfer of title,*** such as seller's promise to remove all rubbish from the premises. The merger doctrine is under attack and courts are apt to find a great many provisions of the sales contract to be independent of or collateral to transfer of title. The Uniform Land Transactions Act, §1-309, eliminates the merger doctrine and permits

all provisions of the sales contract to remain alive and enforceable by the buyer after acceptance of a deed.

5. **Breach of covenants of title:** Covenants of title may be divided into ***present covenants*** and ***future covenants.*** A present covenant is breached, if at all, at the moment the deed is delivered. A future covenant is breached when the grantee is actually or constructively evicted at some time in the future.

   a. **Present covenants — Seisin, right to convey, and encumbrances:** These are representations of presently existing facts. Either the grantor owns the property or he does not: he has the right to convey or he does not; title is burdened by an encumbrance or it is not. The covenant is either breached when made (because it was not true) or can never be breached (because the facts were as promised at that moment in time).

      i. **Breach of covenant of seisin:** This covenant is broken if the grantor doesn't own what he purports to convey, regardless of whether he is aware of the defect or not. The covenant is broken even if the grantee knows that the grantor does not own the interest purportedly conveyed. If title is totally defective (or so defective that the grantee is left with good title only to an unusable parcel) the grantee is entitled to a return of his purchase price but must reconvey the right to possession to the grantor. If title partially fails the grantee is entitled to recover that portion of the purchase price that is equal to the value of the failed title and must reconvey his possessory right.

      ii. **Breach of covenant of right to convey:** This covenant is broken if the grantor lacks the power or authority to convey the interest (e.g., grantor is a trustee who is barred by the trust instrument from transferring title), whether or not he is aware of the limits on his authority to convey. Grantee's knowledge of the grantor's lack of authority to convey is not usually a defense to suit on this covenant. The measure of damages for breach is the same as for breach of the covenant of seisin.

      iii. **Breach of covenant against encumbrances:** This covenant is breached if the title is encumbered (other than as expressly excepted in the deed) at the time of delivery of the deed, whether or not the grantor is aware of the encumbrance. In most states, the grantee's knowledge of the encumbrance does not excuse or obviate breach, but a minority of states hold that the grantee's knowledge (actual or constructive) of an ***open and visible*** encumbrance (such as an easement) prevents breach. See, e.g., *Leach v. Gunnarson*, 290 Ore. 31 (1980). The prevailing rule is that violations of governmental land use regulations that are not known to the seller and which have not become the subject of government enforcement are not encumbrances.

         ★**Example:** DiLoreto owned property abutting a tidal marsh. He contructed a bulkhead, filled a portion of the marsh, built a house, and sold it to Anzellotti by quitclaim deed. Two years later Anzellotti conveyed the property to Frimberger under a general warranty deed. When Frimberger sought to repair the bulkhead he learned that a significant portion of the lot unlawfully encroached on protected wetlands. Rather than seeking a variance from the use regulation Frimberger sued Anzellotti on the covenant against encumbrances. In ***Frimberger v. Anzellotti***, 25 Conn. App. 401 (1991), the Connecticut intermediate appeals court held that "latent violations of [governmental] land use regulations that do not appear on the land records, that are unknown to the seller . . . as to which . . . no official action to compel compliance [has been taken] at the time the deed

was executed, and that have not ripened into an interest that can be recorded . . . do not constitute an encumbrance." Recall that in ***Lohmeyer v. Bower*** the Kansas courts held that a present violation of zoning laws made title unmarketable and entitled the buyer to rescind the sale contract. The different result here is arguably justified by difference between an executory agreement and a fully executed one. In the executory agreement (e.g., ***Lohmeyer***) permitting the buyer to rescind enables the seller to minimize loss by finding another buyer willing to take the defective title (perhaps at a reduced price), but in the fully executed contract (e.g., ***Frimberger***) the damages imposed on the seller are under the buyer's control (perhaps Frimberger would conform to the use regulations in a particularly expensive way, calculated to enhance value to Frimberger). The ***Frimberger*** rule is not universally applied. See *Bianchi v. Lorenz*, 166 Vt. 555 (1997), in which the Vermont Supreme Court held that any significant violation of a government land use regulation, the existence of which could be determined by inspecting government records, constituted an encumbrance.

The measure of damages for breach depends on whether the encumbrance is removable by the grantee. If the ***grantee can remove the encumbrance*** (e.g., by paying off a mortgage or lien) the grantee is entitled to recover what he expended to remove the encumbrance. If a grantee fails to remove a removable encumbrance he will not receive damages unless he proves actual damage by selling the property for less than its unencumbered market value. If the encumbrance is ***not removable unilaterally by the grantee*** (e.g., an easement or use covenant) damages are measured by the difference between the unencumbered and encumbered fair market value at the time of the conveyance.

iv. **Statute of limitations:** Because breach of present covenants occurs, if at all, at the moment the covenant is given the statute of limitations begins to run at that moment. The length of these statutes varies, but is usually 3 to 6 years. Of course, the buyer ought to know about breach almost immediately.

v. **Assignment of present covenants:** The still-prevailing majority rule in America is that a present covenant is for the benefit of the immediate grantee and that, if breached when made, the grantee has a ***chose in action*** — the claim against the grantor — that is ***not impliedly assigned*** if the grantee conveys to a remote grantee. This rule is rooted in the now outmoded view that choses in action are not assignable. But because we permit assignment of choses in action today, there is no good reason to bar implicit assignment of the chose in action to the remote purchaser — the person who needs the benefit. Some states recognize this logic and hold, as do English courts, that a transfer to a remote grantee implicitly operates to assign the grantee's chose in action to the remote grantee.

★**Example:** Connelly acquired title to 80 acres at a foreclosure sale, then conveyed the property by general warranty deed to Dixon, who in turn conveyed by special warranty deed to Hansen & Gregerson. The foreclosure sale was invalid so Connelly never owned the 80 acres and thus breached the covenant of seisin given to Dixon, but because Dixon had conveyed by special warranty deed he had not breached the covenant of seisin he gave to Hansen & Gregerson. H&G sued Connelly on the covenant of seisin he had given Dixon, H&G's vendor. In ***Rockafellor v. Gray,*** 194 Iowa 1280 (1922), the Iowa Supreme Court ruled that Dixon's chose in action was impliedly assigned to H&G by the conveyance to H&G.

b. Future covenants — General warranty, quiet enjoyment, and further assurances: These are representations as to future events, guaranteeing the grantee's security of title in the future. They are breached only when the grantee is actually or constructively evicted, which always occurs some time after the transfer. Actual eviction is, of course, actual dispossession from title or possession. Constructive eviction occurs whenever the grantee's possession is interfered with in any way by someone holding a superior title.

★**Example:** Bost conveyed 80 acres to Brown under a general warranty deed containing no exceptions, even though Bost only owned one-third of the mineral rights. After the statute of limitations on the present covenants had expired, Brown agreed to sell the mineral rights to Consolidated Coal for $6,000, but was forced to accept only $2,000 once it was learned that Brown owned only a third of the mineral rights. In ***Brown v. Lober***, 75 Ill. 2d 547 (1979), the Illinois Supreme Court ruled that Brown had not been constructively evicted because "the mere existence of a paramount title does not constitute a breach of the covenant" of quiet enjoyment. If the owner of the other two-thirds of the mineral rights were to start mining coal under Brown's land, Brown would be actually evicted. If, in order to prevent a real and manifest threat of such mining, Brown purchased the other two-thirds of the mineral rights from the owner, Brown would be constructively evicted, but if Brown purchased the other two-thirds of the mineral rights without such a threat it would probably not constitute constructive eviction.

i. **Breach of future covenants:** The future covenants are breached only when the grantee's possession has been disturbed by someone holding superior title. That can occur years after the original transfer and, as in ***Brown v. Lober***, after the statute of limitations has barred suit on the present covenants.

ii. **Benefit runs with the estate:** If there is ***privity of estate*** between the ***original grantor*** and the ***remote grantee*** the benefit of a future covenant given to the original grantee runs with the estate conveyed to the remote grantee. For this purpose, privity of estate means that the original grantor conveyed ***either* title *or* possession** and the same interest was conveyed to the remote grantee. If the original grantor had **neither *title nor possession*** (e.g., the original grantor was a brazen fraud with no interest in the subject property) there is no estate created with which the covenant can run. This rule, though logical, insulates wrongdoers from liability to remote grantees; thus it is not surprising that some courts have invented an "estate" held by the original grantor and passed on to the remote grantee, usually the mere possibility that the original grantor might later acquire an interest that would be passed on to the remote grantee under the doctrine of after-acquired title.

iii. **Extent of the obligation to defend:** The covenant of general warranty obliges the grantor to defend against **lawful *superior claims of title***, but imposes no obligation to defend against the spurious claim of paramount title. Because it is impossible to know one from the other with certainty prior to litigation, the effect is to require the ***grantee*** to defend. In the event the third party's claim of paramount title is lawful, the grantee will be able to recover the costs of defense plus damages. But if the third party's claim is defeated, the costs of the victory are borne entirely by the grantee, because the claim was not lawful. If the grantor is notified of the claim and asked to defend, the grantor will be bound by the result whether or not he defends.

Otherwise, the litigation between the grantee and the third party does not bind the grantor.

c. **General limit on damages for breach:** The overwhelming majority rule is that the grantee may not recover more than what the grantor-in-breach received for the property. This is problematic under several circumstances.

i. **Suit by original grantee:** When the original grantee has expended considerable sums to improve the property, or the property value has increased markedly due to extrinsic factors, the grantee will not be able to obtain the benefit of the bargain, but is limited to a return of his purchase price. On the other hand, without the basic damage limitation, grantors would face the specter of potentially ruinous open-ended liability. Prejudgment interest on the damages is often awarded but courts split over whether the interest should accrue from the date of the promise or the date of eviction. Courts holding to the former view argue that, because the grantee might be liable to the paramount for the grantee's wrongful occupation, interest is fair compensation for that potential liability. Courts holding to the latter view argue that, unless such a claim for rent is actually made, it would be a windfall to the grantee to award interest for the time the grantee is in possession. Some courts refuse to award damages to the grantee if the transfer was a gift.

ii. **Suit by remote grantee:** Nearly all courts agree that if the remote grantee has paid ***more*** for the property than the original grantor received, the remote grantee is subject to the general damage limit and will only recover what the original grantor received. See, e.g., ***Rockafellor v. Gray,*** 194 Iowa 1280 (1922). But if the remote grantee paid ***less*** for the property, courts differ on whether the remote grantee should recover (1) what the original grantor received, (2) what the remote grantee paid, or (3) actual damages up to the amount received by the original grantor.

6. **After-acquired title (estoppel by deed):** If a grantor conveys an interest in property that he does not own, and later acquires the unowned interest, this doctrine operates to send that after-acquired title directly and immediately to the grantee or his successors in interest. The grantor is estopped from denying the scope of the original deed. Put another way, the grantor's original deed carries an implied promise that he will convey the missing pieces of title should he later acquire them. Though originally limited to warranty deeds this doctrine now applies to quit-claim deeds conveying fee simple absolute, on the theory that the doctrine operates to effectuate the parties' probable intent.

Example: Schwenn gave her mineral rights to oil-producing property to her daughter. Then she conveyed the property (with no exception or reservation of the mineral rights) to Kaye. Once litigation threatened, Schwenn asked her daughter to reconvey the mineral rights to her and the daughter did so. At that moment, Schwenn's after-acquired title to the mineral rights was vested in Kaye. Schwenn was estopped from denying the validity and scope of her original deed to Kaye. *Schwenn v. Kaye,* 155 Cal. App. 3d 949 (1984).

C. **Delivery:** A deed must be delivered by the grantor in order to be effective to transfer an interest in land. ***Delivery*** means that the grantor has said or done things that demonstrate the ***grantor's* intent to transfer immediately** ***an interest in land to the grantee.*** Delivery does ***not necessarily require*** the physical act of handing over the paper deed to the grantee. The key is the ***grantor's intent.*** If a grantor hands a deed to the purported grantee and says, "You are to hold on to this until I'm dead.

and only then will it be effective," there has been no delivery. If the grantor executes and records a deed to the grantee, vacates the property, tells others that he has "given the farm" to the grantee, but neither informs grantee nor physically hands the deed to grantee, delivery has nevertheless occurred. Delivery problems do not usually occur in commercial transfers; usually delivery problems crop up when gifts are involved.

1. **Presumed delivery:** Courts employ a ***rebuttable presumption*** that delivery has occurred under any of the following circumstances: (1) ***physical transfer to the grantee,*** (2) ***notarial acknowledgment*** of the deed, or (3) ***recording*** of the deed. Courts also employ a ***rebuttable presumption*** that no delivery has occurred if the grantor retains physical custody of the deed.

   ★**Example:** Maurice Sweeney, estranged from his wife Maria, wished to ensure that upon his death his brother John would take Maurice's farm and tavern, rather than Maria. Maurice executed and recorded a deed of the property to John, and John executed a deed of the property to Maurice, which was not recorded. Both deeds were prepared at the same time by the town clerk, who gave the originals to Maurice. Later, Maurice gave both deeds to John. When Maurice died, Maria contended that the unrecorded but fully executed deed from John to Maurice had been delivered to Maurice and operated to vest title in Maurice. Accordingly, she claimed her elective share in Maurice's estate, including the farm and tavern. John asserted that there had been no delivery because he had never intended to deliver the deed to Maurice or, in the alternative, that there was an oral condition attached to the delivery — that the deed be effective only in the event John died before Maurice. In ***Sweeney v. Sweeney,*** 126 Conn. 391 (1940), the Connecticut Supreme Court of Errors ruled that because the John-to-Maurice deed had been manually delivered to Maurice there arose a presumption of delivery, which presumption was not rebutted by the fact that the motivation of John and Maurice was to defeat Maria's elective share by ensuring that title to the farm was in John at Maurice's death, but to cause title to return to Maurice if and only if John died before Maurice.

2. **Attempted delivery at death:** An attempt to deliver a deed at the death of the grantor is almost always ineffective. If the grantor intends that the deed become effective only upon his death, the deed is void unless it can be admitted as a will, and this is not usually the case because the formalities required for making a will are often lacking in the execution of a deed. If the grantor intended the deed to be effective during his life, the grantor's death does not destroy the delivery already accomplished by that intent.

   ★**Example:** Harold and Mildred Rosengrant, a childless elderly couple in failing health, owned a farm in Oklahoma which they wished to convey to their nephew, Jay Rosengrant, effective at their death. Harold and Mildred went to a local bank, where they executed a deed of the farm to Jay, which they handed to Jay, and Jay then handed the deed to the banker for safekeeping. Harold instructed the banker to keep the deed until he and Mildred had died, then to give it to Jay so that he could record the deed. The banker put the deed in an envelope marked J.W. Rosengrant or Harold H. Rosengrant and kept it in the bank's vault. After Harold and Mildred's deaths Jay Rosengrant retrieved the deed from the bank and recorded it. An Oklahoma trial court canceled the deed and in ***Rosengrant v. Rosengrant,*** 629 P. 2d 800 (Okla. App. 1981) the Oklahoma court of appeals affirmed, reasoning that the deed was never delivered during Harold and Mildred's lifetime because there was never any intent to give "outright ownership at the time of the delivery." The court made much of the fact that under the bank's policies the deed could have been taken at any time by Harold, but the court found the parties' extraordinarily clear intentions to be of lesser moment.

a. **Exception — Irrevocable escrow:** If a grantor executes a deed in favor of grantor and hands it over to an escrow agent with ***irrevocable*** instructions (either ***written*** or ***oral***) to hold it until the grantor's death, delivery has occurred. The rationale is that the escrow agent is the agent of ***both the grantor and the*** **grantee.** Delivery to the grantee's agent is delivery to the grantee. But if the escrow is ***revocable*** the escrow agent is deemed to be only the grantor's agent, so no delivery has occurred. It is sometimes said that delivery has not occurred because the deed is not yet out of the grantor's control. This rule is often criticized on the ground that a grantor can validly accomplish the same end by simply transferring the property into a revocable trust, with the grantor as both trustee and beneficiary for life, and the grantee as beneficiary upon the grantor's death.

b. **Uncertain exception — Express conditions:** A deed may contain an express provision that makes transfer of possession conditional upon the grantor's death (e.g., "to *A*, effective upon my death" or "to *A* if *A* survives me"). These conditional grants can be interpreted to mean either that the deed has passed a ***springing executory interest*** to the grantee or that ***no delivery has occurred*** — the deed is a nullity until the subsequent condition (the grantor's death) occurs. By the latter construction the deed would be of no effect unless it could qualify as a will. By the former construction the grantee received a valid springing executory interest which became possessory upon grantor's death. Courts are badly divided on this issue, and there is no safe general answer. The academic answer is that the deed should be given effect as making a transfer of a springing executory interest, because the deed is adequate by itself to indicate the grantor's intentions at death. There is little reason to be worried that, by giving effect to the deed, the grantor's wishes concerning disposition of his property upon death are not being carried out. Presumably the grantor appreciated the significance of the deed when he signed it and there is no need to rely on evidence other than the deed itself to carry out the grantor's wishes.

i. **Grant of life estate distinguished:** Of course, a grantor can convey by deed a life estate to himself and a remainder in another grantee. Such grants are valid and not problematic, so long as they are clear. The effect of a grant from *O* "to *A*, effective on my death" and a grant from *O* "to *O* for life, then to *A*" may be functionally identical, but only the latter clearly creates a life estate. The former style is uncertain. While it may be valid as a springing executory interest many courts will conclude that it is void for want of delivery — the present intention to transfer an interest in the subject land.

3. **Delivery subject to oral condition:** The usual response to delivery of a deed subject to an oral condition is to disregard the oral condition and treat the delivery as complete and unqualified, but this rule is not invariable.

★**Example — Unenforceable condition:** Refer back to ***Sweeney v. Sweeney***, 126 Conn. 391 (1940), section II.C.1, above. John Sweeney claimed that the John-to-Maurice deed was delivered to Maurice subject to an oral condition — that delivery be effective only if John predeceased Maurice — and that because that condition had not occurred there was no valid delivery. Connecticut's highest court rejected this contention, noting that because the delivery had been made directly to the grantee (Maurice) rather than to a neutral escrow agent the condition was unenforceable.

★**Example — Enforceable condition:** Facing the prospect of hazardous military duty, Husband delivered a deed to Wife with oral instructions that if he were killed she should record the

deed, but if he returned she must return the deed to him for destruction. Husband returned from the mission but Wife refused to return the deed, perhaps due to other marital difficulties. In *Chillemi v. Chillemi*, 197 Md. 257 (1951), Maryland's highest court enforced the oral condition and voided the deed. The court styled as "primitive formalism" the "ancient rule" that physical transfer of a deed to the grantee subject to an oral condition of later effectiveness is a completed delivery. In the Maryland court's view, "conditional delivery is purely a question of intention, and it is immaterial whether the [deed], pending satisfaction of the condition, is in the hands of the grantor, the grantee, or a third person."

4. **Commercial escrows:** Most real estate transfers involve a commercial escrow. Usually, the seller gives the escrow holder specific written instructions that define the escrow agent's authority to hand over the deed to the buyer. The transfer of a deed into escrow along with written instructions is a completed delivery. Delivery is also completed when the deed is given to the escrow holder under oral instructions ***if there is a written sale contract.*** But without a written sales contract, an escrow agent holding a deed under oral instructions is deemed to be the seller's agent only, and the seller is empowered to revoke the escrow at any time. The power to revoke undermines the claim that the seller had an intention to pass title at the moment the deed was placed into the escrow agent's hands. Also, the oral instructions may well be silent on the essential issue of price. Despite these objections, a few states regard delivery as completed when the deed is placed in escrow under oral instructions.

   a. **Equitable title:** Although legal title passes only when the deed is handed over to the grantee out of escrow, equitable title passes to the grantee once delivery is completed to the escrow agent. This is more usually called the ***relation-back doctrine*** — the essential idea is that the buyer's title, once acquired out of the escrow, will "relate back" to the moment the deed was delivered into escrow. This fiction enables courts to ignore the effect of the grantor's death or incapacity after deposit into escrow, or a creditor's attempted seizure of the property after the deed is delivered into escrow. From that moment on, the buyer has equitable title.

      i. **Exception — Bona fide purchasers:** If a seller double-crosses his buyer after depositing a deed into escrow, by conveying a deed to a ***bona fide purchaser*** (a person who pays real consideration and has no knowledge of the pending escrow), the bona fide purchaser (holder of legal title) prevails over the first grantee's equitable title. As between two innocents, the loser is the one who has yet to rely completely upon the seller's duplicity.

5. **Delivery by estoppel:** Even if a grantor does not intend to deliver a deed, he will be estopped from denying delivery in two principal circumstances.

   a. **Entrustment to a deceitful grantee:** If the grantor gives a deed to a grantee with no intent to transfer title, but the grantee uses the deed to convey to a third party bona fide purchaser, the grantor will be estopped from denying delivery.

   Example: Damian gives Agnes a deed to Blackacre, telling her, "Look it over and think about it, for this is what I propose to do if you will marry my son, Mordred." Instead of marrying Mordred, Agnes records the deed and promptly sells Blackacre to Myrtle, who pays good value and is utterly ignorant of the circumstances under which Agnes obtained the deed from Damian. Damian will be estopped from denying delivery to Agnes. Damian had more opportunity than Myrtle to avoid the problem (he could have simply told Agnes of

his planned marital gift), so the loss should fall on him. Of course, he may have recourse against Agnes.

b. **Entrustment to a negligent escrow agent:** If the grantor gives a deed to an escrow agent but the grantee obtains it wrongfully, using it to sell the property to a bona fide purchaser, courts are split on whether the grantor is estopped from denying delivery.

   i. **Rationale for estoppel:** The grantor chose his escrow agent so he ought to shoulder the consequences of a poor choice. The grantor could have picked a more careful or honest agent. The grantor is more culpable than the bona fide purchaser so the grantor should lose.

   ii. **Rationale for no estoppel:** The grantor didn't intend delivery so he ought not be prevented from denying delivery. The problem with this view is that it does not really address the underlying issue — of two innocents, which should bear the loss? The usual answer to this question is that it should fall on the party who had the better ability to prevent the loss in the first place. To say that the grantor didn't intend delivery does not address this problem. However, courts holding to this view will estop the grantor if the grantor knew about the grantee's wrongful possession and did nothing about it. In a sense, these courts are saying that they will not hold the grantor's agent's conduct against him, but will hold the grantor responsible for his own conduct.

III. FINANCING DEVICES: MORTGAGES, DEEDS OF TRUST, AND INSTALLMENT CONTRACTS

A. **Mortgages:** Loans secured by mortgages are the principal device enabling people to acquire real property. Very few people are able or willing to pay the entire purchase price in cash. Instead, they borrow a significant portion of the purchase price from a lender on terms that require them to repay the loan with interest via monthly payments made over an extended period of time (frequently 30 years). To secure repayment of the loan, the lender will require the borrower to give the lender a mortgage on the property. The mortgage empowers the lender to sell the property in the event of the borrower's default on the loan, and to apply the sale proceeds to repayment of the loan. Any proceeds left over go to the borrower. Generally, if the sale proceeds do not eliminate the loan the borrower remains liable for the deficiency. This discussion of mortgages is only the tip of the mortgage law iceberg; there are a great many state variations on the general principles outlined here, but this outline will enable you to understand mortgages in the context of a first-year Property course.

1. **The mortgage transaction:** The term "mortgage" is often used loosely to refer to the entire transaction, which consists of two distinct elements: the ***loan*** and the ***mortgage.*** The loan is evidenced by a ***promissory note,*** a personal promise to repay the loan on the terms contained in the note. The mortgage is evidenced by a document called a ***mortgage;*** it is a ***security agreement*** between the parties, by which the borrower gives the lender the right to sell the property if the borrower defaults on the loan and to apply the sale proceeds toward reduction of the loan. The mortgage is usually recorded in the public land records, thus giving notice of the lender's security interest in the property. In some places the note and the mortgage are combined into a single instrument, but they still perform separate functions. The borrower is often called the ***mortgagor;*** the lender is the ***mortgagee.***

a. Development of the mortgage: The mortgage began as a conveyance. Lenders would require the borrower to convey the property to the lender in fee simple subject to a condition subsequent (e.g., "Borrower conveys Blackacre to Lender, but if Borrower pays £1,000 to Lender on Christmas Day, 1643, Lender will reconvey Blackacre to Borrower"). The law courts rigidly enforced this provision. If Borrower tendered £1,000 on Boxing Day (Dec. 26), 1643, it was too late: Blackacre was irrevocably Lender's.

i. Equity of redemption: The equity courts began to rule that the borrower had an equitable right to redeem the property at any time after the due date. This ***equity of redemption,*** unlimited in time, was a constant cloud on title that made the property effectively inalienable. To remove the blot, lenders then brought suit in the law courts to ***foreclose equity of redemption*** — by obtaining a court order to extinguish the equitable right of redemption and sell the property free of that cloud to a new purchaser. Today's mortgage foreclosure is similar — the equity of redemption is extinguished, the property is ordered sold, the sale proceeds are applied to the loan and any excess is given to the borrower. Note carefully that the foreclosure sale cuts off ***only*** this ***judicially created equity of redemption.***

ii. Statutory right of redemption: About 20 states have created a separate, independent ***statutory right of redemption,*** which gives the borrower a defined period of time (anywhere from a few months to a year or two) ***after the foreclosure sale*** in which the borrower can redeem the property from the purchaser at the foreclosure sale.

b. Types of mortgages: Although all mortgages have the same general characteristics there are some terms of art used to describe mortgages with different features. The principal types follow.

i. First and second mortgages: The same property can be used to secure more than one loan. The first mortgage is the mortgage that is given first in time. The second mortgage is given next in time. Sometimes these are referred to as senior mortgages or junior mortgages. The second mortgage is taken subject to the rights of the senior mortgage. Upon foreclosure, the holder of a second mortgage is entitled to share in the sale proceeds only after the first mortgage has been fully satisfied.

ii. Fully amortized mortgage: A fully amortized mortgage loan is one in which the principal is retired over the life of the loan so that the monthly payments are constant (if the interest rate is fixed for the life of the loan) or vary with interest rates (if the interest rate is adjustable by formula during the life of the loan). Most residential mortgage loans in the United States are fully amortized.

iii. Balloon payment mortgage: Some mortgage loans provide for very small payments of principal during the life of the loan (or none at all). While such loans reduce the monthly payment, they require payment of the entire principal balance on the due date. Because few borrowers are likely to have cash on hand to make that payment, a balloon payment mortgage has the practical effect of forcing the borrower to obtain a new mortgage loan to retire the old one.

iv. Purchase money mortgage: A mortgage loan made for a portion of the purchase price is a purchase money mortgage.

2. **Title or lien?** States take different views of whether the mortgagee (the lender) has ***title*** to the mortgaged property or only a ***lien*** upon that property. The title theory predominates in the east and the lien theory is favored by western states. The difference is no longer of much practical consequence, because title theory states treat the lender's title as for security purposes only, thus making it virtually indistinguishable from a lien. The only difference lies in who is entitled to possession. In some title theory states the mortgagee is entitled to possession; in other title theory states the mortgagor is entitled to possession until default and the mortgagee is entitled to possession thereafter. In lien theory states the mortgagor is entitled to possession until foreclosure. In title theory states a lender has enhanced ability to recover possession after default fairly quickly (by suit for ejectment or judicial appointment of a receiver).

3. **Sale or transfer by the mortgagor:** A mortgagor is always free to transfer his ***"equity"*** — his interest in the property. *Equity* is the term used to describe the value of the borrower's interest in the property — the difference between market value and the principal balance of the loan secured by the mortgage. The term originated as a shorthand expression for the interest protected by the equity courts in the early days of mortgages. A buyer of the mortgagor's interest can acquire the interest ***subject to the mortgage*** or can ***assume the mortgage.***

   a. **Acquisition subject to the mortgage:** By taking title subject to the mortgage the buyer incurs ***no personal liability on the mortgage.*** In the event of default the mortgagee can foreclose and sell the property, but if the foreclosure sale proceeds do not extinguish the debt the lender has no further recourse against the owner who has acquired title subject to the mortgage. The lender can, however, obtain a personal judgment against the original mortgagor for the deficiency, except to the extent states prohibit deficiency judgments.

   b. **Assumption of the mortgage:** If a new buyer assumes an existing mortgage he becomes ***personally liable for the mortgage loan.*** The lender can obtain a deficiency judgment against the assuming buyer as well as the original mortgagee (unless the lender has released the original mortgagee).

   c. **Due-on-sale clauses:** Lenders dislike transfer of the mortgagor's interest, whether by assumption or by taking subject to the mortgage, because it is against their financial interest. In periods of declining interest rates, buyers will not likely assume or take subject to an existing fixed-rate mortgage, because they can obtain a new mortgage at lower rates. But in periods of rising interest rates, buyers will be anxious to assume or take subject to an existing fixed-rate mortgage at a lower-than-current-market rate. Lenders, of course, would prefer that the buyer obtain a new mortgage at a higher rate. Lenders also say they are concerned that the new buyer might be less creditworthy, but that argument is mostly bogus because the original mortgagor remains personally liable and the property is the principal security for the loan. To prevent assumption of or a sale subject to a mortgage lenders insert a ***due-on-sale clause*** into the mortgage and loan. This provision permits the lender to demand immediate payment of the outstanding principal balance of the loan in the event the mortgagor sells his interest. In the 1970s some states, particularly California, invalidated due-on-sale clauses. Lenders reacted by obtaining federal law, which preempts state law, making due-on-sale clauses enforceable. See, e.g., *Fidelity Fed. Sav. & Loan Assn. v. De La Cuesta,* 458 U.S. 141 (1982).

4. **Default by mortgagor:** In most states the lender has the option of a suit to collect the debt or to foreclose and effect a sale of the property to satisfy the debt. A few states require the lender first to foreclose and sell before seeking to enforce the debt personally by obtaining a deficiency judgment. The availability and utility of deficiency judgments are often limited by statute.

   a. **Anti-deficiency statutes:** Some states prohibit deficiency judgments on purchase money mortgage loans for residences. These statutes reflect a legislative bias in favor of home-owners. A variation is to permit a deficiency judgment only for the amount by which the debt exceeds a judicially determined fair market value for the property.

   b. **Statutory right of redemption:** The statutory right of redemption after foreclosure typically permits redemption by paying the ***foreclosure sale price*** rather than the ***mortgage debt.*** This is a strong inducement to the mortgagee, who is often the only bidder at a foreclosure sale, to bid the amount of the mortgage debt. Otherwise, the mortgagee might buy the property for a trifling fraction of the mortgage debt and seek to collect the remainder through a deficiency judgment. In some states the mortgagor in default may stay in possession until the expiration of the statutory redemption period.

   c. **Inadequate sale price at foreclosure:** The fact that the sale price at foreclosure is inadequate, in the sense that it is less than fair market value, will not by itself void the foreclosure sale. The usual rule is that the sale price will stand unless it is so far below market value that it "shocks the conscience" or fraud or other overbearing unfairness is present. Some states go further, however, and impose on the mortgagee a fiduciary duty to act in a commercially reasonable manner in conducting a foreclosure, such that reasonable efforts are made to realize a fair price.

   ★**Example:** The Murphys refinanced their home in 1980, executing a promissory note secured by a first mortgage in favor of Financial Development Corp. FDC then sold the mortgage to Colonial Deposit. By September of 1981 the Murphys were 7 months in arrears on their mortgage payments and the lender gave notice of its intent to foreclose. Although the Murphys then paid the overdue mortgage payments they failed to pay additional costs which had come due as a result of the foreclosure notice. The lenders scheduled a foreclosure sale for December 15, 1981, which occurred on that day. Present at the foreclosure sale were the Murphys, a lawyer retained by the lender to conduct the sale, and a representative of the lender. The lender made the only bid, $27,000, which was roughly the amount owed to the lender by the Murphys. Two days later the lender sold the Murphys' home to a realtor for $38,000. The Murphys sued to set aside the foreclosure sale; a trial court refused to set aside the subsequent sale to the realtor because he was a bona fide purchaser for value but did award the Murphys $27,000 damages, an amount equal to the difference between the foreclosure sale price and the market value of the home, and legal fees due to the lender's bad faith. In ***Murphy v. Financial Development Corp.,*** 126 N.H. 536 (1985), the New Hampshire Supreme Court ruled that the lender was a fiduciary in conducting a foreclosure sale, and thus owed a duty of good faith and due diligence to exert commercially reasonable efforts to obtain a fair and reasonable price, but the court ruled that the lender did not act in bad faith. The lender did not advertise or use any other commercially reasonable methods to generate interest in the property. The New Hampshire Supreme Court also ruled that the trial court erred in its determination of damages: Rather than finding damages to be the difference between foreclosure price and *fair market value* damages are the difference between foreclosure price and a *fair price*. A fair price may

be less than fair market value because fair market value can be expected to be realized in a voluntary exchange with plenty of opportunity to shop for buyers; in a forced sale some diminution in price is reasonable. But the key point is that the lender must act diligently to generate a fair price.

B. Deeds of trust: The deed of trust is used in many states as the form of mortgage.

1. **How it works:** The borrower conveys the real property to a third party as ***trustee*** for the lender, for the limited purpose of securing repayment of the debt. The trustee is often a nominee of the lender (e.g., the lender's lawyer, employee, or affiliated corporation). The deed of trust gives the trustee the power to sell the property upon default (the ***power of sale***), to use the proceeds to pay off the debt, and return any excess to the borrower.

2. **Difference from the mortgage:** Traditionally, judicial foreclosure was required to enforce a mortgage, which meant bringing suit and conducting a judicially supervised sale, a time-consuming and costly process. A power of sale vested in a trustee, by contrast, is relatively quick and cheap. In some states, the mortgagee may not be given a power of sale; in other states, a mortgagee may exercise the power of sale if the mortgage gives the mortgagee that power. Under a deed of trust the sale is conducted by the third party trustee at the lender's request, which is virtually identical to the procedure under a mortgage with power of sale vested in the mortgagee. Some states treat deficiency judgments or redemption differently, depending on whether a deed of trust or mortgage is the security instrument.

C. Installment sale contracts: The installment sale contract is, in form, merely a contract of sale for real property obligating the purchaser to pay the purchase price in installments and obligating the seller to deliver title to the buyer after the purchase price has been paid in full. Economically, the transaction is indistinguishable from delivery of a deed to the buyer in exchange for a note and purchase money mortgage to secure the purchase price.

Example: Vendor, owner of Blackacre, agrees to sell Blackacre to Vendee for $133,333, under an installment sale contract by which Vendee takes possession and agrees to pay the purchase price at the rate of $1,111 per month for 10 years, and Vendor agrees to deliver a deed to Vendee when the purchase price is fully paid. This is economically identical to a transaction by which Vendor deeds Blackacre to Vendee now, and receives from Vendee a note for $100,000, bearing interest at 6 percent per year, requiring Vendee to make monthly payments of $1,111 for 10 years (at which time the debt will be extinguished), secured by a mortgage.

1. **Treated as contract of sale:** The original reason for the installment sale contract was the seller's desire to avoid the procedural difficulties of extinguishing a mortgagor's equity of redemption. If a buyer under an installment sale contract defaulted, the seller could summarily evict the buyer upon default and, perhaps, keep all or a large part of the partially paid purchase price as damages. See, e.g., *Jensen v. Schreck*, 275 N.W. 2d 374 (Iowa 1979). Because the seller retained legal title until the buyer had fully performed, buyer's default served to excuse any further performance on the seller's part. This result was very much like the old ***"strict foreclosure,"*** by which the equity of redemption was irrevocably cut off. See, e.g., *Harris v. Griffin*, 109 Ore. App. 253 (1991).

2. **Treatment as a security device:** The modern trend of courts is to treat installment sale contracts as security devices. There are two good reasons for this view: (1) the installment sale contract is economically indistinguishable from a mortgage, and (2) it is inequitable to

permit a buyer to lose his equity of redemption under circumstances where an identically situated mortgagor would not. Nowadays a court is likely to require judicial foreclosure of an installment sale contract, permit the seller to retain payments only to the extent of the reasonable rental value of the property, and perhaps give the buyer an equitable right to cure his default and resume payments (analogous to the mortgagor's equity of redemption).

★**Example:** Buyer agreed to purchase Seller's home under an installment sale contract for $15,000. The contract required Buyer to pay the $15,000 over 15 years at 5 percent interest on the unpaid balance, in monthly installments of $118.62, for a total of payments of about $21,350. The contract provided that if Buyer defaulted and failed to cure the default for 30 days Seller could terminate the contract, take possession, and retain all payments paid. Eight years into the contract Buyer defaulted, having paid about half the purchase price. Seller sought to eject Buyer and a New York trial court granted summary judgment to Seller. In ***Bean v. Walker***, 95 App. Div. 2d 70 (1983), a New York intermediate appeals court reversed, holding that the principle of equitable title or equitable conversion applied, causing title to vest in the buyer at the moment the contract was executed, placing the buyer in the same position as a mortgagor. See also *Parise v. Citizens Natl. Bank*, 438 So. 2d 1020 (Fla. App. 1983); *Skendzel v. Marshall*, 301 N.E. 2d 641 (Ind. 1973); *Union Bond & Trust Co. v. Blue Creek Redwood Co.*, 128 F. Supp. 709 (N.D. Cal. 1955).

Exam Tips on *TRANSFERS OF REAL PROPERTY*

- Note your professor's interests and inclinations. A lot of this area is contract law imported into Property. If your professor is fond of this material it is more likely to be tested. If your professor treats it in cursory fashion, don't ignore it, but it may be of lesser importance in his or her pedagogical calculation.
- Contracts of sale involve issues of enforcement and choice of remedies. Remember the implied duties imposed on sellers here; watch out for facts suggesting a lack of marketable title, or breach of a duty to disclose.
- Deed warranties are fruitful areas of testing. Pay attention to the type of deed and the facts that will indicate which, if any, covenants may be violated. Make sure you have a good understanding of the method by which damages for violation of deed covenants are determined.
- The law pertinent to real estate finance is a bit of a speciality, but if your professor covers this material, watch out for an exam question. Good candidates include an installment sale contract in which the buyer has defaulted, and foreclosure or private sale at which the lender arguably fails to act in a commercially reasonable manner.

CHAPTER 7

ASSURING GOOD TITLE TO LAND

ChapterScope

- This chapter examines the problem of how current owners can obtain assurance that they actually have good title to the land they purchase. Included is discussion of how problems occur, often by multiple purchasers of the same land from the same seller, and the mechanisms of resolving these competing claims — recording acts, marketable title acts, title insurance, and registered title. Here are the most important points in this chapter.
- In cases of conflicting claims to the same property, the common law preferred the earliest claimant in time. That rule has been largely displaced by recording acts, which operate to give priority to those claimants who comply with the terms of the act.
  - Recording acts are based on the fact that every county in America maintains a public record of title transactions in real estate, usually organized and indexed alphabetically by grantors and grantees, in which any title transaction may be recorded. There are three types of recording acts: Race, Notice, and Race-Notice.
    - Race statutes give priority to the title claimant who first records his deed.
    - Notice statutes give priority to the bona fide purchaser who lacks notice of a prior unrecorded claim.
    - Race-Notice statutes give priority to the bona fide purchaser who lacks notice of a prior unrecorded claim only if the bona fide purchaser records first.
- Marketable title acts function as a statute of limitations to cut off old claims of title. The acts bar assertion of title claims that are not in the chain of title within some specified period of time prior to the present, but there are many exceptions to the limitations bar of marketable title acts.
- Registered title substitutes a registration system for the prevailing notice system. Under registered title, the title is exactly what is registered in the registry, and nothing can impeach that title. It delivers certainty but if the registered title is in error, the results can be devastating. Registered title is not popular in the United States.
- Title insurance is the most widely used method of providing meaningful assurances of good title. A well-funded title insurer issues a policy of title insurance to the owner, promising to insure that title is as stated in the policy, and stands ready to reimburse the insured for any title defects, up to the policy limits.

I. INTRODUCTION

A. The problem: To paraphrase James Madison, if men were angels there would be no need for methods to assure good title to land. But humans are often rogues, and sometimes they convey the

same property more than once. The rogue grantor may be universally condemned, but the remaining problem is to decide which purchaser from the rogue is to prevail.

Example: Rogue, owner of Blackacre, conveys it to Angel on January 1 for $50,000. On January 10, before Angel has taken possession, Rogue conveys Blackacre to Beatrice for $50,000. Beatrice is ignorant of the prior conveyance to Angel. Rogue is, of course, a scoundrel, but let us suppose he has disappeared with his $100,000 and so cannot be forced to disgorge his ill-gotten gain. As to the innocents — Angel or Beatrice — who should prevail?

1. **The common law answer:** The common law used the ***first-in-time*** principle to award title to Angel. She was the first grantee and, at that moment, Rogue conveyed his interest in Blackacre. Rogue had no interest in Blackacre to convey to Beatrice, so she was the loser. To protect grantees, the common law relied heavily on the warranties of title contained in a general or special warranty deed (see Chapter 6, section II.B), but these were of little use if Rogue had skipped off with his loot.

2. **Modern answers:** Because the common law method was crude, uncertain, and harsh, Americans quickly devised better methods of assuring good title. A brief summary of these methods follows.

   a. **Recording:** The first innovation was ***recording.*** A recording act creates a system for placing conveyances in a public record, and then stipulates who has priority in the event of conflict. A deed is valid without recording, but an unrecorded deed is likely to lose out to a recorded deed if both deeds are from the same grantor to the same property. In the example, neither Angel nor Beatrice have recorded, so the recording act does not apply until one or both records. There are three different types of recording acts, and the answer may vary. See section II, below.

   b. **Registration:** A later method, and one not much used in the United States, is to create an official registry of land titles. This system is different from recording of conveyances in that the ***registry is the title,*** and the public records simply contain ***evidence of title.*** From the example above, Rogue's registered title, in a registry system, would be replaced by a new registration in Angel. Beatrice would probably never part with the purchase price because of the inability to register title in her name. See section III, below.

   c. **Title insurance:** A ubiquitous method for obtaining practical assurance of good title is to obtain ***title insurance.*** For a fee, a title insurer agrees to ***defend title*** and to ***compensate for the loss of the insured title to the claim of a paramount owner.*** So long as the title insurer remains solvent, this is good enough for most buyers. The title insurer, of course, carefully examines title before issuing its title insurance policy, and will refuse to insure if it finds any defects in title. But a title insurer will not generally insure title unless the purchaser's deed is recorded and the insurer is satisfied that no rival claimant can have a better title. In the example, because neither Angel nor Beatrice have recorded, it is not likely that either could find an insurer willing to provide title insurance without specifically excepting from its coverage any unrecorded prior conveyances.

II. RECORDING ACTS AND CHAIN OF TITLE PROBLEMS

A. **The recording system:** A public official in each county, often called the county recorder, maintains a record of the transactions affecting real estate located in the county, but that record is only as

complete as what is presented to the recorder for filing. Any instrument affecting realty may be filed and recorded so long as it meets the formal requirements for recording (usually notarial acknowledgment). The most common instruments that are recorded are deeds and mortgages, but such things as judgment liens, tax liens, installment sale contracts, and leases can and often are recorded.

1. **What the recorder does:** The recorder's job is mostly ministerial. The recorder accepts instruments for filing by stamping the date and time of filing on them, then photocopying them and placing the copy in an official record. The original is returned to the person who presented it for filing. Then the recorder ***indexes the instrument*** by noting a description of the instrument in an index maintained to facilitate location of the instrument. Just as a searcher for a library book must consult a catalog of books by author, or subject, or title, the searcher of title records must consult the recorder's index. There are two types of indexes.

   a. **Grantor-grantee index:** By far the most common type of index is the grantor-grantee index. An alphabetical record of all grantors and all grantees, by surname, is maintained in separate volumes. The typical entry will contain the date, the name of the grantor (or grantee, as appropriate), the other party to the transaction, a brief description of the property and the instrument, and a citation to the precise location in the public records of a complete copy of the instrument.

   Example: On July 2, 1988, Harry Simpson conveyed 123 Elm Street to Agnes Darby. Here is how that transaction might appear in the grantor index of the county:

   > SIMPSON, Harry to Darby, Agnes. 7/2/88. General warranty deed to 123 Elm Street, recorded in Book 484, Page 1186.

   And here is how that transaction might appear in the grantee index of the county:

   > DARBY, Agnes from Simpson, Harry. 7/2/88. General warranty deed to 123 Elm Street, recorded in Book 484, Page 1186.

   b. **Tract index:** A few jurisdictions maintain a tract index, in which every transaction pertaining to a particular parcel is entered in one location, instead of chronologically by grantor and grantee. Tract indexes are most common where property has been platted by map into various blocks and lots within blocks.

   Example: Here is how the transaction in the last example might be indexed in a tract index:

   > TRACT: BLOCK 39, Lot 2 (123 Elm Street). 7/2/88. General warranty deed from Harry Simpson to Agnes Darby, recorded in Book 484, Page 1186.

2. **What the title searcher does:** A title searcher's objective is to identify all the ***past*** title transactions pertinent to a particular parcel, in order to determine the ***present*** state of title. This is a simple job if the jurisdiction maintains a tract index; the title searcher finds the page describing all title transactions pertinent to the parcel. The process is more complicated if a grantor-grantee index is involved. The searcher begins by looking back in time through the grantee index to find the transaction by which the present owner acquired title, then searches the grantee index further back to find the transaction by which the present owner's grantor acquired title. This process continues until an adequate root of title has been found (usually a title transaction far enough back in time to cut off any prior claims by a statute of limitations)

Then the searcher will turn to the grantor index and search forward in time, beginning with the initial grantor, to see if any owner ever conveyed her interest prior to the grant that appears to make up the chain of title traced backward in time. In most jurisdictions the searcher need only search forward from the time the grantor acquired title to the point when the grantor transferred title to the next owner in the chain. But in a few jurisdictions it is necessary to search forward to the present for every grantor.

Example: In 1890, Arthur conveyed Blackacre to Smith. In 1910, Smith granted Wilson an appurtenant easement for right of way over Blackacre. In 1920, Smith conveyed Blackacre to Rogers. Rogers conveyed Blackacre to Candiotti in 1950. Candiotti conveyed to Alvarez in 1980. In 1990 Alvarez granted Trustco a mortgage upon Blackacre. Your client, Barker, wishes to purchase Blackacre. To determine the state of title you would search the grantee index, under Alvarez, from the present time back to 1980, when you would find the deed from Candiotti to Alvarez. Then you would search the grantee index under Candiotti back to 1950, when you would find the deed from Rogers. Then you would search the grantee index under Rogers back to 1920, when you would find the Smith conveyance. Ditto back to 1890 when you would find the Arthur conveyance. Assume that a conveyance more than 80 years old is an adequate root of title; that makes the Arthur to Smith conveyance of 1890 the root of title. Then you search forward from 1890 in the grantor index under Smith. You will first find the 1910 easement grant to Wilson, then the 1920 conveyance to Rogers. You will search the grantor index under Rogers until you find the 1950 conveyance to Candiotti. You will then search under Candiotti from 1950 until 1980, when you find the conveyance to Alvarez. A final search forward under Alvarez from 1980 will reveal the mortgage to Trustco in 1990. You now know that Alvarez has good title to Blackacre, subject to an easement for right of way in favor of the present owner of Wilson's property and a mortgage to Trustco.

a. **Legal obligations of the title searcher:** Any title searcher is obligated to exercise reasonable diligence in performing the search. A searcher is liable for a negligent search that results in damage to the buyer if the search results are provided to the buyer. This is true even if the search is performed for the seller, because the buyer is universally treated as the third party beneficiary of the search and it is obviously foreseeable that a buyer might rely on any such search.

B. Race acts: A race act provides that, as between two grantees to the same property, the ***earliest to record*** prevails. Hence there is a race to record first. Under a race act, it does not matter that the first person to record had notice of a prior unrecorded conveyance. The reason for ignoring such notice is that making the record dispositive obviates the need to rely on extrinsic evidence about notice, which may be controverted and unreliable. But most jurisdictions regard the equitable cost of the race statute as too high, because it permits a later grantee to prevail over a known earlier grantee so long as the later grantee is quicker to record.

Example: On January 15 Rogue, owner of Blackacre, conveys for value to Prof. Scatterbrain, who absent-mindedly leaves the deed on his desk for a month, before recording it on February 15. Prof. Sly, Scatterbrain's colleague, sees the deed on Scatterbrain's desk, reads it, and observes that it is not yet recorded. On January 30, Prof. Sly pays value to Rogue for Blackacre and receives a deed from Rogue, which Prof. Sly records on February 1. As between Sly and Scatterbrain, Sly prevails because he recorded first. Sly's knowledge of Scatterbrain's prior purchase is irrelevant.

C. Notice acts: Notice acts address the inequity of permitting a later purchaser to prevail over an earlier purchaser when the later purchaser knows of the prior purchase. They do so by providing that a ***subsequent bona fide purchaser*** **without notice of a prior unrecorded transfer** prevails over the prior purchaser who has failed to record. And this is true ***even if the subsequent purchaser has not recorded.*** Here is a simplified example of a notice statute: "No conveyance is valid against a subsequent bona fide purchaser who has no notice of the conveyance, unless the conveyance is recorded." About half of American states have notice acts.

Example: On January 15, Able conveys Blackacre to Hector, who fails to record the deed. On February 15, Able conveys Blackacre to Artemis for $100,000. Artemis is ignorant of the January conveyance to Hector. Artemis prevails over Hector, regardless of who might first record his deed. The critical facts are that, at the moment Able conveyed to Artemis for value, (1) Artemis lacked notice of the prior conveyance to Hector, and (2) Hector had not recorded his deed (which would have given constructive notice to Artemis).

D. Race-notice acts: A race-notice act protects a more limited class of subsequent bona fide purchasers who lack notice of the prior conveyance: It protects only those subsequent bona fide purchasers who lack notice and who ***record before the prior purchaser.*** Here is a simplified example of a race-notice statute: "No conveyance is valid against a subsequent bona fide purchaser who has no notice of the conveyance and who has recorded his conveyance first." The supposed virtues of a race-notice act, as compared to a notice act, are (1) encouraging recording, and (2) eliminating disputes over which of two conveyances was first delivered. The first rationale is probably true but weak, and the second addresses a largely imaginary problem. Even so, these arguments are persuasive enough to cause about half of American states to have enacted race-notice acts.

Example: On June 1, Bilbo conveys Blackacre to Jane, who does not record. On July 1, Bilbo conveys Blackacre to Sally for $100,000. Sally is ignorant of the prior conveyance to Jane. On July 15 Jane records her deed. On July 20 Sally records her deed. Jane prevails over Sally because, even though Sally lacked notice of the conveyance to Jane, Jane recorded before Sally.

E. The consequences of recording: Recording provides constructive notice to the world of a conveyance. Even if a later purchaser fails to consult the record he is charged with knowledge of its contents. In a race or race-notice jurisdiction recordation cuts off the possibility that either a prior unrecorded purchaser or a later purchaser could prevail. In a notice jurisdiction recordation provides constructive notice, thus preventing later purchasers from prevailing.

1. **The consequences of not recording:** There are two important consequences to failure to record.

   a. **Common law rule applies:** If nobody has recorded the common law principle of "first-in-time" continues to apply, except in a notice jurisdiction when the subsequent bona fide purchaser lacks notice.

   b. **Grantor can convey good title to a later purchaser:** More ominous to purchasers is the fact that, without recordation, the grantor is left with the power to convey good title to a later purchaser. Of course, the grantor who does this is often a scoundrel, and may well be liable to the losing first purchaser for the proceeds received from the second purchaser.

   Example: Olivia, the record owner of Blackacre, conveys Blackacre to Brewster, who fails to record. Then Olivia conveys Blackacre to Abigail for $100,000. Abigail, who is ignorant

of the conveyance to Brewster, then records. In all three types of jurisdictions Abigail will prevail. Had Brewster recorded before the sale to Abigail, Brewster would have prevailed everywhere. Brewster may be able to recover from Olivia the $100,000 she received from Abigail, on the theory that Olivia holds those proceeds in a constructive trust for Brewster, but Brewster could have avoided the whole mess by prompt recordation. Always record promptly.

F. When is an instrument recorded? To be recorded, an instrument must be eligible for recording and be entered in the records in a manner that complies with the jurisdiction's requirements. Virtually anything that affects title to or an interest in real property may be recorded. Most states require that an instrument may not be recorded without a notarial acknowledgment. To obtain a notarial acknowledgment, the grantor must prove his identity to a notary and sign the document with the notary as witness. Some states require or permit witnesses to perform the function of the notary. The problem is that recorders, being human, are not infallible. The following are the common instances of instruments appearing in the record that are wholly are partially unrecorded.

1. **Instrument not indexed:** This recorder's error is to fail to index an instrument or to index it so improperly that it cannot be found by a diligent searcher using the standard search methods. Jurisdictions split on the proper resolution of this problem. The older rule is that "a purchaser is charged with constructive notice of a record even though there is no official index which will direct him to [the particular instrument]." 4 Amer. Law of Prop. §17.25 (1952). On this theory, the purchaser has done all he can do by tendering an eligible instrument to the recorder for recording. See, e.g., *Haner v. Bruce,* 146 Vt. 262 (1985). However, the diligent searcher cannot find the unindexed instrument. Because constructive notice from the record is founded on the assumption that a searcher can find it if he looks, the newer rule is that the unindexed or improperly indexed instrument ought not provide constructive notice. See, e.g., *Hochstein v. Romero,* 219 Cal. App. 3d 447 (1990).

2. **"Omnibus" or "Mother Hubbard" clauses:** A variation on the improperly indexed instrument is an instrument that accurately describes one parcel, Blackacre, and also includes "all other land owned by the grantor in the county." These omnibus clauses are sometimes called "Mother Hubbard" clauses, because they "sweep the cupboard bare." The recorder can only record this instrument by reference to Blackacre, because it is an unreasonable burden on the recorder to search the records to identify all the other property owned by the grantor. Omnibus clauses are void as against later purchasers of the grantor's property (other than Blackacre) because a diligent searcher of the index (with respect to a parcel other than Blackacre) will never locate any reference to the omnibus clause.

★**Example:** Grace Owens owned interests in eight oil and gas leases in Coffey County, Kansas. She assigned to International Tours her interest in those leases under an assignment that specifically described each of the seven different parcels and included an omnibus clause that assigned to Tours Owens's interest "in all oil and gas leases in Coffey County, Kansas" owned by Owens, "whether or not [such leases] are specifically enumerated" in the assignment. The Kufahl lease, in which Owens had an interest, was not specifically described. Four years after Tours recorded the assignment Owens assigned her interest in the Kufahl lease to Burris, who had checked the public records and had obtained an abstract of title from a professional title searcher. Neither search revealed the existence of the omnibus clause in the Owens-to-Tours assignment. Kansas has a notice statute. In ***Luthi v. Evans,*** 223 Kan. 622 (1978), the Kansas Supreme Court held that the omnibus clause in the Owens-to-Tours assignment did not

give constructive notice to later purchasers of Owens's interest in the Kufahl lease. Burris prevailed, taking the Kufahl lease free of Tours's interest because it was not reasonable to expect a title searcher to locate and read every other conveyance ever made to Owens at any time conferring an interest in an oil and gas lease in Coffey County, Kansas. That would be a monumental task, greatly increasing the time and expense of title searches, which Kansas's recording act did not contemplate.

3. **Misspelled names:** Jurisdictions divide over whether a misspelled name in a recorded instrument gives constructive notice. All jurisdictions agree that if the misspelling is so significant that it does not even sound like the correct name, there is no constructive notice. Thus, "Kirk" for "Church" is inadequate, even though both names refer to a house of worship. The problem that divides jurisdictions is whether the misspelling that sounds like the correct name supplies constructive notice. The doctrine of *idem sonans* holds that a misspelling that sounds substantially identical to the correct name gives constructive notice. See 4 Amer. Law of Prop. §17.18, which adopts *idem sonans* so long as the misspelling begins with the same letter as the correct spelling. However useful *idem sonans* may be to establishing identity in other contexts, it is ***not the prevailing rule*** with respect to the issue of constructive notice from the real estate records.

★**Example:** Orr obtained a judgment against Elliott, but Orr's lawyer prepared the judgment by spelling Elliott's name as "Elliot." An abstract of the judgment, listing the judgment debtor as "Elliot" or "Eliot" was recorded in Orange County, California and indexed under those two names only. Elliott later conveyed property subject to the judgment lien to Byers and Orr sought to foreclose his lien against the parcel acquired by Byers from Elliott. In ***Orr v. Byers,*** 198 Cal. App. 3d 666 (1988), the California intermediate appeals court held that *idem sonans* did not apply in California, and thus that the recorded abstract did not give constructive notice of Orr's lien. Byers prevailed, but if he had had *actual notice* of Orr's lien he would have lost. The court reasoned that *idem sonans* would place an unreasonable burden on title searchers, especially given the uncertain contours of the doctrine in a highly multicultural society. Also, the problem can be more easily avoided by those who prepare instruments for recording.

4. **Ineligible instrument:** The usual ineligible instrument is an unacknowledged instrument that nevertheless appears on the record through the recorder's oversight. Because such an instrument is not eligible for recording, it is treated as unrecorded and thus does ***not give constructive notice*** of its contents. A subsequent purchaser will prevail unless she has ***actual notice*** of the prior conveyance or is under a duty to inquire and that inquiry would reveal the prior conveyance.

   a. **Defect not apparent on the face of the instrument:** Jurisdictions split on whether constructive notice is imparted by an apparently recorded instrument that is ineligible for recording due to some defect ***not apparent*** from the instrument itself. The majority rule is that an instrument with a defect on its face does ***not*** give constructive notice but an instrument with a hidden defect ***does impart*** constructive notice. See, e.g., *Metropolitan Natl. Bank v. United States,* 901 F. 2d 1297 (5th Cir. 1990); *Mills v. Damson Oil Co.,* 437 So. 2d 1005 (Miss. 1983). Because even the most diligent searcher of the records could not possibly have any inkling of a hidden defect, it makes little sense to rule that the instrument is not recorded and thus imparts no constructive notice, but some states do just that.

   ★**Example:** Caroline Messersmith and her nephew Frederick owned land in North Dakota as equal tenants in common. Caroline conveyed to Frederick her interest under a deed that

Frederick did not record, probably because the parties intended the deed to be a will substitute. Caroline, still in possession, conveyed a half interest in the mineral rights to Smith under a deed that Smith then took to a notary, who then spoke to Caroline by phone to ask whether the signature on the deed in front of the notary was hers. Upon being assured that the signature was Caroline's the notary affixed his notarial seal and acknowledgment, but this notarial acknowledgment was void because Caroline was not physically present to be certain that the document in front of the notary was in fact the deed she signed and not some other instrument. (It's possible that Smith could have forged her signature to a different deed which he then presented to the notary.) Smith then conveyed his mineral interest to Seale, who claimed to have no notice of Frederick's interest in the land. Only then did Smith record the Caroline-to-Smith deed; on the same day the Smith-to-Seale deed was recorded. Six weeks later Frederick recorded his Caroline-to-Frederick deed, and then brought suit to quiet title in his name. A trial court ruled that because Seale was a bona fide purchaser who lacked notice of the Caroline-to-Frederick deed and who recorded his deed from Smith and the Caroline-to-Smith deed before Frederick recorded, Seale should prevail under North Dakota's race-notice statute. On appeal the North Dakota Supreme Court, in ***Messersmith v. Smith,*** 60 N.W. 2d 276 (N.D. 1953), reversed, holding that no subsequent instrument in the chain of title passing through the secretly defective instrument is validly recorded. Given that the defect could not possibly be known to anyone carefully scrutinizing the record, it is hard to see what purpose was served by the ruling. Notarial acknowledgments are intended to prevent forgery, but there was no allegation of forgery and, absent that, the record should speak for itself.

G. Scope of protection afforded by recording acts: The protection afforded by a recording act is defined by the statute, as interpreted by the courts of the jurisdiction. Read the recording act carefully!

1. **Invalid conveyance:** Although recordation creates a presumption of validity, if in fact the instrument was invalid (e.g., it was forged or never delivered) recordation does not make it valid.

2. **Interests in land created by operation of law:** Recording acts only apply to ***conveyances*** (e.g., deeds, mortgages, grants, contracts) and ***liens*** created by operation of law (e.g., judgments). They do ***not apply to* interests *created by operation of law,*** such as adverse possession, prescriptive easements, or implied easements. Even though such interests are not of record, they are still valid and enforceable against subsequent purchasers.

3. **Bona fide purchasers:** Notice and race-notice recording acts are intended to protect the ***bona fide purchaser*** of property. A bona fide purchaser is one who gives ***valuable consideration*** to purchase the property and is ***without notice*** of a prior unrecorded conveyance. Race acts protect bona fide purchasers only to the extent they are the first to record. Obviously, a ***donee does* not receive protection** because a donee has not given value.

   a. **Shelter rule:** The protection given a bona fide purchaser under a recording act extends to all takers from the bona fide purchaser, even if such a taker knows of a prior unrecorded conveyance. This "shelter rule" is necessary to give the bona fide purchaser the full value of his purchase in reliance on the records. Part of that value is the ability to transfer good title to others.

Example: Ovid conveys to Alan, who does not record. Ovid then conveys to Barbara, a bona fide purchaser (BFP), who does record. Barbara then conveys to Charles, who knows all about the Ovid-to-Alan deed. Barbara will prevail over Alan in all three types of jurisdictions. In a notice or race-notice jurisdiction, Charles's knowledge of Alan's deed is irrelevant only because he is a taker from Barbara, a bona fide purchaser. Charles is "sheltered" by his vendor's status as a BFP.

4. **Mortgagees:** Mortgagees are generally treated as bona fide purchasers, either because the statute specifically includes them or because courts have interpreted the phrase *bona fide purchaser* to include them. But this only applies to the mortgagee who actually gives value (e.g., the loan proceeds) in return for the mortgage. In most states a mortgagee who receives a mortgage to secure a ***pre-existing debt*** without some detrimental change in its position (e.g., a reduction in the interest rate) has not acquired the mortgage for value and so is not a bona fide purchaser. See, e.g., *Gabel v. Drewrys Ltd., U.S.A., Inc.*, 68 So. 2d 372 (Fla. 1953). The contrary view is taken by the Uniform Simplification of Land Transfers Act, §§1-201(31) and 3-202.

5. **Creditors:** The status of creditors depends on the language of the act.

   a. **No protection:** If a recording act protects only "purchasers," a creditor is protected only if he should purchase the owner's interest at a judicial sale resulting from a successful lawsuit to collect the debt.

   b. **Specific protection:** If a recording act specifically protects "creditors" or "all persons" a creditor will receive protection without the necessity of a purchase at a judicial sale, but the scope of that protection is often limited by courts to ***judgment creditors*** or ***lien creditors.*** The rationale is that creditors do not generally rely on the state of the public land records in extending unsecured credit, but a creditor who has reduced a claim to judgment or lien intends to seize and sell the debtor's property. The judgment or lien creditor has an interest in the state of the record in order to know what his priority is with respect to the debtor's property.

H. **Notice:** To be protected under a notice or race-notice statute, a purchaser must be without ***actual or constructive notice*** of any prior unrecorded interests at the time the purchaser pays the consideration.

1. **Actual notice:** Actual notice is real, actual knowledge of the prior unrecorded transaction. Evidence beyond the record is necessary to prove actual notice.

2. **Constructive notice:** There are two forms of constructive notice: ***record notice*** and ***inquiry notice.***

   a. **Record notice:** The entire world, specifically including a subsequent grantee, is charged with constructive notice of the contents of the record. If an instrument is validly recorded, every subsequent grantee has constructive notice of it, and so cannot be a bona fide purchaser. However there can be argument over what constitutes the record, thus supplying constructive notice to subsequent purchasers.

      i. **"Wild deeds" — Outside the chain of title:** If a complete stranger to the record chain of title records a conveyance (a "wild deed"), the conveyance does not give constructive notice because it is not within the chain of title.

★**Example:** In Minnesota, a race-notice state, Hoerger conveyed a lot to Duryea & Wilson (D&W), who did not record. D&W then conveyed the lot to Board of Education, who did record, after which Hoerger conveyed the same lot to Hughes, who lacked notice of the conveyance from Hoerger to D&W. Hughes recorded. In ***Board of Education of Minneapolis v. Hughes,*** 118 Minn. 404 (1912), the Minnesota Supreme Court decided that Hughes prevailed over the Board of Education because the conveyance from D&W to the Board of Education was outside the chain of title and did not impart constructive notice. At the time Hughes purchased from Hoerger, a diligent title search would reveal Hoerger to be the record owner. Even though the deed from D&W to the Board of Education was recorded first, it would appear to be a deed made by a complete stranger to the chain of title. Because the Hoerger-to-D&W link in the chain was not recorded a diligent searcher would never find the D&W-to-Board conveyance. See also ***Zimmer v. Sundell,*** 237 Wis. 270 (1941).

ii. Expanded chain of title — Deeds from common grantor: Reciprocal implied covenants restricting land use may be implied by a developer's conveyance of property subject to express covenants burdening the developer's retained land (see Chapter 9), but such a covenant does not appear in the chain of title of the retained land, if it is conveyed without the implied covenant being made express. Does a deed by a developer to Lot 1, which imposes a use restriction on Lot 1 and all other lots retained by the developer (including Lot 2), impart constructive notice of the covenant to a later purchaser of Lot 2 from the developer? Note that the use restriction does not appear in the developer's deed to Lot 2. Jurisdictions split on this issue. Most conclude that the burden on title searchers to locate and read all deeds out from a common grantor is unreasonable. See, e.g., *Buffalo Academy of the Sacred Heart v. Boehm Bros., Inc.*, 267 N.Y. 242 (1935). A few states conclude that purchasers of property from a common grantor have constructive notice of the contents of all deeds out from a common grantor, thus imposing the practical burden of searching all deeds out from a common grantor.

★**Example:** Gilmore, a developer and subdivider, conveyed a lot to Guillette under a recorded deed that restricted the lot's use to a single-family residence, and recited that "the same restrictions are hereby imposed on each of [the] lots now owned by seller." This was effective to impose the single-family residence use restriction on all of Gilmore's remaining lots. Later, Gilmore conveyed a restricted lot to Daly under a recorded deed that made no mention of any restrictions. Daly obtained a building permit to construct 36 apartment units on the lot. Other owners of lots in the development (all of whom obtained title from Gilmore) sought to enjoin Daly from violating the single-family residence use restriction. In ***Guillette v. Daly Dry Wall, Inc.,*** 367 Mass. 355 (1975), the Massachusetts Supreme Judicial Court held that Daly acquired the lot with constructive notice of the restriction even though the restriction was not in the chain of title from Gilmore to Daly. The ***Guillette*** rule requires a purchaser to expand his search of title to include all conveyances made by the grantor of other adjacent property he owned, in order to be certain that the grantor did not burden his remaining property with a use restriction contained in a deed to a third party. Jurisdictions rejecting this rule reason that this search burden is not reasonable.

iii. After-acquired title: Suppose a grantor conveys title without having title, but then later acquires title. Under the after-acquired title doctrine (see Chapter 6) the title "shoots

through" the grantor to the grantee. But suppose the grantor conveys title twice, once before acquiring it and once afterward to a person without actual notice of the prior conveyance, and both conveyances are immediately recorded. Does the first conveyance, made at a time when the grantor has never been a grantee (and thus will not be found in the usual backwards-in-time search by grantees) impart constructive notice? Or should a title searcher be obligated to search a period earlier in time than the grantor acquired title, on the possibility that the grantor conveyed away his title before he ever got it? The majority rule is that the first conveyance does ***not impart constructive notice*** because it is not reasonable to expect title searchers to search the records for the time period prior to the grantor's acquisition of title on the off chance that the grantor might have conveyed his title before he received title.

Example: The United States owned a tract of land that Lowery occupied under a statutory right of temporary possession, a latter-day version of the Homestead Act under which Lowery could ultimately acquire title if he performed certain acts of improvement over a specified time period. While Lowery was in possession but before he had any title to the land Lowery conveyed his interest in the tract to Horvath, who recorded the deed. Later, after the United States had conveyed its title in the land to Lowery (and Lowery had recorded the deed from the United States), Lowery conveyed the same property to Sabo, who recorded his deed. In *Sabo v. Horvath*, 559 P. 2d 1038 (Alaska 1976), it was held that Sabo prevailed over Horvath, because Horvath's deed was outside the chain of title. A diligent title searcher would go back in time until he found the conveyance from the United States to Lowery in the grantee index, and would then search the grantor index (under Lowery) forward in time to see if Lowery had made any other conveyances, but could not reasonably be expected to search the grantor index ***before Lowery had title.***

A few old cases apply after-acquired title doctrine uncritically and hold that title searchers must examine the grantor index before the time each record owner acquired title in order to see whether the owner conveyed title before he acquired it. See, e.g., *Tefft v. Munson*, 57 N.Y. 97 (1874); *Ayer v. Philadelphia & Boston Face Brick Co.*, 159 Mass. 84 (1893). By requiring a more extensive search these cases expand the scope of the chain of title and such expanded searches are expensive, especially if the chain of title is long.

iv. Deed recorded after grantor has parted with record title: Must a title searcher search the grantor index forward past the point that the record discloses he has already parted with title? If the first recorded conveyance is to a bona fide purchaser (BFP) and the shelter rule applies there will be no need to do so, but if the first recorded conveyance is ***not*** to a BFP (perhaps it is to a donee or a purchaser with actual notice of a prior unrecorded conveyance) the question becomes more complicated. Jurisdictions split on this issue.

Example: Ovoid, owner of Blackacre, conveys to Alice, who fails to record. Then Ovoid conveys Blackacre to Ben, who knows of the Ovoid-to-Alice conveyance. Ben records his deed. Alice then records her deed from Ovoid. As between Alice and Ben, Alice will prevail because Ben is not a BFP without notice. But then Ben conveys to Charles, who pays value and is ignorant of the Ovoid-to-Alice conveyance. Charles records. Who prevails, Alice or Charles? The answer depends on whether the Ovoid-to-Alice deed

although recorded later than the Ovoid-to-Ben deed, gives constructive notice to Charles, a later BFP. About half the states rule in favor of Alice, holding that the chain of title includes all instruments of record up to the moment the subsequent purchaser acquires title, even though they may be recorded after a grantor has first parted with record title. In these jurisdictions, a diligent title searcher must shoulder the huge burden of searching the grantor index forward to the present for each person who ever owned the property. See, e.g., *Woods v. Garnett,* 72 Miss. 78 (1894); *Westbrook v. Gleason,* 79 N.Y. 23 (1879); *Mahoney v. Middleton,* 41 Cal. 41 (1871); *Angle v. Slayton,* 102 N.M. 521 (1985). The other half of the states rule in favor of Charles, reasoning that a title searcher should be excused from further search forward in time after he finds a recorded conveyance of title from the grantor to another person. Thus, once a searcher has found the Ovoid-to-Ben deed, he need not search any further forward in time. In these jurisdictions the Ovoid-to-Alice deed is outside the chain of title and provides no constructive notice. See, e.g., *Morse v. Curtis,* 140 Mass. 112 (1885); *Day v. Clark,* 25 Vt. 397(1853).

v. **Prior deed recorded after partial payment by later purchaser:** Courts are much vexed over the following problem: Owner conveys to Prior Purchaser, who fails to record the deed; Owner then conveys to Later Buyer (who lacks notice of the prior conveyance) under a contract calling for a down payment and subsequent payments; Later Buyer records his deed but before making the final payment learns of the prior conveyance. Who should prevail: Prior Purchaser because Later Buyer was on notice of the prior claim before he fully paid (depriving Later Buyer of BFP status) or Later Buyer because he lacked notice at the time he entered into the transaction? The traditional answer is to prefer Prior Purchaser and employ ***restitution*** as the remedy: Give the property to Prior Purchaser on condition that he reimburse Later Buyer for the payments made by him. The alternative answer is to give Later Buyer the ***benefit of the bargain:*** Award the property to Later Buyer but require that the remaining payments be made to Prior Purchaser rather than Owner.

★**Example — Restitution:** Jacula conveyed a lot to Daniels and in the contract of sale gave Daniels a right of first refusal to purchase another parcel contiguous to the first lot (the "Contiguous Parcel"). The contract was not recorded. Later, Jacula conveyed the Contiguous Parcel to Zografos for $60,000, under an installment sale contract calling for a $10,000 down payment and later installments. Zagrofos paid Jacula another $30,000 before learning of Daniels's prior claim, made the final payment of $20,000, and then received and recorded a deed. Daniels sought and received specific performance of his purchase option. In ***Daniels v. Anderson,*** 162 Ill. 2d 47 (1994), the Illinois Supreme Court affirmed, reasoning that Zografos was protected by his lack of notice only for the payments made before he received notice, and concluding that an award of the property to Daniels with a requirement that Daniels reimburse Zografos for the total of his payments to Jacula was the best method to deal with the mischief caused by Jacula.

★**Example — Restitution:** Thomas and his son Charles owned a house as equal tenants in common. Thomas then conveyed his interest in the house to Mary, his daughter. A week later Thomas conveyed the same interest to Charles in return for $1,000 and Charles's promise to care for Thomas for the remainder of his life. Charles, who was unaware of the prior deed to Mary, recorded his deed. A few months later Mary recorded

her deed. Charles cared for Thomas until Thomas's death. Mary claimed a half interest based on her prior deed; Charles claimed to be a subsequent purchaser without notice of Mary's prior claim. In ***Alexander v. Andrews,*** 135 W. Va. 403 (1951), the West Virginia Supreme Court held that Charles was protected only to the extent of the $1,000 he paid before Mary recorded. The value of his care of Thomas after Mary's recording was expended with constructive notice of Mary's claim.

★**Example — Benefit of the bargain:** The Lewises agreed to purchase a house from Shipley for $2.3 million. Before the closing Fontana Films filed for recording a *lis pendens* on the house. A *lis pendens* is a notice of pending litigation in which the plaintiff claims an ownership interest in the subject property; once duly recorded it is a lien on title and any subsequent purchaser takes subject to the plaintiff's claim. On February 28, 1992 the Lewises paid Shipley $350,000 down, gave Shipley their note for $1,950,000, and received and recorded a deed. On February 29, 1992 the *lis pendens* was indexed, the magic moment of recording in California; from then on it constituted constructive notice. (Note that because California is a race-notice state Fontana lost its priority to the Lewises because they recorded first without notice.) In March 1992 the Lewises paid Shipley the balance due on their note and then spent another $1 million or so on renovations. (This is Southern California.) Only in September 1993, when Fontana Films served them with summons and complaint, did the Lewises acquire *actual notice* of Fontana's claim but, of course, they had *constructive notice* of Fontana's claim since February 29, 1992. The Lewises sued to remove the *lis pendens* and quiet title in their names. A trial court denied this relief but, in ***Lewis v. Superior Court,*** 30 Cal. App. 4th 1850 (1994), the California intermediate appeals court reversed. Limiting an 1895 California Supreme Court opinion applying the traditional rule to its specific facts, the court of appeal thought that the Lewises should get the benefit of their bargain for four reasons: (1) the traditional rule is inconsistent with modern expectations of a buyer who makes part payment and binds himself irrevocably to pay the rest of the purchase price; (2) the Lewises lacked actual notice throughout the saga and application of the traditional rule to constructive notice "penalizes a completely innocent purchaser for simply living up to his payment obligations"; (3) equity requires that the wrongdoer's interests be sacrificed first and, although the court did not say so, as between the trio involved in ***Lewis,*** inasmuch as Shipley had been paid, the loss should fall on the party best able to avoid it — Fontana, because it could have recorded its *lis pendens* in timely fashion so that it would have been of record when the Lewises closed their deal with Shipley; and (4) the traditional rule provides an anomalous and unwarranted benefit to cash buyers (or those who finance their purchase with third party lenders rather than by installment sale or purchase money mortgages from the seller).

b. Inquiry notice: In most states a subsequent purchaser has an obligation to make reasonable inquiries, and is charged with knowledge of what those reasonable inquiries would reveal. The following subsections explore some of the circumstances that trigger a duty to inquire.

i. Record reference to an unrecorded instrument: If a recorded instrument refers expressly to an unrecorded instrument, a purchaser is under an obligation in many states to inquire about the substance of the unrecorded instrument to which the record refers.

★**Example:** In 1922 Susan Harper conveyed her Georgia farm to Maude Harper for life, remainder to Maude's children. The deed was mislaid and thus not recorded. In 1928, Susan having died, Susan's children executed and delivered a quitclaim deed to Maude by which they conveyed any interest they might have in the farm to Maude. The 1928 deed, which contained a recital that it was "to take the place of the deed made and executed by Mrs. Susan Harper during her lifetime," was duly recorded. In 1933 Maude executed a deed of trust of the farm to Ella Thornton to secure a $50 loan. Thornton foreclosed after default and received a sheriff's deed, recorded in 1936. Through a succession of recorded conveyances from Thornton title to the farm was vested in 1955 in the Paradises. In 1957 the mislaid 1922 deed was found and recorded. Upon Maude's death in 1972 her children sued to recover possession. A trial court ruled for the Paradises but in ***Harper v. Paradise,*** 233 Ga. 194 (1974), the Georgia Supreme Court reversed. Paradise could not rely on a Georgia statute protecting the title of innocent purchasers from heirs or apparent heirs who lack actual notice of prior claims because the recitals in the 1928 deed made specific reference to an unrecorded 1922 deed, thus negating the inference that otherwise would exist that the makers of the 1928 deed were conveying their inherited interest. Adverse possession was unavailing for Paradise because their entry was against Maude and all Maude owned was a life estate; thus the limitations period did not begin to run until Maude's death in 1972. Although the 1928 deed, upon which the Paradises' title was founded was recorded before the 1922 deed, upon which Maude's children based their claim, Georgia is a race-notice state and the court concluded that the recitals in the 1928 deed placed a duty upon subsequent purchasers to inquire of Maude to determine the details of the unrecorded deed referred to in the 1928 deed. Thus, the Paradises had constructive notice of the prior claim when they acquired title and so lost.

This rule is not universally followed, especially when the issue is whether a subsequent taker should be charged with inquiry notice by a recorded memorandum of a lease that does not set forth the specifics of the lease. Compare *Mister Donut of America, Inc. v. Kemp,* 368 Mass. 220 (1975) (inquiry notice, subsequent taker charged with constructive notice of lease contents), with *Howard D. Johnson Co. v. Parkside Dev. Corp.,* 169 Ind. App. 379 (1976) (no inquiry notice and thus no constructive notice of the lease contents).

ii. Possession: Most states impose a duty to inquire of whoever is in possession of the subject property.

★**Example:** Choctaw Partnership, a developer, built a condominium complex financed by construction loans secured by a recorded mortgage, later assigned to Eglin National Bank. Then Choctaw sold Unit 111 to Waldorff under a contract of sale that was unrecorded, but sufficient to vest in Waldorff equitable title to Unit 111. Waldorff moved in and occupied Unit 111 for 11/2 years, then moved out but kept furnishings in the unit and asserted exclusive possessory rights to the unit. Choctaw borrowed additional money from Eglin secured by a recorded mortgage to a number of condominium units, including Unit 111. Then Choctaw, which owed Waldorff money, executed and delivered a deed to Unit 111 in return for Waldorff's cancellation of the debt. Waldorff recorded the deed. Choctaw then defaulted on its notes to Eglin and Eglin sought to foreclose on Unit 111. The trial court ruled that Eglin's prior recorded mortgage liens had priority over Waldorff's interest, but in ***Waldorff Insurance & Bonding, Inc. v. Eglin Natl. Bank,*** 453 So. 2d 1383 (Fla. App. 1984), the Florida intermediate

appeals court reversed. Because Waldorff was in possession Eglin was on inquiry notice that Waldorff might have a prior unrecorded claim. Even though Waldorff, as the party in possession, in theory might be the party who could avoid the problem by recording it is unlikely that the contract of sale was notarized and capable of recording. Sellers under installment sale contracts dislike making such contracts recordable because they wish to avoid any clouds on title until the purchase price is fully paid.

If inquiry would reveal that the possessor occupies under an unrecorded conveyance from the record owner the subsequent purchaser has constructive notice of the claim by virtue of this doctrine of inquiry notice. See, e.g., *Miller v. Green*, 264 Wis. 159 (1953) (inquiry notice of a prior unrecorded contract of sale to a farm predicated upon the later buyer's knowledge of the prior purchaser's acts of fertilizing and plowing the farm in November, time when only owners are apt to be working their land). There are various permutations on the inquiry notice theme: Some states limit the obligation to inquire to instances where the possession is by a stranger to the record title; others limit inquiry to instances where the later purchaser has actual knowledge of the existence of a possessor.

iii. **Character of neighborhood:** As discussed in Chapter 9, reciprocal implied covenants restricting land use may also be implied by a uniform development scheme undertaken by a common owner/developer of property. In states that recognize implied reciprocal covenants from a common scheme, a purchaser is under a duty to inquire about the deeds out from a common grantor, deeds which may establish the common scheme, if the character of the neighborhood suggests such a common scheme. The leading case is ***Sanborn v. McLean,*** 233 Mich. 227 (1925).

iv. **Immediate grantee of a quitclaim deed:** A few jurisdictions hold that a conveyance by quitclaim deed is inherently suspicious because it raises doubts about the grantor's belief in the validity of his own title. Thus, the immediate grantee of a quitclaim deed is obligated to inquire into the actual state of the grantor's title, and cannot simply rely on the public records. But this is ***not the majority rule;*** in most states, the mere fact that a conveyance is by quitclaim deed does not trigger inquiry notice. See 6A Powell, The Law of Real Property ¶905[1][B] (rev. ed. 1992).

3. **Tract index: A solution to chain of title problems?** Grantor-grantee indexes, which are by far the most common form of index to public land records in the United States, spawn a variety of problems with the chain of title which have been discussed above. Many of these problems will not occur with a tract index, but most jurisdictions do not maintain tract indexes, and it would be very expensive to find and index, by tract, all of the prior transactions presently indexed by grantor and grantee.

I. **Marketable title acts:** Marketable title acts are the principal legislative response to the fact that, like all human systems, the recording system is imperfect. Eighteen states have adopted marketable title acts, which are designed to limit the relevant chain of title to some specified period of recent history — from 22 to 50 years in the past. If a chain of title can be traced back to a root of title older than the period prescribed by the marketable title act (say 40 years) most claims based on some older instrument are barred by the statute, unless they are incorporated into a later instrument recorded during the marketable title period.

Example: Blackacre is located in a state with a 40-year marketable title act. In 1953 Elvis, the record owner of Blackacre, conveyed to Frank an easement for parking on Blackacre, which

Frank recorded. George purchased Blackacre from Elvis, via a deed recorded in 1955. In 1964 George conveyed and recorded an easement for cable television access to Cablecorp. The present record owner is Lottie, who purchased from George, via a deed recorded in 1970. The deed from Elvis to George is the root of title, because it is more than 40 years old. If the state's act makes no exception for older claims, the easement in Frank is extinguished by the marketable title act but the easement in favor of Cablecorp is valid because it is of record within the past 40 years. Note that in 2010 the root of title will be updated to the George-to-Lottie deed in 1970, and that will eliminate the easement in favor of Cablecorp, which dates from 1964. This presumes also that none of the post-1953 deeds refer to Frank's parking easement and that none of the post-1964 deeds refer to the Cablecorp easement.

1. **Validity of pre-root interests:** Unless the act makes a specific exception for pre-root interests pre-root interests are invalid unless (1) they are referred to in the root of title itself or some post-root recorded instrument, or (2) they are recorded anew during the marketable title act period. In the preceding example, Frank and Cablecorp could keep their easements alive by re-recording them every 40 years.

   a. **Statutory exceptions:** The interests excepted from marketable title acts vary. Most statutes except most easements, claims of the current possessor, restrictive covenants, and, sometimes, mineral rights. These exceptions undercut the utility of marketable title acts.

III. TITLE REGISTRATION — THE TORRENS SYSTEM

A. **Introduction:** Title registration is a substitute for recording. Instead of recording evidence of title, which is what a recording system does, a registration system makes a certificate of title the exclusive and definitive title. Title registration was invented in Australia in 1858 by Sir Richard Torrens, whose name is commonly used to describe the system. For a registration system to work there must first be a final and conclusive determination of ownership, binding on all the world. This requires a court proceeding to cut off all rival claims. Then the definitive title is registered and indexed in a tract index. When ownership changes, the certificate of title is canceled and a new one issued. The Torrens system is widely used in the United Kingdom, Canada, Australia, and New Zealand. Title registration is an option in 11 American states but is not much used.

B. **Adjudication of title:** To implement title registration it is necessary to adjudicate title, in order to cut off all possible rival claims. The owner must bring an *in rem* action that is functionally identical to a quiet title action. Notice must be given to all persons who might have any conceivable claim to title or an interest in the property. At the conclusion of this proceeding, the court will issue a certificate of title that declares the definitive title to the property. It will state the owner and itemize as "memorials" all encumbrances upon the property (e.g., mortgages, easements, covenants, liens, etc.).

1. **Scope of the certificate of title:** The certificate of title ***is title.*** It is binding on the entire world and cuts off all interests not included as memorials on the certificate, except for those discussed in this section. Otherwise, the certificate as registered in the public records is conclusive title. It is thus not possible to acquire title by adverse possession against a registered title. However, the exceptions which follow are significant and undercut the utility of title registration.

   a. **Federal government claims:** States lack the power to adjudicate claims of the federal government unless the federal government consents to such adjudication. Thus, a certificate

of title does not eliminate federal tax liens or any other interest that might be claimed by the federal government.

b. Statutory exceptions: Most of the American Torrens statutes except from the certificate of title any interests or claims held by persons in actual possession, mineral claims, visible easements, utility or railroad easements, public thoroughfares or other claims of state or local governments. These exceptions make the certificate of title a lot less definitive and conclusive than it purports to be.

c. Defective notice in initial adjudication: If a person with an interest in the property does not receive constitutionally acceptable notice of the initial title adjudication proceeding the certificate of title that results is not effective to bar the person's interest. The due process clause of the Fourteenth Amendment requires that governments give people adequate notice and opportunity to be heard before taking their property away.

d. Fraud: If fraud or deceit is employed to procure the initial certificate of title it can be set aside by the true owner or, alternatively, the registered owner will be held to hold in constructive trust for the true owner. It is not clear whether the true owner could obtain the same remedies against a bona fide purchaser of registered title from the initial and deceitful "owner." If the initial certificate of title is validly obtained, subsequent fraud that results in a new certificate upon which a bona fide purchaser relies is not sufficient to cancel the title held by the BFP.

Example: Arnold adjudicates title to Blackacre and obtains a certificate of title. Then Arnold gives his copy of his certificate to his brother, Bill, who forges Arnold's signature to obtain a new registered title in Bill's name. Then Bill sells Blackacre for value to Jane, who knows nothing of Bill's forgery. Jane has a valid registered title that cannot be upset by Arnold.

e. Not bona fide purchaser: Courts in many Torrens jurisdictions have preserved the rule that a person who takes with notice of some off-record claim or interest takes subject to that claim. Thus, a purchaser of registered title who actually knows of some interest not included as a memorial on the registered title is often held to take subject to that interest. See, e.g., *Butler v. Haley Greystone Corp.*, 347 Mass. 478 (1964).

C. Public records and title transfers in the Torrens system

1. **Public records:** Once a registered title has been adjudicated the official certificate of title is given to the recorder for preservation and a copy given to the owner. The recorder will then maintain a tract index of registered titles and will enter in the tract index the certificate of title. A title searcher simply finds the property in the tract index and reads the certificate of title. If any memorials are noted on the certificate (e.g., mortgages) the searcher will then look up the mortgage instrument to read it fully.

2. **Title transfers:** The holder of registered title may transfer title by surrendering his certificate, together with a deed or other instrument conveying title, to the recorder. The recorder will then cancel the old registered title and issue a new one in the name of the purchaser. If a holder of registered title mortgages the property, the mortgage is simply added as a memorial. If the mortgage is then paid off, the memorial is removed.

3. **Errors by the recorder:** Because the registered title *is title*, errors by the recorder are especially significant. If, for example, the recorder fails to include a mortgage as a memorial on the certificate of title the mortgage is extinguished. Or, if the recorder means to register title to Blackacre in Jones but actually registers title to Blackacre in Smith, Blackacre is owned by Smith, not Jones. This is a serious flaw; Torrens systems deal with this by providing for compensation to those who lose their interests due to recorder error, but the funds provided for compensation "are often absurdly small in comparison to . . . potential liability." Nelson, Stoebuck, and Whitman, Contemporary Property 1004 (1996). Moreover, governments use their sovereign immunity to avoid liability except to the extent of these meager compensation funds. Understandably, this glaring flaw has been a strong inhibition to acceptance of Torrens registration.

D. **The practical realities of Torrens registration:** Torrens registration has not caught on in the United States for three good reasons: initial cost, lack of comprehensiveness, and the risk of uncompensated recorder error.

1. **Cost:** The initial cost of title adjudication is high and most of its benefits are reaped in the form of lower costs of transferring title. There is little incentive for the first owner to incur costs for the benefit of later owners. A developer, however, might find it advantageous to register title for an entire subdivision, in order to minimize the title transfer costs as the subdivided lots are sold, and because the initial cost can be spread over the entire subdivision.

2. **Lack of comprehensiveness:** The exceptions that riddle the purported global effect of a certificate of title further dampen the incentive to incur the cost of obtaining a certificate that is not as conclusive as it is supposed to be.

3. **Risk of uncompensated error:** This problem could be corrected by governmental assumption of liability for all recorder errors, but it is probably politically and practically impossible for financially hard-pressed state and local governments to do so.

E. **Economic theory and Torrens registration:** Under Torrens registration the possessor of the registered title prevails as against a claimant to title however meritorious the claim might be in the absence of Torrens registration. Under the recording system, a meritorious claimant prevails against the possessor. This is of consequence if possessors attach a subjective value to their property, such that they value continued possession more than its market value to prospective purchasers. Many possessors (especially of residences) do attach subjective value to their homes. Under these conditions Torrens is better at accomplishing "exchange efficiency" — ensuring the property ends up in the hands of the party who values it more highly — *if transaction costs of reassigning the right are high.*

Example: Arthur owns Blackacre and would not part with title for less than $100,000. Nobody else would pay more than $70,000 for Blackacre. Arthur's subjective value of Blackacre is $30,000. Bertha, a meritorious claimant to Blackacre, would happily sell Blackacre for $70,000 (its market value) once she secures possession. Under the recording system, Bertha would prevail and Arthur would appear to lose his subjective value. Because Arthur values Blackacre more highly than Bertha, he would presumably pay Bertha a price somewhere between $70,000 and $100,000 to retain possession. Only if transaction costs exceed $30,000 (the total potential gains from trade) would the reassignment of the right back to Arthur not occur. Under the Torrens system, Arthur would prevail and reap the full subjective value of $30,000. If transactions costs are higher than the subjective value, Torrens produces an

"exchange-efficient" outcome. If not, Torrens simply ensures that possessors of registered title reap all the gains, thus essentially distributing income to Torrens holders from meritorious claimants.

Another measure of efficiency is "development efficiency," or the maximization of incentives for socially productive use of land. In theory, because Torrens ensures that there will no claimants, the risk of development is lowered and "development efficiency" is increased under the Torrens system. This conclusion, however, is undercut by the fact that title insurance to indemnify against claims under the recording system is readily available at a reasonable cost, and because the exceptions to Torrens registration are large enough to make it a practical necessity to obtain title insurance for a development even if the developer possesses Torrens title.

F. Possessory title registration: An innovative variant on the Torrens system is to permit landowners to register their title for a nominal fee, but receive a certificate of title that is good only from that day forward. Any claims or interests affecting the property that predate the issuance of the certificate of title are fully preserved. The certificate is not initially of much value but, over time, old claims or interests might disappear. When coupled with a statute of limitations as to old claims (patterned after the marketable title acts) the certificate of title issued under a possessory title registration system would become conclusive after the elapse of the limitations period. This would eliminate the initial cost objection to Torrens registration but, by itself, does nothing to eliminate the problems of lack of comprehensiveness or risk of uncompensated recorder error. Minnesota is the only state to have adopted possessory title registration as a voluntary option.

IV. TITLE INSURANCE

A. Introduction: Title insurance is the most common form of title assurance in the United States. Title insurance involves the issuance of an insurance policy to a person — usually either a mortgage lender or a purchaser of property — by which the insurer warrants that title is as stated in the policy. The policy is a personal contract between the insurer and the person who buys the policy. Title insurers perform their own examination of the public land records in order to issue an insurance policy. They either employ lawyers to search the public records or they maintain their own duplicate set of records, identical to that found in the recorder's office, but often supplemented by a tract index of their own creation.

B. Coverage: The scope of coverage is determined by the contract of insurance. The usual policy insures only that the title stated in the policy is a good record title. The policy does not insure against claims or interests that are not part of the record. Essentially, the insured has a claim under the policy only if someone else asserts a claim based on the public records inconsistent with the record title as stated in the policy.

1. Duty to disclose defects in title: Courts are beginning to impose on title insurers a duty to disclose anything they know about the parcel in question that is material or important, breach of which is actionable in tort.

★**Example:** Kosa acquired a parcel of land from Aiello under a deed that stated the total acreage of the tract was 12.486 acres, based on a survey done by Schilling. Walker Rogge agreed to purchase the tract from Kosa, after Kosa had shown Rogge a survey done by Price Walker that stated the tract consisted of 18.33 acres. The Kosa-to-Rogge contract stated that the acreage was

19 acres, more or less, and stipulated that the purchase price was to be reduced by $16,000 per acre if the tract was in fact smaller in area. The Kosa-to-Rogge deed referred to the Price Walker survey but did not state the acreage. Rogge hired Chelsea Title to examine and insure title. Chelsea did so, issuing an insurance policy that excepted from its coverage "matters which could be disclosed by an accurate survey." At the time Chelsea issued the policy it had in its files a copy of the Aiello-to-Kosa deed, stating the tracts's area to be 12.486 acres. In fact, the tract's acreage was 12.43 acres, close to the Schilling survey of 12.486 acres but significantly less than the Price Walker survey of 18.33 acres. Rogge sued Chelsea for damages on the title insurance policy and also for Chelsea's negligence in failing to disclose the acreage figure stated in the Aiello-to-Kosa deed. A trial court held that Chelsea was liable on its insurance contract because the quoted exception was too vague to apply to these facts and that Chelsea had no liability in tort because it had not assumed a duty to search title and disclose the results of its title search. In ***Walker Rogge, Inc. v. Chelsea Title & Guaranty Co.,*** 116 N.J. 517 (1989), the New Jersey Supreme Court reversed on the first point, upheld the second finding, but remanded for consideration of a different tort issue. First, the contract exception was clear enough to exempt Chelsea from contractual liability for an acreage shortfall that an accurate survey would reveal. Second, there was substantial evidence to support the trial court's finding that Chelsea had undertaken a duty only to ***insure*** title, and that any ***search*** of title was for its own benefit and ancillary to its duty to insure. However, the court remanded for a determination of whether Chelsea had assumed a duty to assure Rogge of the correct acreage of the tract. Facts suggestive of that duty included the following: (1) Chelsea had twice before insured title to the tract and had in its files a copy of the Aiello-to-Kosa deed stating the area at 12.486 acres, and (2) Chelsea handled the closing at which the purchase price was based on the tract's acreage. Under these circumstances, perhaps Chelsea had a duty to reveal to Rogge what it knew (or should have known).

About half the states impose a duty on title insurers to disclose all defects uncovered by the insurer's title search. Thus, if a title insurer issues an insurance policy excluding "encroachments not of record" but discovers an actual, unrecorded encroachment, it has insured only good record title but still has an obligation to reveal the actual encroachment it has discovered.

2. **Marketable title and encumbrances:** Although title insurance policies typically insure against any loss caused by ***defects in title,*** or ***liens*** or ***encubrances upon title,*** or ***unmarketability of title,*** courts limit the scope of this coverage to ***title*** rather than extending it to cover palpable diminutions of ***value*** that affect marketability but have no bearing on the clarity or certainty of ownership.

★**Example:** Lick Mill Apartments purchased and developed a portion of a 30-acre tract that had formerly been the site of chemical processing plants and warehouses. Chicago Title insured title against defects, liens, encumbrances, and unmarketability. Prior to insuring title Chicago Title hired Carroll to inspect the site and Carroll reported the "presence of certain pipes, tanks, [and] pumps." When title was insured the records of various government agencies disclosed the "presence of hazardous substances" on the property, but it was not clear whether those records were inspected by or known to either Lick Mill or Chicago Title. After Lick Mill took title it was required to expend considerable sums to remove and clean up the toxins on the site. Lick Mill then sought to recover those costs from Chicago Title, alleging that the toxins made title unmarketable and constituted an encumbrance on title. In ***Lick Mill Creek Apartments v. Chicago Title Insurance Co.,*** 231 Cal. App. 3d 1654 (1991), the California intermediate appeals court rejected these contentions. The court distinguished ***unmarketable title*** and

unmarketable land: the former consists of a serious problem with the claim to ownership, the latter consists of a serious problem with the physical condition or location of the property. Lick Mill's *title* was impeccable but the toxic wastes present on the land made the property unsaleable. As to encumbrances, while the toxic wastes did produce continuing liability of any owner to clean up the mess that fact was rooted in the property's physical condition, not some continuing defect of the claim to ownership that is title. Note that in ***Lohmeyer v. Bower*** (Chapter 6) a present violation of a zoning law constituted unmarketable title sufficient to enable a buyer to rescind his purchase contract, but in ***Frimberger v. Anzellotti*** (Chapter 6) a present violation of a zoning law did not constitute unmarketable title for purposes of breach of the covenant of general warranty. As with ***Frimberger,*** the difference in result is due to the *ex post* or *ex ante* posture of the problem. When the deal is still inchoate (***Lohmeyer***) it makes sense to allow it to unravel, for that permits avoidance of damage before it hardens, but when it is done (***Frimberger*** and ***Lick Mill***) a finding of unmarketable title shifts costs, perhaps unfairly. Diligent investigation on Lick Mills's part would have enabled it to avoid the loss; shifting the loss to Chicago Title would greatly increase the scope of liability for title insurers, thus raising the cost of title insurance generally and probably imperiling the continuing existence of some insurers.

3. **Exclusions:** Policies typically contain specific exclusions from coverage, including such items as ***liens not on the record*** (e.g., mechanics' liens), ***off-record interests asserted by persons in possession*** (e.g., adverse possession), ***boundary disputes*** (e.g., encroachments or other boundary disputes not of record but which might be revealed by a survey), ***off-record easements or servitudes*** (e.g., implied easements or covenants or prescriptive easements), and ***government land use regulations.***

4. **Measure of damages:** A title insurer is generally liable for the difference in value of the property with and without the insured-against defect, up to the maximum liability specified in the policy. This is true regardless of the amount paid for the property.

   Example: Jonah purchased Blackacre for $50,000 and obtained Titleco's insurance policy for $20,000 insuring good record title. It turns out that Watts, an adjacent landowner, has a record easement over Blackacre for access. If the value of Blackacre without the easement is $65,000 and the value of Blackacre with the easement is $40,000, Jonah has suffered $25,000 in damages, but can only recover $20,000 (the policy limits), even though the diminution in value from Jonah's purchase price is only $10,000. This rule makes sense because Jonah is entitled to the full benefits of his excellent bargain.

Exam Tips on *ASSURING GOOD TITLE TO LAND*

- Recording acts provide ample opportunity for creating a complicated exam question. First, be certain you understand how each of the types of acts works and recognize which is which — your professor may simply quote a statute and not tell you what it is. Second, be sure you understand

what constitutes notice. Actual notice is easy; the problems arise with constructive and inquiry notice. Constructive notice is supplied by the chain of title from the record, and that raises the question of what constitutes the chain of title and what is in the record. States differ on these points; you need to be certain that you understand the policy arguments that surround these differences. Third, be sure you understand the scope of protection afforded by the acts. Note the shelter rule, which protects transferees from bona fide purchasers who are protected, even if the transferee might independently lack protection.

- A marketable title act problem can easily be combined with a recording act problem. The two types of acts perform different functions.
- Title insurance issues typically revolve around the scope of the insurance contract. While your professor may test on this, typically neither this nor registered title is likely to be a significant examination issue.

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Chapter 6

CONSTRUCTION OF DEEDS AND WILLS CONCERNING PRESENT POSSESSORY FREEHOLD ESTATES

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SUMMARY

§ 6.1 Rules of Construction Generally

1. The purpose of construing a conveyance or will when its terms are ambiguous is to determine the intention of the parties. All rules of construction are subservient to this purpose. In other words, the first rule of construction is to give effect to the parties' intent.

2. In construing an instrument every part of it should, if possible, be given a meaning in considering the meaning of the instrument as a whole. This rule might be characterized as the "four corners doctrine," meaning that everything within the four corners of the instrument should be considered in its construction.

3. If possible, parts of an instrument should be construed as consistent with each other.

4. A deed is always construed most strongly against the grantor who has used the language.

5. If an instrument contains two clauses which are contradictory, the former governs over the latter. This is part of the old

maxim, "the first deed and the last will shall operate." In a deed, this may take the form of the granting clause and the habendum clause being repugnant to the other. In this case, the granting clause governs. This "rule of repugnant clauses" in modern times will normally not be applied in an arbitrary manner, and it frequently will be rejected in favor of the "four corners doctrine."

6. A deed will be construed to grant a fee simple absolute rather than a fee simple determinable or a fee simple on condition subsequent if the language of the whole instrument makes this interpretation reasonably possible.

7. A provision in a deed or will directing that the transferee of property cannot dispose of the property is void as a disabling restraint on alienation.[1]

§ 6.2 Fee Simple[2]

1. Estates in fee simple are:
   a. fee simple absolute
   b. fee simple defeasible
2. Estates in fee simple defeasible include:
   a. fee simple determinable
   b. fee simple subject to condition subsequent
   c. fee simple subject to executory interest including:
      (1) springing executory interest
      (2) shifting executory interest

3. The only way a fee simple estate could be created at common law was by the use of the words of limitation "and his heirs" or "and their heirs." These magic words were indispensable. Under modern statutes these words of limitation are not necessary to create a fee simple estate. It is presumed that the named grantee takes the entire estate the grantor had unless a lesser estate is described in the governing instrument.

4. Under many modern statutes the fee tail estate is deemed a fee simple estate. In jurisdictions where this is the case there is but one inheritable freehold estate, the fee simple.

5. A fee simple determinable comes to an end automatically upon the occurrence of some specified event or act expressed in the words of limitation. A fee simple subject to a condition subsequent requires both a breach of the specified condition and an affirmative act by the grantor or the grantor's heirs to terminate the estate.

1. This rule does not apply to so-called "spendthrift trusts."

2. See Ch. 5.

6. Any disabling restraint on the power to alienate a fee simple estate is void.

§ 6.3 Fee Simple Conditional and Fee Tail

1. The fee simple conditional estate was the forerunner of the fee tail estate and existed prior to the Statute De Donis Conditionalibus which was passed in 1285. This statute destroyed the fee simple conditional estate.

2. The fee simple conditional was an estate that terminated upon the transferee's death if the transferee had no child. Upon termination, the estate reverted to the grantor who retained a possibility of reverter. Upon birth of a child, however, the grantee had the power to convey a fee simple absolute. Absent a conveyance, the property descended under like terms to the grantee's heir of the body, or absent such a surviving heir, the property reverted to the grantor.

3. The Statute De Donis (1285) created the fee tail estate and made it a substitute for the fee simple conditional estate.

4. The typical words which created the fee simple conditional estate before 1285 and the fee tail estate after 1285 were, "to A and the heirs of his body."

5. The fee tail tenant owned an inheritable freehold estate but with limited powers over the estate. The tenant in tail could use it during his lifetime, but he could make no disposition thereof so as to prevent its descending to his bodily heirs, if any, or if no bodily heirs, he could not prevent its reverting to the grantor who retained a reversion. Each succeeding fee tail tenant had the same rights and limitations upon his estate.

6. Because the fee tail estate restricted the free alienability of land, the courts did not favor it. Fictitious legal proceedings were evolved to enlarge the powers of the fee tail tenant. The fine empowered him to cut off the rights of his bodily heirs. The common recovery[3] empowered him to cut off both the rights of his bodily heirs and the reversion of the donor.

7. A fee simple estate is a larger estate than a fee tail estate. Thus, when a fee simple owner conveys a fee tail estate, there is a reversion left in the donor.

8. Almost all states by statutes have abolished the fee tail estate by transforming it into a fee simple or into a life estate in the first taker with a remainder in fee simple to his issue or lineal descendants.

3. See chap. 5, note 17.

§ 6.4 Life Estates

1. Life estates include: (a) life estate for the life of the tenant, (b) life estate for the life of one other than the tenant (pur autre vie), (c) life estate resulting from a fee tail special tenancy after possibility of issue extinct, (d) life estate by dower, (e) life estate by curtesy, and (f) life estate by and during coverture.

2. A life estate is one in which the duration of the estate is measured by the life or lives of one or more human beings and is not otherwise terminable at a fixed or computable period of time.

3. If an estate may last for a lifetime, it is a life estate, even though it may be extinguished before it runs its natural course. However, if a limitation is made expressly subject to the will of the grantee or lessee, there is a conflict, and the interest created is either a life estate determinable or a tenancy at will depending upon the jurisdiction.

4. If a conveyance identifies the grantee but fails to describe effectively the estate which the grantee takes, then the grantee takes a life estate at common law. Today, the grantee is presumed to take whatever estate the grantor had to convey unless a contrary intent appears in the governing instrument.

5. A life tenant, in addition to his estate for life, may be given a power to convey, sell, appoint, or mortgage the fee. Upon the exercise of this power, the rights of the remaindermen or reversioners are affected accordingly.

6. Under the Rule in Shelley's Case, a conveyance of a remainder to the heirs or the heirs of the body of the life tenant, gives the remainder to the life tenant in fee or in fee tail, as the case may be. This Rule, which is a rule of property law at common law and does not give way (as a rule of construction would) to a contrary intent, defeats the intention of the grantor to create a life estate and a remainder in the life tenant's heirs.

7. A life estate may be measured by resort to a reasonable number of lives. Thus, a conveyance "to B for the lives of B, C, D and E" terminates upon the death of the survivor of the four named lives. On the other hand, a life estate to B to last for her life and for the lives of all the persons of a given state would give B a life estate for her life only.

8. Forfeiture restraints on the power to alienate a life estate, usually phrased so as to make the life estate defeasible on an attempted alienation, are valid. The reasons for upholding these restraints are: (1) life estates are not readily alienable in a commercial sense anyway; and (2) the restraint may have been imposed for the benefit of the reversioner or remainderman.

§ 6.5 Concurrent Estates

a. *Joint Tenancy*

1. Joint tenancy is always created by deed or by will, never by descent.

2. In joint tenancy there must always be two or more grantees or devisees.

3. O "to B and C and their heirs" are typical words for creating a joint tenancy at common law. Today in the absence of a clearly expressed intent to create a joint tenancy with the right of survivorship, this limitation creates a tenancy in common.

4. At common law a joint tenancy was preferred over a tenancy in common. Under modern statutes tenancy in common is preferred over joint tenancy.

5. At common law, every joint tenancy required the four unities of:

   a. time—meaning all tenants take their interest in the premises at the same instant of time.

   b. title—meaning all tenants take their interest from the same source, the same deed or the same will.

   c. interest—meaning every tenant has the same identical interest in the property as every other tenant, such as fee simple, fee tail, life estate, etc.

   d. possession—meaning the possession of one joint tenant is the possession of all the joint tenants and the possession of all the joint tenants is the possession of each joint tenant.

6. Every joint tenant owns the undivided whole of the property; co-tenants do not own a fractional interest.

7. The grand incident or characteristic of joint tenancy is that of survivorship. This means that upon the death of one joint tenant, the survivor or survivors own the whole of the property and nothing passes to the heirs of the decedent.

8. Upon the death of a joint tenant the survivors take nothing from the decedent but take the whole from the original conveyance which created the joint tenancy and which whole they have owned all the time.

9. A severance of the joint tenancy can be made by a conveyance, but not by will, because survivorship is prior to and defeats any purported disposition in the will.

10. If all joint tenants except one die without having severed their interests, the survivor owns the whole property.

11. Joint tenancy is destroyed by severance inter vivos, by partition, or by any act destroying any one of the four unities.

12. Except in those jurisdictions where the joint tenancy has been abolished, husband and wife may, by a clearly expressed intention in the conveyance, take and hold as joint tenants.

b. Tenancy by the Entirety

1. A tenancy by the entirety is a form of concurrent ownership based upon the common law concept of unity of husband and wife.

2. Tenancy by the entirety is a species of joint tenancy and as in joint tenancy each spouse owns the whole estate and not a fractional part thereof.

3. Tenancy by the entirety can exist only between husband and wife.

4. The doctrine of survivorship obtains in tenancy by the entirety—the survivor taking all and the heirs nothing.

5. Five unities are essential in tenancy by the entirety: (a) time, (b) title, (c) interest, (d) possession and (e) person. The first four are the same as in joint tenancy. The fifth involves the common law concept of unity of person in husband and wife.

6. Tenancy by the entirety is created only by deed or will, never by descent.

7. In most jurisdictions that recognize the estate by the entirety, neither spouse can dispose of any interest in the estate owned by the entirety; both must join in the conveyance.[4]

8. In most jurisdictions that recognize the estate by the entirety, a creditor of one spouse cannot levy upon the estate owned by the entirety, nor is a judgment against one spouse a lien against the estate held in the entirety.[5]

4. In some states in a tenancy by the entirety, the husband has the sole right to possession during the joint lives, and a fee simple absolute in all of the estate if he survives the wife. The wife, on the other hand, has no present estate but she does have a fee simple absolute in all of the estate if she survives her husband. The husband can convey his interests subject only to the right of the wife to absolute ownership if she survives; but the wife, during their joint lives, cannot convey her possibility of acquiring the estate. See Powell on Real Property ¶ 623. See D'Ercole v. D'Ercole, 407 F.Supp. 1377 (D.Mass.1976) (where an estranged wife brought suit claiming that the common-law concept of tenancy by the entirety deprived her of due process and equal protection in that it gave her husband the right of possession and control during his lifetime of their home, the court held that since tenancy by the entirety is but one option open to married persons seeking to take title to real estate, it is constitutionally permissible).

5. In those states that preserve the estate by the entirety in all its common law flavor, creditors of the husband can attach and sell under execution all of his interest in an estate by the entirety, but

9. Divorce eliminates the unity of person, destroys the tenancy by the entirety and the divorced persons become tenants in common of the property, or in some states, joint tenants.

10. Neither spouse has a right to partition a tenancy by the entirety, and neither has power, without the consent of the other, to destroy it.

c. Tenancy in Common

1. Tenancy in common may be created by deed, by will, or by operation of law.

2. Under modern statutes, tenancy in common is preferred over joint tenancy. Thus, a conveyance to two or more persons presumptively creates a tenancy in common.

3. Only one unity, that of possession, need be present in tenancy in common.

4. Each tenant owns an undivided fractional part of the property, none owns the whole as in joint tenancy.

5. Each tenant can dispose of his undivided fractional part or any portion thereof, either by deed or by will.

6. Upon the death intestate of a tenant in common her interest descends to her heirs. There is no right of survivorship.

7. Tenancy in common may be destroyed by partition or by merger when the entire title vests in one person, either by purchase or otherwise.

8. If one cotenant ousts the other from possession, the ousted tenant has a cause of action against the possessor to regain possession.

9. There is no real fiduciary relationship between cotenants merely because of the cotenancy, but good faith between cotenants prevents one cotenant from buying up an adverse title and asserting it against cotenants if the other cotenants offer to share their part of the expense of gaining the title. The buyer of the adverse title is made to hold in constructive trust for his cotenants.

separate creditors of the wife cannot reach her interest. See Licker v. Gluskin, 265 Mass. 403, 164 N.E. 613 (1929) (where a husband and wife were tenants by the entirety and a creditor of the wife attached her interest in the land and sought to sell it, the court held that under force of statute the attachment and levy were void because the creditor could not do what the wife could not do); West v. First Agricultural Bank, 382 Mass. 534, 419 N.E.2d 262 (1981) (suggesting that historical inequalities in tenancy by the entirety were now unconstitutional), Powell on Real Property ¶ 623.

PROBLEMS, DISCUSSION AND ANALYSIS

§ 6.2 *Fee Simple*[6]

PROBLEM 6.1: O grants Blackacre[7] "to B." In the jurisdiction where the land is located a statute provides in substance that every grant or conveyance of an estate in land made to a person shall be deemed a fee simple unless a lesser estate is described in the instrument. (a) What estate would B take at common law? (b) What estate would B take under the statute?

Applicable Law: Words of limitation, "and his heirs," were indispensable to the creation of a fee simple estate at common law. Under modern statutes and some cases, the use of these words is usually not necessary and a fee simple estate may be created without the presence of these words.

Answer and Analysis

(a) At common law B took a life estate in Blackacre but under the statute B takes a fee simple estate. At common law no conveyance could pass a fee simple from the grantor to the grantee without the use of the magic words of limitation, "and his heirs." Thus, even a conveyance to "B in fee simple absolute" gave B only a life estate.

(b) Under the statute the named grantee takes a fee simple estate in every conveyance (assuming the grantor had a fee simple) unless by express words in the deed it is stated that the grantee takes an estate less than a fee simple. Thus, under the statute B takes a fee simple even though the phrase "and his heirs" was excluded from the terms of the conveyance. Some jurisdictions hold that B takes a fee simple in such case even without the aid of a statute.

The common law rule mandating the use of "and his heirs" was subject to some important exceptions. These were:

If O conveys to B corporation (whether sole, aggregate, or municipal), the corporation takes a fee simple absolute without the use of words of inheritance. Although corporations are legal "persons," they do not have heirs.

If O conveys to "B as trustee," B takes such estate as is necessary to carry out the trust, including a fee simple, even though the phrase "and his heirs" did not appear in the conveyance.

6. At this point those portions of chapter 5 describing the characteristics of the fee simple absolute and the fee simple subject to limitations should be carefully re-read. In each of the following problems, assume that O owns Blackacre in fee simple absolute unless the problem provides otherwise.

7. Unless the problem otherwise provides, O or T, when conveying or devising Blackacre, owns Blackacre in fee simple absolute.

If O conveyed to the heirs of B (a deceased person), that heir took a fee simple even though the phrase "and his heirs" did not appear in the conveyance. This resulted from the fact that at common law B had but one heir where primogeniture applied; thus, the use of the plural heirs was a substitute for "B's heir and his heirs." Similarly, if O conveys to B for life, remainder to the heirs of C while C is still living, C's heirs took as purchasers and as a class of heirs a contingent remainder in fee simple. If C dies before B, they then take a vested remainder in fee simple without words of inheritance being used in the deed.

Suppose O conveyed Blackacre to A and B and their heirs as joint tenants in fee simple. A releases her interest to B. B now is owner in fee simple in severalty without use of the words of inheritance in the deed. The reason is that B, as well as A, had previously owned the fee in the whole. By contrast, suppose O conveyed to A and B and their heirs as tenants in common. In this case each of them owns an undivided one half of Blackacre in fee simple. If A grants "to B" A's interest in Blackacre, B will only take a life estate in A's undivided half at the common law unless words of inheritance are used. This is because A's estate is wholly separate and distinct from B's fee simple, each having a different interest. Lastly suppose T devises Blackacre to B. B takes a fee simple without the use of words of inheritance if this is the testator's intention.[8]

PROBLEM 6.2: O conveys Blackacre "to my son-in-law, B, and his heirs to have and to hold for his lifetime, and at his death to be equally divided among his heirs, they being my grandchildren then living." What estate does B take under this deed?

Applicable Law: If two clauses in a deed are in conflict but the grantor's intention can be found by a reading of the entire instrument, this intention shall govern.

Answer and Analysis

B has a life estate. There is an inconsistency between the granting clause which gives B a fee simple and the habendum clause which limits B's estate to a life estate. If the rule of construction is that if the granting clause is repugnant to or inconsistent with the habendum clause, the former governs, then, of course, B takes a fee simple estate. This rule, however, is resorted to only when the intention of the parties cannot be ascertained from the entire instrument. In this problem O's intent can be gleaned by reading the entire instrument.

8. See Restatement of Property §§ 29–37; Simes, 181–185.

In analyzing the entire instrument little emphasis should be placed on the order in which the words, phrases, or clauses appear. In the first place, the grantee, B, is the grantor's son-in-law. In the second place, the deed provides for another purchaser upon B's death, namely, B's heirs, who are the grantor's grandchildren. A is providing for a remainder among B's children, A's grandchildren. True, there can be no heirs of a living person and it cannot be foretold who B's heirs will be at the time of B's death. Nonetheless, there is reason to believe that O is using "B's heirs" as synonymous with "B's children." If this is the case, then it is clear that B takes a life estate and there is a contingent remainder to B's children living at B's death.

Furthermore, by taking this view, the words "and his heirs" used in the granting clause might well be read as "and his children." This construction would give effect to every part of the deed and reconcile the granting and the habendum clauses. Under this interpretation, B takes a life estate in Blackacre and his children living at his death take a contingent remainder. O, of course, retains a reversion. From a reading of the entire deed this seems to be O's intention.

PROBLEM 6.3: In State X a statute provides that a conveyance which prior to the enactment of the statute would create a fee tail estate should thereafter create a fee simple estate in the grantee. O is domiciled in State X. O conveys Blackacre "to B and the heirs of his body." What estate does B take under the instrument?

Applicable Law: Under many modern statutes a conveyance which would have created a fee tail estate at common law now creates a fee simple estate.

Answer and Analysis

B takes a fee simple absolute. Prior to the statute and at common law the expression "to B and the heirs of his body" created a fee tail estate in B. This estate was limited to lineal heirs. Many states have statutes which provide that an estate which was at common law a fee tail shall be deemed a fee simple. Under this type of statute B would take a fee simple estate. Thus if B owned the property at the time of his death and died intestate, the property would pass to B's lineal descendants, or if none, among his collateral heirs.[9] This estate is also alienable and devisable.[10]

9. Depending upon state law, these heirs might be ancestors of B or collateral relatives of B.

10. See Restatement of Property § 42, Simes, 196–202.

PROBLEM 6.4: O conveys Blackacre to "B and his heirs so long as Blackacre is used for school purposes." What interest does B have in Blackacre?

Applicable Law: A grant to B and his heirs so long as the land is used for school purposes creates in B a fee simple determinable; the grantor retains an estate called a possibility of reverter.

Answer and Analysis

B has a fee simple determinable. B has a fee because words of inheritance, "and his heirs" were used following the grantee's name (words of purchase), which indicate the estate in B may last forever. However, additional words of limitation appear in the deed. These words tie up the use to which B may put the land. Because of these additional words of limitation, there is the possibility that B's estate will not last forever. If B ceases to use Blackacre for school purposes, then B's estate automatically terminates and Blackacre reverts to O because the very words of the conveyance state that B's estate shall last just that long. Thus, there is no forfeiture involved. Rather, B's estate ends naturally.

In this problem, the future interest retained by the grantor is called a possibility of reverter. This estate becomes possessory upon the natural termination of B's estate.

In some cases a limitation may be void as a matter of public policy. For example, suppose O transfers Blackacre to A so long as A remains single. If A marries, does Blackacre revert to O? In resolving this issue, the reasonableness of the restriction may be relevant. Generally, restraints on the marriage of a surviving spouse are upheld, while restraints on the marriage of the grantor's children or others are not.[11] Likewise, any restraint that violates some independent body of law, such as the law of race or gender discrimination, is invalid or unenforceable. For example, a grant "To A so long as the property is occupied exclusively by white persons" is not enforceable in a court.[12]

PROBLEM 6.5: Within X County O owned Blackacre which comprised an area of several blocks of land. The land was unimproved and undeveloped. O offered to convey one block of this land, Whiteacre, in the center of the tract to X County to be used for courthouse purposes. The proper county officers agreed to receive the property on behalf of the county and to locate the courthouse there. O executed a deed granting "to X

11. See, e.g, Lewis v. Searles, 452 S.W.2d 153 (Mo.1970) (upholding limitation regarding marriage as against a niece because court found testator only intended to provide for niece when she would have no other sources of support).

12. See Ch. 12.

County, all of my right, title, claim, interest and estate in and to Whiteacre, but upon this condition that Whiteacre shall be used forever as the site on which the courthouse of X County shall be erected." The courthouse was built on Whiteacre and remained there and was used as such for more than 100 years, when it was abandoned as a courthouse. When the structure ceased to be used for courthouse purposes, H was the sole heir of O then living. H sues X County for possession of Whiteacre contending that the above deed created in X County either a determinable fee simple or a fee simple on condition subsequent. May H succeed?

Applicable Law: This problem distinguishes a fee simple determinable from a fee simple subject to a condition subsequent. The provisions of a deed will be construed to create a fee simple absolute rather than a fee simple determinable or a fee simple subject to a condition subsequent, if this interpretation is reasonable.

Answer and Analysis

No. A determinable fee is a fee which is created by an instrument of conveyance which provides that such estate shall come to an end automatically upon the happening of some described event. A fee simple subject to a condition subsequent is a fee which is created in an instrument of conveyance which provides that, upon the happening of some certain event, the grantor or his successors in interest shall have the power to enter and terminate the estate of the grantee. The principal difference between the two is this: in the determinable fee the estate automatically comes to an end when the stated event happens, whereas in the fee subject to a condition subsequent the termination of the estate is not automatic but must be terminated by an entry or exercise of the reserved power by the grantor or his successor in interest. The former involves no forfeiture, the latter does. Whether a given deed conveys a fee simple absolute or a determinable fee or fee simple on condition subsequent is a matter of construction of the words used in the instrument.

In the construction of limitations the courts favor unconditional estates rather than conditional ones for the reason that estates once vested should not be uprooted after long periods of time unless it was the intention of the grantor expressed in the deed that this should occur. Applying this principle the deed should be construed in favor of the defendant county unless it is fairly clear that the grantor intended either a determinable fee or a fee simple upon condition subsequent. In the deed O grants to X County, a quasi-municipal corporation, "all of his right, title, claim, interest and estate in and to Whiteacre." Words of inheritance are not only not

required but are quite inappropriate where a public corporation is the grantee. Thus, it is clear that O intended to grant a fee simple estate to X County.

The words following, "but upon this condition that Whiteacre shall be used forever as the site" of the courthouse are the only words on which it can be contended there was either a determinable fee or fee simple upon condition subsequent. These words show no intention whatsoever that the fee simple in X County should automatically revert to O or his heirs. While they limit the use to which Whiteacre shall be put, they put no limit on the time during which the estate shall last. The typical words for creating a determinable fee are "so long as," "during," "until," or "while." None of these or similar expression was used but the use was to be "forever." Thus, it seems there is no expression of intention by O in the deed that there should be a determinable fee simple in X County.

Was there a fee simple on condition subsequent? A fee simple on condition subsequent is generally introduced by such phrases as "provided that," "on condition that," "subject to the condition that," or "but if." An express reverter clause giving the grantor the right to re-enter generally is appended. But these reverter clauses are not absolutely necessary. The fee simple subject to a condition subsequent always involves a forfeiture of a vested interest. The law abhors forfeitures and the courts will not construe the words of a deed to create this future estate unless the language is so clear as to admit of no other interpretation. In this case the deed did say, "upon the condition" that the tract be used "forever" as a courthouse site. But there is not one word in the deed expressing what should happen in case the site were not so used. There is no right of entry or power to terminate the estate reserved in O or O's successors in interest. Without any express reservation of this power, the court ought not to imply such, when the result of that implication would cause a forfeiture of an estate which has lasted for more than a century. Thus, there was no fee simple upon condition subsequent created in X County.[13]

There is a further economic argument in this case which should not be overlooked. It may be that O's grant of Whiteacre to X County was not wholly altruistic. If the county courthouse could be located in the middle of land owned by the grantor, such an institution might enhance the value of the lots surrounding the courthouse. Reading the language of the deed as a whole and considering the conditions under which it was executed, it seems

13. In Mahrenholz v. County Board of School Trustees, 93 Ill.App.3d 366, 48 Ill.Dec. 736, 417 N.E.2d 138 (1981) grantor conveyed to a local school board with the land to be used only for school purposes; "otherwise to revert to the" grantor. The court held this language created a fee simple determinable.

quite correct to conclude that X County took a fee simple absolute estate in Whiteacre and that no defeasible fee simple was intended. Thus, H should not succeed in his action.[14]

In many jurisdictions statutes require holders of retained future interests to periodically file a notice or claim to the effect they intend to enforce their rights if the limitation or condition occurs. If State X had a statute of this type and neither H nor H's predecessors timely filed this notice, then even if a fee simple determinable or a fee simple on condition subsequent were created, H would be barred from reclaiming possession of Whiteacre.

PROBLEM 6.6: O conveys Blackacre "to B and his heirs provided that, if intoxicating liquors are ever sold on the premises, then O reserves the right to enter and terminate B's estate." What estate does B take under this deed?

Applicable Law: A grant to B and his heirs provided that if a specified condition occurs or fails to occur the grantor or his heirs have the right to re-enter and terminate the estate creates in B a fee simple subject to a condition subsequent and leaves in the grantor a right of re-entry for condition broken which today is also called a power of termination.

Answer and Analysis

B has a fee simple subject to a condition subsequent. The older cases used the expression "right of re-entry for condition broken" to describe O's right. The more recent cases describe O's right as a "power of termination." B has a fee simple because words of inheritance "and his heirs" are used to describe the quantum of B's estate. B's estate may last forever provided intoxicating liquors are not sold on the premises. It may also last forever although intoxicating liquors are sold on the premises provided O or his successors in interest do not terminate the estate of B by exercising their power of termination.

The usual words for creating a condition subsequent are, "on condition that," "but if," "on the express condition that," "provided that" or similar expression. The usual expressions for reserving the power to terminate are that the grantor may "re-enter and take the property," "enter and terminate the estate," "in such case cause the title to revert back to the grantor," or other words evincing an intention to take back the property. The power to terminate may even be implied from such expressions as "every

14. See Chouteau v. City of St. Louis, 331 Mo. 781, 55 S.W.2d 299 (1932) (where a deed conveyed all interest in realty on condition that it should be used forever as a courthouse site with no express provision for re-entry, the deed conveyed a fee and not an estate on condition subsequent and hence the grantor's heir had no right to the property after its abandonment as a courthouse site); Restatement of Property §§ 44, 45.

thing herein shall be null and void" or "this deed shall be null and void and the title shall revert to the grantor."

In this problem, both the condition subsequent and the power to terminate are provided for expressly in the deed. The phrase "provided that if intoxicating liquors are ever sold on the premises" describes the condition subsequent. The phrase "then I reserve the right to enter and terminate the estate hereby created" describes the power to terminate or right to make reentry for breach of the condition. It is clear then that O intended to create a fee simple in B and that if a certain event or condition happened, namely, the selling of intoxicating liquor on the premises, then O would have the right or power to enter and put an end to that fee simple. B's estate would not end automatically. It would end only if and when the condition happened and thereafter the grantor or his successors in interest performed the requisite affirmative act of reentry for terminating such estate.[15]

PROBLEM 6.7: O conveys Blackacre "to B and his heirs but upon the express condition that B shall not dispose of or alienate Blackacre for a period of five years after B receives the title." Ten days after the deed was delivered to B, B purports to convey Blackacre to C. What estate does C have in Blackacre?

Applicable Law: A restraint which disables a fee simple owner of land from alienating the property is void and the owner may dispose of the property in fee simple.

Answer and Analysis

C owns Blackacre in fee simple absolute. O purported to convey a fee simple absolute to B and also to impose on B a restraint on B's power to alienate or dispose of the fee simple estate. Is this restraint valid? The answer is an unequivocal no.

The power to dispose of the fee simple estate is an integral part of the fee simple estate. This estate cannot exist apart from the power in its owner to dispose of it. This type of restraint or power to alienate is classified as a disabling restraint and is void in all cases except when connected with spendthrift trusts. Where this restraint appears in a deed, the grantee takes the property free of the restraint and with full power to dispose of the property.[16] This is true whether the restraint refers to real or personal property,

15. See Restatement of Property § 45; Simes, 30.

16. Accord, White v. Brown, 559 S.W.2d 938, 941 (Tenn.1977) (where the testatrix stated in her will that she wished a named person to have her home to live in and that it was not to be sold, the testatrix passed a fee simple absolute in the home to such person, and her attempted restraint on alienation was void as contrary to public policy).

whether it refers to legal or equitable interests (spendthrift trusts excepted), and whether the estate involved is a fee simple, fee tail, life estate, or an estate for years. In other words, there is no power on the part of a grantor or testator to convey a fee simple estate to a person *sui juris* and deny that person the power to dispose of the estate for five years, for one year, for one day or one minute. In this case then, O's attempted restraint on B's power to alienate the estate was void and B took the fee simple absolute in Blackacre. B's estate was alienable. B had both the right and power to convey the fee simple estate to anyone. Since B granted B's estate to C, C took from B the estate which B had which was a fee simple absolute.

The disabling restraint illustrated in this problem is a type of direct restraint on alienation. Other types of direct restraints are the promissory and forfeiture restraints. Unlike the disabling restraint which is generally held invalid except in the case of spendthrift trusts, promissory and forfeiture restraints are generally held valid when imposed on interests less than fees simple.

§ 6.3 Fee Simple Conditional and Fee Tail [Omitted]

§ 6.4 Life Estates[17]

PROBLEM 6.12: T's first wife died. Later T remarried W–1. T later dies and bequeaths Blackacre to "my second wife, W–1, so long as she remains a widow, and then to my child C and his heirs." W–1 later dies and bequeaths her entire estate to her brother X and his heirs. X enters Blackacre. C sues X in ejectment. Who wins?

Applicable Law: A grantor can create a determinable life estate as well as a fee simple determinable. Ordinarily distinguishing the two is easy. However, where the limitation is tied to an event that could only occur during the grantee's lifetime, ambiguities can arise whether the grantor intended to create a determinable life estate or a fee simple determinable.

Answer and Analysis

C probably wins. Whether C or X wins depends on whether W–1 had a determinable life estate or a fee simple determinable. It W–1 had a determinable life estate, then C would have a remainder which would become possessory at W–1's death. A determinable life estate is neither devisable nor descendible. If, on the other hand, W–1 had a fee simple determinable, then W's estate would be devisable and descendible and, given that the limitation could not occur after W–1's death, C's shifting executory interest[18] could never become possessory.

17. On life estates, see Ch. 5, Part I.

18. The fact that C would have a shifting executory interest is an excep-

The proper classification of W-1's interest depends on T's intent. A strong argument can be made that T wanted W-1 to have only personal enjoyment of the property during her widowhood and not a devisable or descendible estate. This argument is particularly strong where as here, C is a child of T's first marriage and construing W-1's estate as a fee simple determinable would permit her to devise the property to strangers.[19]

PROBLEM 6.14: H and W were husband and wife who had five minor children. H devised Blackacre "to my wife, W, for the term of her natural life, remainder to our children share and share alike, but if my wife, W, determines it to be for the welfare of the family to sell Blackacre, then she is hereby empowered to sell the land and pass a fee simple title thereto." W decided that it was for the family welfare to sell Blackacre so she conveyed it to "B and his heirs." W died and the five children sue B for possession of Blackacre. Should they succeed in their action?

Applicable Law: A life tenant can be granted a power to convey a fee simple even if by exercise of that power the interest of the remainderman is defeated.

Answer and Analysis

No. Sometimes an estate is given with a power in someone to cut short or destroy it. Sometimes an estate is given with a power to enlarge it. This case involves both types—a life estate in W with a power to dispose of the fee simple and a remainder in fee simple in the children with power in W to destroy it. By W's conveyance to B in fee simple she exercised that power. This act both enlarged her life estate to a fee simple absolute in her grantee and destroyed the vested remainder in her children. But until the exercise of the power by W, she had only a life estate.

PROBLEM 6.15: O conveys Blackacre "to B for the lives of B, C, D and E and the survivor of them." B conveyed to X all of B's right, title and interest in Blackacre. B then died survived by C, D and E. O sues to eject X from Blackacre and argues that B's death terminated X's interest in the premises. May O succeed?

tion to the classification structure. Logically, C should have a vested remainder since, if it were to ever become possessory, it would do so following the natural termination of W's estate upon the happening of a limitation, not a condition. However, because of the early common law rule that a fee simple could not follow on the heels of a fee simple, C's interest was classified as a shifting executory interest and continues to be so classified today.

19. Compare Dickson v. Alexandria Hospital, Inc., 177 F.2d 876 (4th Cir. 1949)(fee simple determinable) with Mouser v. Srygler, 295 Ky. 490, 174 S.W.2d 756 (1943)(determinable life estate).

Applicable Law: O "to B for the lives of B, C, D and E and the survivor of them," is valid to create a life estate in B until the death of the survivor of the four named persons, B, C, D and E. O "to B for the joint lives of B, C, D and E" is valid and lasts as long as all four live and ends upon the death of the first of the four; O "to B for B's life and the lives of all the people who live in State X and the survivor" is a valid life estate for the life of B only, the provision for the other lives and survivor being void for impracticability of determining the death of the survivor.

Answer and Analysis

No. It should be noted that the life tenant's name, B, is listed among the measuring lives so that this is not wholly an estate pur autre vie. B has a valid estate for the lives of B, C, D and E and the survivor of them. This phrase makes the life of the survivor of the four the maximum term of the estate which B had and which B assigned to X. Thus, O has no right to eject X until all of the four are dead. If B is not the survivor of them, B's estate passes to those persons who are the successors of his estate—his heirs if B dies intestate; the beneficiaries of the interest if B dies testate.

Had the conveyance read, "for the joint lives, of B, C, D and E," then the "joint lives" could only last until the first of the four died and when B died, O could have ejected X. But the deed did not so provide.

Had the measuring lives been "for the life of B and the lives of all the persons now living in the State of South Dakota and the survivor of them," the provision for the lives beyond that of tenant, B, would be void for the reason that it would be impracticable if not impossible to determine the time of death of the survivor, and B would take a life estate for his own life only.[20]

PROBLEM 6.16: T devised Blackacre to her daughter, D, for life. T's will directed that upon D's death Blackacre should be distributed to D's two children, X and Y, and their heirs. The will also provided that Blackacre should not be sold until X and Y reached 45 years of age. Is the provision against sale valid?

Applicable Law: (a) Disabling restraints on alienation (spendthrift trusts excepted)[21] generally are void regardless of the estate to which they are attached. (b) Forfeiture and promissory restraints on life estates and lesser interests generally are

20. See Restatement of Property § 107, illustrations 1, 4, 5.

21. A spendthrift trust is a trust which provides, among other things, that the equitable life estate (and remainder) while held by the trustee are not alienable nor reachable to the creditors of the income beneficiary or remainderman.

valid. (c) All unreasonable restraints on the alienation of fee simple estates are invalid. (d) Life estates are subject to termination by special limitations and powers of termination.

Answer and Analysis

In most states the restraint on alienation is invalid. The provision against sale is a restraint on alienation of the disabling type.

A disabling restraint is a direction in the creating instrument that the estate shall not be alienated. If this restraint were valid, it would create a non-transferable estate. If a disabling restraint were valid, the transferee subject to the restraint could not alienate the property and would not lose his interest in the property even though in violation of the restraint he purported to alienate the property.

The general rule, with the exception of a disabling restraint on the beneficial interest under a spendthrift trust, is that all disabling restraints on alienation are void. This rule applies whether the disabling restraint is attached to a fee simple, life estate, or lesser interest. It also applies whether the restraint is total or partial, limited or unlimited as to duration. The rule is based upon a public policy preference to eliminate impediments to the alienability of land. When tied to a life estate or other estate smaller than a fee simple absolute, the practical effect of the restraint is unclear. All future interests act as impediments to the alienability of land. Thus, in this problem, if the restraint were limited to the life of D, an empirical question arises whether the land would be any more alienable without the restraint as it would be with it since D's children have a future interest. If they do not join in a conveyance, no purchaser from D could acquire a fee simple estate.

When applicable, the rule of invalidity invalidates the illegal restraint on alienation and makes the estate freely alienable. Thus, in most jurisdictions D acquires a life estate which D can alienate, and X and Y can alienate their remainder interests during the lifetime of D. They also can alienate the fee simple after the death of D regardless of whether or not they reach the age of 45.

Forfeiture and promissory restraints on fee simple estates generally have been held invalid. Forfeiture and promissory restraints on life estates and lesser interests generally are held valid. A forfeiture restraint exists when the creating instrument provides that on an attempted alienation the estate created or transferred is forfeited or terminated with a further provision for the estate to pass to another.

A promissory restraint is in the form of a covenant (promise) that the grantee will not alienate the estate. Thus, in this problem,

if the will provided that should D transfer or alienate her life estate, then her estate should end and the entire estate vest in X and Y, the provision would be perfectly valid and enforceable.

Forfeiture restraints on life estates may be justified on two grounds: (1) they may be imposed for the benefit of the reversioner or remainderman; and (2) life estates are somewhat inalienable (at least in a commercial sense) anyway because of the uncertainties surrounding the life expectancy of the life tenant. Because the life tenant may die the next day, no one is willing to pay very much for a life estate. Forfeiture restraints on leaseholds are common and are valid. These restraints customarily take the form of affording the landlord the right to re-enter and terminate the estate if the leasehold is transferred without the landlord's consent. The interest of the landlord in protecting rental income and the reversionary estate are sufficient justification for upholding such restraints.

Life estates also are subject to termination by (1) special limitation, such as "to B for life so long as B does not sell liquor on the premises," or "to W for life for so long as W remains a widow (or until she remarries)," and (2) by the exercise of a power of termination, such as, "to B but if he does not keep the fences in repair, then I reserve the right to re-enter and take back the premises."[22]

The modern trend toward condominium and cluster housing has given rise to increased restrictions on the use and transfer of such housing units. The close interrelationships of the community members, whether controlled by a home owners' association, a condominium or a cooperative association, have resulted in the use of restrictions in order to achieve a community of compatible and financially responsible persons. The restrictions frequently involve not only restrictions on use, i.e., single family residence, no children under a certain age, or no pets, but also restrictions on sale or transfer.

A wholly disabling restraint on sale most likely would not be used, and even if it were, it would most likely be held invalid although limited as to duration. However, provisions are common

22. See McCray v. Caves, 211 Ga. 770, 88 S.E.2d 373 (1955) (where a husband's will devised a tract of land to his wife for life and at her death to the heirs of her body but should she cease "to be the wife or widow" of the husband "then in that event she forfeits her right to the life estate" to her children, the estate divested upon her remarriage); Restatement of Property § 18, Note 2.

that grant the condominium association a right of first refusal. In other words, when an owner wishes to sell, the association may either approve the prospective buyer and sale, or instead, may buy the unit on the terms and conditions offered by the prospective buyer. As long as the association does not have an unreasonably long period of time in which to exercise its purchase option, such provisions have been, and should be upheld as long as the particular terms do not violate the rule against perpetuities.[23]

One court expressed the opinion that a right of first refusal was not a restraint on alienation since the seller in effect had two purchasers instead of one.[24] This reasoning is questionable. If a right of first refusal exists, any prospective purchaser that the seller gets must be prepared and willing to wait until the association decides whether or not to exercise the option. If the association is given too long a period of time to decide, many prospective purchasers will refrain from making an offer because they will not want to be bound for a long time without an assurance that they will get the land. Thus, there will definitely be a restraint on alienation. Reasonable controls, however, are common and even desirable.

In view of these recent developments, statements about direct restraints on alienation should be phrased as follows: reasonable restraints on alienation are upheld, but unreasonable restraints on alienation are invalid.[25]

23. Options in gross may be subject to the common law Rule against Perpetuities, but options to renew or purchase attached to leases are not generally subject to the Rule, because they promote rather than hinder alienability. See Ch. 13. See generally, Ch. 8, §§ 8.4; 8.5.

24. Watergate Corp. v. Reagan, 321 So.2d 133 (Fla. 4th D.C.A. 1975) (action for declaratory judgment; an agreement granting a right of first refusal with respect to the sale of certain property did not violate the Rule against Perpetuities and enhanced alienability because the seller had two potential buyers instead of one).

25. See Coquina Club, Inc. v. Mantz, 342 So.2d 112 (Fla. 2d D.C.A.1977), holding that unit owner must tender a qualified purchaser (here, with no children under 12), before association has duty to purchase or provide another purchaser; Hoover & Morris Dev. Co., Inc. v. Mayfield, 233 Ga. 593, 212 S.E.2d 778 (1975), holding that owner did not comply with declaration requirements concerning notice to the association so as to require exercise of the option or consent, but that there was evidence of a waiver; and Ritchey v. Villa Nueva Condominium Ass'n, 81 Cal.App.3d 688, 146 Cal. Rptr. 695 (1978), holding that age restrictions on occupancy and sale were reasonable and valid, and that coupled with a right of first refusal as provided in the documents would impose on the association the duty within fifteen days to either provide a qualified purchaser, purchase itself, or waive the restriction. See Ch. 13.

FREEHOLD ESTATES COMPARED WITH AND DISTINGUISHED FROM NON-FREEHOLD ESTATES

Freehold estates illustrated	Non-freehold estates illustrated
Case 1. Fee simple A *to B and his heirs*—this gives B a fee simple and leaves nothing in A. B's estate is inheritable by his heirs general, either lineal or collateral.	Case 1. Estate for years A *to B for 10 years*—this gives B an estate for years and leaves a reversionary interest in A. If B dies during the 10-year period the balance of the term passes to B's personal representative, i. e. his executor or administrator, for purposes of administration. In many jurisdictions the rules as to the intestate transmission of real and personal property are the same.
Case 2. Fee tail A *to B and the heirs of his body*—at common law this gave B a fee tail and left a reversion in A. B's estate was inheritable only by B's lineal heirs. Today the nature of the estate created by such a conveyance varies from state to state.	Case 2. Estate from year to year A *to B from year to year*—this gives B an estate from year to year and leaves a reversionary interest in A. If B dies during the period of the lease the balance thereof passes to his personal representative.
Case 3. Life estate A *to B for life*—this gives B an estate for B's life and leaves a reversion in A. B's estate is not inheritable.	Case 3. Tenancy at will A *to B as long as A wishes* (or as long as both A and B agree)—this gives B an estate at will and leaves a reversionary interest in A. B's death (or A's death) during the tenancy terminates the tenancy and A has the right to immediate possession. NOTE, HOWEVER, that if the limitation is from *A to B for as long as B wishes,* there is a conflict of authority and B has either a life estate determinable (believed to be the better view) or a tenancy at will depending upon the jurisdiction.

Freehold estates illustrated	Non-freehold estates illustrated
	Case. 4. Tenancy at sufferance A leases to B for 2 years and after the expiration of the 2-year term, B remains in possession without A's permission—B has a tenancy at sufferance which is really no tenancy at all but is called such. A has the right to eject B. B has a mere naked possession without right.
SIMILARITIES	
1. In each case B has possession of the land.	1. In each case B has possession of the land.
2. In each case B has an estate in the land.	2. In cases 1 and 2 above B has an estate in the land but in cases 3 and 4 B does not have an estate but mere possession.
DISSIMILARITIES	
1. The interest of B is *real property*.	1. In cases 1, 2 and 3 B's interest is *personal property*—called a chattel real. In case 4, B has no interest.
2. B's interest is *inheritable*—that is, passes to B's heir or heirs in cases 1 and 2 but this is *not true as to case* 3 for a life estate measured only by the life of the tenant is not inheritable.	2. In cases 1 and 2 and 3 B's interest *is inheritable* but in cases 3 and 4 it is not.
3. B's interest is of *indefinite* or uncertain duration.	3. B's interest in case 1 is of *definite* duration, in cases 2 and 3 of indefinite duration.
4. B is *seised* which means that he is possessed claiming a freehold interest in the land.	4. B is *not seised* but only possessed—seisin exists only as to freehold estates.
	5. A tenancy at will is a chattel interest in land, of the lowest nature but it is possession at the mutual wills of the land owner and the tenant, and will support trespass or ejectment; death terminates it.

Freehold estates illustrated	Non-freehold estates illustrated
	6. A tenancy at sufferance is no tenancy at all; it is a mere wrongful, naked possession but neither an estate nor property.

§ 6.5 Concurrent Estates

a. Joint Tenancy

PROBLEM 6.17: O conveyed Blackacre "to B, C and D and their heirs as joint tenants with right of survivorship in the survivors, and not as tenants in common." Blackacre is located in State Z. State Z law provides that all concurrent tenancies shall be deemed tenancies in common and not joint tenancies unless it is expressly declared that the grantees or devisees shall take as joint tenants. B died testate devising all of his interest in Blackacre to X and his heirs. X immediately took possession of Blackacre. C and D sue X in ejectment. May they succeed?

Applicable Law: Joint tenancy must under many modern statutes be expressly declared to overcome the preference for tenancy in common. A joint tenant can convey his or her undivided interest by deed. A joint tenant cannot convey his or her interest by will.

Answer and Analysis

Yes. Under modern statutes the survivorship feature of co-tenancies is not popular. Many such statutes in express terms prefer tenancy in common over joint tenancy, which is the reverse of the common law. In order to create a joint tenancy under the type of statute given in the problem, there must be a clear expression of intention that the grantor intends the grantees to take as joint tenants. Any doubt is and should be resolved in favor of their taking as tenants in common.[26]

It would seem that O has succeeded in creating a joint tenancy in the grantees. O uses these words, "as joint tenants with right of survivorship and not as tenants in common." Three distinct ideas are expressed: (a) the grantees are called joint tenants; (b) they are to have the right of survivorship; and (c) they are not to be tenants in common. Any one of these expressions by itself may not overcome the preference for tenancy in common. But when all three are

26. In Oregon, common law joint tenancies have been abolished. Ore. Rev. Stat. § 93.180 (1973). However, a right of survivorship can be created in two or more persons without the right to sever that feature. This is accomplished by characterizing language which would have created a joint tenancy as creating a life estates in the grantees, and a contingent remainder in fee in the survivor. See Halleck v. Halleck, 216 Or. 23, 337 P.2d 330 (1959).

put in the conveyance, and it is expressly declared to be joint tenancy as the statute requires, then B, C and D would take as joint tenants. Accordingly, when B died testate or intestate, the survivors, C and D, continue as survivors to hold Blackacre in fee simple in joint tenancy. In order to destroy the joint tenancy by severance the joint tenant must convey his or her interest by deed.[27] A destruction of the joint tenancy occurs even by the conveyance of a lesser interest than the joint tenant has. The joint tenant's interest being in fee simple, a severance occurs by a conveyance of a fee tail, life estate or, according to some cases, by his transfer of a term of years. On the other hand, the will of a joint tenant is wholly ineffective to pass any interest in the jointly owned property; at the instant of death the right of survivorship takes effect and the attempted severance comes too late. Thus, B's devisee, X, takes nothing under the will, has no interest in Blackacre, and can be ejected from the premises by the owners and possessors, C and D.

Suppose during his life, B conveyed all of her interest to Y. That would create a tenancy in common in Y as between Y, and C and D. But the joint tenancy of C and D would not be severed by B's conveyance and upon C's death survived by Y and D, D would own 2/3 and Y 1/3 of Blackacre.

> **PROBLEM 6.18:** T owned a regular section of land, Blackacre, in a given township and effectively devised it to A and B as joint tenants. Later, A executed a deed to X as follows, "I hereby convey all of my right, title and interest in the North East Quarter of Blackacre to X and his heirs." Thereafter, Y, a judgment creditor of A, levied upon and sold to M on execution sale, all of "A's right, title and interest in the South Half of Blackacre." A died intestate leaving W his widow and Z his sole heir at law. Who owns Blackacre?
>
> **Applicable Law:** A joint tenant owns the whole of the jointly owned property, not a fractional part. The joint tenant can dispose of his or her entire interest and the grantee of that interest takes a fractional part as a tenant in common. A joint tenant may dispose of an interest in a specific part of the jointly owned property. The interest of a joint tenant can be levied upon and sold by his creditors. Upon the death of a joint tenant, the decedent's surviving spouse cannot claim dower and the decedent's heirs have no interest in the property.

27. Riddle v. Harmon, 102 Cal. App.3d 524, 162 Cal.Rptr. 530 (1980) (contrary to the common law, a joint tenant can sever a joint tenancy by conveying to himself as a tenant in common); Swartzbaugh v. Sampson, 11 Cal. App.2d 451, 54 P.2d 73 (1936) (lease by one joint tenant does not sever tenancy). See also, Tenhet v. Boswell, 18 Cal.3d 150, 554 P.2d 330, 133 Cal.Rptr. 10 (1976. As respects mortgages, see Harms v. Sprague, 105 Ill.2d 215, 85 Ill.Dec. 331, 473 N.E.2d 930 (1984); Brant v. Hargrove, 129 Ariz. 475, 632 P.2d 978 (1981); People v. Nogarr, 164 Cal.App.2d 591, 330 P.2d 858 (1958) (all holding that joint tenancy not severed where one joint tenant mortgages his interest where mortgage is not a transfer of title but merely the creation of a lien). In states following the title theory of mortgages, the execution of a mortgage by one joint tenant can sever the joint tenancy.

Answer and Analysis

(1) B and X are tenants in common of the North East Quarter of Blackacre, (2) B and M are tenants in common of the South Half of Blackacre, and (3) B is the owner in severalty of the North West Quarter of Blackacre.

Every joint tenant owns the whole of the jointly owned property and does not own a share or a fractional part thereof. Furthermore, each joint tenant has the right and power to dispose of his or her undivided interest. This means that A and B as a unit owned Blackacre and that A owned Blackacre and B owned Blackacre. It also means that by a conveyance A had the right and power to dispose of an undivided one half interest in Blackacre. If A could dispose of this entire interest in Blackacre, then A could dispose of part of such interest by limiting the conveyance to the North East Quarter of Blackacre. Thus, A's deed to X carved out and vested in X an undivided one half interest in the North East Quarter of Blackacre. But as to that Quarter, X and B are tenants in common because the unities of time and title have been severed by A's deed. X takes title from a different source than did B and X takes title at a different time than did B. Thus, B and X cannot be joint tenants. B and X each own an undivided one half interest as tenants in common in the North East Quarter of Blackacre in fee simple.

Because a joint tenant has the right and power voluntarily to dispose of an interest in the jointly owned property, the joint tenant's creditors have the right and power to take that interest involuntarily. A's judgment creditor, Y, therefore, had the right to levy upon and sell A's interest in the south half of Blackacre. Having done so, when M purchased Blackacre at the execution sale, the unities of time and title were destroyed because M took this interest in Blackacre from a different source and at a different time than did B. The result is that M and B are tenants in common of the south half of Blackacre, each owning an undivided one half interest therein.

The North West Quarter of Blackacre remained unaffected by the conveyances to X and M. A and B remained joint tenants of that quarter until A's death. Survivorship defeats any right which a surviving spouse otherwise might have in the estate of a joint tenant. It also defeats the rights of the heirs of the deceased joint tenant. Therefore, A's widow, W, and his heir, Z, can claim no interest in the North West Quarter of Blackacre. That quarter belongs to B in severalty in fee simple by the doctrine of survivorship.[28]

28. See Klajbor v. Klajbor, 406 Ill. 513, 94 N.E.2d 502 (1950) (joint tenancy may be severed and the estate destroyed by the conveyance of interest of one of the joint tenants and the interest severed is changed into a tenancy at com-

PROBLEM 6.19: T devised Blackacre "to A and B as joint tenants." The property consisted of a 50 foot lot fronting on a very busy street in a city. One half of the 50 foot frontage was covered by a store building. The other half was vacant. The land was worth $16,000. The building was worth $5,000 but needed $1,000 worth of repairs on the roof as an absolute necessity to make it habitable for business purposes. The other half of the lot could be used for store purposes if a building costing $4,000 were built. A asked B to contribute $500 towards repairing the roof of the existing building and $2,000 towards the construction of another store building on the lot for rental purposes. B refused to do anything. A then repaired the roof for $1,000 and built another store building on the lot for $4,000 and, with B's approval, rented both buildings. A then asked B to repay to A one half of the sums A expended in repairs and in building the new store. B refused. A then sued B to partition Blackacre, it being conceded that it was not partitionable in kind but only by making a sale and dividing the proceeds. Under order of the court Blackacre was sold to X for $26,000. The court then ordered the $26,000 divided as follows: $10,500 to B and $15,500 to A. B objects to this division. Was the court correct?

Applicable Law: A joint tenant has no right of contribution against the other joint tenants for repairs or improvements he or she has made, but if a court orders that the property be partitioned, the court in making an equitable division of the proceeds will take into consideration the expenditures made by one tenant for repairs and improvements.

Answer and Analysis

Yes. A partition suit is in equity and an equity court should do equity. At common law A might have had a cause of action to compel B, the other joint tenant, to contribute for the making of repairs which are absolutely necessary, provided he brought the action before the repairs were made. No such action would lie after the repairs were made. Furthermore, one joint tenant has no cause of action against the other joint tenants for contribution for improvements. Under these principles, it is plain that A had no right against B for contribution either for repairs or the improvement.

In a partition suit, however, each joint tenant has the right to have the jointly owned property partitioned. Under the circumstances, by A making and paying for repairs and improvements, A

mon, but severance of joint tenancy must take place before the death of the cotenant and before the other has become owner of the whole by virtue of the right of survivorship).

has enhanced the value of Blackacre by $5,000.[29] By returning to A the $5,000 which A expended in repairing and improving the property, A is made whole and B is not injured. Had there been no repairs or improvements the property would only have been worth $21,000. There is still that sum left after reimbursing A for A's expenditures for repairs and improvements. Thus, it seems the equity court made an equitable partition of the proceeds.[30]

PROBLEM 6.20: H conveys Blackacre to himself and his wife, W, in the following language, "I, H, hereby grant Blackacre to H and W, husband and wife and their heirs forever, in joint tenancy with right of survivorship, and not to them as tenants by the entirety or as tenants in common, it being my intention that all the rights and powers of joint tenants shall accrue to said H and W." H died intestate leaving S as his sole heir at law. In whom is the title to Blackacre?

Applicable Law: A husband and wife can hold real property in joint tenancy. A joint tenancy (or tenancy by the entirety) in most jurisdictions can be created by husband, H, making a grant "to H and W, husband and wife" with clearly expressed intention to that effect.

Answer and Analysis

W owns Blackacre in fee simple absolute. There is no question concerning H's intention. In unmistakable language H expressed an intention that H and W hold Blackacre in joint tenancy. There is no question either (except in those jurisdictions that do not recognize all types of concurrent estates), that a husband and wife may hold real property either as tenants by the entirety, as joint tenants, or as tenants in common, depending on the intention expressed in the conveyance.

The only real question is this: can a grantor grant to himself and another and thereby create a joint tenancy, (or tenancy by the entirety), when such is the grantor's clearly expressed intention? It

29. While an improver cotenant cannot compel other co-tenants to pay for the improvements, the court takes account of the improvement in the partition action. For example, if feasible, the improvement would be included in the portion of the property set aside to the improver. If the property is sold, however, a portion of the proceeds attributable to the improvement would be set off to the improver. See Johnson v. Hendrickson, 71 S.D. 392, 24 N.W.2d 914 (1946).

30. See Calvert v. Aldrich, 99 Mass. 74 (1868) (where two tenants in common owned a machine shop that needed repair after having caught fire and one tenant paid for repairs after the other refused to contribute, the court held that a tenant in common who makes necessary repairs upon common property without the consent of his cotenant cannot maintain an action at law to recover contribution for costs incurred; rather, partition is the usual and natural remedy). See also, Giles v. Sheridan, 179 Neb. 257, 137 N.W.2d 828 (1965)(Co-tenant who pays off mortgage on which co-tenants are equally liable does so for common benefit of the joint tenants and is entitled to contribution).

seems that a proper analysis can bring only an affirmative answer. The cases present at least three distinct views as to the effect of the conveyance.

At common law the husband and wife were one and he was the one. Thus, when the husband granted to himself and wife, he was granting to himself. When one grants to himself, nothing happens. So the conveyance is void. But this concept is an anachronism. Today the wife is a legal person and her personality is no longer merged in that of the husband.

The second view holds that the effect of the conveyance is to create a tenancy in common between the husband and wife, each owning an undivided one half interest in Blackacre. There are two objections to this result. The first is that it does violence to the grantor's clearly expressed intention that H and W shall not take as tenants in common. The second is that it treats H, the grantor, as the same person, as H, the grantee. This view suggests that one part of the conveyance wherein H conveys to H is void and of no effect, and H therefore remains the owner of one half, whereas the other part of the conveyance from H to W affects only an undivided half of Blackacre which H originally owned and therefore W becomes an owner of such other undivided half. Therefore, they are tenants in common.

The third view and the one which is believed to be the correct one is this: Joint means oneness. In joint tenancy when two, three, or a dozen persons are named as grantees, those joint tenants take as a unit, as one juristic person. In this conveyance H is one person and "H and W" constitute in the singular number quite another person. For the purpose of joint tenancy (or tenancy by the entirety) such grantees or devisees take as a unit personage.

Why do all the cases say that when one joint tenant dies, the survivors take nothing from the decedent but take wholly from the original conveyance? Because each owned the whole and they all owned the whole as a unit. When one died the survivors still continued as a unit owning the whole until there was but one survivor. Thus, when H conveyed Blackacre to "H and W" intending them to take as joint tenants, the grantor, H, was one person, and "H and W" was (singular number) another person, and they as a unit took Blackacre as joint tenants. The grantee, "H and W," take title from the same source, at the same time with the same interest and with unity of possession. When H died W held in fee simple by survivorship.

Today, there is much to be said in favor of carrying out the clearly expressed intention of the grantor in the creation of estates,

even though technically all of the so-called four unities may not be present.[31]

PROBLEM 6.21: T devises Blackacre to A, B and C as joint tenants. A then conveys all of his right, title and interest in the premises "to X for the period of his natural life." (a) What is the effect of this conveyance? (b) Who now owns Blackacre?

Applicable Law: A conveyance by a joint tenant constitutes a severance and a destruction of the joint tenancy as to the conveying joint tenant's interest. Thereafter X owns a life estate in one third as tenant in common and A owns the reversion in that same one third; B and C remain fee simple owners in joint tenancy between themselves as to the other two thirds, but as to X they own the two thirds as a tenant in common.

Answers and Analysis

A's conveyance destroys the joint tenancy as to A's interest and X owns a life estate as a tenant in common in an undivided one third interest in Blackacre; A owns the reversionary interest in that same undivided one third interest; B and C own the remaining two thirds interest as joint tenants between themselves but with X as a tenant in common for his life.

Any conveyance by a joint tenant of his entire interest or a freehold interest, or probably of an estate for years, constitutes a complete severance of that joint tenant's interest in the jointly owned property and destroys the joint tenancy as to that interest. Thus, by conveying a life estate to X, A has severed A's entire interest in Blackacre from the joint tenancy. Having carved out of the whole estate an undivided one third portion, and having created in that undivided portion a life estate in X, A has a reversion in such undivided one third in fee simple. A's conveyance destroyed the unities of time, title and interest without which a joint tenancy could not continue.

However, the four unities remain as to the two thirds interest remaining in B and C which was unaffected by A's conveyance to X.[32] As to that undivided two thirds interest B and C remain joint tenants. If one of them should die without having made a conveyance, the survivor of those two would own that undivided two thirds by survivorship. In other words, there are two tenants in common with the one unity of possession: X has an undivided one

31. See also Miller v. Riegler, 243 Ark. 251, 419 S.W.2d 599 (1967) (Intent to create a joint tenancy is sufficient to create a joint tenancy even though four unities test not met).

32. Jackson v. O'Connell, 23 Ill.2d 52, 177 N.E.2d 194 (1961).

third, and B and C as a unit possess the other two thirds. Thus, B and C occupy two roles. Between themselves they are joint tenants of two thirds interest but as to X they, as a single unit, constitute a tenant in common of the two thirds interest.

A, the owner of the reversion in an undivided one third interest, is not called a tenant in common. Rather A owns a future interest in an undivided one third. A is not called a tenant in common because the phrase "concurrent estates," is limited to possessory estates. It involves presently possessory estates owned by two or more persons. Thus, in our case, B, C and X, but not A, have immediate possessory estates in Blackacre and the possession of B or C or X of Blackacre is in law the possession of all three together.

b. Tenancy by the Entirety

PROBLEM 6.22: T devised Blackacre "to H and W, husband and wife, and their heirs forever, jointly." Thereafter H executed to M a mortgage on Blackacre. H then procured a divorce from W and on a later date married W–1. H then died intestate, leaving W–1 his widow, and X as his sole heir. W sues Y and X seeking to quiet in her the title to the whole of Blackacre. May W succeed?

Applicable Law: At common law, there was a presumption that a conveyance to husband and wife jointly creates a tenancy by the entirety. A divorce eliminates the unity of person in tenancy by the entirety, destroys that tenancy and the husband and wife become tenants in common of the property. During the existence of the tenancy by the entirety, in most jurisdictions neither spouse has the right or power to dispose of or encumber the property without the consent of the other.

Answer and Analysis

No. By appropriate language in the conveyance a husband and wife can hold real property as tenants in common, as joint tenants or as tenants by the entirety, where such estate is recognized. But, at common law, there was a presumption that a conveyance to a husband and wife jointly created a tenancy by the entirety. Under this presumption the conveyance in this case would be construed to make H and W tenants by the entirety rather than joint tenants.

Assuming then that H and W are tenants by the entirety, in most jurisdictions recognizing such estates, neither had the right or power to dispose of or encumber such estate without the consent of the other spouse.[33] Therefore, the mortgage which was executed

33. At common law a husband had greater management and administrative authority over tenancy by the entirety property.

alone by H to M was wholly ineffective at that time to create a lien or incumbrance on the land. M's remedy must be limited to his personal action on the debt owed by H to M. Similarly, creditors of one spouse ordinarily cannot reach the tenancy by the entirety property in satisfaction of their claims.[34]

When H procured a divorce from W, the unity of person which is essential to the creation and continued existence of an estate by the entirety was destroyed and with it the tenancy by the entirety was destroyed.[35] H and W, however, continued in some form of concurrent tenancy. Are they joint tenants with right of survivorship or tenants in common? Logically, theirs would be a joint tenancy because of the five unities in tenancy by the entirety, only one, unity of person, was destroyed by the divorce. The other four unities of time, title, interest and possession, remain. But this generally is not the law. H and W after the divorce should be strangers in their property ownership as far as possible. Tenancy in common is more probably in accord with their intent since it is unlikely either would want the survivorship feature preserved. Most cases so hold.[36]

H and W were then each owner of an undivided one half interest in Blackacre when H married W-1. Upon H's death intestate the title to H's undivided one half interest in Blackacre descended to his heir, X, but subject to W-1's right of dower in such half interest, if dower exists. Thus, W and X each own an undivided one half interest in Blackacre as tenant's in common, with X's undivided half interest possibly being subject to the choate right of dower in W-1 widow.

There is also a good possibility that X's undivided one half interest may be encumbered by the mortgage to M as a result of the doctrine of estoppel by deed. Although the mortgage was initially

34. Sawada v. Endo, 57 Hawaii 608, 561 P.2d 1291 (1977); Central National Bank of Cleveland v. Fitzwilliam, 12 Ohio St.3d 51, 465 N.E.2d 408 (1984) (neither spouse can alienate interest in tenancy by the entirety).

35. Porter v. Porter, 472 So.2d 630 (Ala.1985) (divorce decree does not automatically sever a joint tenancy between the former spouses); Mann v. Bradley, 188 Colo. 392, 535 P.2d 213 (1975) (provision in divorce settlement agreement that joint tenancy be sold upon spouse's remarriage or when youngest child attained age 21 constitutes a severance of the joint tenancy). See also, Duncan v. Vassaur, 550 P.2d 929 (Okl. 1976)(husband and wife were joint tenants and wife killed husband; that act severed the joint tenancy causing ½ of the property to pass to husband's estate and ½ to wife.

36. But see, Finn v. Finn, 348 Mass. 443, 204 N.E.2d 293 (1965) (tenants by the entirety who divorce become joint tenants with right of survivorship pursuant to a property settlement agreement incorporated into the divorce decree). A joint tenancy between husband and wife is not affected by divorce absent a specific provision in their property settlement agreement or divorce decree severing the joint tenancy. See generally, Westerlund v. Myrell, 188 Wis. 160, 205 N.W. 817 (1925).

invalid, upon divorce H acquired an undivided one half interest which was freely alienable and mortgageable. Thus, as to this after-acquired severable interest, H can be estopped to deny the effectiveness of M's mortgage in the same way he would be estopped as to previously conveyed or encumbered other after-acquired property. Thus, if estoppel is invoked against H, his second wife, W–1, and his heir, X, take their interests subject to such mortgage.

COMMON LAW CONCURRENT TENANCIES COMPARED*

Kind of tenancy	How created	Typical words in deed or will	Unities present	Interest owned by tenant	Power of disposition	How can disposition be made	Rights as intestacy	How destroyed
Tenancy by the entirety	By act of the parties, *deed or will*	A "to H & W and their heirs."	Time Title Interest Possession Person	Husband and wife as a unit own the whole, *joint* ownership	Both husband and wife must join in conveyance	By deed only and not by will. Survivorship defeats effect of will.	Survivor continues to own all but in severalty	Divorce terminates the tenancy and makes them tenants in common
Joint tenancy	By act of the parties, deed or will	A to "B & C and their heirs as joint tenants with the right of survivorship and not as tenants in common."	Time Title Interest Possession	All tenants as a unit own the whole, *joint* ownership	All may join and dispose of whole or each tenant can dispose of share he did not own as such	By deed only and not by will. Survivorship defeats effect of will.	If only one survivor he continues to own but in severalty. If more than one survivor they continue to own in joint tenancy.	1-One tenant conveys his interest. 2-By partition in kind among tenants. 3-By any act which breaks any unity.
Tenancy in coparcenary	By law of inheritance	A dies intestate leaving 3 daughters, B, C & D, his only heirs	Title Interest Possession	Each tenant owns an *undivided* portion which portions are not necessarily equal	Each tenant can dispose of his undivided share or part thereof	By deed or by will	Heir or heirs inherits undivided interest of deceased parcener.	1-By partition 2-By conveyance by one parcener 3-By whole descending or vesting in one parcener
Tenancy in common	By act of the parties, deed, will, or by law	A "to B and C and their heirs share & share alike as cotenants."	Possession	Each tenant owns an undivided portion which portions are not necessarily equal	Each tenant can dispose of his undivided share or part thereof	By deed or by will	Heir or heirs inherits undivided interest of deceased co-owner	1-By partition among tenants 2-By uniting all titles in one tenant in severalty by purchase or otherwise

[C2454]

Chapter 15

THE EVOLUTION OF THE MODERN DEED

SUMMARY: CONVEYANCES UNDER MODERN STATUTES

1. Every American state has nearly exclusive jurisdiction over the land within its borders.

2. Each state has the power to prescribe the form which a conveyance of real property shall take and the power to determine the legal effect of a conveyance, subject only to federal law.

3. Whether the form prescribed by a statute is to operate as a common law "grant," under the Statute of Uses, or independently of both, is determined by construing the words of the particular statute.

4. In most states the Statute of Uses, 1535, being in force in England at the time of the American Revolution, and being a statute of general application, is considered part of the "common law."

PROBLEMS, DISCUSSION AND ANALYSIS

15.1 Common Law Conveyances

a. Feoffment

The ceremony of feoffment consisted of: (a) livery of seisin in which the feoffor, A, picked up a twig or piece of turf symbolizing the land itself, and handed it to the feoffee, B, with appropriate words such as, "I hereby enfeoff you and your heirs of Blackacre"; and (b) A's walking off the land leaving B in possession claiming the freehold estate in such land, that is, B claimed either a life estate, a fee tail or a fee simple. B was then seised of the land. A feoffment always transferred the physical possession of corporeal property. It is said to "lie in livery" because the possession of the land could be physically handed over to the feoffee.[1]

1. See A. W. B. Simpson, A History of the Land Law (2d ed. 1986). W. Holdsworth, 3 A History of English Law 3–275 (2d ed. 1937); 7 id. at 3–400 (5th ed. 1942); T. Plucknett, A Concise History of the Common Law 610–623 (1956); Patton, 1 Land Titles 1–8 (2d ed. 1957).

b. Grant

Incorporeal property interests such as reversions, remainders or easements were not subject to physical possession and were therefore said to "lie in grant," which meant they could be transferred only by a deed.

c. Lease and Release

By this transaction A leased to B Blackacre for a week. After B took possession A made to B a deed releasing to B and his heirs A's reversionary interest in Blackacre. The purpose of this conveyance was to save the owner, A, the burden of having to go onto the land to make a feoffment. By first making a lease to B, B was in possession and A now had a reversion. The reversion, an incorporeal interest, could be transferred by deed. When the landlord conveys his reversion to his tenant it is called a release. B is then the owner in fee simple.

d. Surrender

When the landlord conveys her reversion to the tenant it is a release. When the tenant transfers his leasehold estate to the landlord it is a surrender. Two types of surrender, by agreement and by operation of law, are explained in Problem 15.1 below.

e. Dedication

Example, A, fee owner of Blackacre, which consists of 9 blocks or squares of land in the form of a square area, three blocks long and three blocks wide, decides that he can sell the property better if he makes the center block a park. He orally declares his intention by telling his neighbors that he hereby dedicates such block for use of the public as a park. Thereafter people in the community use this block for picnics, playground and recreation. A has dedicated the block. Dedication at common law required no particular form and could be made by words, conduct or writing. When it is accepted by the public by using it as a park, there is a conveyance of an easement for such public use as a park, the fee remaining in A, the dedicator. See Chapter 10.

15.2 Conveyances Under the Statute of Uses of 1535

a. What is a Use?—Brief Historical Sketch

(1) Example: A enfeoffs "B and his heirs for the use of C and his heirs."

The purpose was to give B the legal title only and to give C the possession and enjoyment. These conveyances were common in feudal England before the Statute of Uses.

(2) Why a Use?

There were many advantages or reasons for creating uses, but among the most important were the avoidance of such feudal incidents of tenure as primer seisin, wardship and marriage.

(3) Enforcement of Uses

By Whom? After uses became common, they were enforced by the chancellor, the keeper of the King's conscience. The stated reasons were spiritual: (a) a person should be bound by his promise, or (b) to prevent unjust enrichment, i. e., the feofee to uses would be unjustly enriched if he did not recognize the beneficial interest of the cestui que use.

How? The method of enforcement was characteristic of equity jurisprudence: by injunction, fine or imprisonment against the defendant.

Against Whom? The use was enforced against four different categories of persons: the feofee to uses (analogous to the modern trustee); the feofee's heir; a donee of the feofee; and also a purchaser from the feofee if the purchaser had knowledge of the use. All of these persons would be unjustly benefitted if the use were not enforced against them.

Not Against Whom? There were also four categories of persons against whom the use was not enforced: a bona fide purchaser from the feofee if the purchaser had no notice of the use; the overlord if he obtained the land by escheat, the dower right of the feofee's wife, and a disseisor. The good faith purchaser would acquire both the legal title and an equity from his purchase, and this prevailed over the prior equity of the cestui que use. The overlord had a superior interest and logically the land would escheat free of the use; the dower of the feofee's wife was conferred by law but it is difficult to see how she could get a beneficial estate when her husband had none; and the disseisor, of course, acquired a new and independent title as a result of his own actions and operation of law.

(4) The Statute of Uses—Effect

The Statute of Uses, 1535, converted the use estate into a legal estate. Thus in our example under (1) above, after the Statute of Uses, C acquired a legal fee simple absolute and B had nothing.

b. Political Background

Why was the Statute of Uses passed? It was forced upon an unwilling Parliament by a strong willed monarch, Henry VIII, for the purpose of enhancing the depleted royal revenues. This depletion resulted largely from the fact that perhaps four-fifths of all land in England was held to uses to avoid the heavy burdens of a dying feudal system of land tenures. Much of the royal revenues were gained from the burdens of wardship and marriage in the feudal system.

To illustrate the incidents of wardship and marriage, suppose A is an elderly person who owns Blackacre in fee simple and has a son, B, ten years old. If A should die while B is still a minor, then A's overlord would have the right to the profits of the land until B became of age and would also have the right to determine whom B should marry. These were rights which brought the overlord a substantial income. To avoid such results, A could enfeoff a young man, M, of Blackacre for the use of A's son B. Then A's death would not affect M's rights at all for M is of age. Nor would M's overlord have any rights of wardship or marriage concerning B. Further, M would then hold Blackacre for the benefit and profit of B, and would accumulate the net profits for B till B became of age. Under the modern equivalent: A has set up a trust with M as trustee and B as beneficiary.

The King, being the one lord who was not also a tenant in the system, was most directly affected by the fact that land was held to uses. He introduced and forced the passage of the Statute of Uses for the purpose of eliminating uses. He succeeded as to passive uses.[2]

c. Three Periods of Development

The law of uses developed through three distinct periods: (1) the "law period" between 1066 and about 1433, during which the law courts did not recognize a use as giving any rights; (2) the "equity period" from 1433 to 1535 when the Statute of Uses was passed, during which equity emerged and began to recognize a use as being an enforceable right; and (3) after the Statute of Uses was in force, during which period the passive use was automatically executed into a legal estate.

d. Uses Illustrated

2. See 1 Am. L. Prop. 31 et seq. (Casner ed. 1952).

(1) Uses executed on a feoffment on transmutation of possession (i.e., delivery of possession from feoffor to feoffee):

(a) Use expressly declared by the feoffor at the ceremony of feoffment: example: A enfeoffs B and his heirs of Blackacre *to the use of* C and his heirs

(i) In the law period A had no rights, B had the fee simple and C had no rights at all because the law did not recognize a use. C could merely entreat B to hold the land for C.

(ii) In the equity period A had no rights, B had the fee simple and C could bring a suit in equity and petition the court for a decree ordering B to hold the land for C. The court would issue the decree and B would have to do as ordered or be in contempt of court. This carried out A's expressed intention that the feoffment was for the use of C.

(iii) After the Statute of Uses, A would have no rights, B would have no rights and the legal title in fee simple would be in C. The Statute executed the use by carrying the legal title from B to C in fee simple. This was automatic because the Statute so provided, whereas under (ii) above, before the statute, the use was enforced by proceedings in court.

Note: Resulting Use

In the previous example the reversion in fee simple is in A. Because equity would not raise a use unless there was consideration for the conveyance or a use expressed, it became customary to imply a resulting use in favor of the grantor when the entire beneficial estate was not otherwise disposed of. After the Statute of Uses this resulting use was also executed so that the grantor, A, in the above example, would have a legal reversion in fee simple.

This principle of resulting uses has a modern counterpart in the law of trusts, the usual rule being that the trustee acquires a legal estate just large enough to accomplish the purposes of the trust, and the trustee takes no beneficial interest unless such an intent is clearly expressed.

* * *

(b) Use raised on consideration actually paid at the ceremony of feoffment: example: A enfeoffed B and his heirs of Blackacre, A not stating that it was for the use of C, but C actually pays money to A at the time.

Here the rights of the parties are identical with those given under (a) next above, to wit:

(i) In the law period A had no rights, B had the fee simple by the feoffment and C had no rights because, while the payment of consideration by C raised a use in him, the law courts did not recognize the use or any rights in the cestui que use, that is, C.

(ii) In the equity period A had no rights, B had the fee simple because of the feoffment, but C, whose use was raised by the consideration paid by C, could petition the equity court for a decree ordering B to hold Blackacre for the use and benefit of C. The decree would issue and B would obey or be jailed for contempt of court.

(iii) After the Statute of Uses, A had no rights, B would have no rights and the legal title in fee simple would be in C. The Statute of Uses executed the use by carrying the legal title from B to C in fee simple. This was automatic because the Statute expressly so provided that if one (B in this case) were seised to the use of another (C in this case), then the seisin would be deemed and adjudged in the one who had the use, which was C in this case.

(2) Uses *executed* without transmutation of possession, that is, without a feoffment in which possession is delivered by feoffor to feoffee.

Note

The examples given above involved a feoffment, the common law conveyance in which physical possession was delivered to the feoffee by the feoffor on the land. At common law that was the only way a present freehold estate could be transferred in a single transaction. Then came the revolutionary method of conveying freehold estates in land without making such delivery of possession. The new method, which is codified in modern statutes, eliminates the inconvenience of going onto the land to be conveyed. The conveyance is made by merely executing a deed in the lawyer's office. This was made possible by the Statute of Uses.

(a) Bargain and sale deed: example: A, the fee simple owner of Blackacre, executes and delivers his bargain and sale deed to B. The deed recites, "for and in consideration of $1.00 and other valuable considerations, the receipt of which is hereby acknowledged, I, grantor, A, hereby bargain, sell and convey Blackacre to B and his heirs . . . ," and the deed is signed and sealed by A. What was the legal effect of this transaction in each of the three periods mentioned above?

(i) In the law period this deed had no effect at all. This was not a feoffment, and the ceremony of feoffment with livery of seisin or delivery of possession of the land from feoffor to feoffee was the only method by which A could convey

Blackacre in fee simple to B at common law. Hence, A remained the fee simple owner of Blackacre, and B had nothing and no right in Blackacre because the deed could give him none.

(ii) In the equity period the equity courts recognized that the recital of the $1.00 consideration in the deed raised a use in B. It was immaterial whether or not the $1.00 was paid, because the recital of such payment in an instrument under seal could not be rebutted. Now A, who was seised before the execution of the deed, is still seised because he has not made livery of seisin to any other person. The result was that B, having the use, could petition the equity court for a decree ordering A to let B occupy the land or otherwise use the land for B's benefit. The court would make the order and if A did not obey, he would be punished for contempt of court. But the point is that the equity court before the Statute of Uses in 1535, did enforce the use in B's favor, such use being raised by the recital of the consideration in the bargain and sale deed.

(iii) After the Statute of Uses, A had no further interest in Blackacre, and B was the owner in fee simple. By the recital of the consideration in the deed, the use was raised in the grantee, B. Then A was seised to the use of B. That is the exact situation to which the Statute of Uses applies. In substance it says, when one is seised to the use of another (A seised to the use of B), then he who is seised (A) shall lose such seisin to the other (B). Why did it work that way? Because A had the fee simple before the deed was executed. The deed itself did not transfer the seisin or possession. Neither did A make livery of seisin or deliver possession of Blackacre to anyone. But the deed by its recital of consideration did raise the use in B. *Thus, the Statute of Uses carries the legal title from A who is seised, to the grantee, B, who has the use.*

Note: Historical Elements of Bargain and Sale Deed

Historically, to be effective as a bargain and sale deed three elements were essential. To be a deed it must be under seal. To be a bargain and sale deed the deed must recite a valuable consideration, and it must be delivered, which means it must be intended by the grantor to take effect as a conveyance.

(b) Covenant to stand seised: example: A, owner in fee simple of Blackacre, executes and delivers to B an instrument under seal which provides, "For the love and affection which I have for my son (or son-in-law) B, I hereby covenant to stand seised of Blackacre for the use of B and his heirs" or "For the love and affection which I have for my son (or son-in-law) B, I hereby convey my

Blackacre to B and his heirs." What are the rights of A and B in each of the three periods set forth above?

(i) In the law period, 1066 to 1433, A.D., A remained fee simple owner and B had no rights at all for the reason that at common law only a feoffment could convey a freehold estate, of which the fee simple is one. The law courts did not recognize a use.

(ii) In the period of equity between 1433 and 1535 when the Statute of Uses was passed, A still held the seisin because he had made no transfer of possession by the ceremony of feoffment. However, this sealed instrument raised a use in B which B could, by petition in equity, have enforced by decree against A. In equity the relationship by blood or marriage of the covenantor and covenantee was sufficient to raise a use in the covenantee. On the face of the instrument it appears that B is the son (related by blood, or son-in-law, related by marriage to A) of A. Hence, a use was raised in B so that thereafter A was seised to the use of B. This permitted B to procure a decree in equity ordering A to let B occupy or otherwise use Blackacre for the benefit of B.

(iii) After the Statute of Uses in 1535, which provided that one who was seised to the use of another should lose that seisin to the other, A had no rights in Blackacre and B was the owner in fee simple. This is another example of a modern conveyance without the inconvenience of physical transfer of possession by feoffment out on the land.

Modern statutes on conveyancing are codifications of bargain and sale deeds or covenants to stand seised, both of which grew out of the effects of the Statute of Uses. The Statute of Uses executed the use raised by the instrument of conveyance into a legal title in the grantee or covenantee.

e. *Effect of Statute of Uses on Modern Law*

(1) *Conveyancing.* Land became transferable by a single written deed; livery of seisin is no longer necessary.

(2) *Estates.*

(a) Executory interests, i. e., springing and shifting legal interests, became possible.

(b) The Rule against perpetuities was formulated to prevent indestructible future interests from unduly cluttering titles.

(3) *Trusts.* The modern law of trusts developed.

15.3 Conveyances Under Modern Statutes

PROBLEM 15.1: In some states a simple form of conveyance of real property is set forth as follows:

> "For the consideration of ______, I hereby convey to A. B. the following real property (describing it)."

Audrey owns Blackacre in such a state in fee simple. She signs, acknowledges and delivers a deed in the above form to A. B. She properly describes the property and fills in $1.00 as the consideration. On what theory would this deed operate as a conveyance in State X?

Applicable Law: A conveyance under a modern statutory form may be effective on any one of three theories: (a) as a common law grant; (b) under the Statute of Uses; or (c) merely as a prescribed form set by the legislature.

Answer and Analysis

Assuming the acknowledged instrument to be the equivalent of a common law deed with seal, this deed could operate as a conveyance on any one of three theories:

(a) The deed could be a common law "grant." At common law only incorporeal rights or hereditaments lay in grant, that is, could be transferred by deed. Such rights having no physical existence, they could not be delivered over to the grantee. Only physical property was subject to livery of seisin and required delivery of possession by feoffment. If the legislature of State X intended, by prescribing the above form of conveyance, to say that corporeal real property lay in grant as well as in livery, then such a deed can operate as a conveyance equivalent to a common law "grant."

(b) The deed could be valid under the Statute of Uses. The recital of the $1.00 consideration in the deed raises a use in the grantee, A. B. Then the grantor is seised to the use of A. B. The Statute of Uses then automatically carries the legal title from grantor to A. B., grantee. This statute seems to be a codification of the doctrine of conveyances under the Statute of Uses by bargain and sale deed, for the prescribed instrument contains a recital of consideration.

(c) This statutorily prescribed form can operate as a conveyance wholly independently of the past methods of transfer of real property, whether common law, equity or under the Statute of Uses, simply because the legislature of State X has so declared. The local statute gives this form the efficacy of a conveyance, and no reasons are needed beyond the fact that the legislature has power to prescribe forms of conveyance and this is the form so prescribed.

Note: The Statute of Uses and the Statute of Frauds

The Statute of Uses (1536) made the modern conveyance by written instrument a practical alternative to the ceremony of feoffment

by livery of seisin. Not until after the Statute of Frauds was passed in 1677, however, did courts *require* a writing to give effect to the conveyance of a freehold. In 1845 Parliament provided that a feoffment should be void unless it were evidenced by a written deed.[3]

PROBLEM 15.2: In California the legislature declared that a grant of an estate in real property may be made in substance as follows:

> **"I, AB, grant to CD all that real property situated in JJ county, State of California, bounded or described as follows: (here insert boundaries or description by name as 'The Norris Ranch'). (date) (signed) AB."[4]**

The statute then defined "transfer" as an act of the parties by which title to real property is conveyed from one person to another. It continued by saying that a written transfer is a grant and can be explained by circumstances under which it is made, and that a fee simple is presumed to pass in a conveyance unless a lesser estate is intended.

M owned Blackacre in California. She wrote several letters to her son, Sam, in a distant state requesting him to leave his job there, go to California to live, and take care of Blackacre and other property. In her letters, dated and signed by her, she wrote, "Blackacre is your property" and "I have written you several times that the little place with the garden, Blackacre, is your property." M was a citizen of Germany and lived there. Sam was a United States citizen and lived in the United States. Sam then left his job, traveled to California, moved his family onto Blackacre, and claims the property as his own. Is his claim valid?

Applicable Law: Mere informal letters from the conveyor to the conveyee may constitute an effective conveyance of real property under a modern statute which defines a "transfer" as an act of the parties by which title to real property is conveyed from one person to another.

Answer and Analysis

Yes. There are two questions involved in this problem, the intention of the legislature and the intention of M. It is obvious that the California statute did not intend to require any definite formula of words to constitute a conveyance. No consideration is required. It appears that a mere writing signed and dated by the property owner would constitute a conveyance if that were the

3. 8 & 9 Vict. ch. 3, § 1 (1845). See Goodwin, Before the Statute of Frauds, Must an Agreement to Stand Seised Have Been in Writing?, 7 Harv. L. Rev. 464 (1894).

4. Cal. Civil Code § 1092.

intention of the owner. The statute providing that a fee simple is presumed unless a lesser estate is intended is also typical. It makes unnecessary the common law requirement that words of inheritance "and his (or her) heirs" be used with the name of the grantee.

M's intent seems clear. She wrote, "The property is yours." These informal letters constituted a compliance with the statutory requirements, and conveyed Blackacre to Sam. The State has power to prescribe methods of conveying real property. If it prescribes merely a signed and dated writing, then compliance with such statutes will convey land wholly without reference to technical requirements of the common law or former statutes.[5]

PROBLEM 15.3: H and W were husband and wife. H owned Blackacre and executed, acknowledged, delivered and recorded a deed to Blackacre in favor of W. The deed provided, "This deed is not to take effect and operate as a conveyance until my death, and in case I shall survive my said wife, this deed is not to operate as a conveyance, it being the sole purpose and object of this deed to make a provision for the support of my said wife if she shall survive me, and if she shall survive me then and in that event only, shall it be operative to convey to my said wife said premises in fee simple." It named the wife specifically as grantee and recited a consideration of $1.00 as paid. The statute provided, "a person owning real estate and having a right of entry into it, whether seised of it or not, may convey it, or all his interest in it, by a deed to be acknowledged and recorded as hereinafter provided." Other statutes provided how the acknowledgment and recordation should be made and that such deed should be effective as a conveyance. No specific provision dealt with the time when a conveyance should take effect. H then cut down trees on the premises, and W sues him for damages for waste. May she recover?

Applicable Law: Estates to commence in futuro may be created under modern statutes. This could not be done at common law.

Answer and Analysis

No. There are two reasons why a common law conveyance could not take effect in the future. One is that there had to be livery of seisin which had to be made on the land as evidence of change of possession then or not at all. The other was that seisin could not be in abeyance, for the feudal overlord had to know who was seised at all times so that he would know on whom to call for the feudal services. Under such rule this deed could not operate as

5. Metzger v. Miller, 291 Fed. 780 (N.D.Cal.1923).

a common law conveyance, even though the reasons for the rule have long since disappeared. Under the doctrine of *springing uses*, a valid conveyance could be made to commence in futuro. There being in this instrument of conveyance a recital of consideration, in addition to the love and affection for a spouse, a use would spring up in the grantee, and the Statute of Uses would execute the use into a legal estate. The executed use will be a legal springing executory interest. It will become possessory at the moment of H's death if W survives him. Should W not survive H, W's interest will cease and terminate. And what interest, if any, does W have in Blackacre during the lives of H and W? The answer is that W has an irrevocable assurance that the land will be hers if she survives H, but in the interim she has no interest in the land which will support an action for waste.

Another view may be taken, namely, that the local statute makes the deed effective as a conveyance wholly independent of the Statute of Uses. By analogy the Maine Supreme Court took the view that the publicity and notoriety which livery of seisin gave a common law conveyance, the acknowledgment and recording of a deed gives to this statutory conveyance: "Our law now says to a party having such an interest in real estate as is mentioned in [the statute quoted above,] you may convey that interest or any part thereof in any manner herein prescribed with such limitations as you see fit, provided you violate no rule of public policy, and place what you do on record so that all may see how the ownership stands." The court also concluded that deeds "executed in accordance with the provisions of our statutes and deriving their validity therefrom may be upheld thereby, as well as under the statute of uses, notwithstanding they purport to convey freeholds to commence at a future day." It continued, "The mere technicalities of ancient law are dispensed with upon compliance with statute requirements. The acknowledgment and recording are accepted in place of livery of seisin. . . . "[6]

6. See Abbott v. Holway, 72 Me. 298 (1881).

Chapter 16

CONVEYANCING BY DEED

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16.1 The Written Deed.
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SUMMARY

§ 16.1 The Written Deed

1. The common law ceremony of feoffment by which a freehold estate was conveyed was oral and no writing was required.

2. Today the Statute of Frauds requires a writing and a signature by the conveyor of an interest in real property, excluding short term leases.

§ 16.2 Description and Boundaries

1. To be effective as a conveyance of land the deed must describe the land sufficiently so as to identify it.

2. A deed which fails to describe a specific divided part of a larger tract but describes a distinct fractional part of it is occasionally upheld as a conveyance of an *undivided* part (even though this was probably not the grantor's intent)—e.g., a conveyance of "one half of Blackacre" may be held to create an undivided half interest, rather than exclusive ownership in one half.

3. If a deed, in describing the land to be conveyed, refers to a particular map or plat, that map or plat is part of the deed for the purpose of identifying the land conveyed.

4. A metes and bounds description is the oldest known method of describing land. Literally, the term means "measurements and boundaries." This method describes the tract by using compass directions and distances from an ascertainable starting point. Monuments, when applicable, are frequently included, as, for example, " ... then proceed N. 30 degrees E. for 200 ft. to the South side of

Utopia Avenue." In this case, Utopia Avenue is a "monument," or physical object located in a definite place on the land.

5. In a metes and bounds description, two things are vital: (1) the description must begin at some readily identifiable known point of a substantial character so that it can be relocated if the marker is removed; and (2) the description must close, that is, if the courses and distances are followed step by step, one will return to the place of beginning.

6. When a deed describes the boundaries of the land to be conveyed by reference to monuments, natural or artificial, *the intent of the parties is the controlling factor* and all rules of construction are mere aids in determining such intent.

7. In a description of land, a monument is any object on the ground which helps to identify the land conveyed. It may be either natural or artificial. Such things as a tree, a stone, a stake, a river, a lake, a highway, a wall, a house, a ditch, a graveyard, an ocean, a farm, and a mining claim have been found effective as monuments.

8. The "course" of a line in a description means the direction it takes across the country, and is usually determined by its angle with some other known line.

9. The "distance" means the length of a line from one point to another point, and the "contents" means the area of a tract of land.

10. When the terms of a deed conflict, then generally: (a) monuments, either natural or artificial, govern over courses and distances; (b) courses govern over distances; (c) a specific description will govern over a general description; and (d) any of these will govern over an estimated "contents" or area. These are rules of construction only, not rules of law, and different priorities will prevail if there is evidence of such an intent.

11. Parol evidence is not admissible to determine the identity of land described in a deed unless it is first found that the description is ambiguous. Even then it is not admissible to alter, but only to explain the ambiguity, unless the suit is in equity for reformation.

12. When the description of land in a deed carries it "to," "by," "from" or "along" a street, road, alley, way, highway, creek, stream or similar monument, the common law rule is that the grantee takes title to the land to the center of such monument, assuming, of course, that the grantor owned to the center of such monument.

13. If the description of land in a deed carries it to or from *a point on the side of a street,* stream, road or similar monument, *and along such monument,* still the grantee should take title to the

center of such monument under the common law rule, but there are contrary cases.

14. If the description of land in a deed carries it to or from *a point on the side of a street,* stream, road or similar monument and *along the line on the side* of such monument, still the grantee should take title to the land to the center of such monument under the common law rule unless it is expressly excluded from the grant.

15. An oral agreement made between adjoining owners of land settling an uncertain boundary line or one in dispute is valid and binding and does not come within the Statute of Frauds.

A related but not necessarily identical doctrine is that of acquiescence, under which a boundary can be established by a long period of tacit acquiescence, without an explicit agreement.[1]

16. When the boundary of a tract of land is the thread or center line of a stream of water, such boundary is a variable and changes with the thread of the stream.

17. Title to the land under the waters of a non-navigable stream belongs to the abutting riparian owners, while title to the land under the waters of a navigable stream belongs to the state.

18. When a landowner owns to the water of a stream, lake, pond or ocean, but owns no land under the water, his boundary line and land area may be extended by the imperceptibly slow addition of soil by the action of the water, called accretion, or by the land rising and water receding, called reliction. The newly made land is called alluvion.

19. Alluvion belongs to the owner of the land abutting the water for three reasons: (a) she is the only person who is in a position to use it advantageously and make it produce; (b) such owner runs the risk of losing his land by erosion and should have a corresponding right to the gain by water deposits; and (c) her access to the water as a littoral (i.e., by a lake) or riparian (i.e., by a river) owner should be preserved.[2]

20. When a river by sudden and violent change (called avulsion) alters its course and overflows privately owned land, the title to such lands is not changed.

1. See Ault v. Holden, 44 P.3d 781 (Utah 2002) (requiring 20 continuous years of mutual acquiescence); Day, Validation of Erroneously Located Boundaries by Adverse Possession and Related Doctrines, 10 U.Fla.L.Rev. 245, 263–264 (1957); Browder, The Practical Location of Boundaries, 56 Mich. L. Rev. 487 (1958); Halladay v. Cluff, 685 P.2d 500 (Utah 1984) (noting that doctrine of boundary by acquiescence required a long period of tacit acquiescence but not an agreement, while the doctrine of boundary by agreement required evidence of a parol agreement, but not the long period of acquiescence).

2. See Gifford v. Yarborough, 5 Bing. 163, 130 Eng. Rep. 1023 (1828) (land gradually added to adjoining lands from water dissipation belongs to adjacent land owner, for it would be of no use to the king but the landowner could use it).

21. In the United States private ownership as to tidal lands stops at the high water mark.

22. An exception is an exclusion from the operation of a deed of some part of the corporeal property described in it. The excepted portion is wholly unaffected by the deed and remains in the grantor. E. g., A conveys Section 14 to B and his heirs "except the northeast quarter thereof."

23. A reservation in the United States today is the creation of a new right in the land conveyed for the benefit of land retained by the grantor. E. g., A conveys Blackacre to B and his heirs but reserves an easement across such tract in favor of A's Whiteacre.

24. In the United States the word "reservation" is sometimes construed as an exception, and the word "exception" is sometimes construed as a reservation. The intent of the grantor is the important consideration.

§ 16.3 Exceptions and Reservations

1. An exception in a deed merely subtracts from the entire tract described in the deed some corporeal portion which is not to pass to the grantee, but is to remain in the grantor wholly unaffected by the deed or conveyance.

2. Historically, a reservation created a right or incorporeal interest which had not existed previously, and which issued out of the land as a feudal service. The grantor was considered to have conveyed the entire property to the grantee free from any burden, then the grantee in the same deed "regranted" the interest reserved to the grantor.

§ 16.4 Delivery, Escrow and Acceptance

1. Delivery of a deed means a grantor's intent that it shall operate or take effect as a conveyance.

2. There must be in existence a physical deed duly executed by the grantor before delivery is possible.

3. If the grantor intends the deed to be effective, delivery takes place irrespective of whether the physical paper is in the possession of the grantee, the grantor or a third person.

4. Delivery is primarily a question of fact, and what the grantor does with the physical deed may be some evidence of his intent concerning its taking effect.

5. If the grantor hands the deed to the grantee with no intent that it operate as a conveyance, it is ineffective and there is no delivery; if she keeps possession of the deed but intends that it operate as a conveyance in favor of the grantee, there is a delivery.

6. Delivery, being the state of mind of the grantor, is wholly dehors (external to) the deed, and the parol evidence rule should not apply. That is, delivery must be established by evidence not appearing on the face of the instrument.

7. Delivery to a third person to be delivered to the grantee upon the occurrence of an event or the performance of a condition is commonly referred to as a delivery in escrow. Nevertheless, a distinction between the commercial transaction and a donative transaction is helpful in analyzing the cases and arriving at the correct solution.

8. In a commercial escrow transaction, the delivery is truly conditional. The condition may be the payment of the balance of the purchase price, the obtaining of certain quitclaim deeds, the satisfaction of mortgages or other incumbrances, or the performance of other acts or conditions which may or may not take place. In all of these cases, however, the performance of the condition is beyond the control of the grantor. Control is vested either in the grantee or in third parties.

9. A delivery in escrow in a typical commercial transaction is a valid delivery.

10. There cannot be an escrow or conditional delivery to the grantee under the traditional view. Conditional delivery to the grantee, the grantor retaining no other control over the instrument, takes effect immediately.[3]

11. A true escrow requires the grantor to give up all control over the operation of the deed, subject only to the performance of the condition or the happening of the event which is involved. It vests in the grantee the power to become the owner upon either the performance of the condition or the happening of the event.

12. The delivery in escrow or conditional delivery must be to a third person, and requires the manual handing over of the deed to the escrow depositary.

13. The escrow depositary is neither an agent nor a trustee of either the grantor or grantee; its duty is merely to carry out its instructions.

14. In a commercial escrow, the title to the property passes to the grantee upon the performance of the condition or upon the happening of the event, that is, from the so-called "second delivery." In case of death of the grantor, however, or his becoming *non compos mentis,* title relates back or passes from the date of the

3. But see Chillemi v. Chillemi, 197 Md. 257, 78 A.2d 750 (1951), discussed below.

"first delivery," that is, from the time when the grantor hands the deed to the escrow depositary.

15. When the grantor makes a commercial escrow delivery of a deed, it is irrevocable and she loses all control over the operation of the instrument as a conveyance subject only to the failure of the grantee to perform or failure of the other conditions. There is authority that a commercial escrow delivery is revocable unless there is an ancillary underlying enforceable contract to convey. But there is conflicting authority that the question at this stage of the transaction is not whether there is an enforceable contract to convey, but whether the grantor has sufficiently divested herself of control over the deed and title.

16. In a donative escrow transaction, the grantor delivers the deed to a depositary to be delivered to the grantee upon the occurrence of an event or condition. Depending upon the amount of control relinquished by the grantor, the delivery may be either valid or invalid.

17. In a donative escrow transaction where the delivery to the grantee is to occur on the death of the grantor whenever and however that occurs, there is a valid delivery, because:

a. The death of the grantor is a certainty; the only contingency is when.

b. The grantor in this case gives up all control.

c. When necessary to determine the rights of the parties before the death of the grantor, the analogy to a fee simple and executory interest or life estate and remainder is employed.

d. The deed in this case takes effect on the initial deposit with the depositary. However, it does not then vest the entire estate in the grantee; rather it vests presently a valid future interest.

18. In a donative escrow transaction where the depositary is subject to further instructions and control by the grantor, there is no delivery at all. Such a transaction is illustrated by a direction to the depositary to "deliver this deed to the grantee on my death if I don't recall it before then." In this case it is clear that the grantor reserves the right to control the deed in the hands of the depositary; thus, the depositary is his agent, and there is no delivery.

19. In the case of a donative transaction where the deed is to become effective upon the occurrence of an event within the control of neither the grantor nor the grantee, there are conflicting decisions. This situation may be illustrated by the direction to "deliver this deed if I die before the grantee, but if she dies before me, then return it." It is clear that the grantor does intend to retain (or get back) the entire title if one contingency happens, but to divest

himself completely of the title if another contingency happens. The more logical view is that such a delivery is valid and that the grantee will acquire title if the specified event occurs. The analogy to the commercial escrow situation seems appropriate.

20. An instrument of conveyance may, and usually does, arise out of a preexisting contract, and it may include within its terms a contract such as a warranty of title, but it is not a contract.

21. Logically, because a conveyance is merely a transfer of title from grantor to grantee, like a gift from donor to donee in personal property, no express acceptance is required. The law presumes one will accept that which is to her financial benefit or advantage. The deed poll, the most commonly used deed form in the United States, does not have a space for the grantee's signature; so evidence of the grantee's acceptance is not ordinarily apparent on the face of the instrument.[4]

22. At common law, an heir could not prevent title coming to him by descent by operation of law, although most states now have statutes permitting such refusal. In any event, a conveyance cannot be forced upon a purchaser against his will; every grantee in a conveyance has the right to make disclaimer and cast the title back upon the grantor.

23. Assuming delivery by the grantor, she who says title does not vest in the grantee has the burden of showing affirmative disclaimer by such grantee.

24. Many American cases assert, but fewer cases actually hold, that acceptance of a deed by the grantee is essential to an inter vivos conveyance.

25. All cases agree that infants and persons *non compos mentis* may hold title by purchase even though they have no capacity to accept contractual responsibility.

26. In the absence of evidence to the contrary, a valid delivery to one of several co-grantees serves as a delivery to all of them.[5]

PROBLEMS, DISCUSSION AND ANALYSIS

§ 16.1 The Written Deed

The common law ceremony of feoffment by which a freehold estate was conveyed was oral and no writing was required. The

4. English law required an acceptance, but held that such an acceptance could be presumed if the grant was beneficial to the grantee and there was no evidence of nonacceptance. Thompson v. Leach, 2 Vent. 198, 86 Eng. Rep. 391 (1691).

5. Arwe v. White, 117 N.H. 1025, 381 A.2d 737 (1977) (one co-grantee rejected his share; others not precluded from taking interest conveyed to them); LeMehaute v. LeMehaute, 585 S.W.2d 276 (Mo.App.1979) (delivery to one grantee operates as delivery to all).

common law "grant" conveying such incorporeal interests as remainders, reversions, easements and profits was a deed and had to be under seal. The Statute of Frauds required a writing and a signature by the conveyor of an interest in real property, excluding short term leases.[6] Covenants to stand seised and bargain and sale deeds under the Statute of Uses were required to be under seal. No general statement concerning the requirements of conveying instruments in the United States can have widespread, much less, universal application. The Statute of Frauds and the statute on conveyancing in each state should be consulted. In most states a seal is no longer required for the validity of a deed.[7]

§ 16.2 Description and Boundaries

Note: The Federal Survey

In 1796 Congress adopted the rectangular system of surveys as the official method of land measurement in the United States. The principal units of this system used in land descriptions are townships, ranges, sections and subdivisions. Each regular township is six miles square and contains 36 sections. Each section is one mile square and contains 640 acres. Chart 1 below shows how the system is used in locating townships in any given state. Chart 2 shows the method of numbering the sections within any given township. Chart 3 shows how each section may be subdivided and the number of acres in each subdivision, and is followed by a description of such subdivisions. Federal survey lines are generally given the highest priority in cases of inconsistencies in deed descriptions.[8]

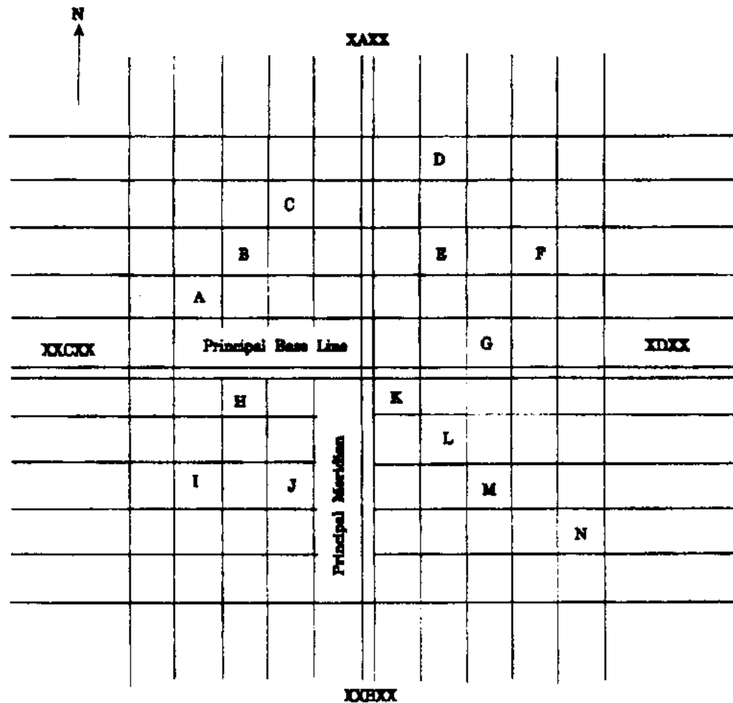
6. E.g., Beazley v. Turgeon, 772 S.W.2d 53 (Tenn.App.1988) (deed with forged signature violated Statute of Frauds).

7. North Carolina (at least as of 1978), is an exception. See Garrison v. Blakeney, 37 N.C.App. 73, 246 S.E.2d 144, 147–148 (1978), where the court states that a seal is necessary in North Carolina and then relates the history of the seal.

8. E.g., Rivers v. Lozeau, 539 So.2d 1147 (Fla.App.1989).

CHART I

SHOWING "PRINCIPAL BASE LINE" AND "PRINCIPAL MERIDIAN" BY WHICH TOWNSHIPS AND RANGES IN LAND DESCRIPTIONS ARE MEASURED



In each state using the rectangular system of surveys there are drawn arbitrary lines perpendicular to each other, one called the "principal base line" running east and west and the other called the "principal meridian" running north and south. Townships are measured north and south of the principal base line and ranges are measured east and west of the principal meridian. Each of the squares indicated in the above chart lettered from A to N indicates a township six miles square.

Some of these squares will be described as they would appear in a land description: the square indicated by letter A would be described as "Twp. 2 N, Rn. 4 W." By counting north from the Principal Base Line we find A in the second tier and by counting west from the Principal Meridian we find A in the fourth tier: thus the description given above. Continuing, square B would be "Twp. 3 N, Rn. 3 W"; square F would be "Twp. 3 N, Rn. 4 E"; square J would be "Twp. 3 5, Rn. 2 W" and square N would be "Twp. 4 S, Rn. 5 E," etc. The abbreviation "Twp." means township and the abbreviation "Rn." means range. In land descriptions, the township always precedes the range.

CHART II

TOWNSHIP MAP SHOWING SECTION NUMBERS

N

6	5	4	3	2	1
7	8	9	10	11	12
18	17	16	15	14	13
19	20	21	22	23	24
30	29	28	27	26	25
31	32	33	34	35	36

S

The method of numbering the sections within a township should be carefully studied even though it is a simple process. Beginning with section number 1 in the northeast corner of the township, the sections are numbered to the left from 1 to 6 in the top tier of sections, then down one tier and the counting is to the right to section 12, then down one tier and to the left, then down one tier and to the right, then down another tier and to the left and down one tier and to the right, ending with section 36 in the lower right hand corner of the township.

[74]

CHART III

SECTION MAP SHOWING SUBDIVISIONS THEREOF

N1/2 of NW1/4
N
80 acres
W1/2 of NW1/4 of NE1/4
20 acres
E1/2 of NW1/4 of NE1/4
20 acres
W1/2 of NE1/4 of NE1/4
20 acres
E1/2 of NE1/4 of NE1/4
20 acres
S1/2 of NW1/4
80 acres
N1/2 of SW1/4 of NE1/4
20 acres
N1/2 of SE1/4 of NE1/4
20 acres
S1/2 of SW1/4 of NE1/4
20 acres
S1/2 of SE1/4 of NE1/4
20 acres
NW1/4 of SW1/4
40 acres
NE1/4 of SW1/4
40 acres
NW 1/4 of NW1/4 of SE1/4
10 acres
NE1/4 of NW1/4 of SE1/4
10 acres
N1/2 of NE1/4 of SE1/4
20 acres
SW1/4 of NW1/4 of SE1/4
10 acres
SE1/4 of NW1/4 of SE1/4
10 acres
S1/2 of NE1/4 of SE1/4
20 acres
SW1/4 of SW1/4
40 acres
SE1/4 of SW1/4
40 acres
W1/2 NW1/4 SW1/4 SE1/4
5 a.
E1/2 NW1/4 SW1/4 SE1/4
5 a.
N1/2 NE1/4 SW1/4-SE1/4
5 a.
S1/2 NE1/4 SW1/4-SE1/4
5 a.
SW1/4 of SW1/4 of SE1/4
10 acres
A
2 1/2 a.
B
2 1/2 a.
C
2 1/2 a.
D
2 1/2 a.
W1/2 of SE1/4 of SE1/4
20 acres
E1/2 of SE1/4 of SE1/4
20 acres

Tract A is the NW1/4 of SE1/4 of SW1/4 of SE1/4
Tract B is the NE1/4 of SE1/4 of SW1/4 of SE1/4
Tract C is the SW1/4 of SE1/4 of SW1/4 of SE1/4
Tract D is the SE1/4 of SE1/4 of SW1/4 of SE1/4

[6A]

PROBLEM 16.1: Arthur, owner of Blackacre in fee simple, borrowed $500 from Doris. To secure this indebtedness Arthur executed a mortgage to Doris describing the mortgaged land as: "That certain tract of land, gristmill and storehouse, said tract to contain three acres and within my forty-acre farm." Thereafter Arthur gave a mortgage to Catherine covering Arthur's forty-acre farm and properly describing it. This was the same farm referred to in Doris's mortgage. Doris was about to sell the land under foreclosure proceedings when Catherine brought suit to enjoin the sale on the ground that Doris's mortgage was void for want of description identifying any specific land. Should the injunction issue?

Applicable Law: No conveyance is valid unless the description of the land sought to be conveyed is sufficient to identify the land.

Answer and Analysis

Yes. No deed or mortgage is valid unless the description of the land sought to be conveyed or mortgaged is sufficient to identify such land. What land is identified in Arthur's mortgage to Doris? The tract is three acres. But where is it? It is some place within a 40 acre tract. But no words locate it at any particular place within the 40 acres, and no words describe the shape of the three acres. Even if the buildings are intended to be within the three acres, a specific shape and location is lacking. Neither do the words used refer to any map or plat from which the three acre tract can be located. No monuments, no lines and no points give any indication of how to identify the land intended to be mortgaged to Doris. Hence, Doris's mortgage is void and the injunction should issue at the instance of the mortgagee, Catherine, whose mortgage appears to be valid.[9]

PROBLEM 16.2: A, being owner in fee simple of Blackacre, executed a deed in favor of B as grantee in which she used the following language, "I hereby grant to B and his heirs that certain piece of land, it being one half of my Blackacre." What are the rights of the parties?

Applicable Law: The courts will give effect to the language of the instrument of conveyance if possible, *even making the parties tenants in common,* when an undescribed "piece" of land is mentioned but which was to be a distinct fractional part of the whole tract.

Answer and Analysis

The answer is probably that A and B are tenants in common of Blackacre, even though this was not likely the grantor's intent. The parties to this transaction intended that something should be conveyed by the deed. If possible the courts give effect to the language used. It is obvious that the words in the deed describe no specific "certain piece" or a divided part of Blackacre. Hence, the deed would fail if it were to be applied to any specific piece of land. On the other hand, the language "it being one half of Blackacre" does describe that which can be the subject matter of a conveyance, an undivided half. Hence, the deed should be construed as transferring an undivided half interest in Blackacre to B, thus making A and B tenants in common of Blackacre. If, on the other hand, such a deed had attempted but had failed to describe a distinct piece of

9. See Harris v. Woodard, 130 N.C. 580, 41 S.E. 790 (1902).

Blackacre, and if it were clear that the grantor intended to convey a divided portion of the tract, and the words, "it being one half of my Blackacre" were meant to describe merely the area of the piece intended to be conveyed, then the deed would fail for lack of description.[10]

PROBLEM 16.3: Florence, owner in fee simple of Blackacre, executed a deed in the following language to Frances as grantee, "I hereby grant to Frances and her heirs that certain Lot 1, Block 1 of Veterans Addition to the City of Tucson, State of Arizona, according to that certain map on page 66 of Book 5 of Maps and Plats filed in the Office of the County Recorder of Pima County, State of Arizona." This described Blackacre. Frances paid full value for the lot and recorded the deed. Then Florence borrowed money from Diana and executed a mortgage on several pieces of land to secure the payment of this debt. Blackacre was included in the mortgage to Diana. Diana foreclosed the mortgage and was about to sell Blackacre. Frances seeks to enjoin this sale, and Diana contends that the description in Frances's deed is insufficient to pass title. In the trial Frances seeks to introduce in evidence the map and plat of Lot 1 Block 1 as it appears on page 66 of Book 5 of Maps and Plats in the Recorder's Office. Is such evidence admissible?

Applicable Law: If a deed in its description of the land to be conveyed refers to a map or plat, that reference makes the map or plat a part of the deed for the purpose of identifying the land.

Answer and Analysis

Yes. If a deed in its description of the land to be conveyed refers to a map or plat, the reference makes the map or plat a part of the deed for the purpose of identifying the land. It is obvious in the facts given that the description of the land as Lot 1, Block 1, etc., does not describe any land or locate any property which could be the subject of the conveyance apart from the map or plat. But by construing the deed and the map or plat together, there is a piece of land with specific and accurate dimensions which is located on the terrain in reference to other pieces of land which bound it. In fact, with the map or plat the deed is complete; without it the deed is incomplete and void. Thus the courts carry out the expressed intent of the grantor by treating the deed and map or plat as one for purpose of making the conveyance complete. Hence, the evidence is admissible and Frances is the title holder of Blackacre.[11]

10. See Morehead v. Hall, 126 N.C. 213, 35 S.E. 428 (1900) (conveyance of unspecified "one half of a tract of land" could not convey a divided portion but was sufficient to create undivided one-half interest).

11. See Deery v. Cray, 77 U.S. (10 Wall.) 263, 19 L.Ed. 887 (1869).

PROBLEM 16.4: A owned Blackacre in fee simple. Blackacre was a lot 80 feet wide and 200 feet long. The front 40 feet of Blackacre was subject to an easement for street purposes, and was not usable by the owner as long as Market Street was used over such area. Market Street was 80 feet wide and the south line of Blackacre formed the center line of such Street for a distance of 80 feet. The long sides of Blackacre extended due north and south and were perpendicular to Market Street which extended due east and west. A executed a deed to B of such property using the following language, "I hereby grant to B the following described property to wit: Beginning at a steel stake in the north side line of Market Street exactly 100 feet west of the intersection of said north side line of Market Street with the west side line of Spruce Street, in the City of Dover, State of Arisota; thence due north at right angles to the north side line of Market Street 160 feet to another steel stake; thence due west and at right angles to the line just drawn 80 feet to another steel stake; thence due *north* and at right angles to the line just drawn 160 feet to Market Street; thence along Market Street to the place of beginning." (a) Is this deed valid to transfer to B any part of Blackacre? (b) If so, does B take title to the 40 feet of the lot which is covered by Market Street?

Applicable Law: (a) If, in the description in a deed there is a conflict between the calls of a deed as to courses and distances on the one hand, and monuments, natural or artificial, on the other, the monuments will govern over the courses and distances. (b) When the description in a deed carries it "to," "by," "from" or "along" a street, road, alley, way, highway, creek, stream or similar monument, the common law rule is that the grantee takes title to the center of such street, road, alley, way, highway, creek, stream or similar monument, provided the grantor owns to the center of such monument. (c) Courses govern over distances.

Answers and Analysis

The answers are (a) the deed is valid and passes title to B, and (b) title to the 40 feet covered by Market Street passes to B. Question (a) raises a very important rule of construction: when there is a conflict in a deed description between the calls of a deed as to courses and distances on one hand and monuments natural or artificial on the other, *the monuments will govern over courses and distances.*[12] The reason for the rule is that human experience

12. Some courts apply this rule even when it is clear that the monuments were improperly placed. E.g., DD & L, Inc. v. Burgess, 51 Wash.App. 329, 753

suggests that one is much more apt to be correct when referring to a monument than when turning off an angle for the direction of a line (a course) or in measuring a distance. The description in the problem started at a monument, a stake specifically located in the north line of Market Street. The first course went north to another monument, a stake; the second course went west to another monument, a stake. Thus far the courses and distances and monuments coincide. Next comes the parting of the ways. The course turns due north but the monument, Market Street, is south. If the course is followed, there will be no land enclosed and the deed will fail for the courses describe only a broken line. If the monument governs, then the course will be carried not due north as the words indicate, but due south where the monument is located on the ground. Furthermore, by carrying the third course to the monument, Market Street, it will be possible, by following the fourth course, "along Market Street to the place of beginning," to enclose a piece of land which could be the subject matter of the conveyance. By using the rule of construction that monuments govern over courses and distances, the deed with its calls enclose an area of ground and will be valid. Thus, the third course runs "due south" to Market Street, the monument, and not "due north" as the deed states in words, and the deed is valid to pass title to B.[13]

Question (b) involves another very important common law principle of construction: when the description of land in a deed carries it "to," "by," "from" or "along" a street, road, alley, way, highway, creek, stream or similar monument, the grantee takes title to the land to the *center* of such monument, provided the grantor owns to the center. In our case the calls of the deed start from a point on the side line of Market Street and take a northerly direction "from" such point or Street. When the calls return to the monument, Market Street, they run "along" Market Street to the place of beginning. If the view is taken that the stake in the north side line of Market Street indicates an intent on the part of the grantor that the land conveyed shall be no further south than that point, then it can be argued that the grantee takes only to the north side line of Market Street, the tract which B gets is only 80 ft. by 160 ft., and no part of the lot under Market Street passes to B. But the general rule stated above should ordinarily apply and the stake on the north side line of Market Street is but a measuring

P.2d 561 (1988). See also Doman v. Brogan, 405 Pa.Super. 254, 592 A.2d 104 (1991) (where property description divided a building by reference to a "center wall," which was inconsistent with the given metes and bounds description, court divides property along wall currently in place closest to center, even though it may not have been the historical wall referenced in the deed; significantly, the metes and bounds description would have divided the property down the center of a room).

13. See Providence Properties, Inc. v. United Virginia Bank, 219 Va. 735, 251 S.E.2d 474 (1979).

point from which the area to be conveyed is to be identified. The location of that stake does not, in the absence of other factors, constitute a basis for determining the grantor's intent as to the area to be conveyed. The reason for the rule is that the only purpose which the retention in the grantor of a narrow strip of land in a street can possibly serve is to be the subject of future litigation. This possibility is eliminated by construing the deed in B's favor.[14]

Note

Another rule of construction is that *courses govern over distances* in the calls of a deed when the two are in conflict. To illustrate, suppose the third call in a deed is from a point to a given line on the side of a road south of said point. The deed reads, "then south to the road a distance of 66 feet, such line forming a right angle with the line on the north side of said road." The fact is that a line between the point and the line and forming a right angle with it will be exactly 60 feet long. If the line is to be 66 feet, then it will do one of three things as it swings in an arc: it will go 6 feet past the line; or it will form either an acute or an obtuse angle with such line. In such case the *course,* the direction of the line from the point to the road and making a right angle therewith, will govern over the length of the line, the *distance,* and the deed will be so construed that the line will be 60 instead of 66 feet in length.[15] Suppose the lengths of two lines in a deed cannot both be correct. One or the other must be in error. In that case there is an ambiguity and parol evidence is admissible to explain what was actually done on the ground.[16] In Temple v. Benson,[17] the court permitted a remote grantor to testify to the boundaries as they were marked out on the ground.

14. See Hoban v. Cable, 102 Mich. 206, 60 N.W. 466 (1894); Low v. Tibbetts, 72 Me. 92 (1881).

15. See Hall v. Eaton, 139 Mass. 217, 29 N.E. 660 (1885).

16. See Walters v. Tucker, 281 S.W.2d 843, 847 (Mo.1955):

> The law is clear that when there is no inconsistency on the face of a deed and, on application of the description to the ground, no inconsistency appears, parol evidence is not admissible to show that the parties intended to convey either more or less or different ground from that described. But where there are conflicting calls in a deed, or the description may be made to apply to two or more parcels, and there is nothing in the deed to show which is meant, then parol evidence is admissible to show the true meaning of the words used.... Such evidence must not contradict the deed, or make a description of other land than that described in the deed.

17. 213 Mass. 128, 100 N.E. 63 (1912). Accord Riley v. Griffin, 16 Ga. 141 (1854), where a witness was permitted to testify concerning his recollection as to where surveyor's marks on trees were located, even though the trees had been cut down many years earlier.

One should distinguish the case where surveyors or other experts are brought in to testify as to the meaning or interpretation of certain terms of art. Cf. Philpot v. State, 843 So.2d 122 (Ala. 2002) (permitting surveyor to testify, even though dead was not found to be ambiguous).

PROBLEM 16.5: Marion owns Blackacre, a quarter section of land which abuts Lincoln Highway, a road 80 feet wide. The south 40 feet of Blackacre is covered by the pavement of Lincoln Highway. In her deed to Fried as grantee, Marion uses this language, "thence south to a point on the north side line of Lincoln Highway, thence along the north side line of said Highway to the place of beginning, being a steel stake in the north side line of said Highway." The rest of the description was accurate as to Blackacre lying north of Lincoln Highway. Lincoln Highway was then abandoned, and Fried took possession of and struck oil on the 40 feet of Blackacre which had been used as part of said Highway. Marion sues to eject Fried from said 40 foot strip. May Marion recover?

Applicable Law: If the description in a deed is carried to two points constituting a line or the "side line" of a street, road, alley, way, highway, creek, stream or similar monument, still the grantee takes title to the center of such monument unless in express words the grantor excludes any part of such monument from the operation of the deed. This is the better rule, but some cases disagree.

Answer and Analysis

The dominant, but not uniform, answer is no. When the description in the deed describes two points or a line which constitutes one side of a monument, such as a road, street, highway, stream, alley or the like, and the grantor owns to the center of the monument, does the description carry title to the center of the monument, or does the grantor retain the strip between the side line and the center of the monument? To be sure, two points determine a line and a line determines a boundary. The grantor has described the boundary line of the land conveyed as the "side line" of the Highway. This suggests that no part of the Highway passes to the grantee. The result is that the strip in the highway still belongs to Marion, and Marion can eject Fried.

The better view is that when a description carries the boundary of land conveyed to a monument such as a street, stream, road and the like, the general rule that the land goes to the center of the monument should apply unless the strip between the center and the side line is expressly excluded. This view seeks to avoid litigation which may arise by the grantor's retention of narrow strips of land. Such litigation is just about the only purpose which such retention of title can serve, for until the street is abandoned the grantor is in no position to use it beneficially. What of the grantor's intent? The parties usually do not think of the strip under the monument when the deed is delivered. Of course, the grantor has the right to retain the strip, and also the grantee would have the

right to reject the deal if the strip were retained. However, it is not inconsistent with the general rule allowing title to the center of the monument to pass to the grantee, to treat the two points, or the line on the side of the highway where it is more convenient to place stakes than in the road, not as a boundary line as such, but merely as the measuring points from which to identify the land conveyed, and indicating the side of the road on which the land lies.[18]

PROBLEM 16.6: A owned Blackacre in fee simple, which consisted of a tract 180 feet square and bounded on the north by the line AB, on the east by the line DA, on the south by the line CD and on the west by the line BC. Monument A was at the northeast corner, Monument B at the northwest corner, Monument C at the southwest corner and Monument D at the southeast corner. A executed his deed to a portion of Blackacre to B, using the following language: "I grant to B that certain portion of Blackacre bounded on the east by the line AD, on the north by the line AM which is the easterly 100 feet of the line AB, on the south by the line DN which is the easterly 100 feet of the line DC and on the west by the line joining the two points M and N, which enclosed tract is the easterly one half of my Blackacre." B fenced in the easterly 100 feet of Blackacre, which left the westerly 80 feet in A's possession. A sues B to eject him from the westerly 10 feet within B's fence. May A succeed?

Applicable Law: When there is a conflict in the description in a deed between a specific description or description by metes and bounds on the one hand, and a general description by fractional part or area on the other, the clear specific description will govern over the general description.

Answer and Analysis

No. It is obvious that the first part of the description in the deed defines with particularity the boundary lines of the east 100 feet of Blackacre. It is just as obvious that the east 100 feet of such tract is more than half by an excess of 10 feet in width. Consequently, if B owns such 100 feet to the east, then A has only 80 feet to the west and has retained less than half of Blackacre. Here then is a conflict between a specific description or description by metes and bounds on the one hand, and a general description by fractional part or area on the other. In such case the rule is well settled that the clear specific description governs over an inconsistent general description. Title to the east 100 feet of Blackacre passes to B, and

18. See Salter v. Jonas, 39 N.J.L. 469 (E. & A.1877) ("nothing short of an intention expressed in ipsis verbis, to 'exclude' the soil of the highway, can exclude it"). See also Safwenberg v. Marquez, 50 Cal.App.3d 301, 123 Cal. Rptr. 405 (1975) (grantee takes to center).

A's general description that such property conveyed was one-half of Blackacre has no effect.[19]

§ 16.3 Exceptions and Reservations

PROBLEM 16.7: Greg, fee simple owner of Blackacre, used the following language in his deed to Sara as grantee: "I hereby grant to Sara and her heirs Blackacre except the east half thereof, and except the standing timber on Blackacre, and except the coal under Blackacre." What interest did Sara take under the deed?

Applicable Law: An exception in a deed merely subtracts from the entire tract described in the deed some corporeal portion which is not to pass to the grantee, but is to remain in the grantor wholly unaffected by the deed or conveyance. Such portion must be sufficiently described so that it can be identified.

Answer and Analysis

Sara took the west half of Blackacre minus the standing timber and the coal. An exception merely subtracts from the entire tract described in a deed, some corporeal portion which is not to pass to the grantee. Of course the portion excepted must be clearly described so that it can be identified. The deed given describes Blackacre. It then, by exception, subtracts the east half, all the standing timber on the whole tract, and all the coal under the entire tract. All three subjects of exception, the east half, the standing timber and the coal, are corporeal property. The grantor can dispose of such excepted property by deed or by will, or it will descend by intestacy.

PROBLEM 16.8: A, being fee simple owner of Whiteacre and Blackacre which abutted each other, and there being a visible roadway from a highway to the house on Whiteacre running across Blackacre (a quasi-easement), executed to B a deed to Blackacre, using these words: "I hereby grant Blackacre to B and his heirs, reserving to me and my heirs an easement from my house on Whiteacre to the highway along our usual roadway;" (a) What interest was conveyed to B? (b) What interest, if any, was retained by A in Blackacre?

Applicable Law: This case distinguishes exceptions and reservations as they existed at common law, the former applying only to corporeal property which remained in the grantor wholly unaffected by the conveyance, and a reservation being

19. See Morse v. Kelley, 305 Mass. 504, 26 N.E.2d 326, 127 A.L.R. 1037 (1940).

limited to incorporeal rights newly created by the deed and issuing out of the land. In the United States today, both easements and profits may be created by "reserving" such to the grantor if this is her intent. Indeed, the intent of the grantor will govern whether the word "exception" or "reservation" is used. Words of inheritance never had to be used in cases of an exception. Such words must be used in creating a reservation to last longer than the grantor's lifetime unless a statute dispenses with such in the creation of a fee simple estate.

Answers and Analysis

The answers are as follows: (a) B received Blackacre in fee simple burdened with an easement appurtenant in favor of Whiteacre, and (b) A retained in Blackacre an easement appurtenant to Whiteacre running from the house on Whiteacre across Blackacre to the highway over the road which had been the usual way of passage.

In the common law field of exceptions and reservations, history has played an important role and cannot be ignored. In England, a reservation created a right or incorporeal interest which had not existed previously, and which issued out of the land as a feudal service. It was created as a "regrant." The grantor was considered to have conveyed the entire property to the grantee free from any burden, then the grantee in the same deed "regranted" the interest reserved to the grantor. This was possible in England where both grantor and grantee signed or sealed the deed. But the theory did not seem to work in this country where only the grantor usually signed the deed. How, then, did our courts reach the result given in the answer above? They solved the case given as though it were an exception rather than a reservation. Because exceptions applied only to presently existing interests, the concept could not be applied to an easement or profit which was to be newly created by the deed and which did not exist before. So the courts simply took the view that a "quasi-easement" (case in which the grantor had two properties and used one to serve the other, which, of course, in law, was no easement at all), constituted a sufficiently existing "present interest" to be the subject of an exception. By so treating the matter in our case, the grantor, A, simply excepted his "quasi-easement" over Blackacre, and it became an actual easement over the now servient estate, Blackacre, in favor of the dominant estate, Whiteacre, which was retained by A.

Suppose, however, that Blackacre had never been used by A to serve Whiteacre when she owned both Blackacre and Whiteacre. The same fiction obtained and the same result achieved, and A was considered the owner of an easement over Blackacre without any

previously existing quasi-easement. If a "quasi-easement" can be made into an easement just by calling it such, the courts had no difficulty in saying a (non-existing) "quasi-easement" is an easement, if the grantor so intended. The result is that the word reservation may now actually create a new incorporeal interest in the grantor in the land conveyed, whether it be easement or profit, which was not a feudal service and which did not issue out of the land.

Notice that the set of facts given uses words of inheritance, "reserving to me *and my heirs*" an easement, etc. Words of inheritance were never necessary in an exception because exceptions were simply unaffected by the conveyance. But on the theory of a regrant in a reservation, only an easement or profit for life of the grantor could be created unless words of inheritance were used. Some cases held such reservation lasted only for the lifetime of the grantor and could not be claimed by his heirs. Of course, in a jurisdiction which has a statute dispensing with words of inheritance to create an estate of inheritance (fee simple or fee tail), the easement or profit reserved to the grantor without using the words "and his heirs" could last beyond his lifetime.[20]

PROBLEM 16.9: Amy owned Blackacre in fee simple. Millie owned adjacent Whiteacre in fee simple. A road over Blackacre would be a great convenience to Whiteacre as a much shorter way to travel to and from a nearby small town, Ionia. Amy executed a deed to Blackacre using the following language, "I hereby grant Blackacre to Missie and her heirs, reserving to Millie and her heirs a way across Blackacre in favor of Whiteacre to Ionia, such way to be over a 10 foot strip along the east edge of Blackacre." The deed was delivered to Missie. Millie starts to use the road described in the deed. Missie seeks to enjoin Millie's use. Should the injunction issue?

Applicable Law: Although courts are divided on the issue, they increasingly hold that a reservation of an easement made in favor of a third party to the deed should be valid if such be the intent of the parties.

Answer and Analysis

The answer is no. Missie's suit is based on the traditional proposition that a reservation must be wholly and solely for the benefit of the grantor or conveyor. In this case the reservation is in favor of Millie, a third party to the deed. Historically, an exception or a reservation could be in favor of the grantor only. Obviously the way attempted to be created in favor of Millie cannot be an exception, for it was not in existence before the deed. It seems fair

20. See Restatement of Property §§ 472, 473.

to assume from the very words of the instrument taken as a whole, that the grantor Amy intended to create in Millie an easement appurtenant to Whiteacre. There is no logical reason why a grantor cannot in the same deed create a possessory estate in one person and an easement in another. No one could question Amy's power to create such interests had Amy used two instruments, first, one to Millie granting the easement, and second, one to Missie creating the fee. It should make no difference that two interests, one possessory and the other nonpossessory, are created in the same instrument if such be the intent. If these propositions be true, then the fact that Amy used the word "reserving" instead of "granting," or "I hereby grant" should be immaterial, provided Amy intended to create in Millie an easement over Blackacre.[21]

§ 16.4 Delivery, Escrow and Acceptance

PROBLEM 16.10: A, owner of Blackacre in fee simple, was negotiating with B for a sale of the premises for cash. A made out a complete deed to the land, named B as grantee and acknowledged it before a notary public. When B came to A's house to talk further about the possible deal, A handed B the deed with these words, "If we make this deal and you pay me the $5,000.00 cash, this is the deed which I will give to you." B replied, "I'll take the deed home and show it to my spouse. We may buy the property tomorrow." B left with the deed, recorded it in the proper county office and now sues to eject A from Blackacre. Should she succeed?

Applicable Law: Delivery of a deed to real property means that the grantor intends that the deed shall operate as a conveyance. To effectuate such a conveyance there must be a physical deed and an intent on the part of the grantor that it take effect as a conveyance. It is not material where the physical deed is.

Answer and Analysis

No. A can convey title by deed by doing two things: (a) making a deed; and (b) delivering it to the intended grantee. In this case he made out the deed. He did not make delivery. It is true, A handed over the deed physically to the named grantee, B. B had physical

21. See Restatement of Property §§ 572, 573. See also Willard v. First Church of Christ, Scientist, Pacifica, 7 Cal.3d 473, 102 Cal.Rptr. 739, 498 P.2d 987 (1972), upholding a reservation in favor of a third party. The deed to X contained a provision "subject to an easement ... for parking purposes ... for the benefit of [Y] Church." The court repudiated the old rule of no reservation in favor of a third party, and gave effect to the intent of the parties. Some courts cling to the historical rule forbidding such reservations. E.g., Estate of Thomson v. Wade, 69 N.Y.2d 570, 574, 516 N.Y.S.2d 614, 615, 509 N.E.2d 309, 310 (1987) (declining to follow *Willard*).

possession of the deed with no wrongdoing on her part. *But delivery is a question of the intent of the grantor that the instrument shall operate as a conveyance,* and that it shall pass title to the grantee. The grantor must intend to relinquish all control over the instrument as an effective transfer of title. Giving up control over the mere physical piece of paper on which the writing or printing appears is insufficient. Such intent is in the mind of the grantor and is usually a question of fact. In this case it is probably so clear that reasonable people could not differ as to A's intent. The grantor's words were, "If we make this deal ... I will give it to you...." This indicates no present but a future time when A intends to give efficacy to the deed, and on a condition. The words of the named grantee likewise show no misunderstanding. She too understood that, while A did intend to hand over physical control of the deed, he did not intend to relinquish control of the deed as a transfer of title to Blackacre.[22] Hence, there was no delivery and as between A and B, A is still the owner of Blackacre.[23]

PROBLEM 16.11: Roselle, owner in fee simple of Blackacre, makes out a completed deed to Michael. Roselle puts the deed in the drawer of her office desk. Michael, who has been negotiating with Roselle for the purchase of Blackacre, hands Roselle the agreed price of $50,000.00 which Roselle accepts and says to Michael: "Blackacre is yours." Thereafter, Roselle having refused to turn over the physical deed to Michael, Michael sues Roselle in ejectment. Roselle answers that Blackacre is still hers because there has been no delivery. How should the court rule on Roselle's defense?

Applicable Law: Title will pass to the grantee if there is a physical deed and the grantor intends it to operate as a conveyance, even though the grantor retains possession of the physical paper on which the deed is written.

Answer and Analysis

The court should reject Roselle's defense. The alleged facts constitute delivery as a matter of law. The deed being made and delivery being a question of the grantor's intent, it is clear that the words of the grantor, "Blackacre is yours," meant that she intended the deed to operate as a transfer of title to Michael. It is important that Michael have possession of the physical deed so that he can record it as evidence of his title. But he need not have the

22. See Rosengrant v. Rosengrant, 629 P.2d 800 (Okl.App. 1981) (brief handing of deed to boy by banker, acting as grantor's agent, was not a delivery).

23. See Martinez v. Martinez, 101 N.M. 88, 678 P.2d 1163 (1984) (grantor instructed grantee to place deed in escrow awaiting for delivery contingent on mortgage payment; grantee recorded it immediately; no delivery).

physical piece of paper or deed in order to have the title as against Roselle when it is established that there is such a physical deed, and that Roselle intended it to be operative as a legal conveyance of title from Roselle to Michael.[24]

Note: Delivery and the Language of the Deed

Delivery is a physical act entirely distinct from the drafting of a deed, and quite independent of any language that the deed might contain. For example, a deed that says "O unequivocally, absolutely and unconditionally hereby grants Blackacre to A" nevertheless transfers no interest if it is not delivered. As a general rule courts hold that the fact of delivery must be established "*dehors* the instrument"—or by evidence entirely independent of the language of the deed itself. A few courts, perhaps inadvertently, have suggested that the fact of delivery could be inferred (or negated) by the language of the deed. Such reasoning is generally incorrect.[25]

The other side of the coin is that you should distinguish the *delivery* question from the issue of conditional language in the deed itself. For example, although courts hold that a conditional delivery of a deed passes no title, because it reveals that the grantor did not intend to depart with dominion and control, many courts hold that *conditional language in the deed itself*, entitling the grantor to revoke, is valid. If such a deed is properly delivered, both the grant and the power to revoke are valid in a plurality of jurisdictions.[26] Some courts hold that such deeds are really will substitutes and do not validly convey any property interest as deeds, although they may as wills.[27] Of course, a will can be revoked by the testator any time until her death, while a deed, once delivered, cannot be. A few courts hold that the grant is valid, but the reserving condition is not; so the conveyance is absolute.[28]

24. See Kanawell v. Miller, 262 Pa. 9, 104 A. 861 (1918).

25. For example, see State, by Pai v. Thom, 58 Haw. 8, 563 P.2d 982 (1977), which found delivery, in part because the granting language of the deed was "absolute and unconditional." In this case the words "grant, bargain, sell, transfer and deliver unto Grantee" showed "the present intention of the appellants to grant their interest.... We find no clauses or conditions in the deed limiting or qualifying the estate conveyed." Compare Erbach v. Brauer, 188 Wis. 312, 206 N.W. 62 (1925), finding no delivery because "the deed itself contains no language expressive of a delivery or of an intention of delivery."

26. See, e.g., St. Louis County National Bank v. Fielder, 364 Mo. 207, 260 S.W.2d 483 (1953), where the deed conveyed decedent's home, but reserved a "life estate with power to sell, rent, lease, mortgage or otherwise dispose of property during [decedent's] life." The court held that the deed created a defeasible fee subject to a life estate. Since the life estate had expired, the grantee had absolute title.

27. E.g., Peebles v. Rodgers, 211 Miss. 8, 50 So.2d 632 (1951) (deed providing that grantor was to live on, control and possess property during his lifetime, and to take effect upon his death, was testamentary, and inoperative).

28. See Newell v. McMillan, 139 Kan. 94, 30 P.2d 126 (1934), where the deed gave a fee simple subject to life estate in grantor, but also gave grantor

PROBLEM 16.12: A, being owner in fee simple of Blackacre, makes and delivers a deed to B as grantee. B initially takes the deed and puts it in his pocket but later decides that he does not want to be indebted to the grantor. He gives it back, saying "Here is your deed back again. Thanks, anyway!" B handed the deed to A and A tore it up and threw it in the stove where it was totally destroyed by the fire. Who is the owner of Blackacre?

Applicable Law: Once title has lodged in the grantee, he cannot abandon such title. Title can leave him only by his act by deed or will, or by another taking from him by adverse possession. Once title has lodged in the grantee without his disclaimer, he cannot reconvey to the grantor by returning to the grantor the same deed which the grantor delivered to the grantee. He can reconvey only by drafting a new deed.

Answer and Analysis

B is the owner of Blackacre. The facts state that A "delivers" his deed to B. That means that he intended such deed to pass title to B. It transferred title to B, subject only to B's disclaimer which would cast title back on A *ab initio*. But B did not disclaim. So title was in B. When B later changed his mind, such change of mind did not change the title which was in B. There are only two ways by which B can be divested of the title to Blackacre: (1) by a deed or will voluntarily executed by B as grantor to another and; (2) by some other person taking it from B involuntarily by adverse possession. When B returned the deed to A, he was returning A's voluntary conveyance or deed. It was not B's deed to A. B had not executed a deed of his own and delivered it to A. Title had vested in B, and a voluntary conveyance executed by B was essential to reconvey the property to A. All that A destroyed was evidence. This is fundamental to one's understanding of the nature of a conveyance. The fact that such facts may be difficult or impossible to prove is totally immaterial here because the facts are stipulated.

This problem should be distinguished from one in which the grantee immediately states that he does not want the property, or his first reaction upon hearing that he has received property is to reject it.[29]

the right to mortgage, sell or otherwise dispose of the property. The court found the reservation of the powers to mortgage, sell or dispose void. "A clause in a deed which is at variance with the grant is a nullity." Only the life estate was validly reserved.

29. See Hood v. Hood, 384 A.2d 706 (Me.1978) (finding no delivery where a son immediately told his mother that he "wanted no part" of the property).

PROBLEM 16.13: John, owner in fee simple of Blackacre, made a deed to Nancy as grantee and placed it in his safe deposit box in the bank where it was found upon John's death. John's will did not mention Blackacre but disposed of all the rest of his property. A dispute arose between Nancy and John's heirs as to who was the owner of Blackacre. Who owns Blackacre?

Applicable Law: (a) Delivery is a question of intent and intent is a fact question to be determined by the trier of fact. (b) Delivery is in the mind of the grantor and wholly *dehors* the deed. (c) The burden is on the one who says there was a delivery to prove it.

Answer and Analysis

This question cannot be given a yes or no answer in its present form because it merely raises an issue of fact. The answer depends upon whether or not John made a delivery of the deed during his lifetime. If, during John's lifetime, he intended that deed to be effective to convey title to Nancy, then Nancy is the owner of Blackacre. If, during John's lifetime, he had no intent that the deed convey title to Nancy, then the heirs of John are the owners of Blackacre. No deed can be effective unless delivered during the lifetime of the grantor for the simple reason that there can be no intent in one who is deceased. Only a will can take effect the instant following death. The fact that John made a deed to Blackacre is no evidence of and raises no presumption of delivery. The fact of delivery is wholly outside of and extrinsic to the instrument itself. Delivery must be proved as an independent fact, and the burden is on the person claiming delivery. In this case the burden would be on Nancy to show by a preponderance of evidence that during his lifetime John intended the deed to be effective. Whether he did or did not so intend would be a question for the trier of fact.[30] Possession of the deed by the grantee creates a presumption that it has been delivered.[31]

PROBLEM 16.14: A, fee simple owner of Blackacre, made a complete deed to Blackacre in favor of B, the named grantee. A authorized C to record the deed. When the deed was recorded it was mailed to C who returned it to A. A remained in possession of Blackacre. B died and D was his sole heir. A now brings suit

30. See Erbach v. Brauer, 188 Wis. 312, 206 N.W. 62 (1925). See also Lenhart v. Desmond, 705 P.2d 338 (Wyo. 1985), holding that when the grantor placed a warranty deed in his safety deposit box and gave grantee access to the box, no delivery occurred. The grantor's intent was apparently to pass title upon his death, not before. Grantee's taking the deed from the box and recording it without grantor's knowledge did not create a presumption of delivery.

31. Walls v. Click, 209 W.Va. 627, 550 S.E.2d 605 (2001).

against D to remove the cloud which the recorded deed casts upon his title. The only evidence adduced at the trial on the question of delivery were C's statement that A told C to record the deed, and A's bald assertions that the physical deed was never in B's possession and that he, A, had never "delivered" the deed to B. The trial court, sitting without a jury, found for and gave judgment to the defendant and A appeals. How should the appellate court rule?

Applicable Law: When the grantor makes out a deed and has it recorded in favor of the grantee, there is a presumption of delivery and the burden is on the grantor to overcome such presumption.

Answer and Analysis

The appellate court should affirm the decision of the lower court. Here again the question of delivery is a question of fact. But when a grantor records his deed in favor of a grantee, there is a presumption that she intends to deliver the deed, and that it shall pass title to the grantee. The burden of overcoming the presumption is then on the grantor. A mere assertion by the grantor that he did not intend to deliver the deed is ordinarily not sufficient to overcome the presumption of delivery. He must prove no delivery by clear and positive proof. In this case he might have done so by showing clearly that C was not authorized by A to record the deed. This was not accomplished by merely saying he did not deliver the deed. In any event the question of delivery was a question of fact, and the trial court found the question in favor of the defendant with plenty of evidence to sustain the finding.[32]

PROBLEM 16.15: A, owner in fee simple of Blackacre, made a complete deed in favor of grantee, B. A handed the deed to B with this admonition, "I'm going on a dangerous mission. If during this mission I am killed, record this deed." A returned safely from the mission, but during A's absence B had recorded the deed and claimed the property. May A set aside the deed?

Applicable Law: A grantee cannot be an escrow depositary. A conditional delivery cannot be made to the grantee; the deed either takes effect at once or not at all.

Answer and Analysis

No, but this holding is anomalous. There is no reason in logic why, if delivery is a matter of the grantor's intent, a deed cannot be

32. See Stiegelmann v. Ackman, 351 Pa. 592, 41 A.2d 679 (1945) (grantor's mere assertion that he had no intent to deliver was insufficient to overcome presumption arising from recordation). Accord Estate of Dykes v. Estate of Williams, 864 So.2d 926 (Miss. 2003).

handed to the grantee to take effect on a condition. But the great majority of the cases hold that if the grantor hands the deed to the grantee with the intent that it be a conditional delivery, then it is an absolute delivery. The grantee cannot be an escrow depositary. If effective delivery means what the cases hold, that the grantor intends to give up all control over the operation of the deed as a conveyance, it should be wholly immaterial whether the physical deed is in the hands of the grantor, the grantee or a third person. But in this instance where the grantor hands the paper to the grantee to be effective on a condition which may or may not happen, the shades of the past which treat the deed like a feoffment which must take effect presently or not at all, continue to govern the more enlightened view on the subject.[33]

In an important decision to the contrary, H and W, husband and wife, owned Blackacre in fee simple as tenants by the entirety. H was ordered by the government to perform a dangerous mission in Korea and Japan. He made a deed to W of his interest in Blackacre and handed it to her on the conditions (a) that she would not record the deed until such time as he "should be reported missing, killed or had failed to return," and (b) that if he should return, the deed would be returned and destroyed. W recorded the deed contrary to the condition and refused to return it to H upon his return. H sued to have the deed annulled.

The court found that the deed had been conditionally delivered by H to the grantee, W, and that it should be annulled, saying:

> there is actually no logical reason why a deed should not be held in escrow by the grantee as well as by any other person. The ancient rule is not adapted to present-day conditions and is entirely unnecessary for the protection of the rights of litigants. After all, conditional delivery is purely a question of intent, and it is immaterial whether the instrument, pending the satisfaction of the condition, is in the hands of the grantor, the grantee or a third person. After the condition is satisfied, there is an operative conveyance which is considered as having been delivered, although the ownership does not pass until satisfaction of the conditions. We therefore *hold* that it is the intent of the grantor of a deed that determines whether the

33. See Wipfler v. Wipfler, 153 Mich. 18, 116 N.W. 544 (1908) ("a delivery of a deed by a grantor to a grantee in escrow or upon condition is effectual to pass title presently" and "Nor do we know of any authority which goes to the extent of holding that a deed delivered to a grantee with an intention on the part of the grantor that it shall be subject to a future condition, but with no express provision for recall by the grantor and requiring for its validity no additional act on the part of the grantor or any third person, can be defeated by parol proof of such condition."). Of course, one must distinguish between conditions stated in the deed itself and conditions upon its delivery. See Valley Honey Co., LLC v. Graves, 666 N.W.2d 453 (N.D. 2003).

> delivery of the deed is absolute or conditional, although the delivery is made directly to the grantee.

The court concluded that

> [t]he ancient rule that the mere transfer of a deed from the grantor to the grantee overrides the grantor's explicit declaration of intent that the deed shall not become operative immediately is a relic of the primitive formalism which attached some peculiar efficacy to the physical transfer of the deed as a symbolical transfer of the land.... In England in ancient times there could be no change of possession of land until a livery of seisin had taken place. A knife was produced and a piece of turf was cut, and the turf was handed over to the new owner. Later, under the Roman influence, the written document came into use. These documents, which few people had the art to manufacture, were regarded with mystical awe. Just as the sod had been taken up from the ground to be delivered, so the document was laid on the ground and then solemnly lifted and delivered as a symbol of ownership. In this way the principle developed that the delivery of the deed was the mark of finality.

The court then explained that the first sign of breaking away from this strict formalism was the recognition that there could be a conditional delivery to a third person in escrow. But such conditional delivery was not allowed when the deed was handed to the grantee.[34]

In any event, if a condition is *stated in the deed* itself, this is quite a different matter than if the condition is extrinsic to the language of the deed. For example, if a deed says "Blackacre to A, to take effect only upon A's marriage," the question is not of delivery but merely of the nature of the interest granted. In this case, the deed creates a springing executory interest which is valid, assuming that the deed itself was properly delivered.

> **PROBLEM 16.16:** A, owner in fee simple of Blackacre, executed a specifically enforceable contract to sell Blackacre to B. He also executed a deed in B's favor as grantee and placed it in the hands of X bank, an escrow depositary, with written instructions to X that X should hand the deed to B when B paid the full purchase price to X. Thereafter B paid the full purchase price to X. A then instructed X not to hand the deed to B. X refused to give the deed to B. B sues for possession of the deed. May he recover?
>
> **Applicable Law:** A delivery in escrow is a conditional delivery. When the condition is fulfilled or the event happens on

34. Chillemi v. Chillemi, 197 Md. 257, 78 A.2d 750 (1951).

which the delivery depends, then title passes to the grantee even when the physical deed is retained wrongfully by the escrow depositary, and the grantee has the right to the possession of the physical deed as evidence of his title. There must be a physical deed and it must be handed over to the escrow depositary who is not an agent of either party but has merely the duty to carry out his instructions.

Answer and Analysis

Yes. Such commercial escrow transactions generally produce little difficulty. The rights of the parties are clear. When the specifically enforceable contract was executed, equitable conversion took place whereby B became the equitable owner of Blackacre and A retained the legal title as security for the payment of the purchase price. Had there been no escrow, B, having performed in full, could have sued for specific performance and compelled A to execute to him a deed to Blackacre. These are the rights of the parties under the contract.

Under the escrow transaction it was clearly intended that title should remain in A until B had fully performed his contractual obligations. Conversely, it was just as clear that the deed should take effect as an operative conveyance when B had fully performed. Hence, when B paid the full purchase price to X, the deed became effective and title passed to B irrespective of whether the physical paper were handed over to the grantee, B, because such was A's intent and delivery is merely a question of intent of the grantor that the deed operate as a conveyance. Consequently, B had the right to the possession of the physical deed for the purpose of evidence and to place it of record.

The following principles should be carefully noted in connection with this and every escrow transaction. (a) There must be a deed. (b) It must be delivered to a third person. (c) Title remains in the grantor until the occurrence of an event or performance of the condition. (d) Title passes to the grantee upon the occurrence of the event or performance of the condition irrespective of who holds the physical deed. (e) The escrow depositary has merely the duty to carry out his instructions or perform his contract if there is one. (f) The escrow depositary *is not an agent for either party* nor trustee for either; if he is, then he is not an escrow depositary. In this case when A delivered the deed to X, the escrow depositary, (called the *first* delivery) A invested B with power to become the owner of Blackacre by performing his obligation. Thereafter A had no control over the deed or its operation unless B failed to perform. Neither did A have any control over the escrow depositary X, and X's

refusal to make the *second* delivery to B was without authority. Such is the nature of a true escrow.[35]

PROBLEM 16.17: A, owner in fee simple of Blackacre, *orally* agreed to sell Blackacre to B. A executed a deed to B and placed the deed in the hands of X bank as escrow depositary with oral instructions to deliver the deed to B when B paid the full purchase price, which was to be paid in five installments of $1,000 each. B paid four installments. A then instructed X to return the deed to A, which X refused to do. B then paid the last installment to X, making full payment of $5,000 according to the original oral agreement, and demanded the deed from X which X refused. A offered to repay to B the entire $5,000 which B refused. Who owns Blackacre?

Applicable Law: A conveyance is not a contract. In an escrow transaction the grantor invests the grantee with power to become the owner of the land represented by the deed, and such power is irrevocable as to the grantor who loses all control over the operation of the instrument as a conveyance subject only to the failure of the grantee to perform. Under the better-reasoned cases, the Statute of Frauds has no application, and an oral placing of the deed in escrow is enforceable by the grantee who performs. A specifically enforceable contract is not essential to a valid escrow under this view.

Answer and Analysis

In most jurisdictions B owns Blackacre and has the right to the deed, but there is contrary authority. The answer requires a presupposition as to the very nature of an escrow transaction. If a conveyance is not a contract, and it is not, and if delivery is merely a question of the grantor's intent, and it is, then it would appear that a grantor has the power and right to invest a grantee named in a deed with a power to become the owner of property by performance of a condition, or, or by an act of payment of money. Further, it would appear that he could make such power in the grantee irrevocable as to the grantor, subject only to the performance by the grantee. If such be the case, then the Statute of Frauds has no application to the case and the grantor is bound by his irrevocable delivery to the escrow depositary subject to performance by the grantee. Such seems to be the true nature of an escrow transaction and gives to it great practical utilitarian value in the field of conveyancing. To require in such case a specifically enforceable contract is to thwart the intent of the grantor at the time of

35. See Ferguson v. Caspar, 359 A.2d 17 (D.C.App.1976) (holding that the escrow's duty is merely to fulfill her instructions; if one party attempts unilaterally to change the terms of the transaction, the escrow's duty is to stop the transaction).

establishing of the escrow and permit him to change his mind to the detriment of the grantee, and at the same time to detract materially from the value of escrows as a practical method of carrying on conveyancing business. Surely the grantor intended more than an oral contract for the sale of Blackacre when he executed a deed and placed it in escrow.

Further, delivery is a requirement in addition to the requisite formalities pertaining to the execution of sales contracts and deeds of conveyances. Since it is possible to have a fully completed delivery when there was no ancillary contract at all, then it should also be possible to show that there was a conditional delivery when there was either no contract or only an unenforceable one. The question is not whether there was an enforceable ancillary contract, but whether the grantor had either completely effectuated the conveyance by delivery or had gone so far in that direction as to put it beyond his power to revoke. A conditional delivery in escrow should be irrevocable except for the non-performance of the condition although there is no enforceable ancillary contract. There are cases to the contrary.[36]

PROBLEM 16.18: A, owner in fee simple of Blackacre, executes his deed in favor of B and hands it to X bank with instructions to deliver said deed to B upon A's death. A dies and his heirs or devisees claim Blackacre. Who is the owner of Blackacre?

Applicable Law: A delivery in escrow in a donative transaction in which the deed is to be delivered on the death of the donor whenever and however that occurs, is a valid delivery. When necessary, the relationship of the parties prior to the occurrence of the certain event is analogized to that of a fee simple and executory interest, or life estate and remainder. If the grantor makes the depositary his agent subject to further control, there is no delivery. In donative escrow transactions where the event or condition is not certain to occur, the cases are divided as to whether there is a valid delivery.

Answer and Analysis

B is the owner. Here it should be noted that there is no contract at all; merely an event to happen. This is a donative transaction in which the grantor gave up all control over the operation of the deed as a conveyance, subject only to the occurrence of an event.

The event in this case is certain to happen since death is inevitable. Thus, construing A's instructions as manifesting an intent to deliver the deed whenever and however A dies, the only

36. See generally 3 A.L.P. 323; Campbell v. Thomas, 42 Wis. 437 (1877).

contingency is time. A has thus given up all control over the title's eventually vesting completely in B; thus there is a valid delivery. This should be contrasted with the situation where the grantor and the escrow have an understanding that the grantor can reclaim the deed whenever he pleases. In that case, the death escrow is ineffectual to transfer the interest, even if the grantor in fact never does reclaim the deed.[37]

In the instant case no controversy arose before A's death; so the only question to be decided was whether there was a delivery, and whether B now has title to Blackacre. Suppose, however, a dispute should arise as to the rights of the parties after the initial deposit and before the death of A, as, for example, if B should learn of the deed and bring ejectment against A, or creditors of B should attempt to levy on Blackacre, or B should sue A for waste. What is the status of the parties during the interim? In donative cases of this type, it is frequently held that the deed takes effect on the initial deposit or it does not take effect at all. It is not necessary, however, that the deed take effect initially to convey an entire fee simple; it can take effect presently to convey a future interest. The analogy in this case to the creation of a springing executory interest with A retaining the fee simple subject thereto, or A vesting in B a remainder with the reservation of a life estate, is rather striking and often construed accordingly.[38] Likewise, B should not be able to eject A during his lifetime; and B's creditors could reach only his future interest in Blackacre; further, B should not be able to recover for waste.

Note: Conditional Escrows

If, on depositing the deed with the third party, the grantor evidences an intent to control the deed and title, as, for example, he states that unless he should give contrary instructions or ask for the deed back, then the depositary should deliver the deed on the death of the grantor, the depositary is simply an agent of the grantor and there is no delivery. The transaction is testamentary and fails for lack of compliance with the statute of wills.[39]

37. See Rosengrant v. Rosengrant, 629 P.2d 800 (Okl.App. 1981) (fact that names of both grantor and grantee were on envelope left at bank, the escrow, indicated that either could have retrieved it; thus grantor did not give up control and there was no delivery upon his death).

38. See Osborn v. Osborn, 42 Cal.2d 358, 362–63, 267 P.2d 333, 335 (1954):

It has long been established in this state that the deposit of a deed granting an estate in fee simple, with instructions that it be transmitted to the grantee upon the death of the grantor, conveys a remainder interest in fee simple with a life estate reserved in the grantor, if the grantor intended the deposit to be irrevocable.... The result is the same as if the grantor delivered to the grantee a deed reserving a life estate and granting a remainder in fee.

39. Cf. Estate of Dittus, 497 N.W.2d 415 (N.D.1993), where the grantor gave the grantee one key to a safe deposit box containing the deed but the retained the

The most troublesome cases are donative transactions in which the deed is to become fully effective on the occurrence of an event within the control of neither party and not certain to occur. An example might be the death of the grantor before the grantee. By analogy to the commercial escrow situation, the delivery should be sustained because the grantor has put beyond his control whether or not the title will fully vest in the grantee. On the other hand, he has not irrevocably parted with title, and he will recover full ownership when the condition or event fails to occur. The cases are divided with probably the majority finding no delivery.[40]

PROBLEM 16.19: A, owner in fee simple of Blackacre, executed his deed in B's favor as grantee and delivered it to X bank as escrow depositary with instructions to deliver the deed to B when B paid the full purchase price to X in installments. Before all payments were made and without the knowledge or consent of A, X let B have the deed. B recorded the deed and sold Blackacre to C, a bona fide purchaser, who knew nothing of the escrow transaction. Blackacre is undeveloped land and no one is in possession. A sues B and C to cancel the deeds and to quiet title. May A succeed?

Applicable Law: When the escrow depositary wrongfully hands the deed over to the grantee before the grantee has performed or has a right to the deed, and the grantee records such deed and sells to a bona fide purchaser, the grantor is not estopped to deny the efficacy of his deed, and the bona fide purchaser is not protected unless the grantee is let into possession, the grantor knows of the delivery of the deed and takes no action to revoke, or for other reasons the grantor is estopped. If the grantor retains any control over the operation of the deed it is not a true escrow.

Answers and Analysis

Most courts say yes. A owned Blackacre and placed the deed to B in escrow. Until B had performed the condition of making full payment, no title could pass from A to B. X is not A's agent so as to bind A by his act contrary to his instructions. A is just as innocent as the bona fide purchaser, C. Title being in A, he has the right to quiet title against C, and the recording acts do not change this

other. The court indicated that delivery of *both* keys would have been sufficient evidence of delivery, but the grantor's retention of one key was sufficient to suggest that he did not intend immediately to give up control.

40. See Kenney v. Parks, 125 Cal. 146, 57 P. 772 (1899) (no delivery, where grantor's instruction was to give deed to grantee if grantor died before grantee); Atchison v. Atchison, 198 Okl. 98, 175 P.2d 309 (1946) (no delivery); Videon v. Cowart, 241 So.2d 434 (Fla.App.1970), cert. denied 245 So.2d 88 (Fla.1971) (finding delivery, where deed given on condition that son renounce claim to remaining part of grantor's estate).

result. The recording acts invalidate unrecorded instruments as against subsequent bona fide purchasers for value without notice. They have absolutely nothing to do with recorded but void deeds, and the fact that the deed may be void because of forgery, non-delivery, or for other reasons is entirely immaterial. Thus, the non-delivered deed is invalid and the innocent purchaser relying on the recording act is unprotected.

In the event that the grantor lets the escrow grantee into possession, then the grantor, in the case of a wrongfully procured deed, has in effect permitted the grantee to be clothed with a double indicia of title—both possession and deed. If the grantor remains in possession, then his possession constitutes notice of his interest, and there can be no bona fide purchaser without notice. If nobody is in possession, then the equities should be regarded as equal and the law, holding no title passed, should prevail since the recording acts do not deal with recorded but undelivered deeds. In case the grantor learns of an improperly delivered deed and takes no action to invalidate such a deed, then the grantor should likewise be subordinated to the rights of the bona fide purchaser.[41]

PROBLEM 16.20: A, owner in fee simple of Blackacre, executed a deed to B and placed it in the hands of X bank as escrow depositary with instructions to X that the deed should be handed to B upon B's payment of the last installment of the purchase price. Before the last installment was paid by B, the grantor, A, died. Thereafter B paid to X the last installment and demanded possession of A's deed. In whom is the title to Blackacre?

Applicable Law: The deed in escrow takes effect to pass title on the so-called "second delivery" with the following exceptions: (a) when the grantor dies between the "first" and "second" delivery; (b) when during that time the grantor becomes non compos mentis; or (c) justice requires it—by relation back in these cases the title passes as of the first delivery, that is, when the deed was handed to the escrow depositary.

Answer and Analysis

The title is in B and he has the right to the deed. The courts speak of "first" and "second" deliveries in escrow cases. The first is the handing over by the grantor of his deed to the escrow depositary, and the second is the handing over of the deed to the grantee by the escrow depositary. Of course, the first is not a technical

41. See Mays v. Shields, 117 Ga. 814, 45 S.E. 68 (1903). Everts v. Agnes, 4 Wis. 343, 65 Am.Dec. 314 (1855), indicated that a bona fide purchaser from a grantee of a wrongfully procured deed from an escrow agent would get no title.

delivery for the grantor does not intend title to pass to the grantee at that time. If it is a true escrow, the first delivery merely makes the grantor's deed irrevocable and empowers the grantee, by fulfilling the condition or by the occurrence of the event, to become the owner of the property. Further, upon the fulfilling of the condition or occurrence of the event, the deed operates to pass title even without any handing over of the deed to the grantee because that is the grantor's intent. However, there can be no intent of a deceased grantor. The rule that a deed in escrow takes effect at the "second" delivery cannot apply when the grantor has predeceased the time when the condition is fulfilled. By relation back, the deed is made effective as of the date of the first delivery by the grantor to the escrow depositary.[42]

42. Fuqua v. Fuqua, 528 S.W.2d 896 (Tex.Civ.App.1975), writ refused n.r.e. .. (enforcing sale contract where grantor executed deed, placed it in escrow, but died before delivery to grantee).

Chapter 17

ASSURANCE OF TITLE

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SUMMARY

§ 17.1 Deed Covenants for Title

1. There are six covenants for title to real property:

a. Three of these are in the present and are breached, if at all, when the deed is delivered:

(1) Covenant of seisin

(2) Covenant of the right to convey

(3) Covenant against encumbrances.

b. Three covenants cover breaches that occur after the deed is delivered, that is, in the future:

(4) Covenant of quiet enjoyment

(5) Covenant of general warranty

(6) Covenant for further assurances.

2. A deed providing for "usual covenants" includes the first five covenants, and a deed providing for "full covenants" contains all six.

3. Covenants for seisin and of the right to convey are usually construed as identical, and guarantee to the grantee that the grantor owns the estate that the deed purports to convey. Note, however, that a grantor conveying under a power of attorney could have a right to convey without being seised of an estate; and if in a particular jurisdiction seisin is construed as meaning only being in possession and claiming title, then an owner when the land is in the adverse possession of another may have a right to convey without being seised, and similarly, an adverse possessor would be seised without a right to convey a fee.

4. The covenant against encumbrances is a guarantee to the grantee that the property conveyed is not subject to outstanding rights or interests that would diminish the value of the land, examples of which are mortgages, liens, land use restrictions, easements, or profits.

The existence of zoning restrictions does not constitute a breach of the covenant against encumbrances, but the existence of a violation of zoning or building restrictions may constitute such a breach.

5. Covenants of quiet enjoyment and general warranty are construed to have the same legal effect. They undertake to defend the grantee-covenantee against all lawful claims of the grantor himself or of third persons who would evict the grantee-covenantee, actually or constructively.

6. The covenant for further assurance (of relatively little importance in the United States today) is an undertaking on the grantor's part to do such further necessary acts within her power to perfect the grantee's title.

7. None of these covenants protects the grantee against the trespass or aggression of a mere wrongdoer.

8. The construction of these covenants, which may vary with the language used in each case, are governed by contract law principles.

9. Under the traditional view, the first three covenants cannot run with the land because they become personal choses in action when they are breached at the instant the deed is delivered.

10. The last three covenants are covenants that run with the land and can be enforced by remote grantees who take through the covenantee.

11. More than one remote grantee may enforce a given covenant that runs with the land. E. g., A conveys to B in fee with covenant of general warranty. B conveys the east half of the property to C and the west half to D. Each is evicted by O, who has paramount title. Both C and D may hold A on his covenant.

12. Covenants for title are in their nature contracts of indemnity, and damage must be shown as a condition precedent to recovery for breach; it is not enough merely that there has been a breach.

13. The maximum recovery for breach of title covenants in a large majority of jurisdictions is the purchase price paid plus interest.

Interest is usually allowed only when the grantee has not had possession or the benefits of rents or profits from the land, or has had to surrender them to the holder of the paramount title. Additionally, the grantee can usually recover the costs of his unsuccessful defense of the title.

14. In case of a total breach of the covenant of seisin or right to convey, the measure of damages is the purchase price paid plus interest. These covenants are breached, if at all, on delivery of the deed. In the case of a partial breach, recovery is for a proportionate part of the purchase price plus interest.

15. For breach of the covenant against encumbrances, the measure of damages is the cost of removing the incumbrance when that is possible, and the amount by which such incumbrance reduces the value of the land when removal is not possible.

16. For a breach of the covenants of quiet enjoyment and warranty, the measure of damages is the value of the land at the time of breach (eviction), but not to exceed the purchase price paid by the plaintiff-grantee. For a partial breach, recovery is based on the amount expended by the plaintiff to perfect his title, or on the value of the land lost to the superior title.

17. When a covenant for title runs with the land, an intermediate grantee often occupies a dual role. She is a covenantor as to subsequent grantees if she included the covenant in the deed when she conveyed, and she is a covenantee as to prior grantees. For such an intermediate grantee to maintain an action against the original covenantor, or a prior covenantor, she must show both (a) a breach of the covenant and (b) damage to herself.

For example, A conveys to B with covenant of general warranty or quiet enjoyment. B conveys to C with a similar covenant. C conveys to D with like covenant. X, holding paramount title, evicts D. B sues A for the breach. B cannot maintain the action by merely showing the breach by D's eviction. She must show in addition that

D or C has sued her, and that B has been made (or will be made) to pay damages.

18. Each remote grantee has a right to judgment on a covenant running with the land against each and all of the preceding covenantors when the covenant is breached, but such remote grantee has a right to but one full recovery. For example, A conveys to B with covenant of general warranty or quiet enjoyment. B conveys to C with like covenant. C conveys to D with like covenant. D is evicted by X who has paramount title. D sues and takes judgment for $10,000.00 damage against C, B and A. C pays D in full. C then has a claim against B and A. B pays C in full. B then has a claim against A.

19. Payment in full made by the original covenantor to the evicted *last* covenantee—grantee for his damage, constitutes a good defense to such original covenantor to any action by an intermediate covenantee—grantee.

For example, A conveys to B with covenant of general warranty or quiet enjoyment. B conveys to C. C conveys to D. D is evicted by X who has paramount title. A pays D in full for D's injury. B then sues A for breach. A's payment to D is a complete defense to B's action. But suppose B has also paid D in full for D's injury. If such payment was after A's payment to D, then A's payment is still a good defense and B's remedy is against D for overpayment for money had and received. If B's payment was made to D before A's payment, then it would seem B's action may be maintained against A, and A must look to D for reimbursement.

20. Historically, no warranties were implied in a conveyance of real property, and covenants had to be specifically inserted to be effective. Today, "short-forms" are almost universally permitted by statute. These statutory deeds incorporate by reference the covenants designated in the statute.

21. The historical rule not implying covenants in deeds refers to covenants for title. But increasingly courts have implied a covenant of fitness in the sale of homes. See Ch. 14.

22. Title covenants can be modified so as to exclude certain mortgages, restrictive covenants, or other outstanding interests. When the land is conveyed specifically subject to certain interests, as for example, an outstanding mortgage in accordance with the understanding of the parties, the title covenants should be construed as warranting only the estate granted, that is, subject to the mortgage. This construction should apply whether or not the covenants are expressly so modified, but there are some cases to the contrary, especially older ones.

23. The type of deed to be conveyed, if not stipulated in the sales contract, is determined by state or local law or custom.

§ 17.2 Estoppel by Deed

1. Estoppel by deed is a doctrine by which if a person executes a deed purporting to convey an estate which she does not have or which is larger than she has, and such person at a later date acquires such estate in that land, then the subsequently acquired estate will, by estoppel, pass to the grantee.

2. This doctrine is based on the intention of the parties as expressed in the deed—the grantor intends to transfer the estate described in the deed, and the grantee intends to receive the estate described in the deed.

3. The doctrine is an outgrowth of the common law rules relating to warranty of title, but covenants for title are not necessary today for the doctrine to apply.

4. Whether or not the doctrine operates in a given case is wholly dependent on the language which is used in the deed and appears on the face of the instrument.

5. By the better rule, the doctrine may be invoked in favor of a stranger to the deed and is not limited to the parties to the deed and their privies.

6. The doctrine will operate in favor of the grantee even though the deed contains neither a misrepresentation nor a covenant of title.

7. There are two distinct theories on which the doctrine is claimed to operate:

a. the deed having been given and the estate having been subsequently acquired by the grantor, then as a matter of law, the estoppel operates on the estate itself and passes it to the grantee—it is objective and wholly impersonal and the grantee takes even as against a bona fide purchaser of the after-acquired title from the grantor.

b. the deed having been given and the estate having been subsequently acquired by the grantor, then the grantor is only personally estopped to deny that she owned the estate at the time the deed was given, or she is personally estopped to deny the estate has passed to the grantee, but the estate itself is not affected, and the grantor is bound to convey to the grantee the after-acquired title or estate. Under this theory, the estoppel is personal, and a bona fide purchaser from the grantor of the after-acquired title would have priority over the original grantee.

8. Under either theory, if there is a covenant of title in the deed, the grantee cannot be compelled to accept the after-acquired title either in partial or total satisfaction of the covenant. Instead, the grantee has an election either to sue for damages for the breach or to accept the after-acquired title.

9. In most jurisdictions, the doctrine has no application to the case in which the grantor in her deed undertakes merely to convey whatever right, title or interest, if any, she may have at the time of the deed (the general characteristics of a "quitclaim" deed).

10. Note carefully these three cases:

a. A, having no interest in Blackacre, but not knowing whether or not he has an interest, makes a deed to B as follows: "I hereby convey to B all of my right, title and interest in Blackacre, and hereby warrant to the said B any interest which I presently own in such property." Thereafter A inherits the fee simple estate in Blackacre. Here no estoppel applies, for the deed purports to convey and warrants no particular estate in Blackacre, but undertakes merely to convey whatever interest A has at the time of the making of the deed.

b. A, having no interest in Blackacre, and not knowing whether or not he has an interest, makes a deed to B as follows: "I hereby convey to B and his heirs the fee simple estate in Blackacre and hereby warrant such title in him and covenant to defend such against the whole world." Later A inherits the fee simple estate in Blackacre. A's deed contains a granting clause purporting to convey the fee simple. It also contains a clause warranting such title in the grantee. The doctrine of estoppel by deed clearly applies because A intended to convey and B intended to receive the fee simple title in Blackacre. This would be true under either theory of estoppel.

c. A, having no interest in Blackacre, and not knowing whether or not she has an interest, makes a deed to B as follows: "I hereby convey to B and his heirs the fee simple estate in Blackacre." Later A inherits the fee simple estate in Blackacre. A's deed contains a granting clause purporting clearly to convey the fee simple estate in Blackacre. The doctrine of estoppel applies. The deed contains no misrepresentation of fact and contains no covenant of warranty, but it does contain a clearly expressed intent to convey a fee simple estate which the grantor, A, did not have. Later, A acquired the very estate which his deed purported to convey to B, and which B intended to receive from A. These two items, then: (1) an expressed intent in the deed to convey an estate larger than the grantor has; and (2) later acquisition by the grantor of such

estate, are sufficient to support the doctrine of estoppel by deed.

11. If the grantor later acquires a larger estate than he owned at the time of the conveyance, but smaller than he purported to convey, the doctrine of estoppel will apply to such a conveyance. E.g., O, having only a life estate, purports to convey a fee simple absolute to A. Later, O acquires a fee simple on condition subsequent. A will immediately acquire the fee simple on condition subsequent by estoppel.

§ 17.3 Priorities and Recording

a. *Common Law Priorities*

1. At common law the question of priority of title was usually simply one of time: first in time is first in right. E. g., A, owner of Blackacre in fee simple, conveys to B in fee simple. A then conveys the same Blackacre to C in fee simple. B is the owner merely because there was no interest left in A to convey to C.

This rule of priority applied both to competition between equitable interests and also to competition between legal interests. Further, a prior legal interest prevailed over a subsequent equitable interest.

2. There is one exception to the rule of priority based on time. A bona fide purchaser for value without notice takes priority over a former equity or equitable interest. For example, A, being fee simple owner of Blackacre, declares himself trustee of the property for B. A then conveys the legal title in Blackacre to C in fee simple. C pays full value for the property and has no knowledge of the declaration of trust in B's favor. C owns Blackacre in fee simple and B's equity, even though earlier in time, is cut off.

The above example is an illustration of the common law rule that a subsequent equity, when combined with the legal title, prevails over a prior equity. Thus, in the above illustration, C acquires the legal title as a result of the conveyance and he also acquires an equity from his status as a bona fide purchaser without notice. He accordingly prevails over B.

3. Two early English statutes provided that conveyances made for the purpose of defrauding creditors or subsequent purchasers should be null and void. For example, (a) A, fee simple owner, owes creditor, C. To prevent C's being able to collect the debt A fraudulently conveys to B as a donee, B giving no consideration for the deed and knowing the purpose of the conveyance. C may have such deed set aside as null and void. (b) A, fee simple owner, conveys to C as donee, C paying nothing for the deed. A,

intending to defraud B, conveys to B who pays full price for the property and is given no notice of the prior conveyance to C and buys bona fide. B may have the conveyance to C set aside as null and void.

4. The above common law rules as to priority still prevail when the controversy is not governed by an applicable recording act.

b. The Recording Acts

1. TYPES OF ACTS

Although the language of the recording acts of the several states varies considerably, there are four basic types of recording acts in the United States:

a. *Notice:* An unrecorded conveyance or other instrument is invalid as against a subsequent bona fide purchaser (creditor or mortgagee if the statute so provides) for value and without notice.

Under a notice statute the subsequent bona fide purchaser prevails over the prior unrecorded interest whether the subsequent purchaser records or not. Insofar as the subsequent purchaser is concerned, there is no premium on her race to the recorder's office; her priority is determined upon her status at the time she acquires her deed or mortgage. Of course she should record to protect herself from the possibility of a still later subsequent bona fide purchaser.

b. *Race:* No conveyance or other instrument is valid as against (lien creditors or other specified parties and) purchasers for a valuable consideration until after it is recorded.

Under a race statute, the first to record wins, and a subsequent purchaser need not be bona fide and without notice, since she will prevail if she records first. Priority is determined simply by who wins the race to the recording office.

c. *Race–Notice:* An unrecorded conveyance or other instrument is invalid as against a subsequent bona fide purchaser for value without notice (and possibly other designated parties such as mortgagees and creditors), who first records.

This statute combines the essential features of both the notice and race type recording statutes. In order for a subsequent party to prevail in a race-notice jurisdiction, he must be both a bona fide purchaser for value without notice of the prior interest and record first.

d. *Period of Grace:* A period of grace statute is usually coupled with the features of a notice statute.

Under such a statute, the prior grantee (or holder of other interest) is allowed a period of grace (e. g. 15 days) in which to record his instrument in order to preserve his priority. If a prior grantee does not record within the period of grace, then a subsequent bona fide purchaser will prevail.

Notice and race-notice are the most common types of recording statutes, with only a few jurisdictions having a pure race or period of grace statute.

2. CONSTRUCTIVE NOTICE

a. Under the recording acts in England, a recorded instrument of conveyance *does not* give constructive notice of its contents to subsequent purchasers and incumbrancers.

b. Under the recording acts in the United States, a recorded instrument of conveyance, usually a deed or mortgage, *does give* constructive notice of its contents to subsequent purchasers and incumbrancers. Constructive notice is notice implied by law and is not dependent on actual notice or notice of facts from which knowledge of an unrecorded instrument would be implied, or on whether or not the buyer actually conducted a title search. Constructive notice is a rule of law.

c. Such constructive notice prevents a subsequent purchaser or incumbrancer from being a bona fide purchaser. For example, A conveys Blackacre to B who records his deed. A then executes a deed to Blackacre in fee simple to C as grantee. C pays full value in good faith for the property and has no actual notice of the former deed to B. C is not a bona fide purchaser as a matter of law because she is bound to examine the records and is *construed* to have notice of B's recorded deed whether or not she actually knows about it or actually searched the title.

d. Constructive notice applies whether the interest conveyed by the recorded instrument is a legal or an equitable interest. E. g., A, owner of Blackacre, declares himself trustee of Blackacre for B and records the declaration of trust. Later A makes a deed to C covering the fee simple in Blackacre. C is charged with notice of what appears on the record in the declaration of trust, and takes his deed subject to B's prior equitable interest in the property. C cannot be a bona fide purchaser.

3. PURCHASER AND SUBSEQUENT PURCHASER

The term purchaser as used in the recording acts generally refers to a purchaser of the legal interest, i. e., a grantee for value, mortgagee, or other person who acquires a legal estate or interest in the property. In some jurisdictions, however, either by decision or statute, a subsequent purchaser of an equitable interest, e. g. a vendee under a contract for sale, is protected by the recording act.

4. RECORDER'S ERRORS

A subsequent purchaser or incumbrancer, acting in good faith and with no actual knowledge of a former conveyance, is normally entitled to rely on what appears on the records.

For example, A conveys to B and B does not record. Then A conveys to C who is a bona fide purchaser. C prevails in a notice jurisdiction whether or not C records before B. C prevails in a pure race and a race-notice jurisdiction only if he records ahead of B. In a period of grace jurisdiction, C prevails if B fails to record within the period of grace allowed by the statute.

In the event that B delivers the deed to the proper office for recordation before A's conveyance to C, and the recorder fails to record the deed at all, or the recorder makes a mistake in recording B's deed (such as failing to index it, or misindexing it), then there is a split of authority as to whether C gains priority over B. Under one view, C should be protected on the theory that it was B's responsibility not only:

a. to see that the deed was recorded but also

b. to see that the recordation was accurately made.

Under the other view, which protects B, B's instrument is constructive notice of its actual contents as soon as it is deposited in the proper office. Any mistake as to actual recording or copying of it into the record having no effect on constructive notice.

5. "DULY RECORDED"

To be "duly recorded" and thus constitute constructive notice, the instrument must be properly executed, acknowledged in most jurisdictions, and within the chain of title as a condition precedent to being properly recorded. Some decisions have held that the actual physical recording of an improperly executed instrument does not impart constructive notice to a subsequent purchaser or incumbrancer, the legal effect being the same as though no record had in fact been made. However, if one sees such an improperly executed deed or mortgage, or actually knows about it, then she is

charged with at least inquiry notice, and is held to have knowledge of facts that a reasonable inquiry would have disclosed.

6. VOID INSTRUMENTS

An instrument of conveyance that is void for reasons such as forgery or lack of delivery is ineffective for any purpose, and recording it has no legal effect. For example, A is fee owner of Blackacre. B forges A's name to a deed to Blackacre in which deed B is the grantee. B then mortgages the property to C who lends the money in good faith and without notice of the forgery except as it appears on the record. The mortgage is wholly ineffective as to A, and gives C no interest in Blackacre.

7. ADVERSE POSSESSION

The recording statutes have no application to a title procured by adverse possession or prescription; they apply only to title procured by instruments of conveyance which can be recorded.

8. CHAIN OF TITLE PROBLEMS

a. The chain of title to a piece of land means the regular series of recorded instruments from the patent from the United States Government, or former sovereign, down to and including the instrument through which the party claims ownership, each instrument representing a regular link in the chain. E. g., United States makes patent to A; A deeds to B; B deeds to C; C deeds to D; D mortgages to X; D deeds to E subject to X's mortgage; X executes a satisfaction of the mortgage; E deeds to F; etc., each grantee becoming the subsequent grantor.

b. Every subsequent purchaser or incumbrancer takes its interest in the property conveyed subject to prior interests properly recorded, which proper recording means either:

(1) an instrument in the direct chain of title, or

(2) a recital in an instrument in such direct chain of title. E. g., A, who is grantee in a deed in the direct chain of title, gives to B a mortgage on the property, which mortgage is not recorded. A then gives a deed to C which deed recites, "subject to a mortgage given to B on said property." This recital, being properly recorded gives C constructive, or at least inquiry notice of the mortgage to B and prevents C from being a bona fide purchaser.

c. An instrument which does not constitute a regular link in the chain of title or which is not identified by a recital in an

instrument in such chain, is not considered properly recorded and does not give constructive notice to subsequent purchasers or incumbrancers.

For example, A is a grantee in a deed which is a regular link in the chain of title. A makes a deed to B but B does not record it. B's failure to record breaks the chain of title subsequent to the deed in which A is the grantee. B then deeds to C. B, not having appeared as a grantee in any former instrument of record, is now an interloper and a deed by him is not part of the regular chain of title. Then A makes a deed to the same property to D. D records. The deed of B to C, being no part of the regular chain of title, imparts no constructive notice to D. Hence, D is the owner of the property as against B and C, provided in other respects he is a bona fide purchaser.

9. PERSONS PROTECTED; THE BONA FIDE PURCHASER

a. The recording statutes are construed to give protection to two persons only, (a) a bona fide purchaser or incumbrancer, or (b) one who claims through such a bona fide purchaser or incumbrancer.

b. In order to be a bona fide purchaser protected under the recording act, one must

(1) be subsequent,

(2) pay value,

(3) be without notice, (the value must have actually been paid before notice), and

(4) be of good faith.

c. Recording statutes generally do not protect a subsequent claimant who has not paid more than a nominal consideration; nor one who takes with either actual or constructive notice of a prior interest; to be protected he must acquire his interest both (a) for value and (b) in good faith, which means without actual or constructive notice of prior inconsistent claims.

d. One who takes a mortgage to secure a pre-existing debt without at the same time relinquishing any right or claim as a consideration for the mortgage is not a purchaser for value. But if the mortgagee surrenders other security for the debt or extends the time of payment by a binding contract, he is regarded as a purchaser for value.

With respect to one who takes an absolute conveyance of land in satisfaction of an antecedent debt, the cases are divided on the question whether he is a purchaser for value, but since the debt is

canceled instead of being secured, the position that he does qualify as a purchaser seems sound.

e. If a person is in possession of land, then any person taking an interest in that land is charged with notice of the interest which the possessor claims in the land. This rule is most properly confined to possession inconsistent with record title.

f. A subsequent purchaser who takes under a quitclaim deed, under the better view, is protected by the recording statutes.[1]

g. A mortgagee, although not specifically mentioned in a recording act, is considered a purchaser to the extent of his interest, and is protected by the recording act if he otherwise qualifies as a subsequent bona fide purchaser for value without notice.

10. HAZARDS NOT COVERED BY THE RECORDING ACTS

The recording acts generally afford purchasers and other subsequent parties either no or inadequate protection against the following interests:

a. forged and other void deeds or instruments;

b. deeds by incompetents;

c. fraudulent statements in the instruments as to marital status;

d. claims of undisclosed and pretermitted heirs;

e. falsification of records;

f. undelivered but recorded deeds;

g. false personation of record owner; and

h. adverse possession, prescription, or equivalent property interests acquired by operation of law and without a recordable instrument.

In addition, some statutes afford no protection against:

i. recording mistakes;

j. indexing mistakes; and

k. possibly other undisclosed interests.

1. E.g., Miller v. Hennen, 438 N.W.2d 366 (Minn.1989) (purchaser who paid value and recorded first protected, even though he received quitclaim deed). In some transactions quitclaim deeds plus title insurance are used to effectively transfer risk of unknown defects from the grantor to the title insurer. In that case the use of the quitclaim deed should raise no presumption that the buyer is on notice of a title defect.

11. INDICES

Many of the problems of determining chain of title result from use of the traditional grantor-grantee index. Many of these problems are eliminated when tract indices are used since then all recorded instruments pertaining to a particular tract or parcel will generally be discovered despite "gaps," out of turn recording, and "wild" instruments. Most professional title companies do in fact use their own tract indices (or indices which they share with other companies), regardless of the official index.

Note

Because the provisions of recording statutes vary greatly, the cases construing them often reach opposite results. The statutes and cases of each state should be consulted. In the main, the statements above present the general principles.

§ 17.4 Title Insurance

1. In a title insurance policy the insurer promises to indemnify the insured for any injury if the title to land is less than that described in the policy. Title insurers typically do title searches before writing a title insurance policy. Increasingly, the title insurer also acts as commercial escrow agent and may assist in the preparation of transfer documents.

2. Unlike many other forms of insurance (such as medical or casualty insurance) that require periodic payments, title insurance usually is paid for with a single premium paid at the time of the sale.

3. The title policy typically contains exceptions and exclusions for defects of title not shown by the public record, zoning restrictions, defects that could be disclosed by a survey or other inspection of the property, or rights of parties in possession.[2]

4. A title insurer, unlike the grantor of a warranty deed, is generally obligated by the policy to provide a legal defense of title claims arguably covered by the policy.

5. The title insurer's liability is generally limited to the face amount of the policy, which is generally the whole or some fraction of the purchase price. In addition, the policy typically insures only against title defects that arose before the effective date of the policy, not against defects that come into existence after the policy issues.

2. See, e.g., Panciocco v. Lawyers Title Ins. Corp., 147 N.H. 610, 794 A.2d 810 (2002) (exclusion for "parties in possession" excused insurer from paying for property loss resulting from neighbor's visible adverse possession at time of conveyance).

6. Title insurance contracts are normally construed against the insurer.[3]

PROBLEMS, DISCUSSION AND ANALYSIS

§ 17.1 Deed Covenants for Title.

PROBLEM 17.1: Henry executed a deed conveying Blackacre in fee simple to Priscilla. The deed covenanted that "Henry is lawfully seised in fee simple of such premises; that he has good right and lawful authority to sell the same." This deed was delivered in April 1990. In October 2002 Priscilla sued Henry alleging that "Henry's covenants are not true; that Henry was not seised of Blackacre and had no good right or authority to convey the same." Henry raises the statute of limitation as a defense. Has the statute run?

Applicable Law: Covenants of seisin and right to convey are synonymous in most instances. They covenant that the grantor owns the land when the deed is executed and delivered. If he does not own the land these covenants are breached immediately and a cause of action accrues at the time of the delivery of the deed.

Answer and Analysis

Yes. The plaintiff alleges that defendant has broken the covenants of seisin and of right to convey. These two covenants are identical, and constitute a guarantee by grantor Henry that he owns the land when the deed is executed and delivered. If Henry did not own the land when he made the conveyance, these covenants were immediately broken in April 1990.[4] Since more than 10 years have elapsed between the breach and the time the action was brought, the statute of limitation has run and constitutes a bar.[5]

3. Boel v. Stewart Title Guar. Co., 137 Idaho 9, 43 P.3d 768 (2002) (where government owned strip of land being used as a ditch but insurance policy had exclusion only for damages arising from use of a "ditch," insurer liability remained for claim of the strip itself:

> The United States, as the fee holder of the strip, could have utilized the fee strip for any purpose for which any other landholder might have used it. The fact that the federal government coincidentally utilized its fee strip for the construction and maintenance of the ditch does not mean that the Boels' damages, related to the existence of the deed, in any way "arise" or "result" from the existence of the ditch.)

4. That is, these covenants do not require that the purchaser actually be ousted from the land by someone claiming under paramount title; but merely that there is a substantial defect in the title, whether or not anyone is ready to make a conflicting claim. E.g., Hilliker v. Rueger, 228 N.Y. 11, 126 N.E. 266 (1920).

5. Brown v. Lober, 75 Ill.2d 547, 27 Ill.Dec. 780, 389 N.E.2d 1188 (1979) (plaintiff, having failed to bring a timely action for breach of the covenant of seisin, sought unsuccessfully to bring the action under the covenant of quiet enjoyment).

PROBLEM 17.2: Theodore owned Blackacre in fee simple, which he devised in his will to William. Theodore died and it was discovered that one of the two required witnesses on the will was not qualified. Hence, the will was invalid and Blackacre descended to Theodore's heir, Harriet. In the meantime and after Theodore's death, William had conveyed Blackacre to Paula for $4,000 with a covenant of quiet enjoyment and of general warranty. Paula is in possession of Blackacre and is threatened with eviction by Harriet. Paula pays Harriet $5,000 for a deed in fee simple to Blackacre and sues William for damages for breach of covenants. May she recover, and if so how much?

Applicable Law: The covenants for quiet enjoyment and of general warranty are generally construed to mean the same thing. They bind the covenantor to defend the grantee-covenantee against eviction, actual or constructive, by anyone under paramount title, including the covenantor. These covenants are breached when the covenantee is disturbed in her enjoyment of the premises conveyed. Actual eviction need not take place. If a valid paramount title is asserted and the grantee is compelled, in order to avoid actual eviction, to buy title from the holder of the paramount title, then there is a constructive eviction which will support a claim for breach of the covenants. Damages recoverable are usually the value at the time of the purchase, measured by the price paid, plus interest from the time of the eviction.

Answers and Analysis

Yes, Paula may recover. These two covenants are construed to mean substantially the same thing, and bind the covenantor to defend the grantee against eviction, actual or constructive, by anyone under paramount title, including the covenantor. They are breached when the covenantee is disturbed in her enjoyment of the premises conveyed. In this case Harriet held paramount title to William. It is also clear that had Harriet ejected Paula either by legal action or self-help, Paula would have had a cause of action against William for breach of the covenants made. Actual eviction is not necessary to a claim. Constructive eviction is sufficient. In this case the assertion of paramount title by Harriet and Paula's paying her for a release of Harriet's claim, is constructive eviction which will support a claim for breach of the covenants made in William's deed. Of course, in a suit against the covenantor for damages, the plaintiff-covenantee must prove that she was evicted by one having paramount title.[6]

6. See Northeast Petroleum Corp. of New Hampshire v. State, Agency of Transportation, 143 Vt. 339, 466 A.2d 1164 (1983) (third party's assertion of

The damage which Paula can recover is usually the consideration paid, which in this case is $4,000 and not the value of the land at the time of the eviction.[7] When there are legal proceedings to evict the grantee, if such grantee would bind or estop the covenantor by the judgment itself, she must give the covenantor notice of the proceedings and request that he defend the action. Even without such notice to the covenantor, if the grantee-covenantee is evicted, she may still recover from the covenantor, but he has a heavier burden in having to prove that the party who evicted him had a paramount title. As to the measure of damages, Paula can recover the value of the land, measured by the consideration paid at the time of the conveyance, which is $4,000 with interest, not from the time of its payment but from the time of the eviction. The covenantee should not have both interest on the money and use of the land; and she has had the latter until eviction.[8]

If the breach of the covenant upsets title to only a portion of the land, then damages are assessed as a proportion of the value or acreage that is lost.[9] However, a person who takes land described by defined boundaries has no claim if the land is as described, even though it may have less acreage than he thought he was receiving.[10]

PROBLEM 17.3: A owned Blackacre, worth $10,000, in fee simple. She executed to X a mortgage of $5,000. A then conveyed Blackacre to B in fee simple with a covenant against encumbrances that did not except the mortgage. X threatened foreclosure, and B paid off the mortgage with interest. B now sues A for breach of the covenant. May he recover?

Applicable Law: If an owner of land conveys it with a covenant against encumbrances and there is at the time a mortgage on the premises, the covenant is breached at the time the deed is given. On foreclosure of the mortgage the covenan-

option to purchase constituted a constructive eviction); Foley v. Smith, 14 Wash.App. 285, 539 P.2d 874 (1975) (judgment of different court recognizing third party's paramount title constituted constructive eviction).

7. MGIC Financial Corp. v. H.A. Briggs Co., 24 Wash.App. 1, 600 P.2d 573 (1979) (the "remedy for breach of the covenant against encumbrances is limited to the price paid for the property, plus interest.").

8. See Foley v. Smith, 14 Wash.App. 285, 539 P.2d 874 (1975).

9. See Hillsboro Cove, Inc. v. Archibald, 322 So.2d 585 (Fla.App.1975) (damages limited to proportionate value of the lost portion of larger parcel at the time of conveyance); Maxwell v. Redd, 209 Kan. 264, 496 P.2d 1320 (1972) ("a party contracting on an acreage basis for a specified tract at an agreed price per acre is entitled to recover the difference between the purchase price and the actual acreage times the price per acre.").

10. Ibid. See also Knudson v. Weeks, 394 F.Supp. 963 (W.D.Okl.1975), where part of the house purchased by the plaintiff encroached on adjoining land, necessitating either moving of the house, tearing it down, or acquisition of additional land; the court held that the cost of one of these alternatives should be the measure of damages.

tee who pays such incumbrance is entitled to recover from the covenantor the amount of money paid in principal and interest, plus interest from the date of such payment. If the incumbrance is an easement, a profit or a lease, the damage is the difference between the value of the land with and without the incumbrance.

Answer and Analysis

Yes. First, it is clear that A's covenant against encumbrances was breached the very instant she conveyed to B because the incumbrance of the mortgage burdened Blackacre at that time. Second, the recovery by B on the covenant should be the loss which the breach has caused B. In this case it would be the amount which B has been compelled to pay X in principal and interest, with interest from the time of such payment. But suppose the mortgagee never forecloses or threatens to foreclose and B is never called upon to pay off the incumbrance. Then there is a breach of covenant but no actual damage, and B can recover merely nominal damages. If the statute of limitation is 6 years on the covenant and 10 years on the right of foreclosure, it would be possible for the mortgagee to wait so long to foreclose that the covenantee would actually be limited to his cause for nominal damages. If the incumbrance is not one measured in money like the note and mortgage given, but one such as an easement, restrictive covenant or a lease, then the measure of damages is the difference between the value of the land with and without the incumbrance.[11]

Note: Covenants and Visible Encumbrances

Courts are divided on the issue whether a purchaser who takes land obviously subject to a visible easement or servitude may later claim a violation of the covenant against encumbrances when that visible encumbrance is not excepted in the deed.[12] The traditional rule, which permits the grantee to enforce the covenant, seems to be the better one. Although the buyer may see the encumbrance itself, she has little idea about its legal status. For example, the seller is in a better position to know (1) whether a right of way has been asserted long enough to ripen into a prescriptive easement; or (2) whether the conditions for an irrevocable license have been met. What if the

11. See In re Meehan's Estate, 30 Wis.2d 428, 141 N.W.2d 218 (1966) (indicating that substantial encroachment would be an encumbrance but finding no damages).

12. See Merchandising Corp. v. Marine National Exchange Bank, 12 Wis.2d 79, 84, 106 N.W.2d 317, 320 (1960), holding that a grantor did not need to warrant against an open and notorious prescriptive easement. But see Leach v. Gunnarson, 290 Or. 31, 619 P.2d 263 (1980), stating the traditional rule, and holding that a covenant against encumbrances gave protection against an open and notorious irrevocable license.

encumbrance is not visible, but it is in the chain of title. In Blissett v. Riley,[13] the grantor gave a general warranty deed that neglected to except a restrictive covenant limiting the owner's use of construction materials, but the encumbrance was recorded. The court held that the seller was liable on the covenant. In such a case the grantee who does a title search probably is in a position to know about the legal status of the covenant.

PROBLEM 17.4: Oprah owned Blackacre in fee simple. Phil, who was in possession of Blackacre, conveyed the land to Johnnie with "the usual covenants" of title. Johnnie paid Phil $4,000 for the property and took possession. Johnnie conveyed the property to Joan for $4,000, and Joan took possession. Oprah ejects Joan from the land, and Joan brings suit against Phil for breach of covenants in the deed. May she recover?

Applicable Law: A remote grantee can recover against a covenantor only when the covenant sued upon runs with the land. The expression "with usual covenants" includes: (a) covenant of seisin; (b) covenant of right to convey; (c) covenant against encumbrances; (d) covenant of quiet enjoyment; and (e) covenant of general warranty. Under the majority view, the first three of these cannot run with the land because they are breached, if at all, at the time of the delivery of the deed. The covenants of quiet enjoyment and of general warranty are breached, if at all, after the deed is delivered, and they run with the land. Hence, a remote grantee can sue the original grantor on these covenants.

Answer and Analysis

The answer is yes, but not on all of the covenants. Phil's "usual covenants" include: (a) covenant of seisin; (b) covenant of right to convey; (c) covenant against encumbrances; (d) covenant of quiet enjoyment; and (e) covenant of general warranty. Of course, Phil is liable on his covenants, but to whom? He made them to Johnnie. Johnnie's assignee, not Johnnie, is suing Phil. The assignee, Joan, was no party to the covenants and cannot be unless the covenants "run" with the land conveyed to her. So which, if any, of the five covenants runs with the land? The answer is that the first two covenants were breached the instant the deed was delivered from Phil to Johnnie, and at that instant became choses in action which Johnnie held against Phil personally. Such a chose cannot run with the land because it is no longer a covenant and because it was not expressly assigned by Johnnie to Joan. (Some contrary cases hold either that the covenant runs, or that the deed itself constitutes an assignment of the chose in action, so as to permit the

13. 667 So.2d 1335 (Ala. 1995).

grantee, Joan, to hold Phil liable.) Hence, in most jurisdictions Joan cannot maintain the action against Phil on the first two covenants. One can hardly say that the third covenant, the one against encumbrances, is involved when Phil had no title at all to Blackacre. But, if it were, it would be breached at once and would not run with the land to Joan.

The fourth and fifth covenants can be breached only after the delivery of the deed. These were breached when Oprah evicted Joan. At that time Joan had a cause of action if, and only if, such covenants "ran" with the estate which Johnnie conveyed to Joan. If the benefit of these covenants was attached to the land as it passed from Johnnie to Joan, then Joan can enforce it against Phil. For such covenants to run there must be an intention not only that the covenant shall protect the immediate covenantee, but also any of his successors, heirs, grantees and assignees who take the land from the covenantee and who may be evicted by paramount title such as Oprah held in this case. There must also be privity of estate, which seems in this connection to mean no more than that the person attempting to enforce the covenant has succeeded to the interest of the covenantee. In this case it would seem clear that Phil's fourth and fifth covenants were intended to protect anyone who took through Phil's deed containing the covenants if such covenants are to be given their ordinary meaning and the owners of the land, including remote grantees, were to be given full protection. And, of course, there was privity of estate between the covenantee, Johnnie, and Joan, the plaintiff. Consequently, Joan can recover against Phil on the covenants of quiet enjoyment and general warranty, but not on those of seisin, of right to convey and against encumbrances.[14] In any event, even if a covenant runs with the land, thus permitting a lawsuit against several persons in the chain of title (the immediate grantor plus remote grantors), the plaintiff is entitled to only one recovery.[15]

Note

The answer in the previous problem is called the American view, and is followed by the great majority of cases. But it is worthwhile looking at the opposite side of that holding. A conveys to B with covenant of seisin which means that A covenants that he is seised of the property at the time he gives the deed. In fact, he is not seised at all and has no interest in the property. Then B conveys to C and the

14. See Solberg v. Robinson, 34 S.D. 55, 147 N.W. 87 (1914) (allowing recovery by remote grantee).

15. Taylor v. Wallace, 20 Colo. 211, 37 P. 963 (1894) ("A remote grantee may simultaneously sue his immediate grantor and all previous covenantors, and recover several judgments against each of them, although entitled to but one satisfaction.... ")

real owner, X, evicts C. C has paid B full value for the land. C now sues A for breach of the covenant. The purpose of the covenant is to give security to the grantee, immediate or remote. Today, many technicalities have been erased from our real property law and choses in action are readily assignable. This covenant is no good to B after he has conveyed for full value to C. The only one needing the security of the covenant is the last owner who has been evicted by paramount title, or C. Chancellor Kent called the doctrine that the covenant could not run with the land because it was breached at the instant the deed was given, a mere "technical scruple." It prevents justice and takes the indemnity from C, the very person who should have it. The deed should be considered as an assignment of the chose in action from B to C, and C should have an action against the covenantor, A, because C alone has suffered from the breach.[16]

§ 17.2 *Estoppel by Deed*[17]

PROBLEM 17.5: A owns Blackacre in fee simple. B, having no interest in Blackacre, executes to C a 5 year lease on Blackacre, the term to begin March 1, 2001. Shortly thereafter A executes to B a 20 year lease on Blackacre to begin March 1, 2001. B subleases to D for 5 years to begin March 1, 2001, stating orally to D at the time of the sublease, "I made a 5 year lease to C for the same period but of course I had no interest in the land at the time so C's lease is no good." D takes possession of Blackacre on March 1, 2001. C demands possession, and D refuses. C sues to eject D. May he succeed?

Applicable Law: The doctrine of estoppel by deed is that when a person executes an instrument conveying a larger estate than he has and subsequently acquires this larger estate, it inures by estoppel to the benefit of the grantee. If the conveyor transfers his after-acquired interest to one who is not a bona fide purchaser, then this conveyee is also bound by the doctrine of estoppel by deed and takes title subject to the prior right of the original grantee.

Answer and Analysis

Yes. The doctrine of estoppel by deed is as applicable to leases as to other estates in land. When B made the lease to C for 5 years, C received no interest in Blackacre when B, his lessor, had none. However, when the owner of the land, A, leased to B for 20 years, B immediately had a 20 year term in such land and by estoppel this after-acquired estate inured to the benefit of B's lessee, C. But it is D who is in possession of the land. D is a privy of B, the lessor of C.

16. See Schofield v. Iowa Homestead Co., 32 Iowa 317, 7 Am. Rep. 197 (1871) which follows the English rule in principle.

17. Sometimes called the "after-acquired title" doctrine, or the doctrine of "shooting title."

Both the grantors and their privies are bound by the doctrine of estoppel by deed. D cannot claim to be a bona fide purchaser because he was told by B of B's prior lease to C. So whether we take the theory that the doctrine of estoppel operates as a matter of law on the estate, which does not protect bona fide purchasers, or that the doctrine operates only against the grantor or lessor personally and does not affect the estate, D is bound by the doctrine because he is not a bona fide purchaser from B. The result is that C has a right to eject D from Blackacre and to hold possession under his lease.[18]

PROBLEM 17.6: A, being fee simple owner of an undivided one half interest in Blackacre, conveys "to B and his heirs the fee simple estate in the whole of Blackacre and agrees to warrant and defend this title in B against the whole world." Thereafter D took possession from B as an adverse possessor and is presently possessed, but the statute of limitation has not yet run. A inherits the fee simple in the undivided half of Blackacre which he did not own when he conveyed to B. A dies intestate and P is his heir. P sues D in ejectment. May he succeed in ejecting D?

Applicable Law: Under the theory that the doctrine of estoppel by deed operates in rem and actually conveys the after-acquired estate of the grantor to the grantee, the doctrine will protect a stranger to the original deed as well as the parties to it and their privies; but if the doctrine operates only on persons, and does not affect the estate, it is available only to the parties to the original deed and those in privity with them.

Answer and Analysis

No. When A owned only an undivided one half interest in Blackacre and executed to B a deed which on its face purported to convey a fee simple estate in the whole property, his deed covered a larger estate than he owned in the property. When A later acquired by inheritance the very estate which his deed purported to convey to B, the benefit of the subsequent acquisition inures to B. Had B been the defendant in this case, he could have claimed the benefit of such doctrine for he was a party to the original deed in which A both granted to B and warranted in him the fee simple in all of

18. See Robben v. Obering, 279 F.2d 381 (7th Cir.1960) (applying the doctrine to an oil and gas lease); Poultney v. Emerson, 117 Md. 655, 658, 84 A. 53, 54 (1912) ("It is a well-recognized rule that if a lease is made by one who has no present interest in the demised property, but acquires an interest during the term, the lease will operate upon his estate as if vested at the time of its execution."). Of course the after-acquired title must itself be formally valid. See Reece v. Smith, 276 Ga. 404, 577 S.E.2d 583 (2003) (estoppel by deed did not apply when the transfer claimed to be an after-acquired title was in fact an oral promise not satisfying the Statute of Frauds).

Blackacre. Such doctrine operates in favor of both the parties to the original transaction and in favor of their privies who claim by consent through them. In other words, had D been a grantee of B, there would be no doubt that he would have the benefit of the doctrine.

Here D is not claiming through B by privity of estate, but as an adverse possessor. Hence, D is not in privity with B in any sense. However, taking the position that the doctrine of estoppel by deed does not merely bind the parties and their privies, but that it operates objectively in rem on the estate itself and as a matter of law, then when the grantor, A, inherited the fee simple estate in the undivided one half interest in Blackacre, which he did not own when he gave his deed to B, the title to that undivided half passed *eo instante* to B and is presently vested in B. In an action of ejectment, the plaintiff must recover on the strength of his own title and not on the weakness of his adversary's title. But the adversary can show that the plaintiff has no title at all. In this case then, the defendant adverse possessor, D, can show that estoppel by deed passed A's inherited title to B, and that A had no title or interest in Blackacre at the time of his death. Thus P received no interest therein by being the heir of A. Therefore, D, a stranger to the original deed from A to B, and not in privity with either party, is permitted to set up estoppel by deed as a defense.

On the other hand, if we take the view that estoppel by deed does not pass the estate by operating in rem, but operates only on persons, then D, a stranger to the original deed between A and B, and not being in privity with either, could not claim the protection of the doctrine. Under that approach, the title would still be in A or his heir P, although A or his heir, as against B would be estopped from denying B's title. Under this theory, the after-acquired title would still be in A if he were alive and in P, his heir, if A is dead. However, A or his privies would be prevented from denying that the title is in B or from denying A had title when he gave the deed to B. Under this theory, the estoppel is only a rule of evidence and does not effectuate an actual passing of title. A or his heir, P, would not be estopped as to wrongdoer D, and P should win the ejectment suit.[19]

PROBLEM 17.7: Audrey, having at least an estate *pur autre vie*[20] for the life of Ben in Blackacre, but being quite uncertain of any further interest, conveyed to Phyllis "all of my right, title and interest in Blackacre and hereby warrant and agree to defend such title to Phyllis in the premises." The fee simple in

19. See Perkins v. Coleman, 90 Ky. 611, 14 S.W. 640 (1890), applying the first theory.

20. That is, a life estate measured by the life of another, as often occurs when a life estate is transferred.

Blackacre later came to Audrey by inheritance. Ben died and Audrey demanded from Phyllis the possession of Blackacre. Phyllis refused. Audrey sues to eject Phyllis from the premises. May Audrey succeed?

Applicable Law: If when a deed is made it purports to convey only the interest which the grantor presently owns in the property, and the covenants of warranty do not enlarge the estate described in the granting clause, the doctrine of estoppel by deed has no application, and any after-acquired estate which comes to the grantor may be kept by her free from the operation of the doctrine. The doctrine must be based solely on the language used which appears on the face of the instrument and the construction placed on it.

Answer and Analysis

Yes. Phyllis's only defense must be estoppel by deed against Audrey. Whether that doctrine applies in any given case depends upon the language actually used in the deed. Generally the granting clause in a deed determines the estate which is intended to be conveyed, and any covenant of warranty thereafter does not enlarge upon the estate granted but merely warrants that the estate described in the granting clause is to be defended. In the facts given there is no doubt but that the granting clause describing the estate conveyed as "all of my right, title and interest in Blackacre" purports only to convey whatever interest Phyllis owned at the time of the deed. Does the covenant of warranty which follows the granting clause enlarge the estate described in the granting clause? Such covenant says, "warrant and agree to defend *such title.*" The expression "such title" must refer to the "right, title and interest" described in the granting clause, no more. Clearly, the covenant of warranty does not in any way enlarge the estate described in and purported to be conveyed by the granting clause. Thus, the effect of Audrey's deed was merely to convey to Phyllis any interest which Audrey owned when the deed was made. It was the intention of the parties, as appears on the face of the deed, that Audrey was conveying and Phyllis was receiving only the interest in Blackacre which Audrey owned when the deed was delivered to Phyllis. The doctrine of estoppel by deed does not apply, and any after-acquired estate which comes to the grantor belongs to the grantor free from such doctrine. The result is that Phyllis's estate in Blackacre came to an end with the death of Ben. Thereafter by virtue of Audrey's inherited fee simple, Audrey has the right to immediate possession of the property and the right to eject Phyllis.[21]

21. See Brown v. Harvey Coal Corp., 49 F.2d 434 (E.D.Ky.1931).

The typical quitclaim deed conveys all the grantor's then-existing interest in Blackacre, and typically does not purport to convey a particular estate. As a result, interests that the quitclaim grantor deed acquires later do not ordinarily pass through to the grantee.[22]

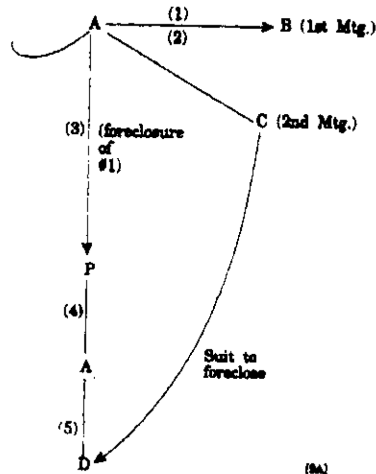
> **PROBLEM 17.8:** A, fee simple owner of Blackacre, gave to B a first mortgage on the property. He then executed a second mortgage to C which contained the following language, "this mortgage is given subject to the first mortgage hereinafter described, and I do hereby covenant with the mortgagee herein that I am seised in fee simple of Blackacre, and that said Blackacre is free of all encumbrances and I will warrant and defend said fee simple title to said mortgagee against all claims whatsoever." Thereafter B foreclosed the first mortgage, making A and C parties defendant in the action. A then purchased Blackacre from the purchaser at the foreclosure sale. Both mortgages and the deed to A following the foreclosure were recorded immediately. A then conveyed to D by a deed purporting to convey the fee simple estate in Blackacre. D paid full price for the property and knew nothing about the above transactions except what appeared on the records. C now seeks to foreclose his mortgage, making both A and D parties defendant. May C succeed?

22. Ellingstad v. State of Alaska, 979 P.2d 1000 (Alaska 1999); see also Webster Oil Co. v. McLean Hotels, 878 S.W.2d 892 (Mo.App.1994), where the quitclaim deed at issue contained this habendum clause:

> TO HAVE AND TO HOLD THE SAME, with all the rights, immunities, privileges and appurtenances, thereto belonging; unto the said party of the second part [Webster Oil Company] and assigns forever; so that neither the said party of the first part [Mid-America Motor Lodges, Inc.], nor any other person or persons, for it or in its name or behalf, shall or will hereafter claim or demand any right or title to the aforesaid premises or any part thereof, but they and each of them shall, by these presents, be excluded and forever barred.

The court concluded that, notwithstanding this language, an after-acquired title did not pass through to the grantee.

The facts may be illustrated as follows:



Applicable Law: The doctrine of estoppel by deed does not require that there be any misrepresentation of fact on the face of the deed. It requires only that the representations on the face of the deed concerning title be made good whether such representations be in the form of a grant or a covenant or both. In some jurisdictions, however, the scope of title covenants may be construed as modified in terms of the estate granted. Under the recording statutes the general rule is that a subsequent purchaser is not charged with notice of a recorded instrument of conveyance by a person in the chain of title unless such record was made at a time later than the records disclose this person to have acquired such title. This means the record must show a conveyor to be a grantee before he can be a grantor. While some cases treat title through estoppel by deed as an exception to such general rule, the better rule is that it is governed by the general rule and that the subsequent purchaser has priority over the one who claims the benefit of the doctrine, but through an instrument which is outside the chain of title. This is the only holding in harmony with the purpose of the recording acts.

Answer and Analysis

The answer should be no. When B foreclosed his first mortgage there is no doubt that such proceedings effectively cut off all rights which the original mortgagor, A, and the second mortgagee, C, had in Blackacre. Indeed, that is the very purpose and effect of such foreclosure proceedings. On the records, neither A nor C appears to have any interest in Blackacre. But A's general covenant of warranty still appears in the second mortgage to C. The question whether

C might hold A liable for damages for the breach of such covenant of warranty is not relevant. C is seeking to gain title to Blackacre through the doctrine of estoppel by deed and foreclosure. Does the doctrine apply? The mortgage to C states "this mortgage is given subject to the first mortgage," etc. There was as to such first mortgage then no misrepresentation of fact. But the mortgage continues, "said Blackacre is free of all encumbrances and I will warrant and defend said fee simple title to said mortgagee against all claims whatsoever." When all of this quoted language is read as a whole it may be construed as saying, "Blackacre is subject to a first mortgage but I hereby warrant it to be free from all encumbrances and will defend in the second mortgagee a clear fee simple title."

The doctrine of estoppel by deed does not require that there be a misrepresentation of fact. It is a technical doctrine requiring merely that the covenant or representation which is made in the deed concerning title be made good. Under the foregoing interpretation, the language in this case shows that the mortgagor, A, intended the mortgagee to have a fee simple title for the subject of his mortgage and that the mortgagee intended to receive such. The recital of the existence of the first mortgage does not prevent the assumption by the mortgagor by his covenant that he hereby estops himself from denying the fact of such prior mortgage.

A different interpretation is not only possible but more reasonable. Applying the principle that a document should be considered in its entirety in order to arrive at its proper construction, then when the instrument itself shows that the land is conveyed or mortgaged subject to an outstanding interest, and this granting clause is followed by a covenant for title, the title covenant should be construed as warranting *only the estate granted or mortgaged in the preceding clause*. In effect, the title covenant is construed as if it stated, " ... warrant and defend the title against the claims of all persons *except as above noted.*" Under this interpretation the grantor, A in the instant case, is not estopped to assert his after-acquired title.

Assuming, however, a jurisdiction that would follow the earlier interpretation and would construe the title covenant most strictly against the grantor and without modification, then we would find that C's mortgage with its covenant of warranty is a conveyance by A of a larger interest than he had in the property at the time it was given. After B's foreclosure, A had no interest in the property because it had been completely cut off by B's foreclosure action. Thereafter, A acquires by purchase the fee simple in the property. At the instant of reacquisition, the benefit inures to C under estoppel by deed. The doctrine is binding both on A, a party to the original second mortgage, and on those who take through him, D in

our case. This is true whether or not D is a bona fide purchaser. Such was the common law rule, and were we to stop at this point the answer to our question would be yes, and C could foreclose his mortgage. In other words, if this case were to be determined wholly on the doctrine of estoppel by deed, then C should have the benefit of A's after-acquired property.

In the event that estoppel by deed would apply to this situation, the further effect of the recording act should be considered. Although there is a conflict of authority, it is believed that the better view is that estoppel by deed is modified by the recording acts, and that a *bona fide* purchaser (purchaser in good faith; hereinafter BFP) under the recording acts takes free of the rights of the grantee under the estoppel deed. To illustrate, assume that A in this case had executed two warranty deeds, one first to B and then one to C. C's deed, of course, was ineffective to convey any title since A had already conveyed it to B. When A later reacquired title by another conveyance and then conveyed to D, the question of D's status as a BFP becomes important. D, in checking the chain of title, would normally disregard A after finding the recorded deed from A to B, and would pick up A again after finding the recorded deed back to him from the subsequent purchaser. Thus, D would not normally find the deed from A to C which was executed at a time when A did not have title. Therefore, D would be a BFP relying on record title, and to give full effect to the policy behind the recording act, D should prevail over the estoppel grantee, C. Of course, the recording act in so many words pertains only to unrecorded instruments, but to give full effect to the policy of the act, instruments recorded *out of the chain of title* should be regarded as not recorded.

This theory of protecting the bona fide purchaser as against the grantee of the estoppel deed was not applied to the mortgage situation in the principal case.[23] If applied to the mortgages in such a situation, the application would be subject to criticism for the following reason: it is difficult to see how D can become a BFP under the recording act. A purchaser in D's position in checking title is not justified in disregarding A after A executes a first mortgage, because A still retains a substantial interest which is subject to further mortgage and conveyance. Further, the second mortgage was recorded and C was made a party to the foreclosure suit. D should necessarily check the foreclosure proceedings, and is charged with notice of everything that would be revealed by a search of the records. Thus, he should be charged with constructive notice of C's mortgage and of the covenant of title it contains.

23. Ayer v. Philadelphia & Boston Face Brick Co., 159 Mass. 84, 34 N.E. 177 (1893).

Under such circumstances it would not be unjust to let the estoppel grantee, C, prevail over D who is charged with notice of his rights.

In conclusion, the result should be that D prevails over C because A's title covenant should be considered modified by the recital in the deed that it was a second mortgage. Thus, estoppel by deed should not apply, but there are cases to the contrary. If estoppel by deed does apply, there are conflicting decisions as to whether the doctrine is modified by the recording acts.[24]

§ 17.3 Priorities and Recording

b. The Recording Acts

PROBLEM 17.9: A, owner of Blackacre in fee simple, conveys it to B. B does not record. A then executes a deed to C purporting to convey Blackacre to C. C, having no notice of the deed to B, pays full value of the property to A. B then records his deed, after which C records his deed. At the time C receives his deed, B is not in possession of Blackacre, but later C finds B already in possession. The recording statute in the jurisdiction provides, "Every conveyance of real property shall be void as to subsequent purchasers and incumbrancers who give value and take without notice, unless such conveyance is duly recorded before such subsequent purchase or incumbrance." C sues to eject B. May C succeed in the action?

Applicable Law: The recording statutes are intended to protect subsequent purchasers and incumbrancers who give value and take title in good faith without notice of a prior claim. Under notice statutes bona fide purchasers or incumbrancers have priority over prior purchasers who do not record their deeds until after such subsequent purchasers have expended their money and taken their deeds in good faith.

Answer and Analysis

The answer is yes. The legislature of a state has power to determine the form, effect and priorities of conveyances of land within the borders of the state. In this case the legislature by its recording statute has undertaken to make void a conveyance as to "subsequent purchasers and incumbrancers ... unless ... duly recorded before such subsequent purchase or incumbrance." This is a *notice* statute which protects the subsequent BFP from claims arising under a prior unrecorded instrument. A's deed to B is a

24. See Breen v. Morehead, 104 Tex. 254, 136 S.W. 1047 (1911), holding for the BFP (subsequent purchaser). See also Sabo v. Horvath, 559 P.2d 1038 (Alaska 1976), holding for the BFP under a federal statute that had the same effect as the doctrine of estoppel by deed.

conveyance of real property which was not recorded. C is a subsequent purchaser who gave full value and had no notice of B's deed. C's purchase preceded in time the recording of B's deed. Every item of the statute specifically applies to C's claim and by the very words of the statute, B's deed is made "void" as to C's purchase. The fact that B's deed was recorded before C's deed is immaterial, for the statute does not consider or make any provision for priority of recording, as some statutes do. Hence, C having purchased for value and in good faith subsequent to B's deed and B having failed to record his deed before C's purchase, B's deed is void as to C and C has priority under the recording statute. B's failure to record his deed has made it possible for C to be injured, which is the very reason for the statute.

However, the provisions of such a statute can work a similar injustice on B. Suppose that B receives his deed late in the evening when the registry of deeds is closed. Immediately following his transaction with B, A sells the same property to C. When the recording office opens the following morning B is there and presents his deed for recordation. Shortly thereafter C records his deed. Under a statute as quoted in our Problem, C has priority. And yet B has been as diligent as it is possible for a person to be. Such a case has led some legislatures to give priority to the grantee who first records his deed. But legislatures promulgate statutes and courts merely interpret them. In this case, C must be given priority over B and may eject B from Blackacre.[25]

Note: The "Mother Hubbard" Grant

Suppose a deed purports to convey Blackacre in addition to "all the grantor's property in Linn County." Such conveyances are sometimes convenient for grantor's on their deathbeds who do not have time to determine exactly what they own. The deed is presumably recorded in such a way as to reveal it as a conveyance of Blackacre—but does its recordation provide notice to subsequent purchasers of parcels other than Blackacre that may have been conveyed in the "Mother Hubbard" clause?[26]

PROBLEM 17.10: A, being fee simple owner of Blackacre, conveys it to B, for which B pays A $200,000.00. B records his

25. See Parks v. Stepp, 277 Ga. 704, 594 S.E.2d 364 (2004); Randall v. Hamilton, 156 Ga. 661, 119 S.E. 595 (1923); Craig v. Osborn, 134 Miss. 323, 98 So. 598 (1924).

26. See Luthi v. Evans, 223 Kan. 622, 576 P.2d 1064 (1978), holding that the Kansas recording statutes required land to be described with sufficient specificity that it could be identified, or else the recorded deed would not effectively give notice to subsequent BFPs. The court additionally noted that the basic "Mother Hubbard" clause was valid to convey, and would be good against anyone with actual knowledge that a particular parcel was covered.

deed and takes possession of Blackacre. C goes to A and expresses a desire to purchase Blackacre. A advises C that he has already sold the property to B. C hands A $1.00 and asks A to execute to him a deed to Blackacre in fee simple which A does. C records his deed and brings an action against B to eject him from Blackacre. In this jurisdiction the recording statute provides that any conveyance or incumbrance of real property shall be void as to subsequent purchasers or incumbrancers for value and without notice unless the instrument is duly recorded. May C eject B?

Applicable Law: To be a bona fide purchaser entitled to protection under the recording statutes one must give a value which is more than nominal and he must take without notice of a prior claim or interest in the land. One cannot be in good faith if: (a) he takes with constructive notice given by a properly recorded instrument of conveyance; or if (b) he takes with actual notice of a prior claim or interest; or if (c) there is an actual physical possession of the land by one who has a prior interest even though such possessor's deed is not recorded. When one buys land the law charges him with notice of any interest claimed by one in possession of the land, but possession consistent with the record title does not constitute notice of the possessor's inconsistent claims in many jurisdictions, except in the case of tenants.

Answer and Analysis

No. There are four reasons why C cannot eject B from Blackacre, any one of which would give B a good defense. (1) The recording statute is of the notice type intended to protect bona fide purchasers and incumbrancers. To be a bona fide purchaser or incumbrancer one must both (a) give value and (b) take without notice of a prior claim. In this case the subsequent purchaser, C, gave the sum of $1.00 for what appears to be a piece of property worth $200,000.00. Such a nominal consideration does not make one a purchaser for value. Therefore, C is not a bona fide purchaser who is protected by the recording statute. (2) B's recording of his deed from A did two things, it made inapplicable the recording statute making his deed void as to subsequent purchasers and incumbrancers for the deed was "duly recorded," and prevented C's being a bona fide purchaser because such deed on record gave C constructive notice of B's prior claim regardless of whether C had actual knowledge of such. (3) When C sought to buy Blackacre from A, he was told by A that the property had been sold to B. Such actual knowledge prevents C from being a bona fide purchaser. Even had B's deed not been recorded, such actual notice would have prevented C's obtaining any protection under the recording

statute given. B's deed would have been perfectly valid as to C simply because C took his deed with notice of B's prior deed or title. (4) If we assume that B did not record his deed, that C gave full value for Blackacre and that A had not told C of his deed to B, still C would not be a bona fide purchaser and could not eject B. The reason is that B is in actual physical possession of Blackacre at the time A delivered the deed to C. When C makes such a purchase the law puts the purchaser out on the land and charges him with notice of what appears there, and it is immaterial whether or not the purchaser actually inspects the land.[27] C is charged with seeing B in possession of Blackacre, and that places C on inquiry of B to learn just what B's interest in or claim to Blackacre actually is.

However, there are some instances in which possession of the land may give the subsequent purchaser no notice of any adverse or inconsistent claim, in which case the doctrine of inquiry notice does not apply. For example, suppose A and B are on the record as equal cotenants of Blackacre. A conveys his undivided one half interest in the property to B. B does not record his deed. A then gives a deed to C of an undivided one half interest in Blackacre. C records his deed. B's possession would not give C notice that B claimed more than an undivided one half interest because his possession as a co-owner would be entirely consistent with the record (each cotenant is entitled to possess the whole). There is authority, however, that possession of a tenant, although consistent with record title, may constitute notice of an inconsistent claim because of the fairly common practice of landlords and tenants entering into supplemental agreements and arrangements.[28]

PROBLEM 17.11: A, owner in fee simple of Blackacre, conveys it by deed to B. This deed is recorded. B executes to A a purchase money mortgage dated June 1, 1995. This mortgage is not recorded until June 1, 2001. B conveys to C by a deed which states "subject to the mortgage given to A." This deed is dated June 1, 1996 and is not recorded. C gives a mortgage on the premises to D on January 1, 2001 which is recorded January 2, 2001. A brings an action to foreclose his mortgage in which D contends that his mortgage is prior to that of A's. May A have a decree of foreclosure?

Applicable Law: A purchaser of land must use diligence both in searching the records and in inspecting the land respecting

27. As a general matter, a subsequent purchaser is also said to be on notice of easements, covenants or other servitudes that can be discovered by physical inspection of the premises. See Otero v. Pacheco, 94 N.M. 524, 612 P.2d 1335 (Ct.App.1980), cert. denied 94 N.M. 674, 615 P.2d 991 (1980), finding that a buried sewer line was sufficiently "visible" to put purchasers on notice of its existence.

28. See Galley v. Ward, 60 N.H. 331 (1880).

prior interests which may be claimed by others. If either the record or an inspection of the land discloses a circumstance which puts him upon inquiry he must pursue such inquiry to the point that he has used due diligence and is bound by such notice which due diligence would disclose. A subsequent purchaser is charged with constructive notice of every recorded instrument of conveyance which is a link in his chain of title. He is also charged with constructive notice of recitals in a recorded instrument which is a link in his chain of title, which recitals may refer to unrecorded instruments. Finally, he is charged with constructive notice of recitals in an unrecorded instrument of conveyance which is an essential link in his chain of title and through such an unrecorded instrument his own claim must be made.

Answer and Analysis

Yes. For a party to prevail under most of the recording acts, she must at least satisfy the requirements of being a subsequent bona fide purchaser or mortgagee for value without notice, and the prior interest must not be recorded at the time the subsequent party obtains his interest. The chronology of events in the above set of facts is as follows: (1) A conveys to B. (2) B's deed is recorded. (3) B mortgages to A. (4) B conveys to C "subject to the mortgage." (5) C's deed is not recorded. (6) C mortgages to D. (7) D's mortgage is recorded Jan. 2, 2001. (8) A's mortgage is recorded June 1, 2001. From this set of facts the record alone shows (a) B owns Blackacre, (b) C mortgages to D and (c) B mortgages to A.

Any priority which D claims must be based on her taking as a subsequent incumbrancer without notice. So the question is—does D take with or without constructive notice of A's mortgage? It is quite obvious that had B's deed to C been recorded prior to D's mortgage, D would have been given constructive notice by such recordation because C's deed is an essential link in D's chain of title, and a subsequent purchaser takes with notice either (a) of a deed on record which is a part of her chain of title or (b) of a recital in an instrument which is a part of her chain of title. So if C's deed had been recorded, D would have taken with notice of A's mortgage, whether or not that mortgage was recorded, because C's deed recited that it was "subject to the mortgage given A." But on the face of the record C seems an interloper. The record discloses no interest in C prior to her giving the mortgage to D. This should have put D on inquiry to learn the source of C's title, if any. Either there is such a source or there is not. If there is none, then D has no interest under C's mortgage. If there is such a source, D should have discovered it, and in the absence of such discovery she should be charged with notice of the contents of that source whether or

not it is recorded. Thus D is charged with constructive notice of the recital in C's deed that it is given "subject to the mortgage given to A." Hence, A's mortgage from B is prior to that of D who takes with constructive notice and thus is not a bona fide purchaser from C as to A's mortgage.

In the cases involving priorities of instruments of conveyance, the underlying principle should be constantly kept in mind. It is this—one is protected by the recording statutes if she is diligent but not if she is negligent. The purchaser of real property is duty bound to make diligent search of the records for prior claims, and a diligent inspection of the property for possible claims by possessors. If (a) the record gives the purchaser constructive notice, or (b) the record is such as to leave her in doubt, or (c) someone is in possession of the land that is inconsistent with the record, or (d) the possession of the land leaves the purchaser in doubt; in all of these cases the purchaser is charged with notice and cannot be a bona fide purchaser entitled to protection under the recording statutes.[29]

PROBLEM 17.12: In 2001 O gives an oil and gas lease to Blackacre to A; A does not produce oil and gas and there is no evidence of the existence of the lease on Blackacre itself. A does not record the lease. In 2002 O sells the F.S.A. in Blackacre to B by a deed which says "subject to an oil & gas lease in A." B records. In 2004 B conveys F.S.A. in Blackacre to C, by a deed making no reference to the oil & gas lease. Does C take free of the lease or subject to the lease.

Applicable Law: In either a notice or race-notice jurisdiction one is obligated not merely to locate the documents in a chain of title, but also to read their contents, and takes subject to any interest referred to in an earlier document, provided that the interest can be readily identified.

Answer and Analysis

In either a notice or race-notice jurisdiction C will take subject to the oil and gas lease. Under the doctrine of "muniments of title," a purchaser takes with constructive notice not merely of recorded conveyances, but also of unrecorded conveyances referred to in recorded conveyances. The title searcher therefore has a duty to read the contents of each document in the title chain. In this case

29. See Baker v. Mather, 25 Mich. 51 (1872). See also Cohen v. Thomas & Son Transfer Line, Inc., 196 Colo. 386, 586 P.2d 39 (1978), holding that a purchaser who saw tenants on the property had a duty to inquire as to the nature of their unrecorded lease, and thus took subject to a right of first refusal (i.e., a right to purchase the property by matching any offer made by another prospective purchaser).

the oil and gas lease was unrecorded. However, a careful reading of the deed from O to B would reveal that O's interest was subject to the outstanding oil and gas lease.[30]

The doctrine of muniments of title is problematic, however. Although a recorded instrument might refer to an unrecorded instrument, the reference might be so vague that it really does not give a title searcher notice of anything. For example, suppose a title search reveals a fifty-year old deed with a statement that the conveyance is "subject to a mineral lease," but says nothing about (a) the identity of the lessee; (b) the duration of the lease or any requirement that minerals actually be produced; or (c) the identity of the minerals that the lessee has the right to take.[31] A compromise position is to permit the doctrine to be used only when the reference contained in the recorded instrument is sufficiently specific to enable the title searcher to find it.[32]

PROBLEM 17.13: A, fee simple owner of Blackacre, conveys it to X. X does not record. X conveys to Y. Y records. Then A executes a deed to B. B records. B executes a deed to C. C records. Neither B nor C knew of the deeds to X and to Y. Blackacre is vacant land with no one actually in physical possession. Y then moves onto the premises and C sues to eject her. May C succeed?

Applicable Law: Under the recording statutes, priority in right often depends upon the constructive notice imparted by recordation of instruments rather than on the common law rule, priority in time is priority in right. The chain of title means the unbroken continuity of title with every link in the chain being present from the patent to the claimant. A recorded instrument of conveyance outside the chain of title does not impart constructive notice to a subsequent purchaser or incumbrancer. If a grantor appears as a grantor in an instrument on the record without appearing on the record as a grantee, the instrument is a wild deed and not in the chain of title. A subsequent bona fide purchaser takes priority over a grantee in a recorded instrument which is outside the chain of title.

30. See Guerin v. Sunburst Oil & Gas Co., 68 Mont. 365, 218 P. 949 (1923) (recorded option mentioning unrecorded oil & gas lease constituted notice of the lease); Harper v. Paradise, 233 Ga. 194, 210 S.E.2d 710 (1974) (reference to lost deed contained in a later deed gave notice of the lost deed).

31. See L. Simes & C. Taylor, The Improvement of Conveyancing by Legislation 101–102 (1960), concluding that the doctrine unreasonably burdens title searchers.

32. See Richardson v. Lee Realty Corp., 364 Mass. 632, 635, 307 N.E.2d 570, 573 (1974) (no notice if a reference that is "at most ambiguous concerning some possible impropriety" in the title).

Answer and Analysis

Yes.[33] Of course if this were a case at common law where priority in time is priority in right, Y would be the title holder of Blackacre and have the right to possession because after A's deed to X there would be no interest in A to convey to B. But under the recording statutes the common law rule does not always prevail and the question of priority often depends, as in this case, upon the recordation of instruments and the constructive notice which such recordation imparts. When we are told that A is a fee simple owner, such conclusion presupposes a perfect recorded chain of title from the patent of the United States Government, or other former sovereign, down to and including A. It presupposes no break in the recorded chain and that every link properly binds the links preceding and succeeding it. Then A conveys to X but X does not record his deed. Thus the title in X is good between the parties, A and X. But on the record the chain is not complete without the last link. Then X conveys to Y. Y records his deed. But the record discloses a good chain with all links there down to A. But there is no link on the record between A and Y. Y now appears to be an interloper, a stranger to the chain of title because there is no link connecting him with A, the last link in the chain connected with the original source of title. Now A conveys to B and B to C. Both deeds are recorded. Now the chain of title *on the record* is perfect from the patent down to and including C. So the question is whether the subsequent purchasers B and C are bound by any constructive notice imparted to them by Y's recorded deed from X when X, and therefore Y, are *strangers to the chain of title?*

The general rule answers this question in the negative. A subsequent purchaser or incumbrancer is not bound by constructive notice of any recorded instrument of conveyance unless such instrument constitutes an essential link in the chain of title. No recorded instrument of conveyance gives constructive notice to a subsequent purchaser or incumbrancer unless that recorded instrument is made after the time when some other recorded instrument shows the grantor to have obtained the title. In short, *on the record the grantor must first appear as a grantee before he can be a*

33. The answer should be the same under any of the four types of recording statutes, but the reasons would be somewhat different. (1) Under a notice statute both B and C are subsequent BFP's because the X-Y deed is outside the chain of title and doesn't constitute constructive notice. (2) Under a race statute, recording should be construed as meaning the recording of a complete chain of title; therefore the non-recording of the A-X deed precludes Y from claiming a prior recording, and the entire competing chain—A to B to C—is recorded first. (3) In a race-notice jurisdiction, both B and C can qualify as subsequent BFPs whose conveyance were first recorded insofar as Y is concerned because of the reasoning under (1) and (2) supra. (4) In a period of grace statute if the period of grace for X's recording has expired, the result is the same as in a notice jurisdiction, and C will prevail.

grantor. Applying this rule to our facts, X is a complete stranger to the chain of title. He does not appear on the record as a grantee at all, much less before he appears as a grantor. On the other hand C's chain of title is perfect and complete. As a subsequent purchaser C is bound by constructive notice only of the instruments in his chain of title. This does not include the instrument from X to Y. Hence, C holds priority as a bona fide purchaser under the recording statutes and can eject Y from Blackacre. Importantly, B took his interest without notice of any interest in Y, C took whatever interest B had, and notice to C would be immaterial. In other words if B, a subsequent purchaser, takes without notice, then he is empowered to transfer his interest to another who does or does not have notice of the prior claim. Of course, this does not mean that one who holds with notice can improve his position by selling to a bona fide purchaser and buying back again.[34]

Note 1

A literal application of the recording act might suggest a different result in the above problem. Take a typical notice statute which provides, in effect, that no deed shall be valid until recorded as against a subsequent bona fide purchaser for value and without notice. In the instant case Y recorded his deed before A conveyed to B, and B in turn conveyed to C. Thus, it could be argued that Y did record his instrument before B entered the picture; so the recording act has no application, and the common law rule of first in time governs. However, the break in the chain of title from A to X affords such persons as B and C no opportunity to find the conveyances to X and Y. Thus, in order to give effect to the policy behind the recording act, the concept of recording should be construed to mean the recordation of a complete chain of title. Under such an interpretation, Y's deed is not recorded within the intent of the act when it is a wild deed unconnected with a prior deed of record in the chain of title. Thus, the result is the same as previously indicated.[35]

Note 2

If the jurisdiction had an official tract index in which all instruments were recorded in reference to the legal description of the land instead of in reference to grantors and grantees, then the chain of title concept would be inapplicable, and B and C in the above problem would have no difficulty in finding the recorded deed to Y and they would be charged with notice.

34. See Board of Educ. of City of Minneapolis v. Hughes, 118 Minn. 404, 136 N.W. 1095 (1912).

35. See Salt Lake County v. Metro West Ready Mix, Inc., 89 P.3d 155 (Utah 2004).

PROBLEM 17.14: A, having no interest in Blackacre, mortgages the property to X. X assigns the mortgage to Y. Both the mortgage and the assignment are recorded. Thereafter A acquires title to Blackacre and executes a deed for full value to B who conveys to C who conveys to D. All these deeds are duly recorded. Y seeks to foreclose its mortgage against all of the above parties and all resist his effort to foreclose. May Y succeed?

Applicable Law: An instrument of conveyance which operates by way of estoppel by deed is outside the chain of title and does not give constructive notice to subsequent purchasers and conveyancers according to the better view. Hence, the general rule, that a subsequent purchaser or incumbrancer of the after-acquired property takes priority over the grantee or mortgagee in an earlier recorded instrument of conveyance which is outside the chain of title, applies to the ordinary case of estoppel by deed when the recording statutes are involved.

Answer and Analysis

The best answer is no. Both at common law and under modern conveyances the doctrine of estoppel by deed will operate in favor of a grantee and against a grantor as to after-acquired property, and such doctrine extends to the successors in interest of these parties. However, the doctrine of after-acquired title is affected by the recording statutes. When A mortgaged to X and when X assigned the mortgage to Y, A had no interest in Blackacre. His mortgage, therefore, was completely outside the chain of title. He had by such mortgage become on the record a conveyor before any record showed him to be a grantee or a conveyee.

Most courts hold that subsequent purchasers or incumbrancers are not bound by such recorded instruments, because such recordation gives no constructive notice to bona fide subsequent purchasers and incumbrancers. Indeed, when X and Y took A's mortgage they did not carry out their duty of due care with respect to searching the record of the chain of title because the exercise of such diligence would have disclosed that A was not a grantee in the chain of title of Blackacre. Applying the general rule, the purchasers from A after A acquired the title to Blackacre were subsequent purchasers without notice of the mortgage to X and assigned to Y, because such mortgage was outside the chain of title. B and his successors, C and D, are therefore entitled to protection under the recording statutes as subsequent purchasers and take their title free from the encumbrance of Y's mortgage. This is the only holding which complies with the purpose and the spirit of the recording statutes.

There are many cases holding to the contrary, thus making the passing of title by estoppel by deed an exception to the general rule that an instrument of conveyance not in the chain of title does not give constructive notice to subsequent purchasers and incumbrancers. The exception seems unjustified in view of the fact that the one claiming the benefit of the exception is either himself guilty of negligence in searching the record, or he holds through one who is negligent and the record discloses such. Of course, as between parties who are unaffected by the recording statutes, the doctrine of estoppel by deed still continues to operate.[36]

PROBLEM 17.15: A, the owner of Blackacre in fee simple, conveys it to B. B bring his deed to the registry for recording and pays the fee. The clerk misplaces the deed among other papers and it is never recorded. A then deeds Blackacre to C who promptly records. Blackacre is vacant land and C has no knowledge of A's former deed to B. C takes possession of the land and B sues to eject him therefrom. May B succeed?

Applicable Law: Subsequent purchasers and incumbrancers are entitled to rely on the title records. If a holder of a deed presents it for recordation and the officer fails to record it, the loss or injury under one view must fall on the one who presents such instrument for record and not on a bona fide subsequent purchaser. Likewise, if the officer records the instrument but makes an error in its recordation, the loss or injury under this view must fall on the one who had the instrument recorded and not on a subsequent purchaser or incumbrancer. Under this position the duty lies on the holder of an instrument of conveyance not only to see that the instrument is recorded when he presents it for record, but also to see that it is correctly recorded. Under the contrary position, the loss falls on the subsequent purchaser when the recorder makes a mistake. The reason is that the holder of the instrument does all that is required of him when he deposits such instrument for recordation.

Answer and Analysis

The answer is no in many jurisdictions, but there is contrary authority. The rationale for putting the loss on B is as follows: Under the recording acts it seems the better rule to require the holder of an instrument of conveyance not only to present a deed

36. See Breen v. Morehead, 104 Tex. 254, 136 S.W. 1047 (1911), holding for the BFP (subsequent purchaser). See also Sabo v. Horvath, 559 P.2d 1038 (Alaska 1976) (applying the rule to a federal statute operating similarly to estoppel by deed); but see Ayer v. Philadelphia & Boston Face Brick Co., 159 Mass. 84, 34 N.E. 177 (1893) (holding for the earlier purchaser, who received title by estoppel).

for recordation but also to see that the instrument is properly recorded. The holder can more easily return to make sure that a *known* instrument is recorded than a subsequent purchaser can search for an *unknown* instrument. The public should be able to rely on a public servant or official to do his duty. But a public servant or officer is human and may make errors. Only B could have prevented the injury because he alone had complete control of the situation at the time of the attempted recordation. There is no way imaginable by which C, who could only act as a result of what B did or did not do, could protect himself. To require C to do more than examine the record with care and diligence would be a determination that the public or subsequent purchasers cannot rely on the public records as to titles. Hence, it seems proper in carrying out the purpose and intent of the recording statutes to require B to use due diligence not only in presenting his instrument for recordation, but also to require him to see that such recordation is made. This principle applies not only where no record at all is made but also when a record is made but it is erroneously made. For example, suppose in our case the owner A had made a first mortgage on Blackacre for $5,000 to B. B takes the mortgage for recordation. By an error the record shows the mortgage for only $500. Then A gives a second mortgage for $2,500 to C. B sues to foreclose his $5,000 mortgage. C is made a party defendant and agrees that B has the right to foreclose for $500 but not for $5,000. Here again B is bound to see that his mortgage is correctly recorded and, as to C, he can foreclose only as to $500. Such doctrine is the only one which gives full effect to the principle that subsequent purchasers and incumbrancers are entitled to rely on what they find on the title records.[37]

The alternative rationale for protecting B and putting the loss on C is that B has done all that is required under the recording act when she files her instrument for record with the proper official. Further, some delay will occur between the deposit of the instrument in the registry and spreading it on the records, and even further delay in compiling the index. Unless the deed is deemed recorded from the time it is deposited in the registry and not from the time it is spread on the record and then indexed, there is a possibility that a person in B's position above will be defeated by a subsequent bona fide purchaser from the original grantor in spite of the fact that B has done all that pragmatically is within her power to do. An ordinary layperson cannot literally perform the recorder's job for him, and it is essential that the deed or other

37. What if the deed is improperly indexed or not indexed at all, owing to no fault of the purchaser? The courts are divided. See Haner v. Bruce, 146 Vt. 262, 499 A.2d 792 (1985), holding that a misindexed deed nevertheless gave notice to a subsequent purchaser, who thus took subject to it. Cf. Mortensen v. Lingo, 99 F.Supp. 585 (D.Alaska 1951) (recordation without indexing does not impart constructive notice).

instrument be deemed recorded from the moment of its deposit in the registry. Thus, although it is hard for an innocent purchaser to suffer a loss as a result of the recorder's mistake, it is equally hard for an innocent owner to suffer such a loss. Under such circumstances there is no more reason to protect the subsequent purchaser than the owner. Such errors in recording, like forged and other void instruments, are simply matters against which the recording act offers no protection. The remedy of the innocent purchaser in such cases should be against the recorder.[38]

PROBLEM 17.16: A, fee simple owner of Blackacre, was negotiating with B for the sale of the property to B. B requested A to make out a deed to B, saying he would be back the following day to examine it. The day following B returned to A's house and A handed to B for examination the deed which A had signed and acknowledged as B had requested. B examined the deed and pronounced it satisfactory but stated that he would have to think over the matter a little longer. B returned the deed to A who put it in his pocket. Without A's knowledge or consent and without negligence on the part of A, B clandestinely picked the deed from A's pocket, recorded it, and sold Blackacre to C. Blackacre was vacant property and C had no knowledge other than the record. C took possession of Blackacre and A sues to eject him. May A succeed?

Applicable Law: A forged or an undelivered deed is a nullity and no one can claim any interest through such. Placing such a deed on record does not add any legal efficacy to such a forged or undelivered instrument. The recording statutes are not intended to be a means of conveyance nor are they intended for the purpose of assisting wrongdoers, tort-feasors, criminals and forgers in depriving innocent owners of their real property. The original owner continues his ownership even over one who claims even as an innocent purchaser through a forged or an undelivered deed.

Answer and Analysis

Yes. A did not deliver the deed to B. Further, A was not negligent in respect to B's gaining possession of the instrument

38. However, the recorder may not be liable. See Siefkes v. Watertown Title Co., 437 N.W.2d 190 (S.D.1989) (doctrine of sovereign immunity barred damages action against county registry of deeds for negligent indexing). Contra Terrell v. Andrew County, 44 Mo. 309 (1869). See also 70 A.L.R. 603–608.

Suppose that a grantee changes his or her name before reselling the property, and the records do not reveal that the two different names belong to the same person? See First Financial Bank, F.S.B. v. Johnson, 477 So.2d 1267 (La.App. 1985), holding that a searcher has no duty to search for variations in name, at least where the contest was between the searcher and an earlier grantee who had negligently misspelled the grantor's name.

which he recorded. Hence, estoppel cannot be used against A. There being no delivery of the deed by the owner and he having been guilty of no conduct which could estop him from denying delivery, A is still the owner with the right to possess Blackacre unless the recording acts preclude him from recovery.

The recording acts are intended to protect bona fide subsequent purchasers. Clearly C should be so classified. We may assume that he examined the records and found a deed properly signed and acknowledged by A and that he paid full value for Blackacre. The recording statutes are intended to protect the innocent and when two persons are equally innocent and one is no more to be blamed than the other for their predicament, then the statutes will have no application and the title will remain where the law would recognize it to be. In our case the title was in A. An undelivered deed is a nullity and leaves the title in the owner. C will have to be content with his personal action against B. Why doesn't the record assist C? Because the recording statutes presuppose a valid delivery of the instrument in order that they have any application. There is no such delivery in our case. The same would be true in case B forged A's name to a deed and placed it on record. It would have no legal effect and anyone who claimed through it would have no interest. Nor is an owner bound to examine the records from time to time to see if anyone has placed a forged or an undelivered instrument of conveyance on record. In short, the recording acts protect subsequent parties against prior otherwise valid and delivered but unrecorded instruments; they have no application whatsoever to recorded but void deeds.[39]

In the disturbing *Messersmith* decision[40] the court held that an improperly acknowledged (i.e., improperly notarized) but otherwise valid deed did not give notice to subsequent purchasers because the recording statute, as many recording statutes, required instruments to be acknowledged before they could be recorded. Thus, even though the deed was valid as between the parties and present for any title searcher to see in the chain of title, it did not provide "notice" in the recording act sense. As a result, a purchaser from the person receiving the unacknowledged instrument was not entitled to rely on the record and lost title to an earlier grantee under an unrecorded quitclaim deed.

39. See Stone v. French, 37 Kan. 145, 14 P. 530, 1 Am.St.Rep. 237 (1887) (no protection given by recorded but undelivered deed). But see Hauck v. Crawford, 75 S.D. 202, 62 N.W.2d 92 (1953), holding that if the grantor's signature is obtained by fraud (in this case the grantor was told he was signing a lease instead of a deed), but it is nevertheless the grantor's signature, then even though the deed might be set aside by the grantor himself in an action against the grantee, or even though the grantee might be charged with fraud, the deed should be good as against a subsequent BFP relying on the record.

40. Messersmith v. Smith, 60 N.W.2d 276 (N.D.1953).

PROBLEM 17.17: O conveyed Blackacre, which is vacant land, to A. A did not then record the deed. Later, O conveyed the land to B who had notice of the earlier deed. B recorded. Sometime later, A recorded his deed, and still later, B conveyed the same land to C. C had no notice of the deed to A. A brings suit to quiet title against C. Will he succeed?

Applicable Law: A subsequent purchaser is not charged with notice of a prior deed or other instrument which is out of the chain of title although it may be placed on record. A prior deed recorded after a second deed to the same property from the same grantor is out of the chain of title. If a purchaser finds a conveyance from the owner to his grantor which gives him a perfect record title, he is entitled to rely thereon and is not obliged to search the records further to see if there were any prior deeds recorded out of sequence.

Answer and Analysis

The answer is no according to the better view. For C to prevail in either a notice or race-notice jurisdiction he must, of course, qualify as a BFP without notice of A's deed. If the contest were between A and B, A would clearly win since B had notice of A's deed. But B recorded before A, and then conveyed to C. At the time C entered the picture, A's deed was filed for record. Looking at the recording statute literally, it might appear that A would be preferred since at the time C entered the picture the prior deed to A had been placed on record, and A had not been divested by the conveyance to B, who took with notice.

However, the realities of tracing title through grantor-grantee indices suggest that C should win. The recording of A's deed out of turn puts it out of the chain of title, since a subsequent purchaser such as C would not be likely to find it in tracing title from O. In checking such title, C would find first the conveyance to B. If thereafter C ignored O on the reasonable assumption that O having conveyed once would have no further title to convey, C would never find the prior deed to A. Thus, C does qualify as a subsequent BFP without notice of the prior deed to A, which is outside the chain of title.

This rule gives due consideration to the practicalities of tracing title. It has also been applied to successive mortgages in the above situation, but the rationale as to mortgages is less sustainable. For example, after O mortgages to A, O still has a substantial interest in Blackacre which is subject to further mortgage or conveyance. Hence, a subsequent person such as C would not be as justified in ignoring O after he finds first the recorded mortgage to B. Of course, C, in taking an assignment of the mortgage from B is

primarily interested in getting a first mortgage and not a junior one. Hence, it is logical to say that he can disregard O after finding the recorded mortgage to B since C is interested only in getting a first mortgage. Having found that B was the first mortgagee, all that concerns C is to be sure that B did not assign the mortgage to someone else. The leading case of Morse v. Curtis[41] did apply the doctrine of chain of title to mortgages in this situation. There is a little authority to the contrary, which regards such out of turn recordings as within the chain of title.[42] This position can be criticized because it imposes a great burden on the title examiner.

The obverse of the situation in problem 17.17 is this one: O sells Blackacre to A; A does not record. O then sells Blackacre to B, a BFP who records promptly. B would thus prevail against A. However, thereafter B sells to C who has actual knowledge of A's interest. This case is governed by the so-called "shelter" rule that once a bona fide purchaser has acquired a title protected under the recording acts, that person is entitled to pass his title on to others. Thus, C will prevail because C's grantor was B, and B would have prevailed over A in a title dispute.[43]

Incidentally, many courts hold that a subsequent purchaser is entitled to protection under the recording acts only if the previous documents in the chain of title were recorded. For example, suppose that O gives A a mortgage on Blackacre. A does not record. Then O sells Blackacre to B by a deed not excepting the mortgage. B does not record either. Now B sells to C who records promptly. Then A records the mortgage and thereafter B records his deed. Who wins in a dispute between A, the mortgagee and C?

In a race-notice jurisdiction A wins because a title search by C at the appropriate time would have revealed that B had no record title. As a result C is not really a BFP "without notice," and he is protected, if at all, only by the recording acts. Thus we revert to common law priorities and A wins.[44]

In a pure notice jurisdiction the outcome might be different, for A's interest would lose to B the instant B purchased, whether or not B recorded first. Under the "shelter" rule B could pass his title on to C; or, to look at it another way, once B acquired his interest A had nothing left to record.

41. 140 Mass. 112, 2 N.E. 929 (1885).

42. E.g., Woods v. Garnett, 72 Miss. 78, 16 So. 390 (1894).

43. Corey v. United Savings Bank, 52 Or.App. 263, 628 P.2d 739 (1981) (even though the defendant had actual notice of an unrecorded access easement, the defendant's grantor was a BFP without notice; D was sheltered by his grantor's protection). See Cross, The Record "Chain of Title" Hypocrisy, 57 Col. L. Rev. 787 (1957).

44. See Zimmer v. Sundell, 237 Wis. 270, 296 N.W. 589 (1941) (one who purchases from a stranger to the title not protected by recording statute).

PROBLEM 17.18: L owned 2 parcels of adjoining land. She conveyed one parcel to M, covenanting that she would not convey the other parcel unless the grantee entered into a covenant similar to that contained in the deed from L to M with respect to certain building restrictions. L's heirs conveyed the other parcel to G without inserting the covenant. The deed to M was duly recorded. G had no actual knowledge of any restrictions upon the land conveyed to him. G brings an action for breach of covenant for title against L's heirs. Will he succeed?

Applicable Law: There is a conflict of authority as to whether the term subsequent purchaser as used in the recording acts means only subsequent purchaser of the same land or whether it means subsequent purchaser from the same grantor. Under the latter view, the subsequent purchaser is charged with notice of servitudes or encumbrances contained in deeds out by a common grantor when such encumbrances affect the land he is purchasing. Under the former view, the subsequent purchaser is charged with notice of encumbrances which appear only in recorded documents pertaining to direct chain of title, i. e., the very land he is purchasing.

Answer and Analysis

The answer depends upon the jurisdiction. Of course, for G to be obligated to observe the building restrictions, he must take with notice of the restriction in the deed from L to M. Since G had no actual notice, the question is whether he is charged with constructive notice under the recording act of the covenant in the deed from L to M. Under one line of authority he is charged with such notice.[45] Under this view, G must not only check to see that his grantor had not conveyed the very parcel of land which he is acquiring, but also must check deeds out from the common grantor to see that in conveying such neighboring land the grantor did not impose a covenant or servitude which affects the remaining land and which is ultimately conveyed to him. Thus, under this view, G takes with notice of the prior servitude. Therefore, his land is so incumbered, and he does have an action against his grantors for breach of the covenant against encumbrances.

Under the other view, G is charged with notice only of those things appearing in his direct chain of title.[46] Under this view, G

45. E.g., Guillette v. Daly Dry Wall, Inc., 367 Mass. 355, 325 N.E.2d 572 (1975) (requiring the purchaser to search both chains); Stegall v. Robinson, 81 N.C.App. 617, 344 S.E.2d 803 (1986) (same; subdivision covenant).

46. E.g., Puchalski v. Wedemeyer, 185 A.D.2d 563, 586 N.Y.S.2d 387 (App. Div.1992) (refusing to require the purchaser to search both chains of title); Witter v. Taggart, 78 N.Y.2d 234, 573 N.Y.S.2d 146, 577 N.E.2d 338 (1991) (same).

need only check prior recorded deeds of his grantor to see that the land he is purchasing has not been previously conveyed. He need not check the contents of the other deeds out by a common grantor. Under this view since G did not have actual notice of the servitude, he takes free therefrom. Thus, the grantors did not breach the covenant against encumbrances, and G has no action.

The question presented in this problem is sometimes stated in terms of the meaning of "subsequent purchaser" under the recording act. Does the term refer to a subsequent purchaser from the same grantor or simply to a subsequent purchaser of the same land? As indicated previously, the courts take different positions, some thinking that the burden is too great to require a purchaser to examine prior deeds out by a common grantor; others take the contrary viewpoint.

CHART COMPARING RECORDING ACTS

Hypothetical I:

1. O, owner of Blackacre, executes and delivers to A a deed conveying Blackacre to A. A does not record.

2. O, then executes and delivers to B a deed of the same land and at that time B knows of A's prior unrecorded deed.

3. B records his deed.

4. B executes and delivers to C a deed of the land and C does not know of A's prior unrecorded deed.

5. A then records.

6. C then records.

At the end of each numbered transaction the location of title would be as follows under the various recording acts:

Steps	1	2	3	4	5	6
Notice	A	A	A	C	C	C
Reason	Rec'd not necessary between the parties	B not a BFP	B not a BFP	C is a subseq. BFP	C is a subseq. BPF	C is a subseq BFP
Race	A	A	B	C	C	C
Reason	Same as above	B did not record	B recorded first	Because B had title-chain of title concept	Because B had title-chain of title concept	Because B had title
Race-Notice	A	A	A	C	C	C
Reason	Same as above	Both of the above	B not a BFP	Subseq. BFP who can rely on B's record	Subseq. BFP who can rely on B's record	Subseq. BFP who can rely on B's record

Hypothetical II:

1. O, owner of Blackacre, executes and delivers to A a deed conveying Blackacre to A. A does not record.

2. O then executes and delivers to B a deed of the same land. B does not know of A's prior unrecorded deed. B does not record.

3. A then records his deed.

4. B then executes and delivers to C a deed to Blackacre. C does not record.

5. A then deeds Blackacre to D who does not know of either B or C. D does not record.

6. B then records.

7. C then records.

8. D then records.

At the end of each numbered transaction the location of title would be as follows under the various recording acts:

Steps	1	2	3	4	5	6	7	8
Notice	A	B	B	C	D	D	D	D
Reason	Rec'd not necessary between the parties	He is a subseq BFP	B was a subseq BFP	C gets B's title	Most subseq BFP	Need not record as to prior parties	He had already divested C's title	was subseq BFP and has now recorded
Race	A	A	A	A	D	D	D	D
Reason	Same as above	Neither recorded so A wins as before	A recorded 1st	A recorded 1st	He gets A's record title	B & C had been divested by A's record	same as ← and chain of title concept	same as ← and D has now recorded
Race-Notice	A	A	A	A	D	D	D	D
Reason	Same as above	Although B is a subseq BFP, he did not record	B did not record 1st	C had constr notice of A's title. A recorded 1st	D is subseq BFP & can use A's recording	Same as ←	Same as ←	D is subseq. BFP and his chain recorded b/4 B's & C's

§ 17.4 Title Insurance

PROBLEM 17.19: A purchased Blackacre in 1994 for $100,000 and took out a title insurance policy in the amount of a mortgage, $60,000. The policy was designed to cover defects in the title or failure of title, but it contained an exception for "easements, liens or encumbrances not shown by the public records." Thereafter, A finds that the land is subject to a prescriptive easement that reduces its value from $100,000 to $30,000. Can he recover? If so, how much?

Applicable Law: Title insurance policies are contractual in nature. Although most courts indulge the presumption that they are to be strictly construed against the insurer, they generally insure only what they say they insure (subject to state regulation, which may require them to insure against certain kinds of losses).

Answer and Analysis

The answer in most states is that A will not recover anything. Although title failed, the defect was not "shown by the public records."[47] A may, of course, have a claim against his grantor or even a prior grantor under a deed covenant (See § 17.1), but not under this particular title policy.

Suppose that the easement was in fact recorded and thus covered by the policy? Would A be any better off with the title insurance policy than he would be with a general warranty deed? In some respects, yes. First of all, the title company is generally under a duty to defend the insured from claims arguably covered by the policy. Thus, if the claim is based on a recorded easement, probably covered by the policy, it would be the insurer's obligation to defend. If the claim were based on a prescriptive easement, not covered by the policy, the insurer would probably not have an obligation to defend.

Damages measurement, just as other elements of the policy, is usually contractual.[48] As a general matter the limit of the insurer's liability is the face amount of the policy; so the insurer in the Problem will not have to pay more than $60,000, even though the policy holder's loss was $70,000. One general exception to this rule is that if an insurer unreasonably refuses to defend a claim and title subsequently fails, the insurer will be liable for any amount,

47. See also Ryczkowski v. Chelsea Title & Guaranty Co., 85 Nev. 37, 449 P.2d 261 (1969), holding that a deed recorded outside the chain of title was not satisfactorily within the public record to be covered by the title insurance policy. The decision has been criticized because title insurers as a general matter do not rely on grantor-grantee indexes but on records contained in their own private "title plants," which are almost always tract indexes. As a result, a "wild" deed is ordinarily easy to discover.

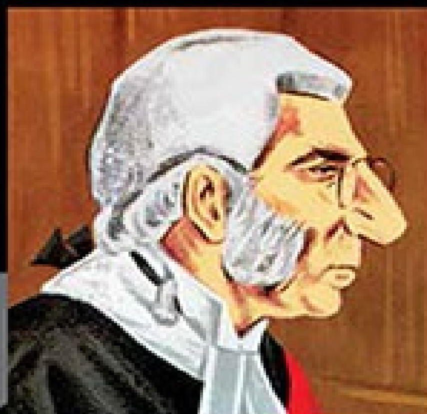
48. But see Jarchow v. Transamerica Title Ins. Co., 48 Cal.App.3d 917, 122 Cal.Rptr. 470 (1975), holding that a title insurer that breached its duty to defend was liable not only for the title loss but also in tort for emotional distress caused by its negligent and bad faith refusal to defend. Jarchow was later overruled insofar as it gave emotional distress damages for a merely negligent refusal to defend: Soto v. Royal Globe Ins. Co., 184 Cal.App.3d 420, 229 Cal.Rptr. 192 (1986) (requiring bad faith and not mere negligence). Other states have refused to follow *Jarchow's* general recognition of tort liability in addition to contract liability. E.g., Brown's Tie & Lumber Co. v. Chicago Title Co. of Idaho, 115 Idaho 56, 764 P.2d 423 (1988) (statute requiring search and examination of title did not create tort duty). See generally Palomar, Title Insurance Companies' Liability for Failure to Search Title and Disclose Record Title, 20 Creighton L. Rev. 455 (1987).

even if it exceeds policy limits. If title fails and an earlier grantor is liable, the title insurer that pays a claim is generally subrogated to any cause of action that the insured had, and may sue for its losses.[49]

Computation of damages is likewise problematic. Is the insurer liable for the full loss up to the limit of the policy, or is it liable only for a percentage of the loss equal to the percentage of coverage that the policy owner purchased? Some courts have held that, for example, if the policy purchaser bought a policy whose face value is only 60% of the purchase price, then the insured should be liable for only 60% of any resulting loss.[50]

49. E.g., Safeco Title Ins. Co. v. Citizens & Southern National Bank, 190 Ga.App. 809, 380 S.E.2d 477 (1989).

50. See Southwest Title Ins. Co. v. Plemons, 554 S.W.2d 734 (Tex.Civ.App. 1977); Southern Title Guaranty Co., Inc. v. Prendergast, 494 S.W.2d 154 (Tex. 1973) (amount recoverable bears same ratio to policy amount as value of outstanding interest to value of fully insured title).



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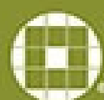

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CHAPTER 11

LAND SALE CONTRACTS, MORTGAGES AND DEEDS

Introductory note: This chapter examines the various steps in the process of transferring (or "conveyancing") land. We examine, in sequence (1) contracts for the sale of land; (2) mortgages (which secure the repayment of loans); and (3) deeds, which are the instruments by which a freehold interest in land is transferred.

I. LAND SALE CONTRACTS

A. Function of a contract: It is theoretically possible for the parties to a commercial land transfer to accomplish the entire transfer in one step. The seller could simply tender his deed, and the buyer could simultaneously hand over the purchase price. If the transaction were handled this way, no ***contract*** to sell land would be necessary.

1. The gap: However, in practice, it is almost always desirable for there to be a ***gap*** (usually a month or more) between the time when the parties agree on a deal, and the time when the title actually passes. During this gap, the buyer typically: (1) arranges financing; and (2) checks the seller's title. For the parties to be bound during this gap, there must be an enforceable agreement between them; this is the purpose of a land sale contract.

B. Statute of Frauds: The ***Statute of Frauds*** is applicable in all states to any contract for the sale of land, or for the sale of any interest in land. Therefore, either the contract itself, or a memorandum of it, must be ***in writing***.

1. Memorandum satisfying: Normally, the contract itself will be in writing, so that the entire agreement of the parties is documented. However, a ***memorandum*** of the parties' agreement, specifying some terms but not the entire oral agreement, may also satisfy the Statute.

a. Elements of memorandum: Generally, the memorandum must state with reasonable certainty the following elements: (1) the ***name*** of each party to the contract; (2) the land to be conveyed; and (3) the

essential terms and conditions. 3 A.L.P. 16.

- **i. Price:** Usually, the memorandum must list the ***purchase price***. However, if the party seeking to enforce the contract can show that the parties did not set a price, and instead agreed that a “reasonable price” would be paid, no statement about the purchase price need appear in the memorandum. 3 A.L.P. 20.
- **ii. Signature:** The ***signature*** of the ***party to be charged*** (i.e., the party against whom enforcement is sought) must appear on the contract. Thus if Seller writes a letter to Buyer, confirming the provisions of their oral contract, this letter can constitute a sufficient memorandum if Buyer seeks to enforce the contract against Seller, but not if Seller seeks to enforce it against Buyer.

b. Intent to make subsequent writing: The parties may sometimes prepare a ***preliminary, informal***, document, while intending to execute a more complete and formal document later on. The fact that the parties intend to execute a later writing does not make the first writing insufficient as a memorandum. However, the intent to make a later writing may constitute ***evidence*** that the parties did ***not intend to be bound*** until they had done so.

c. Broker’s contract as memorandum: A document may satisfy the memorandum requirement even if it was prepared for an entirely different purpose. For instance, a contract between the seller and a ***real estate broker***, authorizing the broker to sell the property on certain terms, might be held sufficient to bind the seller.

2. Contract for brokerage commission: In many states, a contract between an owner and a ***real estate broker*** is brought within the Statute of Frauds. In such states, the broker cannot collect his commission unless he has a written agreement.

3. The part performance exception: There is one major exception to the Statute of Frauds for land sale contracts. Under the doctrine of ***part performance***, a party (either the buyer or seller) who has taken action in ***reliance*** on the contract may be able to gain at least limited enforcement of it at ***equity***.

a. Acts by vendor: If the vendor ***makes a conveyance*** under the contract, he will then be able to sue for the agreed-upon price, even if

the agreement to pay that price was only oral. 3 A.L.P. 26. This can be thought of as use of the part performance doctrine, though technically what has happened is that once the conveyance is made, the promise to pay is no longer within the Statute.

i. **Price is land interest:** However, this exception does not apply if the price is ***itself*** an interest in land (i.e., the deal is an exchange of one parcel for another). 3 A.L.P. 26.

b. **Acts by purchaser:** The courts are in sharp dispute as to what acts ***by the purchaser*** constitute part performance entitling him to specific performance. Here are some of the acts that some courts have deemed to be sufficient part performance:

i. **Possession alone:** In a number of states, it is sufficient that the purchaser has ***taken possession*** of the property, even if the purchaser has done nothing else.

ii. **Possession and payments:** In some states, possession alone is not enough, but possession coupled with ***payment by the purchaser*** is enough.

iii. **Possession and improvements:** In some states, possession accompanied by the making of valuable and lasting ***improvements*** (e.g., construction of a house or garage) is sufficient. This is true in some of the states which also recognize possession with payment as sufficient.

iv. **Change of position:** In some states, the fact that the purchaser has ***changed his position*** in ***reliance*** on the agreement is a factor. In some of these states, this change of position must be accompanied by the taking of possession. In other states, a change in position alone (without taking of possession) suffices, at least where the seller agrees that the oral agreement was in fact made.

Example: Seller and Purchaser orally agree on the sale of Blackacre for $15,000. Purchaser gives Seller a deposit check for $500, but Seller merely keeps the check, without ever endorsing it or depositing it. Neither party contemplates a subsequent written agreement. Purchaser immediately enters into a binding contract to sell his existing house. Seller then reneges, after receiving a higher offer from someone else. Purchaser sues for specific

performance. Seller defends on the ground of Statute of Frauds, but agrees that the oral agreement was in fact made.

Held, Purchaser wins, and specific performance is ordered. Under Rest. 2d of Contracts, §129, "a contract for the transfer of an interest in land may be specifically enforced notwithstanding failure to comply with the Statute of Frauds if it is established that the party seeking enforcement, in ***reasonable reliance*** on the contract and on the continuing assent of the party against whom enforcement is sought, has ***so changed his position*** that injustice can be avoided only by specific enforcement." The facts here satisfy this standard, which the court accepts. *Hickey v. Green*, 442 N.E.2d 37 (Mass. App. 1982).

v. No act suffices: In a few states, there is ***no act of part performance*** that is sufficient to make the oral contract enforceable.

See C&J, p. 989, note 3.

c. "Unequivocally referable" requirement: Courts generally require that the part performance be ***"unequivocally referable"*** to the alleged contract. That is, the person seeking enforcement must show that the part performance was clearly ***in response*** to the oral contract, and not explainable by some other facet of the parties' relationship. This is usually so even though great hardship may result from the court's decision not to enforce the contract.

Example: Suppose that D, an elderly widower, promises P, his adult daughter (or so P alleges), that if P will give up her rented apartment across town, and move in with him to care for him for a wage of $300 per week plus room and board, he will sell P the house for $100,000 (half its true value) in three years. P moves in with D and cares for him for the next two years. D then tells P that he won't be selling her the house at the end of the three years — he denies ever having made the promise. P sues for specific performance of the alleged promise.

A court is likely to find for D, because what P did was not "unequivocally refer able" to the alleged contract. That is, while P is claiming that she "partly performed" (by giving up her apartment, moving in with D and caring for him), her "performance" could

plausibly have been in response to other aspects of her relationship with D, rather than to the alleged contract. For instance, P has been receiving a current salary and room and board, so it's plausible that P did what she did for these benefits alone. Cf. *Burns v. McCormick*, 135 N.E. 273 (N.Y. 1922).

i. **Some flexibility:** Although courts generally recite the "unequivocal referability" requirement, they usually don't enforce it stringently. After all, virtually every act or combination of acts by the person seeking enforcement could be explained by some reason other than an oral contract of sale (e.g., an oral lease). What courts really require is that the acts "***point with reasonable clarity*** to the presence of a contract." C,S&W, p. 666.

ii. **Defendant admits contract:** Furthermore, if the defendant ***admits*** that the oral agreement took place, but nonetheless tries to plead the Statute of Frauds, courts will not generally apply the "unequivocally referable" requirement at all. Thus in *Hickey v. Green* (*supra*, p. 305), the court ordered specific performance even though the plaintiff's act (sale of his house) could have been very plausibly explained by any of a number of other possible reasons apart from the oral deal — the court was heavily influenced by the fact that the seller admitted that the oral agreement had been reached.

4. **Oral modification and rescission:** Where an enforceable land sale contract exists, the courts are split as to whether it may be orally ***rescinded*** or ***modified***.

a. **Rescission:** A slight majority of jurisdictions hold that a land sale contract may be orally rescinded**.**

i. **Minority view:** But a substantial minority of states hold that the ***rescission must be in writing.***

b. **Modification:** The courts are less willing to permit an oral ***modification*** (as opposed to rescission) of a contract. Most courts reason that a contract is the sum of its terms, and that enforcement of a land sale contract some of whose terms are oral (the modified terms) contravenes the policy of the Statute of Frauds. See Rest., Contracts, §223.

i. Estoppel or waiver: Even where the oral agreement to modify is held unenforceable, the ***action*** of one or both parties may constitute an ***estoppel*** or ***waiver***. If a party's oral promise of a modification leads the other party to ***change his position in reliance***, the former likely to be estopped from denying the enforceability of the modification (or, what amounts to the same thing, held to have waived the term of the original contract claimed to have been modified).

(1) Retraction: One important difference between a binding modification and an estoppel or waiver, is that an estoppel or waiver (but not a modification) can be ***retracted***, so long as the other party has not yet ***changed his position in reliance***.

C. Time for performance: The sale contract will normally provide a ***"settlement date,"*** i.e., a date upon which the closing, or passing of title, is to occur. If one party fails to complete the closing on the appointed day, the question arises whether she is liable for breach of contract, and whether she has lost her rights under the contract.

1. Suit for damages: In a suite for ***damages*** (i.e., a suit brought at law rather than in equity), the time stated in the contract will be deemed to be ***of the essence***, unless a contrary intention appears. 3 A.L.P. 118. Thus if Seller refuses to close on the appointed day, Buyer may bring a suit for damages for the delay, even if it is only a few days. Conversely, Seller may sue Buyer if the latter delays; in this case, the recovery would presumably be for the interest which Seller could have gotten on Buyer's money had the closing taken place as scheduled.

2. Suit at equity: But in a suit ***in equity*** (i.e., a suit for specific performance), the general rule is that ***time is not of the essence***, unless either:

[1] there is an ***express provision*** in the contract making time of the essence; or

[2] such a provision may be fairly ***inferred*** from the ***nature of the property*** or of the ***surrounding circumstances***.

3 A.L.P. 118.

a. Right to close late: The default rule that time is not of the essence means that generally, even though the contract specifies a particular

date for the closing, either party may obtain ***specific performance*** although he is unable to close on the appointed day. (However, the defaulting party must be ready to perform within a ***reasonable time*** after the scheduled date.)

i. Can benefit either buyer or seller: This rule — that a party doesn't lose the right to specific performance for delay if time is not of the essence — can benefit ***either*** a buyer or a seller. Thus a ***buyer*** who is unable to procure the necessary financing until several days after the scheduled closing date may obtain a court decree ordering a sale to him; conversely a ***seller*** who is unable to clear his title until several days late may gain a decree ordering the purchaser to go through with the transaction.

b. Surrounding circumstances: The ***surrounding circumstances*** may indicate that the parties intend time to be of the essence. For instance, in a period when prices are fluctuating widely, a court may conclude that, although the contract is absent on the issue, the parties intended time to be of the essence. Such intent may also be found when one party is very concerned about a prompt closing and the other party knows of this concern. C,S&W, p. 704.

c. Unilateral action: Some courts hold that where the contract does not explicitly make time of the essence, ***either party***, by a ***unilateral notification*** to the other that it will insist upon strict adherence to the contracted for settlement date, may make time of the essence. However, the notification must be given at least a reasonable time before the scheduled closing date.

d. Waiver: Even where time would otherwise be of the essence, a party may ***waive*** his right to assert that fact. For instance, if a party agrees (even orally) to adjourn the closing, he will not be allowed to claim, after the original settlement date, that the other party has defaulted. But such a waiver may be ***retracted*** as long as the other party has not yet relied to his detriment. See 3 A.L.P. 122-23.

e. "Time of the essence" clause: The parties are free to change the above default rules governing when time is of the essence by ***specifying*** whether time should or should not be of the essence. Thus a clause stating that "time is of the essence" will normally be ***enforced***, both at law and in equity.

f. Consequences: Where time *is* of the essence (either because of contractual language or circumstances), that fact will be damaging to a party — whether buyer or seller — who is not ready and able to perform on time.

i. Consequences to late seller: A ***seller*** who does not tender timely performance faces several bad consequences if time is of the essence:

[1] the seller ***loses the right to obtain specific performance*** against the buyer (assuming that specific performance would otherwise be granted; see *infra*, p. 313);

[2] the ***buyer can cancel the contract*** and recover his earnest money deposit;

[3] the buyer probably can ***elect to get specific performance*** against the seller; and

[4] the buyer can ***recover money damages*** to the extent that the delay caused monetary loss to the buyer (a consequence that would occur even if time was *not* of the essence).

ii. Consequences to late buyer: Conversely, if it is the ***buyer*** who does not tender timely performance (i.e., does not timely tender the purchase price) in a deal in which time is of the essence, the buyer faces these consequences:

[1] the ***seller can cancel*** the contract and refuse to convey even if the buyer is now willing to close;

[2] the seller will probably be able to ***get specific performance*** ordering the buyer to tender the purchase price;

[3] the buyer ***loses his right to compel specific performance***; and

[4] the seller ***can recover money damages*** against the buyer for the delay, and/or keep the deposit.

g. No margin for error: Where time is of the essence, the standard is an extremely harsh one: even a delay of a ***single day*** may well be held to be a breach of a time-is-of-the-essence provision. Certainly the court will ***not*** consider whether the delay has risen to the level of "unreasonable," because the idea behind time-of-the-essence is that either party is entitled to insist on ***strict compliance*** with the time

limit.

D. Marketable title: In the vast majority of cases, the contract will require the vendor to convey a ***marketable***, or ***merchantable, title***. However, the courts are not in agreement as to the circumstances in which this obligation arises, or on what exactly a marketable title *is*.

1. Implied in contract: If the contract is ***silent*** on the issue of the kind of title to be conveyed by the vendor, an obligation to convey a marketable title will be ***implied***.

a. Quitclaim deed: The parties, are, of course, free to provide that something less than a marketable title will suffice. For instance, if they call for a ***"quitclaim deed,"***[1] this will typically indicate an intent not to require marketable title.

2. General definition of "marketable title": Although courts may disagree as to whether a title is marketable on a particular set of facts, most courts agree on the general ***standard*** for determining marketability. As one court has put it, a marketable title is one which is ***"free from reasonable doubt*** both as to matters of law and fact, a title which a ***reasonable purchaser***, well informed as to the facts and their legal bearings and willing and ready to perform his contract, would, in the exercise of that prudence which businessmen ordinarily bring to bear upon such transactions, ***be willing to accept*** and ought to accept." *Robinson v. Bressler*, 240 N.W. 564 (Nev. 1932).

a. Reasonable person standard: Thus it is ***not*** sufficient that a court would probably hold the title good in a ***litigation***. The title must be ***free from reasonable doubt*** so that the buyer will be able to resell in the future. If, in the particular community, title examiners have set certain informal standards (e.g., that no title is good so long as there is a recorded mortgage without a recorded discharge), a court is likely to hold that a title failing to meet these informal standards is not marketable, even though the court might well decide in the vendor's favor if he brought a quiet title action effective against the whole world.

i. Need not "buy a lawsuit": As the idea is often put, the purchaser should not be required to ***"buy a lawsuit"***.

3. Deducible of record: In most courts, the validity of the title must be

apparent ***from the record***, without resort to unrecorded documents or other external evidence. Again, the rationale for this is that when the purchaser wants to resell, he should not have to present unrecorded documents, or procure testimony, to show that what appears on the record to be bad title is in fact good title. Thus in most courts the vendor may not establish marketability by an unrecorded deed, or by showing that title vested in a predecessor by adverse possession.

4. **Insurability:** The fact that a title company is willing to ***insure*** the title is ***not*** by itself sufficient to make the title marketable. (For one thing, a title company will insure almost any title so long as the policy excepts listed defects as found in the title company's search.) However, the parties are free to specify in their contract that all that is required is a title which is insurable by a designated company with designated exceptions.

5. **Defects making title unmarketable:** There are a large number of different defects which might make a title unmarketable, and it is not feasible to list them all here. However, some of the more important types of defects may be summarized. These can be divided into broad classes: (1) defects in the record chain of title; and (2) encumbrances.

   a. **Defects in the record chain of title:** Anything in the prior chain of title indicating that the vendor does not have the ***full interest*** which he purports to convey may be a defect.

      i. **Variation of names:** Thus a substantial variation between the ***name*** of the grantee of record in one link and the name of the grantor in the following link is a defect.

      ii. **Misdescription:** A substantial variation in the ***description of the land*** between one deed and the next may be a defect.

      iii. **Not suitable for recordation:** If one of the deeds was ***defectively executed***, so that it was not eligible for recording (even though it was in fact recorded), this will be a defect. Thus an ***unnotarized or unwitnessed deed***, in many states, renders title unmerchantable. (But so-called "curative acts" in many states make such technical defects irrelevant after a short number of years following filing; see *infra*, p. 367.)

      iv. **Adverse possession:** Where the title is required to be marketable

of record, the title will usually be insufficient if it is based on ***adverse possession***.

b. Encumbrances: Even though the vendor may have valid title to the property, it may be subject to ***encumbrances***, a class which includes such things as mortgages, liens, easements, equitable restrictions and encroachments.

i. Mortgage: An outstanding ***mortgage***, of course, constitutes an encumbrance making the title unmarketable.

(1) Right to pay off at closing: However, the vendor has the right to ***pay off the mortgage at the closing***, out of the sale proceeds (though the purchaser has the right to insist that this be done simultaneously with the closing, rather than subsequently). So the fact that a mortgage exists — at least where it's for ***less than the anticipated purchase price***— won't render title unmarketable prior to the closing date, if the seller credibly indicates that he'll pay the mortgage off at the closing. (As to the special problems of mortgages where the contract is an installment contract, see *infra*, p. 311.)

ii. Liens: ***Liens*** against the property are likely to constitute an encumbrance. For instance, ***unpaid taxes***, judgments obtained by creditors, or mechanic's liens filed by persons who have done work on the property, may all constitute defects. (Again, however, the vendor has the right to pay these off at the closing.)

iii. Easements: An ***easement*** will be a defect, if it reduces the ***"full enjoyment"*** of the premises. (But if the easement was notorious and visible, the purchaser will probably be deemed to have seen it, and to have agreed to take subject to it, when he signed the contract. See 3 A.L.P. 137.)

iv. Use restrictions: Similarly, a privately-negotiated ***use*** restriction (e.g., a covenant whose burden runs with the land, to the effect that only residential structures will be built) can be a defect. However, courts generally regard title as defective only if the use restriction is ***already being violated*** before the sale, or if the use that the seller knows the buyer is proposing to make would violate a use restriction.

Example: All deeds in Blackacre Village, which consists of 20 homes, contain a legally enforceable covenant that each lot will be used only for single-family residential purposes. Sell, the owner of one such house, signs a contract to sell the property to Purch, with Sell promising to deliver marketable title. Since the covenant is in accordance with the present single-family use of the house, and since Sell has no reason to believe that Purch is planning to use the property for something other than single-family purposes, the existence of the covenant will *not* be deemed to render Sell's title unmarketable.

v. **Encroachments:** An ***encroachment*** by a neighboring landowner (e.g., a driveway or part of a building running onto the vendor's own land) will constitute a defect, if it interferes seriously with the use and enjoyment of the premises. 3 A.L.P. 140. Conversely, if one of the structures on the vendor's land seriously encroaches onto a neighbor's property, title will also be unmarketable. *Id.*

vi. **Land-use and zoning violations:** A violation of land-use restrictions that are imposed by ***law*** (as opposed to restrictions privately-agreed upon) may or may not be treated as encumbrances.

(1) **Building codes:** Most courts hold that violations of ***building codes*** are ***not*** encumbrances on title. C,S&W, p. 729.

(2) **Zoning violations:** But a violation of a ***zoning ordinance*** usually ***is*** treated as an encumbrance. C,S&W, p. 730.

6. **Time when title must be marketable:** Unless the contract specifies otherwise, the vendor's title is not required to be marketable ***until the date set for the closing***. Thus the vendor may sign a contract to sell property which he does not yet own, and the purchaser cannot cancel the contract prior to the closing date because of this fact. 3 A.L.P. 141.

a. **Outstanding mortgage:** Similarly, the fact that there is an ***outstanding mortgage*** on the property is not an encumbrance — as long as the mortgage is not in default (and the contract price is greater than the amount of the mortgage), so that the owner has the right and probable ability to pay off the mortgage at the closing, the mortgage's existence does not prevent title from being marketable.

i. **Installment contracts:** Suppose that the contract is an ***installment agreement***, by which the vendor is required to convey title only after all installments of the purchase price have been paid. Unless the buyer can carry the burden of showing ***reasonable and serious doubt*** about whether the seller will be ***able and willing to make the mortgage payments while the contract is in force***, the fact that there is an outstanding mortgage won't render title unmarketable. So, for instance, if the outstanding mortgage principal is considerably less than the present value of the property, and the seller has never missed mortgage payments in the past, the buyer probably won't persuade the court that the seller's title is not marketable. Cf. S&W, p. 784.

E. The closing: At the ***closing***, the seller tenders his deed, and any other documents required by the contract or by local custom (e.g., a bill of sale for any personal property involved in the transaction, a satisfaction of mortgage indicating that the mortgage has just been paid off, etc.). The buyer checks each of the proffered documents, and when he is satisfied that everything is in order, tenders payment.

1. **Tender:** In the usual transaction, the seller's duty to deliver the deed and the buyer's duty to pay the money are ***concurrent***. Therefore, if one party is expected to default, the other party must be sure to ***tender his own performance***, in order to be able to hold the other party in default, and sue for damages and/or specific performance. The party who tenders must also make a formal ***demand*** that the other party ***perform***. If the non defaulting party *doesn't* tender performance, she is likely to be found to have waived her right to claim damages for the default (and may lose her right to reclaim any deposit).

Example: Seller and Buyer contract for the sale of Blackacre, closing to occur April 1, for $300,000. The contract requires Seller to deliver marketable title, and time is of the essence. On March 30, Buyer notifies Seller (accurately) that Seller's garage encroaches 2 feet onto Neighbor's property, and that Buyer will not close on April 1 because of the lack of marketable title. (Buyer knew about the defect as early as March 1, but said nothing to Seller until March 30. If Seller had been notified of the encroachment by, say, March 10, there is a good chance he could have purchased the 2-foot strip from Neighbor for a

nominal amount, and thus cured the problem.) On April 1, Buyer does not show that he has the $300,000 purchase price available.

If Buyer sues for damages for Seller's failure to deliver marketable title, Buyer will probably lose. That's because (1) Buyer failed to tender performance on the closing date; and (2) Buyer's failure to tender cannot be excused as a futile act, because had Buyer given reasonable notice of the encroachment problem, Seller could likely have cured it before the closing date. Conversely, if Seller can show that he could have cured the defect with reasonable notice, Seller may have a claim for default against Buyer, since Buyer didn't tender performance.

a. **Effect of other party's repudiation:** But a tender is necessary only where there is some chance that it would be effective. Thus if the other party has ***repudiated***, or if the other party's inability to perform is ***incurable*** (as would have been the case in the above Example if it was clear that Neighbor wouldn't sell Seller the strip for a plausible price), no tender and demand for performance is necessary. See 3 A.L.P. 148.

F. **Remedies for failure to perform:** Where one party fails to perform a land sale contract, there are two distinct remedies which may be available to the other party: (1) a suit for ***damages***; and (2) a suit for ***specific performance***. (Both of these types of relief may generally be sought in the same proceeding, although sometimes an actual award of one will preclude the other.)

1. **Damages:** In nearly all situations, when one party breaches a land sale contract, the other may sue for ***money damages***.

a. **Measure for damages:** In most American jurisdictions, the ***measure of damages*** for breach of a land sale contract is the ***difference between the market price and the contract price*** (sometimes called the ***"benefit of the bargain"*** rule). Thus if the seller breaches, the buyer can recover the amount by which the market value exceeded the contract price; conversely, the seller can recover from a defaulting buyer the amount by which the contract price exceeded the market value. See 3 A.L.P. 170-72.

i. **Time for measuring:** As of ***what time*** does the difference between the market price and the contract price get calculated? The

prevailing answer is, ***"at the time of the breach."*** So where the buyer breaches, and the seller doesn't make a "covering" sale of the property until considerably later, the price eventually received by the seller may not be a good indication of market value at the time of the breach. See, e.g., *Jones v. Lee*, 971 P.2d 858 (Ct. App. New Mex. 1998) (price received by the non-breaching seller at some unknown time after the buyer's breach was merely non-binding evidence as to market value at the time of the breach, which is the time that mattered).

b. **Liquidated damages:** The parties are always free to agree, in the contract, upon ***liquidated damages*** in the event of a breach. The most common example of such a clause is one providing that if the buyer defaults, the seller may ***keep the buyer's deposit***, or earnest money.

2. **Specific performance:** In the vast majority of cases, an action for ***specific performance*** may be brought against the defaulting party, whether she be vendor or purchaser. A decree of specific performance is a court order requiring the defendant to go through with the transaction (to convey the land, if the defendant is the vendor, or to pay the purchase price, if the defendant is the purchaser).

a. **Equitable remedy:** Specific performance is an ***equitable remedy***. However, whereas equitable remedies (especially injunction) in other contexts are allowed only where a damage action would be inadequate, a less strict rule is followed in real estate specific performance cases. Courts reason that the buyer should not be relegated to a damage claim because ***each piece of land is "unique"***; conversely, the seller should not be limited to a damage action because this leaves him with the burdens of owning and maintaining the land (e.g., paying taxes). 3 A.L.P. 173.

b. **Where not allowed:** However, there are a few circumstances in which all or some courts ***refuse to allow specific performance***.

i. **Hardship on one party:** Since specific performance is an equitable doctrine, it will not be granted where this would result in ***undue hardship*** or unfairness to one party. This might be the case, for instance, if the ***circumstances changed*** substantially between the time the contract was signed and the closing date (e.g., zoning of the parcel changed, so that the buyer's proposed use became

illegal).

ii. **Unmerchantable title:** If the seller's title is unmarketable (and the defect cannot be cured by a simple application of the sale proceeds), the court will not, of course, grant the seller a specific performance decree against the buyer for the entire purchase price.

(1) **Deduction:** But the court may, if the defect is not too grave, grant such a decree with a ***deduction for the defect***. 3 A.L.P. 178.

iii. **Suit by buyer:** If the seller's title is defective, and it is the ***buyer*** who brings the suit for specific performance, it will generally be granted to him (probably with an abatement of the purchase price to reflect the defect). If the defect is one which could easily be cleared up, the court may, as part of its decree, order the seller to do this.

3. **Two measures not always inconsistent:** Obviously a party to a breached contract is not entitled to be made more than whole. This means that he may obtain specific performance or damages for the difference between market price and contract price, but not both. However, a party who obtains specific performance may nonetheless be entitle to ***incidental*** damages (e.g., losses directly resulting from the delay in obtaining possession). 3 A.L.P. 182.

4. **Purchaser's rights to recover deposit:** Suppose the purchaser has paid an earnest money ***deposit***; may he recover this sum? Obviously if the seller is in default, the buyer can get his money back as part of his damage or specific performance action. But suppose the seller is not in default, time is of the essence, and the buyer fails to pay the balance on time.

a. **Where contract doesn't contain liquidated damages clause:** First, let's assume that the contract does not contain a liquidated damages clause — in other words, the contract does not say what happens to the deposit in the event of a breach by the buyer. In this scenario, most modern courts seem to allow the breaching buyer to ***recover that part of his deposit that is in excess of the seller's actual damages***. See, e.g., *Kutzin v. Pirnie*, 591 A.2d 932 (N.J. 1991), so holding.

i. **Restatement rule:** This is also the rule imposed by §374(1) of the

Second Restatement of Contracts. Under that section, the breaching buyer is "entitled to restitution for any benefit that he has conferred by way of part performance or reliance in excess of the loss that he has caused by his own breach."

ii. **Rationale:** Why should the breaching buyer get part of his deposit back? Professor Williston answered the question this way: "[T]o deny recovery [in this situation] often gives the [seller] ***more than fair compensation*** for the injury he has sustained and ***imposes a forfeiture*** (which the law abhors) on the [breaching buyer]." (Quoted in *Kutzin, supra*.)

b. **Contract contains liquidated damages clause:** But in the vast majority of sale contracts today, the deposit functions like an advanced-paid ***liquidated damages clause***. That is, the contract typically says that in the event of a breach by the buyer, the seller can keep the deposit. The question is whether such a forfeiture clause is enforceable, or is instead unenforceable as a penalty. The answer mostly turns on the reasonableness of the deposit as an ***estimate*** of the seller's likely damages.

i. **Reasonable estimate:** If the deposit is a ***reasonable estimate*** (viewed *either* as of the time the contract was made or at the time of suit) of the damages that the seller would likely incur if the buyer breached, most courts will hold that it is ***not a penalty***, and will allow the seller to ***keep*** the full amount. That's true even if, by the time of suit on the deposit, it's known that the seller suffered smaller damages than the amount of the deposit, or even no damages at all.

ii. **Unreasonable estimate:** But if the deposit is so ***large*** that it is ***neither*** a reasonable estimate of seller's actual damages viewed as of the moment of the contract signing nor a reasonable estimate of his actual damages viewed as of the time of the suit, nearly all courts will ***refuse to enforce it***, on the grounds that it is a ***penalty***.

(1) **10% down payment:** The most common deposit amount in residential-real-estate contracts is ***10%***, so a liquidated damages clause that calls for the seller to keep the 10% if the buyer defaults is likely to be ***upheld*** as a reasonable estimate.

G. **The equitable conversion doctrine:** During the gap between the signing

of the contract and the delivery of the deed, important questions about the rights of the parties may arise. For instance, the property may be ***destroyed*** during the gap, one of the parties may die, or either party's assets may be subject to collection attempts by creditors. Issues raised by these situations have traditionally been dealt with by reference to the doctrine of ***equitable conversion***.

1. **General meaning of doctrine:** As we saw previously, courts of equity will grant either party to most land sale contracts the relief of ***specific performance*** of the contract. The doctrine of equitable conversion builds on this rule, on the theory that "if there is a specifically enforceable contract for the sale of land, equity regards as done that which ought to be done." DKA&S, p. 483. Therefore, "the buyer is viewed in equity as the ***owner from the date of the contract*** (thus having the ***"equitable title"***); the seller has a claim for money secured by a ***vendor's lien*** on the land." *Id*.
2. **Effect of party's death:** The equitable conversion doctrine is often applied to resolve questions of how property passes upon the ***death*** of either the vendor or vendee.
   a. **Vendor dies testate:** For instance, if the ***vendor*** dies ***with a will***, and leaves his real property to one person and his personal property to another, the equitable conversion doctrine is likely to have an important effect. If the will was drawn ***prior to the making of the contract***, and the contract was still executory at the moment of the vendor's death, then the equitable conversion doctrine applies so that: (1) ***the purchase price goes to the person to whom the personal property was bequeathed***; and (2) ***the person to whom the real estate was bequeathed gets nothing.***
   b. **Death of purchaser:** If the ***purchaser*** dies while the contract is still executory, the equitable conversion doctrine applies so that: (1) the person entitled to receive the decedent's real estate (either under the will or under the intestacy statute) is entitled to the land; and (2) the recipients of the personal property not only do not receive the land, but must pay any remaining portion of the purchase price out of their shares of the estate. See Cribbet, p. 191.
3. **Risk of loss:** The most important, and difficult, issue regarding equitable conversion involves the ***risk of loss***, i.e., the risk that the

property will be injured or destroyed between the signing of the contract and the delivery of the deed. Courts have followed three main approaches to this problem:

a. **Loss always on vendee:** A majority of states have adopted the traditional English view that, since the vendee acquires equitable ownership of the land as soon as the contract is signed, ***the risk of loss immediately shifts to him***. This is true even though the vendee ***never takes possession*** prior to the casualty.

   Example: D contracts to sell land to P. Prior to the delivery of the deed, and while D is still in possession, an ice storm damages all the pecan trees on the property, reducing its market value by $32,000.

   Held, the loss falls on P (who does not get back his earnest money, and who has to pay damages for refusing to go through with the contract). In Georgia, as in most states, the doctrine of equitable conversion means that the risk of loss passes to the vendee as soon as the contract is signed; no exception is made merely because the vendee has not yet taken possession. *Bleckley v. Langston*, 143 S.E.2d 671 (Ga. 1965).

   i. **Exception:** But courts applying this majority rule recognize an exception to it: the vendor will bear any loss which results from his ***neglect***, default, or unreasonable delay in carrying out the contract.

   ii. **Unmerchantable title:** Also, the vendor must bear the loss if, at the time it occurred, he was not in a position to convey the title which he had contracted to convey (e.g., because his title was ***unmerchantable*** due to, say, tax liens). In such a situation, the purchaser is not regarded as the "equitable owner" of the property, since he could not be forced in a specific performance suit to pay full price for the defective title; see B,C&S, p. 978-79, note 2.

b. **"Massachusetts" view:** A minority of courts adhere to the so-called ***"Massachusetts" rule*** (based on an early Massachusetts decision): the burden of loss remains on the vendor ***until legal title is conveyed***, and ***even though the purchaser is in possession***. These courts more or less ignore the equitable conversion doctrine, and rely upon the idea that continued existence of the subject matter is an implied condition

of the contract.

c. **Risk on party in possession:** A third view holds that the risk of loss is on the vendor so long as he remains in possession and has title, but that it then ***shifts to the purchaser if the purchaser takes possession or title***. This is the approach taken by the Uniform Vendor and Purchaser Risk Act, in force with some variation in eight states (including California, Illinois, Michigan and New York).

Note: Regardless of which of these approaches a particular jurisdiction follows, the parties are always free to make an *explicit agreement* resolving the issue in any way they wish.

4. **Effect of insurance on risk of loss:** Our discussion of the risk of loss thus far has ignored any effect which might flow from the fact that one party had ***insurance*** on the premises. The courts are in dispute on this issue, just as they are on the risk of loss question where no insurance is present.

a. **Vendor takes out insurance:** The issue arises most frequently where insurance is carried ***by the vendor*** in his own name. In a situation where the risk of loss is on the purchaser, most courts ***give the purchaser the benefit of the vendor's insurance***.

i. **Rationale:** The rationale for this majority rule is that otherwise, the vendor will receive a large ***windfall***: he will receive the full purchase price, plus the insurance proceeds. Therefore, the vendor is deemed to hold the insurance proceeds in a ***"constructive trust"*** for the vendee. Instead of receiving the proceeds, the vendee is simply given an abatement of the purchase price equal to the amount of the insurance.

b. **No duty to insure:** Keep in mind that, even in courts following the majority rule, the vendor is ***not under any duty*** to keep insurance in force on the property. Thus it makes sense for the purchaser to insist on a clause in the contract requiring such insurance to be maintained on the premises for the purchaser's benefit.

H. **Assignment of contract rights:** Unless the contract provides otherwise, ***either party may assign his rights*** under it. In this respect, a contract for the sale of land is no different from any other contract. Thus the seller may, prior to the closing, sell the property subject to the outstanding

contract rights. Conversely (and more commonly) the purchaser may assign to a third person the right to pay the purchase price and receive the deed.

1. **Prohibition on assignment:** However, the parties to the sale contract sometimes insert a clause purporting to ***prohibit assignment***.

   a. **Enforcement at law:** Generally speaking, such an anti-assignment clause will be ***enforced by a court of law***. Thus if the contract provides that any assignment will be of no effect, the seller may sue the buyer who has tried to assign, and recover legal damages.

I. **Real estate broker's role:** Most sales of real estate involve a real estate broker. Detailed coverage of the law of real estate brokerage is beyond the scope of this outline. However, we can discuss briefly a few of the common issues in this area.

1. **What the broker does:** Normally, the broker makes his money by receiving a commission after the buyer and the seller he has brought together consummate a sale. In most instances, it is the ***seller who pays the commission***. Also in most instances, the broker does his work pursuant to an exclusive listing arrangement between him and the seller; generally, this agreement entitles him to be paid even if another broker, or the seller himself, finds the eventual buyer. (Note that the seller's liability for the broker's commission can be limited in the brokerage contract by agreement between the broker and the seller.)

2. **"Ready, willing and able":** If the broker finds a buyer who in fact goes through with the transaction, the seller will clearly be liable. However, the law in nearly all states has traditionally been that the broker is also entitled to his commission merely by finding a buyer who is ***"ready, willing and able"*** to consummate the transaction — in other words, the broker who finds such a buyer can collect his commission ***even if the transaction never goes through***. (All this assumes, of course, that the prospective buyer produced by the broker is willing and able to do the transaction ***at the price***, and ***on the terms***, that the seller has set.)

   a. **Seller's default:** So if the transaction ultimately fails to go through because the seller has changed his mind prior to a contract, or has defaulted after entering into a contract, all courts continue to hold that the broker may collect his commission. After all, in this instance consummation of the deal was within the seller's own control, so he

should clearly not be able to escape his brokerage obligation.

3. **Scope of broker's duty:** The broker will typically have a ***fiduciary duty*** to the party on one side of the transaction.

   a. **Two types of brokers:** Before we review what the broker's fiduciary duty is, and to whom, we have to distinguish between two types of brokers, the so-called ***"listing broker"*** and the ***"selling broker."***

      i. **Listing broker:** The ***listing broker*** is the broker who ***contracts directly with the seller*** to list the property (e.g., by putting it into a Multiple Listing Service), and to try to get it sold.

      ii. **Selling broker:** The ***selling broker*** is a broker whose primary day-to-day relationship is ***with the buyer***, and whose relationship with the seller is only indirect. The selling broker typically meets with a potential buyer and shows her various potential properties. If the potential buyer makes a purchase, the selling broker typically gets compensated by receiving a ***portion of the listing broker's commission***. DKA&S, p. 466.

   b. **Duties of listing broker:** The listing broker's ***sole fiduciary duty is to the seller***. This makes intuitive sense, since the seller has directly hired the listing broker as the seller's agent.

   c. **Duties of selling broker:** The more confusing issue — at least to people outside the real estate industry — is the fiduciary duty of the ***selling*** broker. Most buyers think that the selling broker that they are working with has a fiduciary duty to them. But this is not correct — under the standard compensation arrangement, the selling broker, like the listing broker, ***owes a fiduciary duty solely to the seller.*** This duty stems from the fact that the selling broker is, technically speaking, a ***"subagent"*** of the listing broker. Since the listing broker owes a fiduciary duty only to the seller, and since all compensation to the selling broker comes in the form of a portion of the listing broker's commission, the selling broker's fiduciary obligations ought to be, and are, the same as the listing broker's, i.e., entirely to the seller.

      Example: The Ps are brothers and sisters who have inherited a family home from their parents. The Ps consult with Schwartz, a local broker, to get advice about marketing the home for sale. Schwartz consults with the Ds, who are two brokers active in the local market.

Schwartz and the Ds agree to a “co-broke arrangement,” whereby the Ds will receive from Schwartz half of the commission if a client of the Ds buys the property. Schwartz then, at the Ds' request, signs a listing agreement with the Ps giving Schwartz an exclusive 24-hour right to re-sell the house for $125,000. The Ds do not contact any of the potential buyers that the Ds have previously identified as being possibly interested in the property. Nor do the Ds disclose to the Ps how much the Ds think third-party buyers might pay for the property. Instead, within the 24-hour listing period, the Ds' make their own offer of $115,000. The Ps, believing that this represents the market value of the property, contract to sell it to the Ds for that amount. The Ds then (that same day) contract to sell the home to a third-party buyer, X, for $160,000. Six days after the Ds close on their purchase, they “flip” the property to X, making a $45,000 gain on their six-day cash investment of $11,500. (X is a neighbor of the Ps, who had been previously known to the Ps as a potential buyer, but who the Ps had instructed Schwartz not to contact.) When the Ps learn of this profit, they sue the Ds for breach of what the Ps say was the Ds' duty to get the best possible price for the Ps.

Held, for the Ps. “A real estate broker is a fiduciary. … As such, he … ‘cannot put himself in a position antagonistic to his principal's interest.’ “The fact that here the Ds contracted with Schwartz doesn't matter: “A real estate broker acting as a subagent with the express permission of another broker who has the listing of the property to be sold is under the *same duty* as the primary broker to act in the utmost good faith.” This fiduciary obligation means that “upon hearing that a more advantageous sale … can be made, the facts concerning which are unknown to the principal, the broker has the duty to communicate these facts to the principal before making the sale.” Therefore, the trial court correctly ordered the Ds to pay the Ps the $45,000 profit they had earned by this breach of fiduciary duty. *Licari v. Blackwelder*, 539 A.2d 609 (Conn. Ct. of App. 1988).

II. MORTGAGES AND INSTALLMENT CONTRACTS

A. Two devices to secure repayment: Normally, the purchaser is not sufficiently liquid to be able to pay the entire purchase price at once.

Therefore, it is necessary for him to find some device by which to pay the purchase price over a period of time. Beyond the portion of the money which the purchaser is able to pay right away, the remainder of the price must in effect be lent either by the vendor or by some third party; in either case, the lender will want ***security*** for repayment. There are two basic approaches to securing repayment: (1) the ***mortgage***; and (2) the ***installment sale contract***.

B. Nature of a mortgage: If the buyer does her financing via a ***mortgage***, she receives a deed to the property immediately. At the same time, she executes the mortgage. In a conventional third-party mortgage, the buyer gives the mortgage to a commercial or savings bank, and the loan proceeds are paid to the seller at the closing; the seller is thus out of the picture. In the case of a ***purchase money mortgage***, by contrast, the financing is being done by the seller; that is, the buyer pays the seller a down payment, and gives him back a mortgage for the remaining price. Regardless of the type of mortgage, the essence of the transaction is that if the buyer fails to make the payments, the lender may ***foreclose*** on the property itself (and thus is not required to depend on the personal credit of the buyer). Foreclosure is discussed further *infra*, p. 323.

1. Key terms: As a matter of nomenclature, the following are some key terms: (1) the borrower, who gives the mortgage, is called the ***"mortgagor"***; (2) the lender, who has the benefit of the mortgage, is the ***"mortgagee"***; and (3) the mortgagor is said to retain ***"equity"*** in the property (an abbreviation for the "equity of redemption," discussed further *infra*, p. 322).

2. Two documents: There are two documents associated with nearly every mortgage: (1) the ***note*** (or "bond"); and (2) the ***mortgage*** itself.

a. The note: The ***note*** is the buyer's personal promise to make the repayments. Since the note is not an interest in land, it is not recorded. But it serves an important function: if there is a foreclosure against the property, and the foreclosure sale does not yield at least an amount equal to the outstanding mortgage debt (including accrued interest), the note will serve as the basis for a ***deficiency judgment*** against the borrower. This is because the note represents a personal obligation of the borrower, not merely an obligation to be repaid out of the land.

b. Mortgage: The ***mortgage itself*** is a document which gives the lender

a claim against the land for the repayment of the amount loaned. All right of foreclosure comes from this document, not from the note. Since the mortgage in effect gives the mortgagee an interest in the land, the mortgage is ***recorded***.

3. **Sale or transfer of mortgaged premises:** Usually when mortgaged property is sold, the mortgage is ***paid off*** at the closing. One reason for this is that if the mortgage has previously been partially paid off, or the land has appreciated in value since the mortgage, the mortgage will probably not meet the financial requirements of the new buyer (since it will be for too small an amount relative to the purchase price). The second reason is that the mortgage may contain a "due on sale," or "acceleration" clause (discussed further *infra*, p. 326). Nonetheless, there are times when the property is sold without paying off the mortgage; this can be done either by: (1) having the purchaser take "subject to" the mortgage; or (2) having the purchaser actually "assume" the mortgage.

   a. **Sale "subject to" mortgage:** If the purchaser merely takes ***"subject to***" the mortgage, he is ***not personally liable*** for payment of the mortgage debt. Of course, if he wishes to keep his equity in the property, he will have to make the payments, since otherwise the mortgagee will foreclose. But if the mortgagee does foreclose, and the property does not bring enough in the foreclosure sale to pay off the outstanding mortgage debt, the mortgagee may ***not sue the purchaser for the balance***. (The mortgagee may, however, sue the original mortgagor for this balance, since the sale of the mortgaged premises does nothing to the mortgagor's personal liability.)

      i. **Payments in "subject to" scenario:** If the purchaser does not assume the mortgage, the mere fact that the purchaser then ***makes several mortgage payments*** does ***not*** change the basic fact that the purchaser is not liable for any deficiency. In other words, only an ***express promise*** to assume (i.e., to pay the mortgage) will create in the lender the right to get a deficiency judgment against the purchaser.

      ii. **"Due on sale" clause makes no difference:** The fact that a mortgage contains a ***"due on sale"*** clause ***doesn't*** mean that one who purchases the property subject to the mortgage becomes

personally liable. A “due on sale” clause provides that if the mortgagor sells the mortgaged property, the mortgagee can require that the mortgage debt be ***immediately repaid*** in full. Due on sale clauses are common, and are fully enforceable. But such a clause does not give the lender a right to seek payment from the purchaser personally (i.e., the right to a deficiency judgment), if the lender did not already have that right because of an assumption of the mortgage debt by the purchaser.

b. Assumption of mortgage: It is usually in the original mortgagor's interest to persuade the new purchaser to ***assume*** payment of the mortgage. This has the effect of making the purchaser ***liable*** for payment of the mortgage, both to the original mortgagor, and to the mortgagee (probably as a third-party beneficiary). The advantage to the mortgagor is that the foreclosure mortgagee is likely to seek a deficiency judgment against the assuming purchaser before coming after the mortgagor; also, if the mortgagee does get a deficiency judgment against the original mortgagor, the latter can in turn sue the assuming purchaser.

i. Receipt of deed with assumption clause: The buyer will be deemed to have assumed the mortgage if she ***accepts a deed*** that contains a statement that the buyer assumes the mortgage. This is true even if the buyer ***does not sign the deed***, because agreements to assume a debt are not within the Statute of Frauds and thus can be made orally or by conduct. (But the buyer will be liable only if she ***intended*** to assume the mortgage debt, so if she can show that she was not aware of the assumption clause in the deed she received, she will not be liable.)

c. Novation: Occasionally, the mortgagor may get the mortgagee to ***substitute*** the new purchaser for the original mortgagor's own personal liability. This means that not only is the new purchaser personally liable for the mortgage, but the original mortgagor is completely ***off the hook***. Such a substitution is called a ***novation***. (Needless to say, mortgage lenders are generally not overly enthusiastic about such transactions.)

4. Assignment of mortgage: The mortgagee will often wish to liquidate his interest by ***selling the mortgage*** to someone else. Indeed,

government-sponsored corporations like “Fannie Mae” (Federal National Mortgage Assoc.) exist for the sole purpose of enabling banks to write mortgages and immediately sell them to the corporation.

a. **Transfer of mortgage and note:** Normally, the purchaser of the mortgage will insist on receiving an assignment of both the mortgage instrument and the note.

b. **Transfer of mortgage only:** As noted earlier, the mortgage exists only as security for the debt. Therefore, a mortgage ***cannot be transferred independently of the debt***. Any transaction which purports to transfer the mortgage without the note is void.

c. **Transfer of note alone:** But a transfer of the ***note without the mortgage*** is not void. Instead, the mortgage is deemed to pass with the note. Thus even if the buyer receives only the note, he will be able to foreclose on the mortgage if the payments are not made. (However, it is desirable for the purchaser to obtain the mortgage, so that he may record it; otherwise there is a chance that subsequent *bona fide* purchasers or mortgagees may cut off his interest.)

5. **No automatic right to prepay:** The mortgagee has the right to have his money earning interest for the entire term of the mortgage, unless the parties agree otherwise. Thus the mortgagor does not automatically have the right to ***prepay*** the full principal before the maturity date.

a. **Prepayment clause:** Therefore, the mortgagor should attempt to insert a clause in the mortgage giving him a ***right of prepayment***. In many states, the mortgagor is required to be given this right as a matter of law after a certain period (e.g., after the first two years). The matter is frequently handled by charging the mortgagor a prepayment ***penalty*** (e.g., six-months interest); the penalty often declines the longer the mortgage has been in force.

6. **Mortgage to secure someone else’s debt:** A person may grant a mortgage on her own property to secure repayment of ***someone else’s debt.*** Rest. 3d (Mort.), §1.3. In other words, the mortgagor does not need to ***receive any direct benefit*** for granting a mortgage.

7. **Absolute deed as substitute for mortgage:** Sometimes an arrangement that is really in economic function a loan is cast in the documents as a ***sale by the borrower to the lender,*** together with some sort of

repurchase right by the borrower. Where this happens, courts will treat the arrangement as ***being a mortgage***, and the lender will ***have to use foreclosure procedures.***

a. **Oral right of repurchase:** That's true even if the borrower's right of re-purchase was granted ***orally*** rather than in a writing signed by the lender. In other words, in this special situation where there is clear evidence that what was intended was a financing device rather than a sale, the Statute of Frauds will ***not be applied*** to the borrower's repurchase option, and the repurchase option will instead be treated as a mortgagor's right of redemption (see *infra*, p. 322).

Example: Investor pays Owner $200,000, and Owner simultaneously conveys Blackacre to Investor. The parties intend this as a financing device. They do this by orally agreeing, at the same time as the conveyance, that if before the first anniversary of the conveyance Owner pays Investor $200,000 plus a 10% profit, Investor will re-convey Blackacre to Owner.

If Owner doesn't make the payment on time, the court will treat this as a mortgage. The consequence is that Investor won't be able to just sit on the deed — instead, Investor will have to start state-law foreclosure proceedings, and Owner will have until the end of those proceedings to pay Investor the $100,000 + 10% and get the property back.

8. **Redemption of mortgage:** When the mortgage is paid off, the property is said to have been ***"redeemed"*** from the mortgage.

a. **"Equity of redemption":** Before the mortgage has been paid off — up until the moment when a foreclosure sale is completed if the mortgagor defaults — the mortgagor is said to have an ***"equity of redemption,"*** i.e., the right to pay off the mortgage and own the property outright.

b. **Who has right:** Any party with an interest in the property has the right to pay off the mortgage, and thus redeem the property. So a ***fractional owner*** (say, one of three tenants in common) has the right to pay off the entire mortgage, as does a junior mortgagee, the holder of a long-term lease on the property, etc.

i. **No redemption until entire mortgage paid off:** But a fractional

owner does ***not*** have the right to pay off ***just his "fractional portion"*** of the mortgage and thereby redeem his equity (i.e., get free-and-clear title to his fractional interest). Instead, the mortgagee (the lender) is entitled to keep a mortgage on the ***entire property*** for as long as she is owed a single penny. This means if one fractional owner is unwilling or unable to pay his pro rata share of the mortgage, any other fractional owner risks losing his entire interest unless he is prepared to step in and pay off the entire mortgage.

9. **Mortgagee in possession:** There are a few situations in which the mortgagee will be entitled to ***take possession of the property*** before the mortgage is paid off or the property foreclosed upon. If the mortgagee does so, he is referred to as a ***"mortgagee in possession."***

   a. **Abandonment:** The most important scenario in which the mortgagee will have the right to take possession prior to a complete foreclosure proceeding is the ***"abandonment"*** scenario. That is, if the mortgagor stops paying and ***abandons the premises***, the mortgagee is entitled to take possession and administer the property to maintain the value of his security interest.

   b. **Missing payments not enough:** But the mere fact that the mortgagor has ***stopped making payments,*** standing alone, does ***not*** entitle the mortgagee to take possession.

   Example: Own, owner of a home, borrows $200,000 from Bank, secured by a mortgage. If Own misses several mortgage payments, this will entitle Bank to start foreclosure proceedings, and to declare the whole principal due (assuming, as is likely, that the note contains an acceleration clause). But it will *not* entitle Bank to immediately oust Own and take possession. However, if Own moves out without putting someone else in possession, then this abandonment *will* entitle Bank to take possession immediately, even before completing foreclosure proceedings.

   c. **Duties of mortgagee in possession:** Once the mortgagee takes possession, he has ***duties*** that are roughly parallel to those of the actual owner. For instance, he must ***maintain the property in***

reasonable condition, and must credit any rents (less reasonable expenses of managing and repairing the property) against the mortgage debt.

C. Foreclosure: ***Foreclosure*** is the process by which the mortgagee may ***reach the land*** to satisfy the mortgage debt, if the mortgagor defaults.

1. Modern-day foreclosure: Foreclosure ***by sale*** has become the standard means of foreclosing mortgages in America. Since it will frequently be the case that the property is worth more than the outstanding mortgage debt (i.e., that the mortgagor has some "equity" in the property), ***foreclosure by a public sale preserves the mortgagor's right to receive the excess.*** Also, it safeguards him from being unfairly held for a deficiency judgment.

a. Judicial foreclosure sale: In many jurisdictions, a foreclosure sale must be conducted under ***judicial supervision***, and is handled by a public official such as a ***sheriff***. The court supervises the advertising done to publicize the sale, and supervises the time and place. Such a "judicial foreclosure sale" requires a ***costly*** and ***time-consuming lawsuit*** by the mortgagee. On the other hand, the mortgagor usually cannot attack the foreclosure sale after the fact (e.g., on the grounds that it fetched an unfairly low price, and deprived him of his equity) if the judicially-supervised procedure is used.

b. Private foreclosure sale: Some but not all jurisdictions give the lender a second way to foreclose: he may conduct a ***private foreclosure sale***, without the need for a formal lawsuit or judicial supervision. In states that allow this method, the lender must usually bargain for it in advance by getting his security in the form of a ***"deed of trust"*** (rather than a "mortgage"). Under the deed of trust, the borrower conveys title to the property to the lender or to a third party, who holds the title in trust; if the borrower defaults, the trustee can sell the land without going to court.

i. Mortgagee's obligation: To prevent the lender from conducting a private sale that fetches an ***unfairly low price*** (so that the borrower either has to pay a deficiency or loses some or all of his equity in the property), statutes and courts in some states that allow private foreclosure sales require the lender to use ***good faith*** and ***due diligence*** to get the highest possible price at the sale. If the lender

does not do this, he may lose his right to a deficiency judgment, and may even have to pay the borrower damages equal to the amount of equity that the borrower would have realized from a properly-conducted sale.

(1) **Illustration:** For instance, in *Murphy v. Financial Development Corp.*, 495 A.2d 1245 (N.H. 1985), the court held that the low price received at foreclosure, when coupled with the fact that the mortgagee knew or should have known that the price was low, meant that the mortgagee failed to do the requisite due diligence when it refused to either set a minimum bid or postpone the sale until more bidders could be found. Therefore, the court awarded the borrowers damages equal to "the difference between a fair price for the property and the price obtained at the foreclosure sale."

(2) **Unusual result:** But *Murphy, supra*, is an unusual case, in that the low price itself, when coupled with the mortgagee's knowledge that it was low, was found to be enough to cause the sale to be invalidated. In most states, a ***mere low price***, even if the mortgagee is aware of it, will ***not be enough*** for the private sale to be invalidated. The borrower/owner must typically show either that the procedures were somehow ***irregular***, or that the bidding was intentionally ***chilled***.

2. **Deed in lieu of foreclosure:** When the mortgagor can't or doesn't want to continue making payments, and the value of the property is less than the outstanding mortgage amount, the mortgagee generally doesn't gain anything by insisting that the lender go through a formal foreclosure process. In such a scenario, the lender and borrower will often agree to an exchange called ***"deed in lieu of foreclosure."*** That is, the borrower conveys full title to the property to the lender, and the lender in return agrees not to pursue a deficiency judgment against the mortgagor for the difference between the present value of the property and the outstanding mortgage debt. DKA&S, p. 553.

3. **Not binding on senior mortgagee:** ***No foreclosure is ever binding on a mortgagee whose interest is senior to the foreclosing creditor's interest.*** In other words, if a ***junior creditor*** forecloses, that foreclosure proceeding can only wipe out the equity and any interest(s) ***junior*** to

that of the foreclosing creditor. See Rest. 3d (Mort.) §7.1 ("Foreclosure does not terminate interests in the foreclosed real estate that are senior to the mortgage being foreclosed").

Example: On April 1, Bank lends *O* $100,000, secured by a promptly-recorded mortgage on Blackacre. On May 1, Finance Co. lends *O* $200,000 secured by a promptly-recorded mortgage on the same property. On June 1, Cred lends *O* $50,000, also secured by a promptly-recorded mortgage. In November, *O* falls behind on the payments to Finance Co. but not the payments to Bank or Cred. Finance Co. starts a foreclosure proceeding, and purports to join Bank and Cred in that foreclosure.

Bank will be entitled to have the action dismissed as to it. Therefore, what will be foreclosed is merely *O*'s equity, plus any interest junior to Finance Co.'s, including Cred's interest. Thus if *X* purchases at a foreclosure sale, *X* will own the property, but subject to Bank's mortgage. And, still assuming that Bank elects not to join the foreclosure proceeding, any amounts paid by *X* will go first to pay off Finance Co., then Cred, then *O*.

4. **Priorities (allocation of foreclosure proceeds):** When a foreclosure sale occurs, the proceeds are distributed in descending order of the claimants, with each mortgagee or lien holder entitled to be satisfied in full before any lower-ranking creditor receives anything. The owner of the equity in the foreclosed property ***ranks last***— that is, she does not receive anything until all persons having a lien or security interest in the property have been satisfied.

   a. **Judgment lien creditor's status:** You may have to worry about the status in a foreclosure of a ***judgment lien creditor*** of the mortgagor. A judgment lien creditor is a creditor who gets a judgment against the mortgagor (typically in an action having nothing to do with the mortgage and perhaps not related to the mortgaged property), and who under state law then gets a lien on all the debtor's real property. The two things to remember about the judgment lien creditor's status are:

      [1] the creditor gets an interest that is ***equivalent to a mortgage***; and

      [2] the priority of that lien (i.e., that mortgage-equivalent) ***dates***

from the day the lien is filed, not the day the underlying debt that is secured by the lien accrued.

b. "Future advances" clauses: You should also be aware of ***"future advances"*** clauses. Under a future advances clause, the borrower and lender agree that the lender at its option may (or in some cases, that contractually it definitely *will*) ***make additional loans***, and that these further loans will be covered by the mortgage. Here are the important principles governing such future advances clauses:

[1] the priority of any later advance ***dates back to the recording date*** of the mortgage; [2] statement #1 is true ***even if no money at all was advanced*** on the date the mortgage was signed and recorded; and

[3] both statement #1 and #2 are true even though the lender had ***no contractual obligation*** to make the future advance.

Rest. 3d (Mort.), §2.1(f), and §2.3 (including Comm. a thereto). A good summary of these rules is that "later-advances clauses are as powerful — as beneficial to the lender — as you can imagine they might be."

Example: Developer owns a parcel, Blackacre, on which she wants to erect an office building, with construction financing from Bank. Therefore, on April 1 Developer and Bank sign a loan agreement in which Bank agrees to make, over time, up to $1 million in total advances to fund the construction of the building; no advance is required to be made by Bank unless Bank, in its sole discretion, is satisfied that Developer has already invested in the construction an amount equal to the requested advance. Simultaneously with this loan agreement, Developer signs a mortgage document, which Bank records on April 1. On May 1, Developer borrows $100,000 from Cred, secured by a mortgage on Blackacre dated and recorded that same day. On June 1, Bank (which is by then aware of Cred's loan and mortgage) makes its first advance, for $100,000, under the April 1 mortgage. Developer defaults on both loans, and both lenders join in a foreclosure proceeding. The property is sold for just $100,000. Who has priority in the proceeds?

Bank has priority. Bank's priority runs from the date its mortgage was recorded (April 1), even though no advance was made until later. Therefore, Bank has priority over the later-made-and-recorded (May 1) Cred mortgage.

c. **Mortgagee can't get excess:** ***No mortgagee can collect more than the amount owed on the mortgage*** (plus expenses of foreclosure, accrued interest, etc.). In other words, any "excess" proceeds remaining after a particular mortgagee has been paid off belong entirely to any junior claimants and/or the equity holder, in descending order of priority. '

d. **Equitable subrogation:** Another doctrine of interest in connection with mortgages is ***equitable subrogation.*** Under that doctrine, a person other than the mortgagor who pays off a mortgage can ***step into the shoes*** of the now-paid-off mortgagee, and maintain that mortgage in place for the payor's benefit, as if it hadn't been paid off. This lets the payor keep the priority level of the paid-off mortgage. Cf. Rest. 3d (Mort.), § 7.6(a).

i. **Where relevant:** The most common scenario for subrogation is where there are ***three creditors*** (let's identify them from most senior as #1 down to most junior as #3). #3 pays off the debt held by #1, and the question then becomes who has priority, #3 or #2? By use of the doctrine of equitable subordination, #3 "inherits" the priority of #1 as if the #1 mortgage had never been dissolved; this lets #3 take ahead of #2. So you should only need to worry about equitable subordination when there are at some point ***three claimants in the picture***.

5. **Acceleration clauses:** A mortgage usually provides that in case of a default, the ***entire principal sum*** shall become immediately due and payable. Such a provision is known as an ***acceleration clause***. If the mortgage did not contain such a clause, the mortgagee would have to start a new foreclosure suit upon each default (and have that proceeding rendered moot by payment of just that outstanding installment).

a. **Waivable:** Most acceleration clauses are drafted so that they may be ***waived*** by the mortgagee. If a waiver provision is omitted, the clause in effect allows full prepayment without a penalty if the mortgagor defaults; the mortgagor might therefore intentionally default, pre-pay

in full, and refinance elsewhere at lower rates.

D. Subprime mortgages and foreclosure during the Great Recession — background: Beginning in about 2000, mortgage lenders made it steadily easier to obtain a home mortgage. The dramatic easing in mortgage credit led in mid-decade to what is usually called the ***"subprime mortgage crisis,"*** in which foreclosures skyrocketed. The subprime mortgage crisis, and the consequent failures of financial institutions like Lehman Bros. that made or heavily invested in mortgages, were a major cause of the "Great Recession" that began at the end of 2007, the steepest economic downturn since the Great Depression.

1. How credit was loosened: It's worth spending a moment describing how this easing of home-mortgage credit took place. There were several big changes:

[1] The ***credit-worthiness*** that a buyer needed to obtain any sort of mortgage was dramatically ***lowered***. Most of this easing took place in the category of "subprime borrowers," that is, the group of borrowers with the weakest credit histories. Additional major growth in loans came through so-called "Alt-A" loans, to borrowers whose credit worthiness was almost but not quite equal to that of traditional "prime" borrowers.

[2] Buyers in the subprime and Alt-A categories were often not required to ***document their income or assets.*** Therefore, these borrowers — often with the express or tacit encouragement of banks and mortgage brokers — often dramatically exaggerated, or even totally falsified, their income and assets on their mortgage applications.

[3] The minimum ***"loan-to-value" ratio*** required by lenders steadily dropped, again with most of the change occurring in the subprime and Alt-A categories. Subprime and Alt-A loans were often made at down payments of 3% or even less-than-zero (whereby the buyer/borrower could borrow not only the entire purchase price but also something for renovations).

[4] Many mortgages were written as ***"negative amortization"*** loans, in which the borrower was permitted to make payments of just a portion of the interest due, with the rest accruing and thus being added to the balance due. These were often combined with low

introductory ***"teaser rates"*** that would reset to higher levels after two years. The combination of the negative amortization and the sudden rise in current interest due once the 2-year teaser period was over meant that unless the borrower could refinance at the end of the teaser period, she would likely lose the house to foreclosure.

See generally Mayer *et al*, "The Rise of Mortgage Defaults", 23 J. Econ. Perspectives 27 (2009).

2. **Price spikes:** Nonprime mortgages (subprime and Alt-A) went from 10% of all mortgage originations in 2003 to 32% by 2005. These mortgages helped fuel a massive spike in American home prices: from early 2000 to early 2006 home prices nationally increased by 89%, as measured by the Case-Shiller National Home Price Index.

   a. **Prices plummet and foreclosures spike:** Then, a vicious combination of an economic slowdown, declining home prices and increasing foreclosures began after 2005. From their mid-2006 high, prices fell nationally by 33% to their (apparent) low-point in mid-2009. *Id*. At the same time, mortgage defaults spiked; for instance, by late 2008 over 23% of subprime mortgages were seriously delinquent. Mayer, *op. cit.* at 28. Meanwhile, new mortgage loans became vastly harder to get.

E. **Foreclosures on subprime mortgages — the judicial response:** State and local governments responded to the subprime crisis and the Great Recession in a number of ways. Of particular interest to us here is that many ***state courts*** began ***scrutinizing the foreclosure process*** much more tightly.

1. **Packaging of loans:** Before we look at these judicial responses, we need to take a look at the modern ***secondary mortgage market.*** Typically, after a lender "originates" a mortgage (i.e., disburses the loan once the borrower has signed the documents), the lender d***oes not keep ownership*** of the loan. Instead, the lender ***sells*** the loan to a ***"packager"*** like Fannie Mae, Freddie Mac or Ginnie Mae.[2]The packager then ***pools*** many loans together, and sells ***bonds backed by the pool*** of loans to hundreds of investors. After this, a servicing company services the loan (by sending bills and collecting payments) under a Pooling and Service

Agreement (PSA).

a. **Consequence:** One consequence of this pooling is that ***later mortgage renegotiations become difficult or impossible***. Because the servicer does not own the loan, a bor rower who hopes to renegotiate the payment terms — something that many borrowers, especially those with "negative equity," have tried to do in recent years — will likely find that neither the PSA servicer or nor anyone else has authority to act on behalf of the "lender," who is not an institution or person as in the old days but is instead a collection of hundreds of bondholders.

Now, we're ready to look at a couple of judicial responses to the mortgage crisis.

2. **Proof that foreclosing bank owns the mortgage:** One response is that courts and other government agencies have begun demanding better ***documentary evidence that the foreclosing creditor really owns the mortgage*** in question. Often, a lender or investor who has purchased a mortgage — perhaps by buying the pool of which that mortgage is a part — has asserted in foreclosure papers that it is the owner, but has failed to attach accurate ***documentary proof*** of the ***chain of title*** by which ownership of the mortgage passed from the original lender to the person now claiming to own it.

   a. **Assignment must have occurred before start of foreclosure:** At least some courts now require the foreclosing lender to show that it took title to the mortgage in question ***before*** starting the foreclosure proceeding, which lenders do not always take the trouble to do. The Massachusetts case described below is the best-known state court case to take this strict approach.

   b. **Foreclosing lender loses after the fact (*U.S. Bank v. Ibanez*):** The Massachusetts case was ***U.S. Bank Natl. Association v. Ibanez***, 941 N.E. 2d 40 (Mass. 2010), a decision of the highest court in Massachusetts (the Supreme Judicial Court or "S.J.D."). The case involved mortgages on two homes, but for simplicity we'll consider just the facts of one mortgage, on a home owned by the Ibanez family. Unfortunately, a fair amount of detail about the underlying mortgage paperwork is necessary for understanding what the S.J.D. decided and

why.

i. Various assignments: When the Ds (the Ibanez family) bought the home in December, 2005, they took out a $103,500 loan from a lender, Rose Mortgage, and gave Rose a mortgage to secure the loan; Rose promptly recorded. Several days later, Rose executed a "blank" assignment (i.e., it signed an assignment on which the assignee's name was blank, apparently because was not yet clear what institution would buy the mortgage from Rose and thus be the assignee). This assignment was not immediately recorded. Some time later, the blank on the assignment was filled in with the name "Option One Mortgage Corp." as assignee. The filled in assignment was recorded in June, 2006. At some point not specified in the opinion (we don't even know whether this was before of after the June, 2006 recording), Option One seems to have made a full assignment to a unit of the Lehman Bros. investment bank ("full" meaning with the name of the assignee specified); that unit then assigned the mortgage to a sister unit of Lehman, and the sister unit eventually assigned to an entity called "Structured Asset."

ii. Pooling into mortgage-backed pool: At this point, Structured Asset pooled the Ibanez mortgage together with about 1,220 other home mortgage loans, and assigned the whole pool to a trust, participating securities in which were sold to investors. (That is, the whole group of mortgages were ***"securitized,"*** i.e., turned into "mortgage pass-through certificates," each holder of which would receive a defined portion of all principal and income payments from the pool.) As part of the securitization process, U.S. Bank was named as the trustee, putting it in charge of "servicing" the underlying mortgages.

iii. Trust agreement never recorded: The trust agreement appointing U.S. Bank as trustee for the certificates was apparently never recorded (and never became part of the record in the lawsuit). But when the mortgage certificates were offered to private investors, the investment bankers prepared a private placement memorandum (PPM) summarizing the trust agreement; the PPM said that the various mortgages that would make up the

collateral for the certificates “will be” assigned to the trust. The PPM eventually became part of the litigation record (though apparently it was never recorded anywhere in the real estate records); but the PPM did not identify *which* particular mortgages were going to be assigned to the trust. Thus by the time the validity of the mortgage procedure was being scrutinized by the Massachusetts courts, those courts had *still* never been given any document listing the Ibanez mortgage as one of the ones assigned to the trust.

iv. **Foreclosure action started by U.S. Bank:** By 2007, the Ibanez family was in default on the mortgage. In June of that year, U.S. Bank, acting as trustee for the trust, published in the Boston Globe newspaper a notice of the foreclosure sale, as required by state law governing foreclosures. The notice identified U.S. Bank as the “present holder” of the mortgage. Under Massachusetts law, this publication effectively began the foreclosure proceeding.

v. **Foreclosure sale:** Then, in July, 2007, U.S. Bank conducted a ***“foreclosure sale”*** of the Ibanez’ home. This foreclosure sale occurred without any judicial oversight, since none was required under Massachusetts law. At the sale, U.S. Bank purchased the property on behalf of the trust for about $94,000, an amount that was (the S.J.C. later found) “significantly less than the outstanding debt and the estimated market value of the property.” At the conclusion of the foreclosure sale, U.S. Bank created a deed, which listed the grantor as being U.S. Bank, trustee, as purported holder of the mortgage, and listed the grantee as being U.S. Bank, trustee, as the purchaser at the foreclosure sale. Then, almost a year later (in May, 2008), U.S. Trust ***recorded*** this foreclosure deed.

vi. **State of the title at this point:** As the SJC's opinion notes, even after U.S. Bank recorded this foreclosure deed, the bank was still not the “record owner” of the mortgage.[3] Thus the opinion says, accurately, that until a later recording of an assignment by Option One (discussed in Par. (vii) below), Option One, not U.S. Trust, continued to be the “record holder” of the mortgage. But as we'll see (in Par. (ix)(2) below), this fact was not fatal to U.S. Bank's

attempt to get a judgment of clear title.

vii. Option One assigns: Finally, on September 11, 2008, a "successor-in-interest" to Option One (American Home Mortgage Servicing) recorded an assignment of the mortgage by itself to U.S. Trust. So it was not until that date (i.e., more than a year after the foreclosure sale was complete) that anyone searching the public records using standard search techniques would have discovered that U.S. Trust was now the record holder of the mortgage.

viii. Suit to clear title: Finally, in September or October 2008, U.S. Trust brought an action in Massachusetts' special "Land Court" to ***quiet title*** to the Ibanez property.[4] The suit asked the court to declare that (1) the Ibanezes had no further interest in the property, and (2) U.S. Trust as trustee for the mortgage-backed securities holders now owned the property free and clear.

ix. U.S. Trust loses: But the Massachusetts courts ***denied*** U.S. Trust the judgment of clear title it sought. At the Land Court trial level, the court rejected the quiet-title action because U.S. Trust had not borne the burden of showing that it was the ***owner of the mortgage*** at the time the bank ***started the foreclosure proceeding.*** And the S.J.C. ***agreed***, based on a careful reading of the Massachusetts statutes governing the foreclosure process.

(1) Must be holder of mortgage at time of foreclosure: The S.J.C. explained that because U.S. Trust had not shown that it was the "holder" (owner) of the mortgage at the ***time it gave notice that it was starting the foreclosure proceeding*** , the bank did not satisfy the state statutory requirements for a valid foreclosure: "The key … is that the foreclosing entity ***must hold the mortgage at the time of the notice of sale*** [.]"

(2) Need not have recorded the mortgage: The court clarified another point: the foreclosing mortgage holder did not have to be the ***record owner*** of the mortgage at the time the foreclosure started. So what was fatal to U.S. Trust's quiet-title claim was not the fact that U.S. Trust failed to *record* its assignment from Option One until long after the foreclosure sale was purportedly complete that. Rather, all that *was*

required was that U.S. trust have been the ***"holder"*** (owner) of the mortgage — whether shown as such on the public records or not — and U.S. Trust could have gained that status only by means of a legally-sufficient assignment. But here, U.S. Trust had never received a ***completed assignment*** (i.e., a properly-executed document naming both the Option One as the assignor, and itself as assignee, and mentioning the Ibanez property) by the time it started the foreclosure of the Ibanez mortgage. Why? Well, since the mortgage here was part of a pooling, Massachusetts law did not require that there be a separate *freestanding* document of assignment — it would have been sufficient had there been a blanket document assigning the entire pool of mortgages from Option One to U.S. Trust, as long as ***each individual mortgage was clearly identified on a schedule*** to the master assigment document. But ***no such blanket document with an adequate schedule existed*** at the time U.S. Trust started the foreclosure by making the publication notice.

x. Practical result: So the Ibanez family achieved at least a partial victory: U.S. Trust, once it was finally (by the time of the S.J.C.'s 2010 ruling) in possession of a proper assignment to it of the mortgagee's rights, would now have to ***bring a new foreclosure suit,*** starting with a new notice-by-publication. This would give the family a new opportunity to come up with the funds needed to pay off the mortgage. If they couldn't do so prior to the new foreclosure sale, they would of course lose the property once again; but they gained more than two years of extra time to arrange a refinancing. (The record does not reflect whether the Ibanezes were able to avoid a second foreclosure and keep their home.)

c. "Robo-signing": In the *Ibanez* case, there was no indication that the foreclosing lenders ever ***misrepresented*** their chain of ownership. But in other Great Recessionera foreclosure cases, many allegations emerged of ***"robo-signing"***— cases in which the foreclosing mortgagee was shown to have ***used forged documents*** to prove that it was the true owner of the mortgage, or ***affidavits*** by bank officers ***falsely certifying they had reviewed the relevant loan documents and determined that the foreclosing party was the true owner***.

i. **Result:** Needless to say, false robo-signed documents cannot be the basis for a valid foreclosure. The mortgage-lending and mortgage-servicing companies came to realize that if they were proven to have engaged in widespread robo-signing in connection with foreclosures, they would have substantial civil, and perhaps criminal, liability. Thus in February, 2012, after being sued by the federal government and 49 states, the five biggest mortgage servicers (all of them large banks) agreed to a ***$25 billion settlement*** to remedy these foreclosure abuses.

d. **Moratorium on foreclosures:** Beyond judicial insistence (as in *Ibanez*) that foreclosing lenders clearly establish title to the mortgages on which they foreclose, there was a second major judicial response to the wave of foreclosures during the sub-prime era: some courts sought to ***slow down foreclosures*** of entire categories of mortgages. Here, too, as in *Ibanez*, the Massachusetts S.J.C. has been in the forefront. Thus in the pre-*Ibanez* case of ***Commonwealth v. Fremont Investment & Loan***, 897 N.E.2d 548 (Mass. 2008), the S.J.C. upheld the state Attorney General's attempt to ***impose a moratorium*** on the ability of a particular lender, Fremont, to foreclose on a broad category of subprime loans it had written in the state.

i. **Facts:** The Attorney General identified a category of adjustable rate subprime loans by Fremont whose combination of features made it "almost certain the borrower would not be able to make the necessary loan payments, leading to default and then foreclosure."[5]

ii. **Holding:** The court agreed with the Attorney General that these loans constituted an ***unfair and deceptive trade practice***, outlawed by state law. Therefore, the court upheld the trial court's injunction under which Fremont was ***not permitted to foreclose*** on any of these loans without first trying to reach agreement with the Attorney General on a non-foreclosure restructuring of the loan, and then, if such an agreement couldn't be reached, obtaining the trial court's approval for foreclosure.

F. **Installment contracts:** Land, like personal property, can be bought under an ***installment contract***. Such a contract provides for a down payment, with the balance of the purchase price to be paid in installments (usually

monthly). What makes such an arrangement different from a purchase money mortgage (the other principal means of seller-financing) is that the buyer does ***not receive his deed*** until ***after*** he has paid all, or a substantial portion, of the purchase price.

1. **Why used:** A buyer almost never uses an installment contract when there is some other financing solution. Such contracts, like their counterparts in the personal property area, are typically used by buyers who have poor credit and no ability to make more than a small down payment; for such buyers an installment arrangement is the only hope of someday gaining title to real estate.

2. **Forfeiture:** The most important practical difference between mortgages and installment contracts is the consequences of a ***default***. If the mortgagor fails to make his payments, the mortgage must be foreclosed, pursuant to a whole array of statutory and judicial safe guards (involving substantial expense to the mortgagee). Where the installment buyer defaults, on the other hand, the seller generally just exercised his contractual right to declare the contract ***forfeited***; no judicial proceedings are necessary, and the buyer ends up forfeiting both the property and any payments he has already made.

   a. **Modern treatment of forfeiture:** Until the last few decades, courts tended to enforce installment contract forfeiture clauses as written (unless the court could find that the seller has ***waived*** his right to insist on strict performance, e.g., by accepting last payments in the past). But modern courts have frequently refused to enforce such clauses literally.

      i. **Right to foreclosure safeguards:** For instance, many courts have held that where the buyer has paid a ***substantial portion*** of the purchase price, and the seller would be unjustly enriched by a complete forfeiture, ***statutory foreclosure proceedings applicable to mortgages*** must be used. This effectively gives the buyer an equity of redemption (*supra*, p. 322), so that the buyer gets extra time — all the way until the actual foreclosure sale — to make up the missing payments.

   b. **Defenses to summary proceeding:** Where an installment seller declares the contract forfeited, his next step is to seek to ***evict*** the buyer. To do this, he may usually employ ***summary proceedings*** of

the same sort used to evict a tenant (see *supra*, p. 160).

III. DEEDS

A. Nature of a deed: The deed is the document which acts to ***pass title*** from the grantor to a grantee.

1. Doctrine of merger: The deed typically ***replaces the contract*** as the embodiment of the parties' relationship. Under the doctrine of ***merger***, most obligations imposed by the contract of sale are ***discharged*** unless they are repeated in the deed. See Cribbet, p. 202. Thus if the contract calls for a merchantable title, as embodied in a warranty deed, but the purchaser carelessly accepts a quitclaim deed, the buyer will not be able to sue on the contractual provisions if the title turns to be defective; he is limited to the provisions of his deed. Thus the contract is relevant only during the gap between its signing and the delivery of the deed.

2. The modern deed generally: There are two basic types of deeds: (1) the ***quitclaim*** deed, in which the grantor makes no covenant that his title is good; and (2) the ***warranty*** deed, in which the grantor makes one or more promises about the state of the title. (The various covenants for title which might be made in a warranty deed are discussed *infra*, p. 338.)

B. Description of the property: An accurate ***description of the property*** is clearly one of the most important aspects of the deed. Not only must the description correspond to what the parties actually intend to convey, but it should be worded in such a way that the grantee's title will be merchantable for purposes of a future sale.

1. Types of description: There are several ways of describing land in the deed. Their use varies both according to the part of the country, and according to whether the land is urban/suburban or rural.

a. Metes and bounds: One common method is the ***metes and bounds description***. Such a description begins by establishing a starting point, usually based on a ***"monument"***, i.e., a visible landmark, whether artificial or natural. Then, a series of ***calls and distances"*** is given, each of which represents a line going in a certain direction for a certain distance. Thus a metes and bounds description might, after specifying a beginning point (e.g., the intersection of two particular

streets), state “running thence North 50 degrees 26 minutes 36 seconds West for 273 feet, thence North 59 degrees 30 minutes 8 seconds East for 76 and 37/100th feet,” etc.

i. **Used in east coast:** The metes and bounds description is found most often east of the Mississippi River.

ii. **Must close:** The metes and bounds description must ***“close.”*** That is, by following each of the courses and distances, one must eventually be brought back to the starting point. (However, if the failure to enclose is clearly attributable to a particular clerical error, the court may order the deed reformed or interpreted in such a way that the error is rectified.)

b. **The plat method:** Another common method is the ***“plat”*** method. Recall that a developer who wishes to subdivide his property may record a map, or plat, of that property, which shows the location of individual lots. A recorded plat furnishes a convenient means of describing land; the deed merely refers to, e.g., “Lot 2 in Block 5 in Highwood, a subdivision platted on a map filed in the Officer of the Registrar of the County of Westchester on June 13, 1910.” Anyone reading this description in the records would then look at the recorded map to see exactly where the boundaries of the lot are located.

2. **Inadequate description:** If the description is ***not sufficiently specific or accurate*** to let a court determine what property is meant, the ***entire deed*** will be found to be ***invalid***.

Example: *O* owns a 100-acre farm. He hands a deed covering “the 15 acres along the creek” to his son. There are 25 acres each of which could be said to be “along the creek.” A court is likely to hold that the description is so imprecise (exactly which acres are covered?) that the deed is invalid.

a. **Subsequent actions of parties:** But the court will try to resolve ambiguities, so that it can uphold the deed. In resolving ambiguities, the courts will look to the ***subsequent actions of the parties***. For instance, if either or both have ***physically marked the boundaries*** in a particular way, the court will treat this as some evidence of their intent (particularly if both have agreed on the marking).

b. Construction in grantee's favor: One often-cited canon of construction is that the deed will be interpreted in the way which is ***most favorable to the grantee***. See Cribbet, p. 210. Since the deed is almost always drafted by the grantor, this amounts to the traditional contract rule that a document will be construed against the draftsman.

C. Various formalities: We consider now several formalities required for the valid ***execution*** of a deed.

1. Identification of parties: The deed must correctly ***identify the parties*** (the grantor and the grantee).

a. Void if not satisfied: A deed that does not correctly identify the parties is ***void***, i.e., of no effect at all.

i. Imprecise identification: The deed will also be void if it attempts to identify the parties, but does so in such an ***imprecise manner*** that a court cannot tell with reasonable precision what particular persons or entities were intended. This is most likely to be an issue on the ***grantee*** side (since circumstantial evidence will usually help identify the grantor).

b. Deceased grantee: If the grantee listed on the deed is ***dead*** at the time the deed is "delivered" (see *infra*, p. 335, for a discussion of delivery), the deed is deemed not to identify the parties correctly, and therefore to be ***void***.

c. Non-existent entity: Similarly, if the grantee is a ***corporation*** or other entity that ***does not exist*** at the time the deed is delivered, and never comes into existence, the court will likely hold that the deed is void. S&W, §11.1, p. 811.

2. Signatures: The grantor must place his ***signature*** on the deed. However, any mark intended to authenticate the document will suffice (e.g, an "X" mark if the grantor is illiterate). The signature of the ***grantee*** is ***not necessary***.

3. Seal: At one time, a deed had to have a private ***seal*** affixed to it to be valid. But today, nearly all states have ***abolished*** the seal requirement.

4. Attestation: Statutes in some states require a deed to be ***attested*** to, i.e., ***witnessed*** by one or more persons not parties to the transaction.

5. Acknowledgment: Statutes sometimes require that the deed must be

acknowledged, i.e., ***notarized***. It is only the grantor's signature which must be notarized in such cases. (However, many statutes require acknowledgment and/or attestation only as a prerequisite to ***recording***, not as a prerequisite to the validity of the deed between the grantor and grantee.)

6. **Consideration not required:** But a deed does ***not*** require ***consideration*** to be binding. 3 A.L.P. 287-88. So a deed that is given as a ***gift***, or a deed that ***falsely states*** that it is given in exchange for some ***specified consideration***, will nonetheless be ***valid***.

D. Delivery of deed: For a deed to be valid, it must not only be executed, but also ***"delivered."*** But this "delivery" requirement does not refer solely to physical delivery. The concept of "delivery" includes two sub-requirements:

[1] that there be a ***physical transfer*** of the deed by the grantor to someone else (even if only to an agent of the grantee rather than to the grantee herself); and

[2] that the grantor use ***words or conduct*** evidencing his ***intention*** to make the deed ***presently operative*** to vest title in the grantee.

1. **Presumption of delivery from physical transfer:** ***Physical transfer*** of the deed by the grantor ***to the grantee*** will create a ***strong presumption*** that the "intent to make presently operative" requirement (requirement [2] above) has been satisfied.

   a. **Must take effect immediately:** But never lose sight of the underlying rule: the requirement that the deed be "delivered" is merely an ***abbreviated*** way of expressing the idea that the conveyance does not occur unless the grantor intends that it ***take effect immediately.***

2. **Presumption from fact of recording:** The fact that the deed has been ***recorded*** raises a strong ***presumption*** that the grantor ***intended delivery to occur*** prior to the moment of recording.

   a. **Presumption is rebuttable:** But this presumption can be ***rebutted*** by clear evidence of a contrary intent by the grantor.

   Example: Grantor hands the deed to Grantee, with a side letter that says, "Don't record this deed now, because I don't want it to take effect until I die." Grantee records anyway. Here, the side letter

successfully rebuts the usual presumption that recordation shows the grantor's intent for delivery to have occurred prior to the recording. (Then, if Grantor dies intestate, the deed won't become effective then either, because this sort of “gift conditional on grantor's later death” is not a valid testamentary substitute, under state laws designed to make sure that wills obey certain formalities like being witnessed.)

3. **Request not to record:** We've just seen that if the deed is ***recorded***, this fact raises a presumption of delivery. But the ***converse is not true***— as long as the grantor intends that the conveyance be effective immediately (i.e., intends for delivery to occur now), the fact that the grantor asks the grantee ***not to record*** the deed until some later date ***doesn't prevent immediate delivery*** from occurring. Again, remember that delivery is always a question of the ***grantor's intent,*** and the mere fact that the grantor requests the grantee to wait until recording typically will not mean that the grantor intends for there to be a postponement of delivery.

   Example: *O* hands his son Sam a deed, saying, “I want you to have Blackacre. You can move in tomorrow. But don't record the deed until I've had a chance to tell your sister that I gave the property to you instead of her.” Delivery will be found to have occurred immediately (especially given the strong presumption of present delivery that applies whenever there is a physical transfer of the deed directly to the grantee).

4. **Delivery to agent of grantee:** As long as the grantor intends for delivery to take place immediately, it ***does not matter*** that he ***does not hand the deed physically to the grantee***— any act sufficient to manifest the grantor's ***intent that the deed be immediately effective*** will suffice for delivery. For example, if the grantor hands the deed to an ***agent of the grantee***, with words making it clear that the grantor intends for the transfer to be immediately effective, this will suffice for delivery.

   Example: *O* makes out a deed to Blackacre running “to my son Sam and his heirs.” *O* then hands the deed to his secretary and says “Take this for Sam, I want him to have the property.” *O* dies the next day. The words to the secretary are sufficient to indicate *O*'s intention to

make the gift immediately effective; therefore, delivery will be deemed to have occurred, and the gift will be effective.

5. **Promise of later delivery:** A promise by the grantor of ***later delivery*** typically means that no delivery is meant to occur at the time of the promise. Thus suppose Grantor says something like, "You'll ***get the deed later***, when [event X] occurs." Since Grantor is ***not intending to make a present delivery*** of the deed, ***no conveyance occurs*** at the time of the conversation. Then, if Grantee somehow comes into possession of the deed without the intent of Grantor, that won't change the fact that no delivery has occurred.
   a. **Event later occurs:** Nor will delivery occur when the event that Grantor originally referred to ***eventually occurs***— for delivery to occur, there must be a ***single moment*** when the grantor (i) makes a ***physical transfer*** of the deed to some other person; and (ii) has the ***present intent*** to make the deed ***immediately effective.*** So if the physical transfer of the deed and the enabling event occur at different times, this requirement of ***"simultaneity"*** has never been satisfied.

      Example: Dad says to Son, "Here's a deed to our house. You'll get it when your sister, Sis, moves out to get married." Dad then puts the deed (conveying the house to Son) into a drawer. Sis later moves out to get married, and Son removes the deed from Dad's drawer (without Dad knowing) and records it.

      There has been no delivery. At the time Dad made the "You'll get it when …" remark, the remark showed that Dad had no intent to make the deed presently operative. Then, when the condition occurred (Sis moved out to get married), there was no indication that Dad still had the present intent to make the deed immediately operative, something that's required to exist at the moment claimed to be a delivery. So neither the occurrence of the condition (Sis' move-out), nor Son's act of gaining physical possession of the deed and recording it, had any legal effect, and Dad still owns the house.

6. **Delivery to a third party (escrows):** Suppose physical transfer of the deed is made not to the grantee himself, but to a ***third party,*** to be re-transferred to the grantee if certain conditions are met. Assuming that the third party is not an agent of either the grantor or grantee, the

transaction is referred to as an ***escrow***.

a. **Terminology:** The third party with whom the deed (or any other instrument) is deposited is usually called the ***"escrow agent"*** or ***"escrowee."*** The instruments to him are generally called the "escrow agreement."

b. **Must be to stranger:** The essence of the escrow is that it is held by a party who is a ***stranger to the transaction***. Thus a transfer of the deed to the grantee himself cannot be an escrow; since it cannot be an escrow, in nearly all states conditions upon the effectiveness of the delivery will not be respected.

c. **When title passes:** The deposit of the deed with the escrow agent usually ***does not act to transfer legal title***. Thus legal title remains in the grantor until the performance of the stated ***conditions*** or the happening of the stated ***event***. Burby, pp. 301-02. Once the event or condition occurs, title ***automatically vests in the grantee***; re-delivery of the deed by the escrow agent to the grantee is not necessary (though this re-delivery, sometimes called the ***"second delivery"*** is customary).

   i. **Unauthorized delivery:** Thus if the escrow agent delivers the deed to the grantee before the condition or event has occurred, this delivery is ***ineffective to pass title***.

   ii. **Bona fide purchaser:** What if the grantee in such a case ***records the deed***, and then sells to an innocent third person who buys in good faith and for value (i.e., a ***bona fide purchaser***)? The courts are split on this question, with most of them holding that the original grantor keeps title, and that the *bona fide* purchaser is out of luck.

7. **Subsequent attempt to revoke:** If the delivery is valid, title ***passes immediately*** to the grantee. Thereafter, ***return of the deed to the grantor*** has ***no effect*** either to ***cancel*** the prior delivery or to ***reconvey*** the title to him. 3 A.L.P. 314-15. The only way the title can get back to the grantor is if a ***new, formally satisfactory, conveyance*** (with grantor's signature, attestation, etc.) takes place.

   Examples: Steps like the grantee's ***handing the deed back to the grantor***, or his ***tearing it up***, or his ***falsely stating*** (even in writing) ***that***

he has destroyed it, will not undo the deed's effectiveness.

E. Acceptance: Most courts hold that a deed will not transfer title until it is not only delivered, but ***accepted*** by the grantee. However, such acceptance will be ***presumed*** if (as is usually the case) the conveyance is beneficial to the grantee.

1. **Rights of third party:** The only situation in which an acceptance issue is likely to arise is where the grantee does not immediately ***learn*** of the conveyance, and in the meantime, a third party has obtained rights. For instance, suppose that O executes a deed to *A*, and that O then puts the deed in a safe deposit box. He does not tell *A* about the conveyance, and then dies. In a suit between O's heirs and *A*, the heirs might prevail on the grounds that *A* could not have accepted the deed prior to O's death, because he did not know about it. 3 A.L.P. 333.

F. Covenants for title: Recall that there are two basic classes of deeds: (1) quitclaim deeds, in which the grantor does not make any representations as to the state of his title, but simply passes on whatever interest he has; and (2) warranty deeds, which contain various representations regarding the state of the grantor's title. In this section, we examine the various representations regarding title which are customarily made in a warranty deed; these representations are referred to as "***covenants for title***" or ***"warranties for title."***

1. **Covenants in "warranty deed":** There are six covenants (individually discussed below) which are commonly used. Thus where the contract calls for ***"a general warranty deed"*** without specifying the covenants to be included in the deed, or where the contract calls for a deed "with the usual covenants," the court is likely to hold that the contract requires a deed with all six of these (although some American courts may not require one, the covenant for further assurance).

2. **Six covenants:** The six commonly used covenants for title are as follows:

   a. **Covenant of seisin:** The ***covenant of seisin*** usually means that the grantor is warranting that he ***owns the estate*** he purports to convey. The covenant might be breached, for instance, if the conveyance was of a fee simple, but a third person had an ***outstanding remainder***.

   b. **Covenant of right to convey:** The covenant of ***right to convey*** is

considered by most courts to be the ***exact equivalent*** of the covenant of seisin. 3 A.L.P. 460.

c. Covenant against encumbrances: The covenant ***against encumbrances*** is exactly what the name implies, i.e., a representation that there are no encumbrances against the property. Encumbrances are those impediments to title which do not affect the fee simple, but which diminish the value of the land. ***Mortgages*** and ***easements*** are examples. The various sorts of encumbrances are discussed more extensively *supra*, p. 310, in connection with the definition of marketable title.

d. Covenants of quiet enjoyment and warranty: The covenants of ***quiet enjoyment*** and ***warranty*** are virtually identical today. They do not promise that title is perfect (this is the role of the three covenants already discussed); instead, they constitute a ***continuing contract*** by the covenantor that the grantee's ***possession*** of the land will be defended against claims by third parties in existence on the date of the conveyance. Since they are in effect covenants for continued possession, they will run to future grantees, as is discussed more fully below. See 3 A.L.P. 467.

e. Further assurance: The covenant for ***further assurance*** is not widely used in the U.S. The covenant is a promise by the grantor that he will, in the future, make ***any conveyance necessary*** to give the grantee the full title that was intended to be conveyed. Cribbet, p. 295.

3. When and how breached: The six above covenants can be divided into two broad classes: (1) ***present*** covenants; and (2) ***future*** covenants.

a. Present covenants: The covenants of seisin, right to convey and against encumbrances are ***present covenants***. That is, they are breached, if at all, at the ***moment the conveyance is made***. Therefore, a breach can occur ***even though there is no eviction***. All the grantee needs to do to recover on the claim is to show that, in fact, title was defective on the date of the conveyance.

b. Future covenants: The covenants of quiet enjoyment, warranty and further assurance, by contrast, are ***future covenants***. They are breached ***only when an eviction occurs***.

Example: In 1957, P purchases land from D, and receives a warranty

deed. In 1974, P grants an option on the land's coal-mining rights to X. Thereafter, P discovers that a prior grantor reserved to himself two-thirds of the land's coal rights in a recorded transaction, so P only owns one-third of the land's coal rights. In 1976, P sues D for breach of the covenant of quiet enjoyment.

Held, for D. To recover for breach of the covenant of quiet enjoyment, P must show actual or constructive eviction. Here, there was neither, since no one holding a paramount title interfered with P's right to possess the coal (e.g, by beginning to mine it). Nor is constructive eviction shown by the fact that P has been required to renegotiate his contract with X for a lesser amount. If the mere existence of a paramount title were enough to constitute constructive eviction, the warranty of quiet enjoyment would be indistinguishable from that of seisin. *Brown v. Lober*, 389 N.E.2d 1188 (Ill. 1979).

i. **Constructive eviction:** However, ***constructive*** eviction will suffice for the future covenants. Thus if a third party actively asserts a paramount claim, the grantee is not required to litigate the matter and wait to be forcibly evicted; instead, he may ***purchase the third party's title*** or satisfy the encumbrance in order to avoid eviction.

c. **Statute of limitations:** A key consequence of the distinction between present and future covenants involves the ***statute of limitations***. The statute starts to run on a ***present*** covenant ***at the time the conveyance is made***; the statute starts to run on a ***future*** covenant ***only when an eviction occurs***. Therefore, when a purchaser only discovers a difficulty with title many years after the purchase, she is likely to find that her only hope of relief lies with the future covenants. For instance, in *Brown v. Lober, supra*, P tried desperately to establish a breach of the warranty of quiet enjoyment (a future covenant) because that claim was not time-barred; there clearly had been a breach of warranty of seisin, but that claim had become time-barred long before P discovered the title problem.

4. **No protection against having to defend invalid claim:** None of the six covenants is deemed breached merely because someone ***files a claim*** against the grantee asserting facts that, if proved, would demonstrate that the grantee has been given imperfect title. This means that if, the day after the grantee takes by warranty deed, someone else claims to be

the real owner, and the grantee successfully defends her title, the grantee ***cannot recover the costs of litigation*** from the grantor — ironically, the grantee does worse (at least as far as recovering her costs from the grantor) if she was given good title than if she had been given bad title.

   a. **Summary:** So to summarize, no covenant of title gives any protection at all against the grantee's ***costs in having to defend an invalid claim*** by a third party.

5. **Prior knowledge of defect:** Suppose that the grantee, before he takes his deed, is ***aware*** of a defect. Does he thereby waive the protection of the various covenants with respect to this defect? The issue arises most frequently in the case of the covenant against encumbrances.

   a. **Ordinary rule:** Ordinarily, the rule is that such knowledge does ***not*** nullify the various covenants.

6. **Enforcement by future grantee (running of covenants):** The distinction between the present and future covenants is critical to the issue of whether the covenant ***runs with the land***, i.e., whether it is ***enforceable by subsequent grantees***.

   a. **Present covenants:** Most courts hold that the ***present*** covenants (seisin, right to convey and against encumbrances) ***do not to run with the land***. Since these covenants are broken at the moment of the conveyance, they immediately become ***choses in action*** (i.e., a present right to sue). At common law, such choses in action were not assignable, and the rule against the running of present covenants derives from this fact (even though the prohibition on general assignment of choses has itself been abolished).

   b. **Future covenants:** The ***future*** covenants (warranty, quiet enjoyment and further assurance) are universally held to ***run with the land***. Since these covenants are not breached until there is an actual or constructive eviction, they would be rendered almost useless if a subsequent transfer of the land cut them off.

7. **Measure of damages:** A defect in the title is likely not to be discovered for a substantial period of time following the original conveyance. If the land has increased in value, what ***measure of damages*** may be recovered by the covenantee (or by a subsequent grantee in a case where the covenant runs with the land)?

a. **Majority view:** A substantial majority of courts hold that, if the title proves completely defective, the covenantee may recover the ***purchase price paid***, plus interest. He may ***not*** recover for any ***appreciation*** in the value of the land (or even for the value of the land as it was at the time of the conveyance, if this is greater than the purchase price). A contrary rule would mean that the covenantor's liability is virtually unlimited, a result that is almost certainly not the intent of the parties.

b. **Intermediate transaction:** Where the party suing is not the original covenantee, but a ***remote grantee***, a number of courts have held that this grantee's damages are ***limited to the amount he paid to his own grantor***, if this is less than the amount paid by this intermediate grantor to the covenantor. Thus if O sells to *A* for $10,000, and *A* sells to *B* for $5,000, under this view *B* would be limited to $5,000 damages in a warranty suit against O.

8. **Estoppel by deed:** Suppose that *A* conveys Blackacre to *B* by warranty deed, at a time when *A* does not own Blackacre. If *A* ***later*** acquires Blackacre, many courts hold that title to Blackacre ***immediately passes to B*** by the doctrine of ***estoppel by deed*** (also called the doctrine of after-acquired title). Thus in a sense, the estoppel-by-deed doctrine furnishes *B* with an additional protection growing out of his warranty deed. The subject of estoppel by deed is discussed more extensively in the treatment of recording acts, *infra*, p. 370.

G. Warranty of habitability: Recall that in the landlord-tenant context, the original rule that the landlord makes no implied warranties of ***habitability*** is now widely giving way to the opposite rule. (*Supra*, p. 149.) A similar reversal is occurring in the area of outright sales of residences.

1. **Common-law rule:** At common law, there were no implied warranties of title, let alone of habitability. A home buyer, like any other purchaser of real property, had only the benefit of those covenants which he could induce the seller to place into the deed.

2. **Modern trend:** But beginning in the 1960's, courts began to feel that the old rule of *caveat emptor* was no more appropriate in home-sale cases than in cases involving the sale of personal property (e.g., a car). Today, most states (and nearly all the states that have considered the matter recently) hold that a ***builder/vendor*** makes a warranty of ***quality*** or

skillful construction when it sells a house. D&K, pp. 624-25.

3. **Lender's liability:** Frequently, a developer/builder who sells shoddy homes will go quickly bankrupt. If so, a suit on an implied warranty or on any other theory against him is not likely to be much good. Some courts have held that a ***lender*** who participates closely with a builder may be subject to negligence or implied warranty liability for failing to see that the houses so produced are merchantable.

4. **Used homes:** The courts have thus far almost always refused to allow an implied warranty claim against one who is ***not in the business*** of building or selling homes. As a practical matter, this means that an implied warranty suit generally cannot be brought by the buyer of a ***used home*** against the ***person who sold it to him***.

   a. **Implied warranty suit against builder:** But most courts now allow a purchaser of a used home to sue the ***original builder*** for breach of the implied warranty of habitability, if a defect is latent when the purchaser buys, and appears within a reasonable time after construction. In other words, ***privity of contract*** seems no longer to be generally required for implied warranty of habitability suits. See, e.g., *Lempke v. Dagenais*, 547 A.2d 290 (N.H. 1988), allowing the purchaser of a used home to recover against the builder for pure economic loss, provided that: (1) the defects were ***latent*** at the time the plaintiff purchased, so that they could not have been discovered by a reasonable inspection; and (2) the defect manifested itself within a ***reasonable time*** after construction.

   b. **Concealment:** Also, even a *non*-builder who re-sells a house that he owns may be liable for ***concealing*** a material defect of which he is aware. See *infra*, p. 341.

5. **Commercial buildings:** Courts have thus far almost always ***declined*** to allow recovery based on implied warranty for sales of ***commercial*** structures.

H. Misrepresentation and concealment: A seller of property who ***misrepresents*** the condition of the property will normally be liable to the buyer for damages, under the common-law doctrine of ***deceit*** or "fraudulent misrepresentation". Normally, the buyer will have to show: (1) a ***false statement*** concerning a ***material*** fact; (2) ***knowledge*** by the seller that the representation is false; (3) an intent by the seller that the buyer

rely; and (4) injury to the buyer (e.g., that the house is worth less than it would be had the facts been as represented). See *Johnson v. Davis*, discussed *infra*.

1. **Non-disclosure:** The common law traditionally has ***not*** made the seller liable for merely ***failing to disclose*** material defects of which he is aware. But this seems to be changing: Many if not most states that have recently considered the question now hold that the seller has an ***affirmative duty*** to disclose material defects that he is aware of, and that he will be liable in damages if he does not do so. California, Illinois, Florida and New Jersey are among the states so holding.

   Example: Buyers contract with Sellers to buy their home for $310,000; Buyers put down a $31,000 deposit. Sellers know that the roof leaks, but affirmatively represent to Buyers that the roof is fine. Before closing, Buyers discover a massive leak, and sue for rescission and return of the deposit.

   Held, for Buyers. "Where the seller of a home knows of facts materially affecting the value of the property which are ***not readily observable*** and are not known to the buyer, the seller is under a ***duty to disclose them*** to the buyer. This duty is equally applicable to all forms of real property, new and used." Therefore, Sellers must refund the deposit plus Buyers' litigation costs. *Johnson v. Davis*, 480 So.2d 625 (Fl. 1985).

   a. **Defect could have been found:** Even these modern cases imposing an affirmative duty on the seller to disclose material defects of which he is aware generally find the seller liable only where ***the buyer could not reasonably have discovered*** the defect by reasonable diligence.

   b. **Seller caused the condition:** Courts are especially likely to find the seller liable for mere nondisclosure where the seller has ***brought about the defect or condition.*** For instance, in perhaps the only case in which a court has held that a seller owes the buyer the duty of disclosing the presence of ***ghosts***, the court relied on the fact that the seller had previously encouraged the house's reputation of being haunted (by reporting the ghosts' presence to *Readers' Digest* and to the local press). Therefore, the court concluded, "Defendant is estopped to deny [the ghosts'] existence and, as a matter of law, the

house is haunted." The court then allowed the buyer to rescind the purchase contract. *Stambovsky v. Ackley*, 572 N.Y.S.2d 672 (N.Y.App.Div. 1991).

c. Disclosure statement required: Some states have enacted ***statutes*** requiring the seller to give the prospective buyer a ***written statement*** disclosing facts about the property, including defects.

i. California statute: For instance, Cal. Civ. Code §1102.6 requires disclosure of dozens of facts, including the existence of structural defects, presence of asbestos, radon gas, lead-based paint or other toxics, flooding or drainage problems, and even "neighborhood noise problems or other nuisances." See *Alexander v. McK night*, 9 Cal.Rptr.2d 453 (Cal.App. 1992), holding that this statute imposes on the seller a duty to warn any buyer about ***"problem neighbors,"*** such as ones who hold lots of late-night parties, park too many cars on the property, or retaliate against any neighbor who complains.

2. Doctrine of merger: Traditionally, sellers were often insulated from liability by the doctrine of ***"merger"***. Under the merger doctrine, a contract of sale merges into the deed, and the deed becomes the final expression of the parties' deal. Therefore, even if the seller made representations or gave warranties in the contract, these would be ***extinguished*** when the buyer closed on the deal and took the deed. (See the fuller discussion of merger *supra*, p. 333.) The merger doctrine would seem to prevent recovery under either an implied warranty of habitability theory or deceit theory. But the merger doctrine has fallen into great disfavor, so that few if any courts would use it to prevent such a recovery on grounds of implied warranty or deceit. See D&K, p. 616.

I. Cooperatives and condominiums: A few words should be said about two forms of real property ownership which are becoming increasingly common, particularly in or near major cities. These are the ***cooperative*** and the ***condominium***.

1. Cooperative: The term ***"cooperative"*** is usually used to refer to a means of owning a multi-unit dwelling (ordinarily a traditional apartment house). Typically, the building is owned by a cooperative ***corporation***. Each resident of the building must be a ***shareholder*** in the corporation.

a. **Proprietary lease:** Ownership of the corporate shares does not directly confer the right to occupy a unit, but each shareholder is entitled to enter into a ***"proprietary lease"***, in which the corporation is the lessor and the shareholder is lessee. The lease almost always provide that its continuance depends upon the lessee's continuing to be the holder of the same shares in the corporation.

   i. **Charges:** The lease will also require the lessee to pay various charges. Typically, these include: (1) a fixed monthly amount to pay off the lessee's fair portion of the building's ***mortgage*** interest and principal, if any; and (2) an amount adjusted annually by the board of directors to defray the maintenance and operating costs of the building (the so-called ***"carrying charges"***).

b. **Board's right of approval:** A key feature of the cooperative form of ownership is that the board of directors, or the entire body of shareholders, typically has the right to ***approve or reject*** any proposed ***sale*** of shares in the corporation. Since ownership of shares is a prerequisite to obtaining the proprietary lease, this right of approval gives existing residents of the cooperatives the right to ***select their neighbors***. Courts have generally held that this right of approval is not an unreasonable restraint upon alienation.

2. **Condominium:** The ***condominium***, by contrast, is a form of ownership in which each individual resident holds a fee simple in a certain physical space or parcel, but all the residents collectively own certain ***"common areas."***

   a. **High-rise apartment:** If the property is a conventional high-rise apartment building, the individual resident might own a fee simple only in a defined vertical space, and would not own any part of the ground surface area. The condominium association (which is really just the individual owners acting as tenants in common) then would own the fee simple to the soil and to the stairways, recreational areas and other common areas.

   b. **"Horizontal" management:** In a more ***"horizontal"*** structure (e.g., two-story ***town houses*** spread over a large parcel), each individual resident might own the soil upon which his townhouse stands, but he would not own the surrounding lawns, swimming pool, etc.; these would be held by the condominium association.

c. Charges: In either event, the association sets charges to defray the cost of maintaining the common areas. But maintenance of the interior living unit (probably including plumbing and heating systems, in a townhouse arrangement) is the responsibility of the individual resident.

IV. CONVEYANCING BY WILL: ADEMPTION, EXONERATION AND LAPSE

A. Conveyancing by will generally: There are three commonlaw doctrines that are specific to conveyances of property by ***will***:

❑ ***ademption***;
❑ ***exoneration***; and
❑ ***lapse***

B. Ademption: The common-law doctrine of ***"ademption"*** deals with those cases in which a testator makes a devise of specific property — personal property or realty — and the specific property is ***no longer part of the testator's estate*** at the time of death. The ademption doctrine says that the bequest ***completely fails*** in this situation, and the legatee ***gets nothing.*** The specific gift is said to have "adeemed," i.e., failed.

> **Example:** At the time Test writes her will, she owns Blackacre. The will recites that Test "hereby bequeaths Blackacre to my daughter Dee." The will gives all other real and personal property to Test's son Sam. One year later, Test sells Blackacre for $400,000, and does not modify the will. Test then dies. At common law, Dee will get nothing, because the gift of Blackacre is adeemed. The $400,000 in proceeds will go to Sam as the residuary legatee.

1. Tip about equitable conversion: Suppose that the specifically-devised property is, at the moment of the testator's death, under a ***contract to be sold.*** Assuming that there is no relevant statute, then probably by the doctrine of equitable conversion (*supra*, p. 314) the purchase price will be ***personal property***, not real estate, and will go to the person identified as the recipient of personal property under the will.

Example: In the above example, if Blackacre is under contract to be sold at the time Test dies, the $400,000 proceeds will go to Sam as legatee of the personal property, not to Dee as recipient of the specific bequest of Blackacre.

C. Exoneration: Under the common-law doctrine of ***"exoneration,"*** a person who receives a bequest of property that is ***subject to a lien or mortgage*** is entitled to receive the property ***"free and clear,"*** if there is no evidence that the testator intended a contrary result. When exoneration applies, the estate's personal property — i.e., its cash — is used to pay off the lien or mortgage.

Example: Test's will bequeaths Blackacre to her son *S*, and all of her other property, real and personal (including $500,000 in cash), to her daughter *D*. At the time of Test's death, Blackacre is subject to a $100,000 mortgage. Assume that all relevant common-law doctrines apply, and that there is no evidence of Test's desires regarding the handling of the mortgage at her death. When *S* takes Blackacre, who is responsible for the mortgage?

S takes free-and-clear of the mortgage, under the common-law doctrine of exoneration. By that doctrine, if the testator does not indicate a contrary intent, any specific devise of real or personal property is to made free and clear of any mortgage or lien. So here, the mortgage on Blackacre will be paid off with some of the cash that would otherwise have gone to *D* as residuary legatee.

1. Statutes: Most states have ***statutes*** altering the common-law exoneration doctrine.

D. Lapse: Under the common-law doctrine of ***"lapse,"*** if a beneficiary named in a will ***predeceases the testator,*** the ***bequests fails***, rather than go to that beneficiary's next-of-kin. Instead, the bequeathed property becomes part of the testator's residuary estate.

1. Statutes: Most states have enacted ***"antilapse"*** statutes. These generally have the effect of abolishing the lapse doctrine — and allowing the dead beneficiary's heirs to take — in certain situations, typically where the pre-deceased beneficiary is a ***relative*** of the testator. (A common definition of "relative" in such antilapse statutes is "a direct descendant

of the testator's grandparent.”)

Example: Test writes a will leaving Blackacre to “my good friend Fred,” who is not a relative of Test. The will leaves all the rest of Test's estate to a daughter Dee. Fred dies intestate after Test's will is executed; Fred is survived by a single heir at law, a son Sam. One year later, Test dies. Assume that the state has a statute providing that in the case of a bequest to a person who is a lineal descendant of the testator's grandparent, if the beneficiary has pre-deceased the testator then the heirs at law of the beneficiary shall take so long as there is no indication that the testator intended a contrary result. In all other respects, the common law applies. Who takes Blackacre, Sam or Dee?

Dee takes Blackacre. Since Fred is not a lineal descendent of Test's grandparent (the facts say that Fred and Test are not relatives), the antilapse statute does not apply. Consequently, the common-law lapse rule applies, so as to cause the bequest to Fred to fail because Fred pre-deceased Test. Therefore, Blackacre becomes part of Test's residuary estate, which goes to Dee.

Quiz Yourself on
LAND SALE CONTRACTS, MORTGAGES AND DEEDS

82. By telephone, Simon agreed to sell, and Bryant agreed to buy, Blackacre for a price of $200,000, the clos ing to take place on April 1. On March 15, the day after this conversation, Simon sent Bryant a letter confirming all of the relevant terms of the agreement. The letter stated, “I will assume that this letter accurately states our arrangement, and will bind us both, unless I hear from you to the contrary by March 20.” Bryant received the letter, but sent no response. On April 1, Simon arrived with a marketable deed at the time and place that his letter specified for closing. Bryant did not show up at all. If Simon sues Bryant for breach of contract, may he recover damages? ___________________

83. Tycoon, a wealthy industrialist, has for many years owned a 100 acre parcel of undeveloped, heavily wooded land, called Twin Oaks, in the state of Bates. Grandson, Tycoon's daughter's oldest son, wished desperately to become a farmer. Tycoon therefore orally proposed to

Grandson the following arrangement: if Grandson would move onto the property, construct a permanent dwelling, and clear at least 50 of the acres, he could keep whatever crops (or their proceeds) he could grow on the property. Furthermore, if Grandson did all this and then continued to farm for at least five years, Tycoon would leave the property to Grandson in Tycoon's will. Grandson moved onto the property, built a small cabin, cleared 75 acres, and farmed them for the next seven years, keeping all proceeds as agreed. Tycoon then died, and his will made no mention of the arrangement. (Instead, the will left Twin Oaks to Tycoon's niece, Edna.) If Grandson sues Tycoon's estate for an order of specific performance directing the estate to convey Twin Oaks to Grandson, will Grandson prevail? Assume that Bates follows the majority approach to all relevant matters. __________________

84. Shelby, the owner of Blackacre, contracted to sell the property to Bennett. The contract document, dated March 1, provided that the closing was to take place on April 1. The contract did not contain a “time is of the essence” clause, and did not specify the consequences if either party was unable or unwilling to close on the appointed day. On March 25, Bennett said by telephone to Shelby, “My bank loan hasn't gone through yet. I won't be able to close on April 1, but I will be ready on April 10.” Shelby replied, “Either close on April 1, or the contract is off.” On April 1, Shelby showed up at the appointed place with a deed, but Bennett did not appear. Bennett tendered a check for the purchase price on April 10, but Shelby refused to take it. There is evidence that Shelby was trying to get out of the contract not because the delay was material in light of the surrounding circumstances, but because someone had unexpectedly come along and offered Shelby a higher price. If Bennett sues Shelby for a decree ordering Shelby to convey the property to Bennett for the contract price, will a court grant Bennett's request? __________________

85. Squires contracted to sell Whiteacre to Brady, the closing to take place on June 1. The purchase price was to be $200,000, in the form of a cashier's or certified check. The contract required Squires to convey a marketable title. On June 1, both Squires and Brady turned up at the appointed place for the closing. Squires tendered a deed, together with an abstract of title showing that Squires had good title. The contract also required Squires to have a Certificate of Occupancy for a newly-constructed deck attached to the house. Brady demanded the Certificate of Occupancy, and Squires

said, “I don't have it.” Brady responded, “Well, I refuse to close.” Squires asked Brady to show him the certified check for the purchase price. Brady said, “I don't have it. I didn't bother going through with my bank loan, because I knew you didn't have the Certificate of Occupancy.” (This assertion is true.) Squires refused to return Brady's 10% deposit, paid to Squires at the time the contract was signed. (The deposit is returnable, according to the contract, only if seller is in default and buyer is not, on the closing date.) If Brady sues Squires for the return of his deposit, will Brady win? ___________________

86. Same basic fact pattern as prior question. Now, however, assume that the abstract of title proffered by Squires on June 1 showed that the house on the property (an important part of the overall value of the property) encroached 10 feet onto the property of Squires' easterly neighbor. If Brady sues Squires for return of his deposit, and Squires asserts the defense that Brady did not tender his own performance (because Brady did not bring a check to the closing), may Brady recover the deposit? ___________________

87. Sherman contracted to sell Greenacre to Bruce. The contract was signed on June 1, 2012, and called for a closing to occur on August 1, 2012. On July 1, 2012, Sherman died. His will (executed in 2010) left all of Sherman's personal property to his daughter Deirdre, and all of his real estate to his niece Nell. The closing took place as scheduled on August 1, with the sale proceeds paid to Sherman's estate. Who should receive the sale proceeds, Deirdre or Nell? ___________________

88. Spratt contracted to sell a house to Booth. After the contract was signed, but before the scheduled closing date, the house burned down. Spratt was not at fault. Neither Spratt nor Booth had any insurance in force on the property. On the closing date, is Booth obligated to pay the purchase price to Spratt, in return for a deed to the now-much-less-valuable property? ___________________

89. Spence sold a house and lot to Bagley under an installment sales contract. The contract provided for the $200,000 purchase price to be paid at the rate of $5,000 per month for 40 consecutive months (with interest on the unpaid balance also being payable each month). The contract further provided that if Bagley ever became more than 30 days in arrears on any payment, Spence could at his sole option declare the contract forfeited,

and reclaim the property. Bagley moved in, and made the first 20 payments without incident. He then lost his job, and fell 90 days behind in the payments. The fair rental value of the property is $2,000 per month. Spence sent Bagley a letter stating, “Because you have violated the terms of our agreement, I am hereby exercising my right to declare the agreement terminated. Please vacate immediately.” If Spence seeks an order declaring the contract terminated and decreeing that Bagley leave the premises, will Spence succeed? ___________________

90. Steel contracted to sell Greenacre to Boswell. The contract stated that Steel would convey marketable title to Boswell, and that the deed would be a warranty deed free of all easements and other encumbrances. On the appointed closing date, Steel tendered to Boswell a warranty deed which stated that the property is “subject to an easement on behalf of a parcel located to the northwest of the subject parcel, enabling the beneficiary of the easement to use the subject parcel's driveway.” Boswell and Boswell's lawyer did not carefully read the deed. Instead, they accepted it, and paid the purchase price, without realizing that the deed was subject to the easement. Several days later, when Boswell's neighbor used Boswell's driveway, Boswell realized that he had been given a deed which did not conform to the contract. Boswell now sues to recover damages under the contract for breach of the representation concerning lack of easements. Assuming that Boswell shows that the property is less valuable because the easement exists, may Boswell recover under the contract?

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91. Fred was the owner of Greyacre, located in the state of Cabot. Cabot law requires all deeds for the transfer of real property to be witnessed by two people. Fred, who was getting on in years, decided to make a gift of Greyacre to his son, Stewart. He therefore prepared a deed giving Stewart the property, signed it, and had it witnessed by two people (thus fulfilling all of the requirements for a deed in Cabot). He handed the deed to Stewart, saying, “You are now the owner of Greyacre.” The next day, Fred had a change of heart, realizing that he might live another 15 years and wanting the satisfaction of knowing that he was still the owner of Greyacre. He therefore asked Stewart to return or rip up the deed. Stewart was upset, but he was also a dutiful son. He therefore ripped up the deed (first making a photocopy, however), and told Fred that he had done so. Shortly thereafter, Fred died, leaving all of his personal and real property

to his daughter, Denise. Who owns Greyacre, Stewart or Denise? ___________________

92. In 1980, Spitzer conveyed Blackacre to Butler, under a standard warranty deed. In 2012, as Butler was preparing to resell the property, he discovered that Spitzer's predecessor in title had lost his title through adverse possession before ever conveying to Spitzer. The present holder of title by adverse possession is Adolf, who is not in possession of the property (Butler is), and who has never actively asserted rights to the property. Butler realizes that he will not be able to convey a marketable title to any subsequent pur chaser because of Adolf's superior title. Butler therefore wishes to sue Spitzer for breach of some or all of the covenants of title. The statutes of limitation on actions for breach of the covenants of seisin, right to convey and against encumbrances are all five years in the jurisdiction. The statutes of limitation on the covenants of quiet enjoyment and warranty are both three years. If Butler brings suit in 2012 against Spitzer for breach of all of these covenants, on which, if any, may he recover? For each covenant on which he may not recover, state the reason. ___________________

93. Same facts as prior question. Now, assume that Butler, without disclosing the fact that Adolf had a superior title, conveyed the property by warranty deed to Capshaw in 2000. In 2012, while Capshaw was still the record owner of the property and in possession of it, Adolf brought an action for a declaration that he was the legal owner of the property. If Capshaw immediately brought suit against Spitzer for violation by Spitzer of the covenant of quiet enjoyment, could Capshaw recover? (Assume that nothing in the Butler toCapshaw deed refers to any covenants made by Butler's predecessor(s) in title.) ___________________

94. Schneider conveyed a house and lot to Block, under a general warranty deed. The deed did not list any encumbrances or encroachments. At the time Block received (and paid for) the deed, he was aware that a garage built and belonging to Schneider's eastern neighbor, Jones, was located half on Jones' property and half on Schneider's property. (Block closed the transaction anyway, because he thought he was getting a price that was good enough to overlook this problem.) Several years later, Block decided that he had made a mistake in tolerating this state of events. He therefore instituted a suit against Schneider for breach of covenant.

(a) For breach of which covenant should Block sue? ___________________

(b) Will Block be found to have waived the benefit of that covenant by agreeing to close with knowledge of the problem? ___________________

95. Developer was in the business of buying large parcels, subdividing them, and building new houses on each. Developer sold a newly built house and the lot on which it stood to Benjamin, a would-be-home-owner. The transaction was done by warranty deed. Both the sale contract and the deed contained the following statement in capital letters: "DEVELOPER MAKES NO OTHER WARRANTIES, EXPRESS OR IMPLIED, REGARDING THE STATE OF THE LAND OR STRUCTURES BEING TRANS FERRED." Unbeknownst to either Developer or Benjamin, Developer's employees, because of their ignorance, had failed to use the proper mix of sand and gravel in the cement employed for the building's foundation. Hairline cracks began to appear shortly after the closing, and within one year the house was structurally unsafe and unsalable.

(a) What action, if any, should Benjamin bring against Developer? ___________________

(b) What is the probable result of the action you advised bringing in (a)? ___________________

96. Same facts as prior question. Assume that during his first and only year of ownership, Benjamin did not become aware of the cracks in the foundation. At the end of a year, he sold the house to Carter, and Carter moved in. If Carter sues Benjamin on the same theory as you gave in your answer to part (a) of the prior question, will Carter succeed against Developer? ___________________

Answers

82. No. The ***Statute of Frauds*** is applicable in all states to any contract for the sale of land, or for the sale of any interest in land. Therefore, either the contract itself, or a memorandum of it, must be in writing. Furthermore, the contract or memorandum must be signed by the "party to be charged." On the facts here, the party to be charged is Bryant, and

the contract is not enforceable against him because of the lack of signature.

83. **Yes, probably.** Most (but certainly not all) states recognize the ***"part performance"*** exception to the Statute of Frauds for land-sale contracts. Under this doctrine, a party (either buyer or seller) who has taken action in reliance on the contract may be able to gain enforcement of it at equity. In most states, if the "purchaser" (here, Grandson, in the sense that he was "purchasing" the farm in exchange for his services) takes possession, makes improvements and changes his position in reliance, this will be the sort of part performance required. Courts generally require that the part performance be ***"unequivocally referable"*** to the alleged contract, i.e., that the part performance be clearly in response to the oral contract, and not explainable by some other facet of the parties' relationship. This requirement seems to be met here, since Grandson has made permanent improvements to the property, by building the cabin and cutting down the trees, and these improvements are not readily explainable by the mere Grandfather-Grandson relationship.

84. **Yes, probably.** In a suit for specific performance of a land sale contract, the general rule is that time is ***not of the essence*** unless the contract expressly so provides or the surrounding circumstances indicate that it is. Thus generally, even though the contract specifies a particular closing date, either party may obtain specific performance although he is unable to close on the appointed day (as long as the defaulting party is able to perform within a reasonable time after the scheduled date). Since the surrounding circumstances do not suggest that time was of the essence from Shelby's perspective, and since Bennett was able to perform within what a court would probably find was a reasonable time of the scheduled closing date (10 day delay), the court will probably grant Bennett a decree of specific performance. (But a few courts, most notably the New York courts, hold that where the contract does not explicitly make time of the essence, either party, by a unilateral notification to the other that it will insist upon strict adherence to the contracted-for settlement date, may make time of the essence. In such a state, Shelby would win.)

85. **No, probably.** The key to solving this question is that where the seller's duty to deliver the deed and the buyer's duty to pay the money are ***concurrent***, then each party must be sure to ***tender his own performance***, in order to be able to hold the other party in default. Therefore, Brady

could hold Squires in default (and get a return of his deposit) only if Brady tendered his own performance. Since Brady did not have the certified check with him, or even have the funds readily available, Brady did not tender his own performance. Consequently, Squires' own "breach" is irrelevant, and Squires will probably be allowed to keep the deposit. (The result might have been different if Squires' failure to comply with the contract stemmed from an incurable problem, such as complete lack of title in Squires; it also would have been different if Squires had repudiated the contract ahead of time. But neither of these events happened here.)

86. Yes, probably. The usual rule that each party must tender his own performance in order to hold the other in breach (see prior question) does not generally apply where a defendant's inability to perform is ***incurable***. On these facts, Squires' lack of marketable title (due to the encroachment) was so severe, and so impossible to cure, that Brady's failure to tender his own performance would probably be overlooked by the court, and Brady would get his money back.

87. Deirdre. "Common sense" would suggest that the answer should be Nell, since Sherman died while still the technical owner of the real estate, so it would seem fair to give Nell the proceeds from the post-death sale of an asset that was earmarked for her. But instead, courts apply the doctrine of ***"equitable conversion."*** By this doctrine, the signing of the contract is deemed to vest in the purchaser equitable ownership of the land, and the vendor is treated as becoming the equitable owner of the purchase price at that time. As a result of the equitable conversion doctrine, the purchase price goes to the person to whom the personal property was bequeathed, and the person to whom the real estate was devised gets nothing.

88. Yes, probably. Most courts adopt the rule that since the vendee acquires equitable ownership of the land as soon as the contract is signed (see answer to prior question), the risk of loss immediately shifts to him. This is true even though the vendee never takes possession prior to the casualty. There is an exception if the vendor caused the loss negligently, but the facts indicate that this was not the case.

89. No, probably. When the purchaser under an installment sales contract has paid a substantial percentage of the purchase price, most courts try hard to avoid allowing the seller to make the buyer "forfeit" his rights

under the contract. The court might order Spence to use statutory foreclosure proceedings before evicting Bagley. In that event, Spence would have to put the property up for sale, and would have to pay to Bagley any amount that the property sold for less the $100,000 that Bagley still owes Spence. (In other words, the installment contract would be treated as if it had been a mortgage.) Or, the court might give Bagley the right to make the payments on which he had been in arrears ($15,000), and then continue with the contract. If the $5,000 monthly payments due from Bagley were no more than a fair rental price for the property, the court would probably not use either of these methods, since the situation would be analogous to a tenant who falls behind in his rent. But here, the monthly payments are much more than fair rental value, so the court would, as stated, take steps to avoid forfeiture.

90. **No, probably.** Under the doctrine of ***merger***, obligations imposed by the contract of sale are generally discharged unless they are repeated in the deed. There is an exception where the contract covenant is "collateral" to (i.e., not directly related to) the promise to convey land. But here, the representation in the contract that there were no easements related directly to the transfer of title, and most courts would hold that that representation was merged out of existence when Boswell accepted the deed that did not repeat the obligation. (But the Uniform Land Transactions Act, if in force in the jurisdiction, would prevent merger from happening.)

91. **Stewart.** If a deed is validly executed and delivered, title passes immediately to the grantee. Thereafter, return of the deed to the grantor, or even destruction of the deed, has no effect either to cancel the prior delivery or to reconvey the title to the original grantor. The only way the title can get back to the grantor is if a new, formally satisfactory, conveyance takes place. Since Stewart never executed and delivered a valid deed to Fred, title remains in him.

92. **None.** The covenants of seisin, right to convey and against encumbrances are all "present" covenants. That is, they are breached at the moment the conveyance is made. Therefore, a breach of these can occur even though there was no eviction. Consequently, these were violated by Spitzer at the time of the original conveyance (at least the covenants of seisin and right to convey were breached, though the covenant against encumbrances may not have been). However, Butler's problem is that these covenants are time barred: the five year statute of limitations on each began to run at the

time of conveyance, and the actions became time barred in 1985. The covenants of quiet enjoyment and warranty, by contrast, are "future" covenants. That is, they are breached only when an eviction occurs. The covenants both promise that the grantee's possession will not be challenged. An action on either of these future covenants is not time barred, since they have not yet started to run. However, there is no cause of action on these, either: until Adolf starts eviction proceedings or otherwise actively asserts that his title is superior, Butler has not even been constructively, let alone actually, evicted. Therefore, Butler will have to wait until Adolf actively asserts his title before he may sue Spitzer. To the extent that the uncertainty renders Butler unable to convey a valid title, Butler is simply out of luck.

93. Yes. The future covenants (warranty, quiet enjoyment and further assurance) are universally held to ***run with the land***. Since these covenants are not breached until there is an actual or constructive eviction, they would be rendered almost useless if a subsequent transfer of the land cut them off. Therefore, Capshaw can sue Spitzer even though he had no privity of contract with Spitzer.

94. (a) Covenant against encumbrances. The covenant against encumbrances is a representation that there are no encumbrances against the property. The encroachment by Jones was such an encumbrance, so this covenant was violated.

(b) No, probably. Most courts hold that even where the grantee is aware of a defect, his knowledge does not nullify the relevant covenant.

95. (a) Suit for breach of the implied warranty of habitability. Many courts today allow a home purchaser to sue a professional developer for the breach of this warranty, in a way that is analogous to the landlord-tenant implied warranty recognized in nearly all jurisdictions.

(b) Split of authority. The strong emerging trend is to recognize an action for implied warranty of habitability in sales by professional developers of new homes.

96. No. Courts have nearly always refused to allow an implied warranty claim against one who is not in the business of building or selling homes. The consequence is that the buyer of a used home, such as Carter, cannot

sue the person who sold it to him (Benjamin).

Exam Tips on *LAND SALE CONTRACTS, MORTGAGES AND DEEDS*

The topics in this chapter tend to be very heavily tested.

Land sale contracts

Within the area of contracts for the sale of land, here are the most frequently-tested issues:

- **Statute of Frauds:** When a fact pattern indicates that a contract was made ***orally***, make sure you discuss the Statute of Frauds issue. Be on the lookout for exceptions to the general requirement of a writing for any transfer of an interest in land.
  - **Reliance:** The most important exception is that where the purchaser takes action in ***reasonable reliance*** on the contract's existence, the court will generally grant at least limited enforcement at equity.
    - **Actions showing reliance:** Common actions showing reliance are ***building a structure***, ***fencing in***, paying ***taxes***, and making other improvements on the land. Remember that in some courts, the reliance or detriment must be ***substantial***, so note the cost and extent of the actions.
    - **"Unequivocably referable":** Don't forget that in most courts, the supposed reliance actions must be shown to have been taken ***clearly in response*** to the oral contract, and not otherwise explainable. This is the ***"unequivocably referable"*** requirement (the reliance must be "unequivocably referable" to the alleged oral contract).

      Example 1: B leases and operates a gas station owned

by O. After the lease period ends, O and *B* enter into a oral agreement for the sale of the premises to *B* and they agree that no further lease payments are required. Then *B* installs new equipment on the premises at a cost of $18,000. Since it would otherwise be illogical for *B* to make improvements on the premises after the expiration of the lease period, his actions will probably be found to be unequivocally referable to the alleged oral agreement of purchase. That agreement will therefore be enforceable although oral.

Example 2: O orally says to his daughter, D, “I'm giving you the house and lot.” D takes possession of the house, makes substantial and expensive improvements and lives in it for six years (without paying anything to O) until she relocates for business purposes. O and D then have a falling out, and O claims that the house still belongs to him. If D was an only child, O can plausibly argue that D's actions were not unequivocally referable to O's transfer of the property to her because she could have been preparing for her likely inheritance of the land and her actions are therefore otherwise explainable. If the court agrees that this explanation is plausible (the court does not even have to believe that the explanation is probably the correct one), the oral agreement will be without effect.

- **Equitable conversion:** The issue of equitable conversion arises frequently in the case where property is destroyed and it must be determined who bears the risk of loss.
  - **Common scenario:** A contract is entered into for the sale of realty. Then a fire partially destroys the realty. Remember that most courts apply the equitable conversion doctrine here: the signing of the contract is deemed to have shifted equitable title to the buyer, so the risk of loss passes to the buyer at that moment.

    Example: In May, O and *B* contract for the sale of O's home, title to close in July. *B* is to move into the house in

June and to pay rent until the closing. In June, after *B* moves in, he falls asleep while smoking in bed and causes damage to the house. *B* attempts to collect on an insurance policy he purchased in May. In a jurisdiction recognizing equitable conversion, *B* would be deemed to have an insurable interest as of the time of closing, and he could therefore collect on the policy. (On the other hand, *B* won't be able to void the sale contract, or lessen the purchase price, on account of the fire, because the risk of loss will be deemed to have passed to him on the signing of the contract in May.)

- ☞ **Exceptions:** But remember that even in courts applying equitable conversion, there are some ***exceptions***. Most important: if (1) the damage is due to the ***vendor's negligence***, or (2) the vendor did not have, and probably wouldn't have been able to get, ***marketable title***, the doctrine doesn't apply.
- ☞ **Parties' right to allocate:** Also, remember that parties can agree as to when risk of loss passes regardless of the rule in their jurisdiction.

☞ **Death:** If the fact pattern mentions the ***death*** of one of the parties to the contract after the contract has been entered into, apply the doctrine of equitable conversion in enforcing the contract. If the seller dies, the devisees of his personal property collect the proceeds of the sale. And, if the buyer dies, the buyer's estate may specifically enforce the contract against the seller (and vice versa).

☛ **Marketable title:** Generally, a seller must convey ***marketable title,*** i.e., a title that a reasonable buyer, fully informed of the facts and their legal significance, would be willing to accept. Look for an impending sale of property where there is an ambiguity about title.

☞ **Common scenario:** You'll sometimes see an earlier series of grants and/or devises which do not validly transfer the property because true title to the parcel lies in a different

party. In general, these earlier ineffective grants ***won't*** impair the marketable title of the person who in fact has good title.

Example: O conveys Blackacre to “my sisters S and T as joint tenants.” S dies and devises “all my interest in Blackacre to my daughter, D, for life, then to D's daughters, A and *B* for life, then to all the children of A and *B* whenever they are born.” T dies, and devises “all my interest in Blackacre to my friend, F.” F then quitclaims the parcel to Y for $20,000. Y contracts to sell the parcel to Z, promising to convey marketable title. Z claims that the devise to D renders Y's title unmarketable.

Z will lose. When S died, T received S's interest as the surviving joint tenant, rendering S's attempt to devise her property invalid. Therefore, F received an unclouded title from S and transferred an unclouded title to Y, who can transfer an unclouded title to Z.

- **Encumbrances:** Because a reasonably prudent purchaser would not be willing to buy a lawsuit, ***encumbrances*** on the property requiring litigation to clear them up would render title unmarketable and are also considered to be a breach of warranty. (See also the section on deeds, p. 355 below.) Look for these possible encumbrances:
  - **Zoning ordinance**: Any deviation from an applicable zoning ordinance, however slight, should be considered an encumbrance, because it would present the reasonable buyer with fear of litigation.

    Examples of zoning violations that would probably render title unmarketable:
    - ❑ Violation of a setback rule, even if only by a fraction of a foot;
    - ❑ Proposed sale of a business and property located in an area zoned exclusively for residential use, even though authorities have never tried to shut the business down.

- **Adverse possession:** Seller's title based on ***adverse possession***, unless there has been a judicial determination, is ***insufficient***— the buyer shouldn't be required to litigate whether the requirements for adverse possession have been satisfied.
  Example: AP has been in possession of Blackacre for 21 years (the statutory period is 20 years), has never paid any rent to O (the record owner), and has never made any agreement with O. O lives in another city. AP now contracts to sell Blackacre to *B*. *B* declines to close on the ground that AP does not have marketable title.
  B will almost certainly win — a title founded upon adverse possession is not marketable, unless there has been an adjudication that the title has passed to the adverse possessor.

- **Mortgage**: An outstanding mortgage may be satisfied by the seller — i.e., paid off — at the ***closing***, out of the sale proceeds, thereby avoiding a breach of covenant. So the fact that there is a mortgage prior to closing does not mean that the seller has violated the promise to convey marketable title. (But if the mortgage was for more than the proposed selling price, then the mere existence of the mortgage might make title prospectively unmarketable, since the seller wouldn't be able to satisfy the mortgage out of the sale proceeds.)

- **Implied:** If the contract is silent about whether there is an obligation to convey marketable title, the requirement of marketable title will be ***presumed***.
- **Death of either party:** Remember that the ***death*** of the seller does not prevent the title from being deemed marketable — the seller's estate can make the sale.

Mortgages

- **Mortgage assumption:** Pay attention to whether a party takes ***"subject to"*** a mortgage or ***"assumes"*** a mortgage. A party who assumes a mortgage agrees to be personally liable for payments

on the mortgage note, whereas one who takes subject to the mortgage does not.

- ☞ **Forever liable:** Don't be misled by a fact pattern where there is a series of subsequent sales and the different buyers assume and/or take subject to the mortgage. *All* of the parties who assume the mortgage remain liable on the note and can be sued.

  Example: O sells to A; A assumes the mortgage to Bank. A then sells to B; *B* assumes the mortgage. A is still personally liable to Bank, even though *B* has assumed.

- ☞ **Absolute deed as disguised mortgage:** Be on the lookout for a transaction that's cast as an ***absolute sale*** of the property, but where the underlying facts show that the parties intended a ***financing device***. When this happens, courts will require that mortgage rules (including foreclosure rules) be used.

  Example: O, who owns a house, wants to borrow $200,000 against it for 2 years from Financier. Financier insists that the transaction be done as an outright sale by Financier to O, with O getting a right to re-purchase the house within 2 years for $240,000, a deadline as to which "time is of the essence."

  If O can't come up with the $240,000 by the 2-year deadline, the court will probably treat this as a mortgage, in which case Financier has to use foreclosure proceedings, and O can "redeem" by paying the $240,000 any time up until the foreclosure sale.

- ☞ **Foreclosure not binding on senior mortgagee:** When you encounter a foreclosure fact pattern, remember that ***no foreclosure is ever binding*** on a mortgagee whose interest is ***senior to the foreclosing creditor's interest.***

  Example: Bank lends first to *O*, and takes a mortgage. FinCo lends second, and takes a mortgage. If FinCo forecloses, the foreclosure sale will not wipe out Bank's mortgage — instead, the buyer at the foreclosure will take

subject to Bank's mortgage. This result occurs even if Bank has notice of FinCo's foreclosure proceeding. (Separately, the foreclosure sale under the FinCo mortgage will cause Bank's mortgage to become immediately due if the Bank mortgage has a "due on sale" clause.)

Deeds

- **Deeds generally:** Concentrate on these issues:

  - **Merger:** Remember that if there is a disagreement between the contract and the deed, the terms of the deed prevail.

    Example: O owns two adjacent parcels, Whiteacre (where O lives) and Blackacre, a vacant parcel. O and *B* sign a contract under which O agrees to convey Blackacre to *B*. As O knows, *B* plans to use the property for a factory. The contract is silent about any restrictions on how Blackacre is to be used. At the closing, O hands *B* a deed in which *B* agrees, on behalf of his successors and assigns, to use the property only for residential purposes. *B* reads the deed, pays the sale price, but refuses O's request that *B* sign the deed. O records the deed.

    A court will probably hold that *B* (and his successors) may not use the property for non-residential purposes, because in the case of a conflict the deed controls over the contract. (And the fact that *B* refused to sign the deed is irrelevant, because although the Statute of Frauds requires a writing for a land transfer, the recipient's signature on the writing is not considered necessary to satisfy the statute.)

  - **Identification of property:** Make sure the deed contains an ***adequate description*** of the realty so that it can be identified.

    - **Non-traditional descriptions ok:** Don't rule out a description that is not in the traditional form of metes and bounds, markers, or property address as long as the

parcel ***can be identified with reasonable effort.*** (*Example:* Land covered by a grant of "all my land in the state of X …" is easily identifiable, so the grant is adequate.)

- **Error in size:** Also, don't void a description that is sufficient to identify the realty, but makes an error as to the ***size*** of the parcel. (*Example:* X grants "All of my property located on Barrett Road, consisting of four acres of undeveloped land." Even though the realty is a three-acre parcel, the description is adequate.)

- **Identification of parties:** Make sure that the parties are adequately described. (*Example:* A deed cannot be made out to "bearer.")

  - **Error:** Again, though, a less-than-perfect description is not necessarily void — all that's required is that the intended parties be readily identifiable.
    Example: A grant of "all my land in the state of X to my niece and nephew Paula and Mark as joint owners." The first names are sufficient if the parties can be accurately identified, i.e., if there are only one niece and one nephew of the grantor with those names.

- **Consideration:** Remember that a conveyance can be a gift, so that there is ***no*** requirement that a deed be ***supported by consideration***.

- **Delivery**: Delivery issues are the most frequently-tested aspect of deeds.

  - **Intent to have deed take present effect:** Remember that a deed isn't effective to complete a transfer unless the grantor ***intends that the deed be effective immediately.*** Therefore, looks for facts showing the grantor's intent to have immediate effect. These may be ***words of present intent*** (e.g., "I now

give …”). Alternatively, present effectiveness may be shown by the fact that the grantor ***gives up control over the deed*** so that revocation is not possible. It doesn't matter that later on the grantor acts in such a way as to attempt to revoke the grant (by giving a deed to another party).

- ☞ **Physical delivery to grantee:** ***Physical delivery*** is a common way of effecting a present transfer. Tricks to watch out for:

  - ☞ **Delivered to cotenant:** Watch for a fact pattern where the deed grants realty in cotenancy and the deed is handed to only one of the tenants. Delivery to one cotenant is usually viewed as ***delivery to all cotenants.*** Argue that there has been delivery.

  - ☞ **Oral conditions:** Watch for a grantor who imposes an oral ***condition*** to the effectiveness of the deed. As long as the grantor intends the transfer to be immediately effective, the fact that the grantor has imposed some condition or delay to the effectiveness of the estate in land being transferred won't invalidate the transfer. *Example:* G, a landowner, drafts a deed purporting to grant an undivided one-quarter interest in the parcel to C, grantor's chauffeur. G hands C the deed, and says, “Because you have been a good and faithful chauffeur, I'm giving you this deed. But you don't get your interest in the property until I die.”

    The transfer is likely to be construed as a present transfer of a future interest to become possessory on the grantor's death. In that event, the delivery is valid, despite the condition. Alternatively, however, a court might construe the condition as making the deed itself ineffective until G's death; in that event, the transfer would be completely invalid unless it satisfied the requirements for a will (e.g., notarized and witnessed).

- ☞ **Remains in the grantor’s control:** Look for facts showing

that the grantor still has ***control over the deed*** and is ***free to change his mind.*** This would mean that delivery did not occur.

- ☞ **Agent of grantor:** This can happen in fact patterns where the grantor enlists an ***agent*** to take transfer the deed — while the deed is still in the agent's possession, it probably hasn't been "delivered" yet, since the grantor still has power to terminate the agency and get the deed back.
  Example: G gives a deed to her chauffeur, C, and says, "I want you to give this deed to my niece, N. I also want you to go to the bank and the grocery store. Be sure and call me before you come home." C goes to the bank and the grocery store, then checks in with G to find out whether there is anything else she wants him to do. He is told that G died shortly after he left the house. Since C was G's employee, G retained the right and power to change her mind. Consequently, there was no delivery of the deed. The property will instead pass according to G's will.

- ☞ **Ready to be mailed:** Similarly, a fact pattern may indicate that a deed is ready to be mailed (e.g., it has been placed on the dining room table and the grantor intends to mail it the next morning). If the grantor dies before it is mailed, there has been no delivery.

- ☞ **Escrow agent:** A grantor who deposits a deed with an ***escrow agent*** no longer has control over the deed. In this situation, the deed is to be delivered to the grantee upon the happening of a condition outside the grantor's control, and title will pass automatically upon the happening of the specified condition. Consequently, if the grantor dies (or tries to revoke) after the escrow deposit, the transfer will still be ***effective***.

- **Acceptance:** “***Acceptance”*** of the deed is also required. But remember that if a conveyance is beneficial, it is ***presumed*** to be accepted

  - **Returned for safekeeping:** Watch for a fact pattern where the grantee ***returns the deed*** to the grantor. If the return is just for safekeeping, this will not equal a lack of acceptance.
    Example: G gives Z a deed. Z examines the deed, thanks G, and hands the deed back to G, asking that G hold it for safekeeping. The deed has been accepted by Z, and is thus effective.

- **Interest conveyed:** A deed that is silent as to the ***type of interest*** conveyed, but is otherwise complete, is presumed to convey ***whatever interest the grantor holds*** at the time of conveyance.

  - **Quitclaim:** Likewise, a ***quitclaim deed*** conveys only the interest which the grantor holds at the time of its execution. The most important thing about a quitclaim deed is that it includes ***no implied warranties*** of title.

  - **Estoppel by deed:** Look for a fact pattern where a party attempts to convey an estate which he does not have but ***subsequently acquires*** title to. The ***estoppel-by-deed*** doctrine causes the after-acquired title to ***pass directly to the grantee.***

    Example: O purports to sell realty to A, who immediately records the deed. O's grandmother is the true owner of the realty. Later, O's grandmother dies, devising the realty to O. Then O deeds the realty to C for full satisfaction of a debt owed to C by O.

    In a contest between A and C, A will win. Under the doctrine of estoppel by deed, title to the realty passed to A immediately upon O's grandmother's death, so there was nothing for O to deed to *C*.

Covenants of title

Covenants of title are not tested very often. A couple of things to look for:

- **Breach of covenants as to title, generally:** Most covenant problems relate to the ***"present"*** covenants (covenants of ***seisin***, right to convey and against encumbrances). These are representations that the grantor has a right to convey the title which he purports to convey. The present covenants are breached ***only at the time the deed is delivered***, and only the ***grantee*** can bring an action for damages.

    Example: G grants a fee simple absolute to O, under a warranty deed. O then grants a fee simple to A. It turns out that X, not G, had title to the property. A may not bring an action against O for breach of warranty, because only the grantee may sue for breach of the covenant of seisin. Same result if the breach was because X had an undisclosed easement over the property (breach of covenant against encumbrances).

- **Easement**: Sometimes you'll have to know whether the presence of an ***easement*** in favor of a third party constitutes a breach of the seller's covenant against ***encumbrances***.

    - **Buyer unaware:** If the buyer was ***unaware*** of the easement at the time she took the deed, clearly the easement's existence is a breach of the covenant.

    - **Buyer aware:** If the buyer was aware of the easement at the time she took the deed, courts are split, but many recognize a breach of the covenant here, too.

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1. A quitclaim deed, described more fully *infra*, p. 333, is one which does not purport to do anything

more than convey whatever interest the grantor has, if any.

2. Fannie Mae and Freddie Mac are currently, as of early 2012, still operating under federal conservatorship, having effectively gone broke as a result of facilitating and buying too many bad mortgage loans.

3. That is, a searcher using the standard "grantor/grantee index" method of title searching would not have found a transfer of the mortgage to U.S. Bank if the searcher started with the mortgage given by the Ibanez family to Rose Mortgage. For the details of why this is so, see the discussion of "wild" or "fugitive" deeds *infra*, p. 370.

4. The opinion doesn't make the exact filing date clear, but from context, it seems as though the suit wasn't filed until after the September 11, 2008, recording of the assignment to U.S. Trust of all of Option One's and its successor's interest in the mortgage.

5. For instance, the loans had an introductory rate of three years or less that was at least 3 percentage points below the "fully indexed" rate that would apply later, and were written to borrowers for whom the debt-toincome ratio would have been more than 50% if the fully-indexed payments had been used in the computation.

EXAMPLES & EXPLANATIONS

Property

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PART IV

Transfers of Land

CHAPTER 21

The Sales Contract

INTRODUCTION

This chapter covers the purchase and sale of real property. An owner wishing to sell real property typically places it on the market by listing the property with a ***real estate broker***. The broker is the potential seller's agent and the broker's employment agreement is known as a ***listing agreement***. In practice, most sellers enter into these agreements without involving an attorney. Purchasers also often contact a broker to locate suitable property.

Once brought together, sellers and potential purchasers negotiate the terms of the sale, often through real estate brokers. The purchasers may conduct studies related to the suitability of the land for their needs. Assuming the parties agree on such matters as the sales price, the parties enter into a ***sales contract***, also known as a purchase and sale contract, earnest money contract, deposit contract, or other such name. Both seller and purchaser incur enforceable obligations when they execute a sales contract.

From the date the purchaser and seller execute a sales contract to the date their transaction is completed (or "closed"), legal disputes may arise concerning the performance of the contract. Because between these two dates

the contract is executory (meaning that it is in the process of being performed by the parties), the period of time between the two dates is known as the ***executory period*** or the ***gap period***.

Because of the importance of the sales contract, each party should be represented by an attorney before signing it. In most residential sales, however, the parties rely instead on a preprinted, standard form contract supplied by the seller's broker. The blanks on the form identify the parties, set the sales price or at least a method to determine the sale price, describe the property to be conveyed, include language that the seller will convey and the purchaser will acquire the property, set the closing date, delineate the manner of payment including cash and seller-financing, and acknowledge receipt of the deposit, down payment, or earnest money. Filling in these blanks is incidental to the broker's business, and so is not the unauthorized practice of law.

Brokers often supply a form that contains a provision detailing the amount of the sales commission payable to the broker from the deposit. Additional preprinted terms in the typical form contract concern the remedies —specific performance, damages, or rescission—that each party has if the other breaches. The parties may insert other conditions, such as making the sale contingent on the purchaser's obtaining financing, having the land rezoned, or selling an existing residence.

CLOSING

After entering into the sales contract, the ***purchaser*** may inspect the property, review title documents, survey the property, and secure loan commitments. The ***seller*** may need to correct any title imperfections or repair the property. Based on what's found about these matters, one of the parties may decide not to complete or close the transaction (and may or may not be successful at avoiding the obligation to complete the sale or pay damages).

At closing, then, the parties complete their transaction. The seller transfers the property to the purchaser by deed of some type. The seller might also assign all contracts, leases, and personal property on the premises to the purchaser. The purchaser will pay the seller cash or execute a note to the seller (or a combination of the two). The closing agent will prorate (allocate)

the current year's taxes, insurance, and other items between the seller and the purchaser. If the purchaser borrows money to purchase the property, the purchaser and the seller must execute documents to satisfy the lender's preclosing conditions, so that the title and the loan can be closed on the same day.

REAL ESTATE BROKERS AND AGENTS

Sellers often engage licensed real estate brokers or real estate agents or salespersons to market their property. Licensed real estate agents legally must work under the supervision of a licensed real estate broker. An agent is thus, under the law of agency, a sub-agent of the broker. A broker unlicensed under state law when executing a listing agreement may not sue for or collect a commission. Similarly, a licensed broker may not share a commission with an unlicensed one.

Both a broker and an agent owe ***fiduciary duties*** of loyalty, good faith, and fair dealing to the seller. Absent an express power of attorney, neither is empowered to negotiate or sign a contract or other documents on the seller's behalf—that is, the broker cannot obligate the seller to sell the property. A listing agreement is only an employment and personal services contract.

Either the jurisdiction's Statute of Frauds[1] or a regulation of the state agency licensing brokers requires an enforceable written contract for a broker or agent to be entitled to a sales commission. Generally, the listing agreement authorizes the payment of the sales commission. The commission is typically a percentage of the purchase price procured by the broker, split 50-50 between the listing broker and a cooperating selling broker, with a part of each commission split again with any agent or salesperson who might be involved in the transaction, or with the brokerage firm of each broker.

There are three types of listing agreements: Open listing, exclusive agency contract, and exclusive right to sell contract. If the listing agreement provides that the seller may use other brokers to sell the listed property, the agreement is an ***open listing***. It is a nonexclusive arrangement. A broker is due a commission only if the broker finds a ready, willing, and able buyer. Before a broker performs, it is a unilateral contract, an offer to pay a commission to be accepted by the broker's performance, and is revocable

beforehand.

There are two types of ***exclusive listing agreements***. In one, known as the ***exclusive agency contract***, the seller is free to find her own purchaser; and if the seller finds a purchaser without the broker's assistance, and without any other broker's assistance, the seller owes no commission. In an exclusive agency contract, then, the seller promises that "if I sell using another broker, I will pay you a commission anyway (even if I owe that other broker a commission too), but I reserve the right to sell the property myself." Under the second type, known as the ***exclusive right to sell contract***, the broker receives a commission no matter who sells the property, whether it be the listing broker, another broker, or the listing owner.

Example: *O* (Owner) lists Whiteacre with broker *B* under an exclusive right to sell contract. *P* drives by Whiteacre, sees *B*'s for sale sign, and thereafter deals exclusively with *O*. Broker *B* is entitled to a commission because the listing agreement is an exclusive right to sell contract. This is why brokers overwhelmingly prefer exclusive right to sell listings.

In most jurisdictions, unless the listing agreement provides otherwise, the seller's broker earns a commission when he procures a ***ready, willing, and able*** buyer, whether or not the sale closes. A sales contract may be the broker's best evidence that the buyer is ready, willing, and able to meet the terms of the listing. It does not matter if the sales contract closes or is completed: A broker earns her commission just by procuring the seller to a prospective "ready, willing, and able" buyer. Generally, payment of the broker's commission is deferred until closing, but the commission once earned is due even if the sale does not close. (Whether a broker would sue for it is another matter, often involving a business decision.)

To illustrate, a seller lists Blackacre with a broker in a state where the "procuring a ready, willing, and able buyer" rule determines when brokers are entitled to commissions. The broker locates a prospective buyer who signs a valid sales contract with the seller. The contract provides that the broker's commission is "due at closing." The buyer breaches the contract and refuses to close. The broker is still entitled to a commission. There is a difference between being entitled to the commission and its being payable at closing. It might be convenient for the seller to pay the commission out of the sale proceeds, but the phrase "due at closing" does not make closing a condition precedent to the broker's receiving a commission.

In about a dozen states, a broker's commission is not payable unless the sale is closed: No closing, no commission is their rule. This minority rule assumes that a prospective buyer cannot be shown to be "ready, willing, and able" until the closing. Only then, for example, has the buyer qualified for a mortgage loan and shown himself "able" to purchase. More generally, the minority rule does not allocate to the seller the risk that the buyer will turn out to be unready, unable, or unwilling to close. Thus, the seller is not responsible for investigating the buyer's personal and financial capacities before signing the sales contract. Further, the minority rule is consistent with what most sellers expect.

Even in jurisdictions adopting the "no closing, no commission" rule, a seller still may owe the broker a commission if the closing does not occur because the seller breached the sales contract. The seller's breach gives the broker a cause of action (a) in tort for interference with a contract or a prospective advantage, or (b) in contract because the seller made an implied promise to close, breached that promise, and injured the broker. Both in tort and contract, therefore, a breaching seller is liable for the broker's commission.

If, in a "no closing, no commission" state, no closing occurs because the prospective purchaser (rather than the seller) breaches the contract, many courts force the breaching purchaser, who was not even a party to the listing agreement, to pay the commission to the broker as a third-party beneficiary of the sales contract.

The majority and minority rules have a common element. Both rules require that the broker "procure the sale" of the listed property to a ready, willing, and able buyer. Under the majority rule, then, the procuring clause means the buyer and seller signing the sales contract, but in a minority rule state it means the completed closing. Whatever the state's rule, the parties can specify in the sales contract precisely when the broker's fee is earned and what contingencies if any affect the broker's right to the commission.

Although brokers and agents are involved in the majority of home sales, a growing number of homeowners have begun using websites and yard signs to offer homes "for sale by owner" (FSBO). This option eliminates or reduces the broker's commissions, but places a marketing and appraisal burden on owners.

BROKER AS SELLER'S AGENT

There are usually two brokers or agents participating in the sale and purchase of real estate. The seller initially signs a listing agreement with a ***listing broker***. The broker who finds the ready, willing, and able purchaser is called the ***selling broker***.

The listing broker is the seller's agent and owes a duty of loyalty, good faith, fair dealing, and disclosure of material facts to the seller. The duty of loyalty includes a prohibition against self-dealing: The listing broker can buy property from his principal (the seller) but must disclose to the seller that the broker is buying the property and must disclose, if true, that the seller has set a below-market asking price. Similarly, a broker must promptly relay all offers to the seller and cannot intentionally delay efforts to sell the property until his principal lowers the listing price just so the broker, or a friend or relative, can buy the property at a lower price. Although not guaranteeing success, the broker must diligently seek a purchaser. The broker cannot perform any act showing disloyalty. In some states, this duty prohibits the broker from indicating to potential purchasers that the seller is desperate to sell or would accept a lower price.

Selling brokers, those brokers that show properties to prospective buyers, perhaps contrary to what most homebuyers expect, are typically sub-agents of the listing broker, even if they work for another broker or real estate firm.[2] Their main contact, however, is with prospective buyers. In fact, they may show a single prospect many properties, all owned by different sellers, yet they are paid their commission pursuant to a sharing arrangement with the listing broker through a listing agreement with the seller. Selling brokers owe a duty to the seller despite having considerably greater contact with the buyer. Recognizing this reality, a few jurisdictions require the selling broker to inform buyers the agent legally represents the seller. In line with many buyers' expectations, some states hold the selling broker to be the buyer's agent. In any jurisdiction and with proper disclosures, a broker may become a dual agent, representing both the buyer and the seller, a situation rife with conflicts of interest.

Example 1: *H* and *W*, a young couple, have been driving around looking at homes with broker *B*. When getting out of *B*'s car to inspect *O*'s home, *W*

says to *H*, “Let’s offer $250,000, then we can go as high as $300,000.” If *B* overhears this, she must report it to the listing broker if *B* under local law is the seller’s broker, but not if *B* is a buyer’s broker.

Example 2: The facts are the same as in the prior Example, except that *B* is the seller’s agent and responds to *W*, saying that “there is an outstanding offer of $275,000 for this home.” Has *B* breached her duty of loyalty to *O*? Maybe not, because making the negotiations a realistic exchange is well within the broker’s province. Saying that *O* would not accept less than $275,000 would be a breach. A broker is everywhere barred from disclosing a listing owner’s lowest acceptable or “reservation” price.

BROKER’S DUTY TO DISCLOSE LATENT DEFECTS TO PROSPECTIVE PURCHASERS

A broker may have a duty to the buyer to disclose latent defects[3]—that is, a duty to disclose facts materially affecting a residential property’s value or desirability when the broker, using reasonable diligence and making a reasonable inspection, discovered or could have discovered them, even though the buyer did neither of those things. This duty is independent of the seller’s duty to make the same disclosures.[4] The broker may be directly liable for her breach of the duty to disclose, and the seller may be liable both for his failure to disclose and for the broker’s breach of her duty to disclose.

Traditionally, the broker (and the selling landowner) owed no duty to purchasers to disclose defects under a theory known as ***caveat emptor: let the buyer beware***. Caveat emptor is still the default rule in many states. Even when caveat emptor prevails, however, a broker can be liable for ***intentional misrepresentations*** or ***affirmative acts*** to conceal facts or to mislead purchasers about material facts. Most states also hold the broker liable for ***negligent misrepresentation***, i.e., where a broker knows or should know of matters underlying a false statement. Generally, negligent misrepresentation occurs when a broker gives erroneous information about a matter of general knowledge affecting all property in the community: zoning laws, location within a flood plain, or building codes, for example. Eight jurisdictions even hold the broker liable for ***innocent misrepresentation***, in effect making the

broker liable for good faith statements that turn out to be incorrect.

In the majority of jurisdictions, caveat emptor is no longer the rule. The opposite view prevails: A broker, in addition to not misrepresenting material facts, has an affirmative duty to disclose latent and material defects that the broker either knew about or could have discovered upon reasonable inspection. ***Latent defects*** are those not discoverable by a buyer or his representative upon a reasonable inspection. In order to hold a broker liable, not only must the defect be latent, rather than open and discoverable on a buyer's reasonable inspection, but the condition or defect must be a ***material defect***, one significantly affecting the value or use of the property.

Most states have statutes requiring sellers of residential property to fill out detailed, statutorily prescribed disclosure forms covering many of the major features of a listed property—for example, the condition of its roof, HVAC systems, plumbing, and foundation. The owner's doing so entitles a broker to rely on these disclosures in representing a property to prospective buyers, thus making the owner ultimately liable for any misrepresentation on the form.

THE STATUTE OF FRAUDS

Every American jurisdiction has enacted a Statute of Frauds. The ***Statute of Frauds*** requires deeds and real estate contracts be in writing and signed by the person to be bound. The Statute of Frauds applies to transfers of any interest in real estate, including fees simple, easements, real covenants, mineral rights, water rights, long-term leases, life estates, remainders, and liens. Some states also require that options to purchase be in writing. In most states, modifications of provisions in a writing must also be in writing. A slight majority of states, however, allow a person entitled to rescind a contract to orally rescind it. In all states, the Statute of Frauds or a regulation of the state's real estate licensing board requires listing agreements made by real estate brokers to be in writing.

The Statute of Frauds does not render noncomplying contracts void, illegal, or unperformable; rather, it renders them voidable (not void)—i.e., unenforceable in court.[5] If, however, the parties perform the oral sales contract to fruition, a court will not undo the sale and transfer of title.

Not all provisions of the real estate contract or deed must be in writing to satisfy the Statute of Frauds. Oral provisions will be enforced as long as a sufficient writing exists concerning the transaction. A memorandum of an oral contract, for example, satisfies the writing requirement. Although the Statute of Frauds does not itself set out minimum requirements of a "writing" (except the writing must be signed by the person to be bound), courts have established four essential requirements.

The essential requirements of a writing that satisfies the Statute of Frauds are that the writing must (1) identify the parties, (2) describe the property, (3) state the price, or at least a method to determine it, and (4) be signed by the party to be bound. Some authorities add that the writing must state an intent to transfer the property. These essentials do not have to be contained in the same document or even in formal documents. Courts have concluded that a series of letters can constitute a writing or that a check can be the writing or part of the series constituting the writing if it contains all the required information. Courts require at least one of the writings to reference the others before they consider the separate documents to be one writing.

Example 1: *S*, intending to sell Blackacre, places the word "assignee" in place of the name of a buyer. This is an insufficient designation of the parties to the contract and does not comply with the Statute of Frauds.

Example 2: Seller and an authorized agent[6] for the true buyer execute a contract for the buyer's purchase of Whiteacre. So long as the agent is identified, the true buyer need not be. The true buyer might be a wealthy person afraid that if her identity is known to Seller, Seller will demand a purchase price above Whiteacre's market. The authorized agent's signature on the contract binds the true buyer as long as the authorized agent, when signing, acted within the scope of his agency. The party to be bound need not sign in her own hand.

Example 3: Seller and Purchaser execute a brief written sales contract of sale for Greenacre. The contract satisfies the Statute of frauds, except that Purchaser's "signature" is an electronic one contained in an e-mail. Most jurisdictions hold that the "party to be bound" has "signed" the contract.

Example 4: Seller and Buyer execute a brief written contract for the sale

of Brownacre complying with the Statute of Frauds in all respects except that the description of the property is a street address as opposed to a legal description. Just as a document complying with the Statute need not be a formal one, so too the description need not be one required for a deed. So long as the property is described with a precision that permits later location, the description is sufficient. A postal address of “1234 Country Lane” may be sufficient whereas “P.O Box 294” may not.

In addition to requiring essential terms, some jurisdictions require that, to comply with the Statute, a contract contain its material terms. Material terms are those subject to performance during the executory period. For example, a financing contingency may require that the buyer obtain third-party mortgage financing before being legally obligated to purchase the property, and this contingency must be sufficiently definite so that the parties can tell when it is satisfied and when it is not. Similarly, a contract might call for rezoning the property or for the sale of the seller’s present home before a closing can be held. If a term is nonmaterial, then a court will supply it based on a rule of reason or custom and usage in the locale. For example, if a contract is without a date for closing, a court will say that the closing must take place within a reasonable time; if it does not say when possession of the property will change, a court will infer that it does so at closing.

In interpreting a contract with both oral and written provisions, courts will not allow testimony to contradict any written provision but will allow testimony to clarify it and to clarify or contradict oral provisions. Testimony also will be allowed to contradict the terms of a memorandum of an oral contract.

PART PERFORMANCE AND OTHER EXCEPTIONS

Despite the seeming absoluteness of the Statute of Frauds writing requirement, courts have crafted exceptions to the writing requirement based on equitable principles. Exceptions are granted when the facts and circumstances surrounding an oral contract show that enforcing it will not work a fraud on the party seeking the protection of the Statute. In addition,

the complaining party (1) must prove an oral contract exists, and (2) must persuade a court to excuse the party's failure to produce a writing containing the essential elements of the contract. Three categories of exceptions have evolved.

(a) Part Performance

Part performance focuses on the buyer's actions. A court will excuse a failure to procure a writing satisfying the Statute of Frauds when the buyer does some combination of the following in order to demonstrate ***part performance*** of a sales contract: (1) pays the purchase price, (2) takes possession of the property, and (3) improves it. Paying the purchase price alone is insufficient to warrant enforcement of the contract since the complaining party can be put back into the position he would have been in if there had been no contract simply by having the money returned to him (i.e., by restitution). Some courts accept partial payment, some require substantial payment, and some require full payment of the purchase price. Even with payment of the full purchase price, courts usually require at least one of the other two requirements before excusing noncompliance with the Statute.

Taking possession entails more than delivery and acceptance of title: The buyer must physically move onto the property and in some jurisdictions even incur substantial moving expenses from another location. A party who substantially improves the property may be excused from complying with the Statute. When the required elements of this exception are met, the acts constituting part performance serve as an alternative form of evidence of the contract.

(b) Equitable Estoppel

Under the ***equitable estoppel*** exception to the writing requirement, courts in a few states will excuse noncompliance with the Statute of Frauds if a party seeking performance, in justifiable reliance on an oral contract and the continuing assurances of the other party, so substantially changes his position that injustice would result unless the contract is enforced. Equitable estoppel

or equitable fraud usually is invoked in cases involving persons, often family members, who move to the property to care for the property's owner, who also lives there, on the oral promise that the owner at her death will devise the property to the moving party. The consideration for the contract is the services performed. The following are the requirements for the equitable estoppel or equitable fraud theory:

(1) A promisor (the landowner) makes a certain and definite oral promise that the promisor should reasonably expect would induce the promisee to act;
(2) The promisee (the buyer) in fact acts in reliance on the promise and in pursuance of the agreement; and
(3) A refusal to fully execute the oral contract would be unconscionable, and place the promisee in a situation not remediable by damages.

The substantial or full performance of the contract by one party is strong evidence of a contract. For courts to accept performance in lieu of a written contract complying with the Statute of Frauds, the acts constituting the performance must refer unequivocally to the contract; that is, the acts must make sense only if they are in furtherance of it and the owner of the property has benefited from it. Enforcing the contract in this situation avoids unjust enrichment. For example, if an elderly parent makes an oral promise to convey her home to a child who comes to live there and care for her until her death, performance of the agreement by the child may be strong evidence the child performed her part of the contract, and justice would be served only by effectuating the oral agreement.

(c) Admission of a Contract in Court

A third exception used in a few states involves the judicial process: When a party to be bound is sued and properly defends on the ground that the Statute of Frauds writing requirement is unsatisfied, but admits in court that there was indeed a valid oral contract, courts divide on the issue of whether the defense will succeed. On the one hand, the contract is not in compliance with the Statute, but on the other hand, the party has brought the matter of the contract's enforceability before the court, where the safeguards against

forcing fraudulent agreements on unwilling parties can be tested, using the rules of evidence, by direct and cross examination under oath. Thus, to some courts, the evidentiary purposes of the Statute are satisfied in court by testing a party's admission. To other courts, testing that admission might encourage perjury, so confining the defense to the requirements of the Statute protects the judicial process.

Examples

Too Broke to Pay

1. *O* lists his home with broker *B1* using an exclusive right to sell listing. *B1* shows the home to clients of buyer's broker *B2*. *B2* knows that these clients are in financial trouble. *B2*'s clients execute a sales contract "subject to financing," but rescind the contract when financing proves unavailable to them. The home plummets in value. *O* then learns that the contract was never likely to close due to the buyers' inability to obtain financing. *O* sues *B2*, based on the lost opportunity to sell to someone else. Will *O* recover?

Where There's a Will

2. Mae owned an apartment complex at 6002 Broad Street worth $250,000. Due to her declining health, Mae felt she no longer could manage the units. Desiring to receive a steady stream of income for the rest of her life, she sold the apartment complex to Donnie, who lived in one of the apartments. He paid $25,000 cash and gave Mae a note for the remaining $225,000. The note provided for interest at the prevailing market rate and for monthly payments of interest only. The note's $225,000 principal was due in a lump sum in 15 years.

   As part of the sale, Mae agreed that if she received timely monthly payments, the unpaid balance of the note would be forgiven at her death. Mae declined to put this agreement in writing at closing, but acknowledged the agreement in the presence of others, and agreed to put it in a writing after closing. Three weeks after closing, Mae executed her will. Her will contained the following provision: "Any note still owing to me or my estate by Donnie should be given to Donnie. This gift is in accord with an agreement made when I sold my apartment units at 6002

Broad Street in Parkville to Donnie but never put in writing. I intend that this agreement be honored."

Eight years later Mae executed a new will revoking all previous wills. The new will made no reference to Donnie, the note, or the apartment complex. Donnie regularly paid monthly interest payments to Mae until he learned of her death, at which time he stopped making payments, relying on the understanding the remaining debt was canceled on Mae's death. Mae's heirs claim Donnie must pay the $225,000 note. Does the Statute of Frauds prevent Donnie from enforcing Mae's agreement to forgive the note at her death?

Marital Bliss

3. Sal and Sally, husband and wife, own a house as tenants in common. Ben and By, husband and wife, negotiate to purchase the house.
   (a) Sal and Sally sign the sales contract and Ben signs on behalf of himself and By. Ben and By refuse to close. Does the Statute of Frauds prevent Sal and Sally from enforcing the sales contract?
   (b) Sal signs the sales contract on behalf of himself and Sally, but Sally does not sign. Both Ben and By sign the sales contract. Sal and Sally refuse to close. Does the Statute of Frauds prevent Ben and By from enforcing the sales contract?
   (c) If Sal signs but Sally does not sign the sales contract, as in (b), can Ben and By invoke the Statute of Frauds to rescind the sale if Sal and Sally seek specific performance?
   (d) Sal signs; Sally does not sign; both Ben and By sign; and, in addition, the contract provides: "This sales contract to be effective upon the execution thereof by both sellers and both purchasers." Ben and By refuse to close. Can Sal and Sally enforce the contract?

Handshake Deal

4. Bess orally agreed to purchase 806 acres from Solomon for $1,000 per acre. Pursuant to the agreement, Bess gave Solomon a $10,000 check as a down payment and agreed to pay $400,000 at closing, and to pay the balance with interest later. Bess applied for and acquired a written loan commitment from Bank for the $400,000 to be paid at closing. Solomon refused to deed the property to Bess and conveyed the property to

someone else instead. Bess brings suit seeking money damages.

(a) Did the delivery of the check and securing the written loan commitment satisfy the Statute of Frauds?

(b) If not, does the transaction fall within either the part performance or equitable estoppel exception to the Statute of Frauds?

Papers Everywhere

5. Stan and Bob agree on terms that Stan will sell Whiteacre to Bob. They both go to the office of Ann, an attorney, and tell her that they want her to draft their sales contract. Ann listens to them discuss the terms of the sale, including an “all cash at closing” provision. Ann fills out a blank deed, which Stan signs and gives back to Ann for safekeeping. Stan and Bob then leave Ann’s office and go together to a local bank to arrange financing for Bob for the cash he’d need to close. Later that day, Ann makes notes about Stan’s and Bob’s discussion of the sale terms. Is the Statute of Frauds satisfied in this situation?

But You Promised

6. Mr. Fox owned a farm when he died intestate (without a will). His heirs were his eight children. Wishing to unify ownership in himself, one of them, Sly, made agreements with six of his siblings to purchase their undivided interests in the farm. One sister, Leona, did not want to sell. She desired a particular lot on the farm, a/k/a the knoll, on which she someday wanted to build a home. Sly and Leona orally agreed Leona would convey her undivided interest in the farm to Sly and in exchange Sly at some future time would convey the knoll to Leona. The seven siblings (including Leona) executed a deed transferring their interests in the farm to Sly. Sly paid six siblings (excluding Leona) $10,000 each for their respective interests in the farm. Leona was the only grantor who did not receive any money. Over the next ten years Leona often discussed “her lot” on the farm with Sly. Sly often complained about the costs and hassles of subdividing, but never disavowed the original oral agreement. Sly never developed the knoll, but he did sell some land from the farm. Following an argument between Sly and Leona, Leona by letter demanded Sly fulfill his agreement to transfer the knoll to her. Sly balked at transferring the land, offering instead to pay Leona the same $10,000 he

had paid the others. Leona sues. Sly defends, citing the Statute of Frauds. Does the contract fall within the part performance or other exception to the Statute of Frauds?

Explanations

Too Broke to Pay

1. Yes, *O* likely will recover. Because the prospective purchasers themselves had a duty to disclose their financial difficulties, *B2* also had, as their agent, a duty to disclose. Not disclosing the prospects' trouble is a violation of the broker's fiduciary duty of loyalty and fair dealing. The suit will be more easily maintained in a jurisdiction where the selling agent is the sub-agent of the listing agent, but in other jurisdictions, the suit might be based in tort for interference with a prospective advantage.

Where There's a Will

2. Donnie should prevail. A writing satisfies the Statute of Frauds if it identifies the parties, sufficiently describes the property, states the purchase price, is signed by the party to be bound, and in some jurisdictions states an intent that the property will be conveyed. If the seller finances the sale, the financing terms are material and the writing must document them, including the interest rate, if any. A provision that the balance (the principal) of a note is to be forgiven upon some condition other than full payment is an essential element related to the financing and must be included in a writing signed by the party to be bound.

    Multiple and nonsimultaneous documents may constitute the "writing" if a signed writing indicates the documents are related to the transaction. Prior to Mae's executing the first will, the agreement that the balance of the note was to be forgiven at Mae's death was merely an oral contract unenforceable under the Statute. Mae's first will referencing the sale of the apartments, including the note, and the contractual forgiveness of the note, memorializes the agreement and refers unequivocally to it. Mae signed the will and thus she is bound. Donnie did not sign it, but since he is not being bound, he is not required to sign.

    Mae's revoking the first will is irrelevant since the debt forgiveness was a part of the original contract and was not a testamentary transfer: A

will may serve as a writing for purposes of the Statute even if it is not valid as a will or is later revoked.

Donnie must rely on the satisfying the Statute of Frauds to prevail. The part performance exception is inapplicable because Donnie has not paid the purchase price. The equitable estoppel exception is also inapplicable: Donnie did nothing substantial beyond or in reliance on the agreement sufficient to excuse a failure to get a writing.

Marital Bliss

3. (a) The contract is enforceable against Ben, but not By. A husband is not his wife's agent just because they are married. No husband-wife exception to the Statute of Frauds exists. By did not sign, so the Statute prevents enforcement of the contract against her. Ben did sign, and the contract can be enforced against him.

   (b) The contract is enforceable against Sal, but not Sally. She never made Sal her agent. If Sal contracted to convey more than his half interest in the tenancy, he is liable in damages; but because he deceived them in the sales contract, Ben and By cannot be forced to accept the title (to Sal's half of the tenancy) in an action for specific performance.

   (c) No. Ben and By are still bound and Sal and Sally can seek specific performance of the contract after Sally either ratifies Sal's actions as her agent, signs the contract before Ben and By's offer is revoked, or sells her interest to Sal so he can seek specific performance.

   (d) None of the parties is bound. The contract is conditioned on all four parties' signing it. Even though three parties to be bound signed, it is not yet effective. Either side may rescind prior to all four parties' signing. Until then, the sale is contingent since the provision makes the sale an "all or nothing" proposition.

Handshake Deal

4. (a) The $10,000 check may satisfy the Statute of Frauds if it contains enough information. While it may come close to satisfying the Statute, it probably will not contain all the essential information. The check might contain a notation describing the property on its memo line, name both parties (Solomon as payee and Bess's name printed

on top of the check), and Solomon's endorsement on the back and Bess's signature on the front. But a check for the deposit lacks both a statement of the full purchase price and the terms of the financing. The loan commitment concerns the terms of the Bank loan, not the terms of Bess's purchase, so it adds no essential information. Together, the check and loan commitment do not satisfy the Statute. Bess has no action.

(b) No. Oral contracts saved by part performance require more than the mere payment of earnest money. Even full payment of the contract price will not save the putative purchaser when she, like Bess, could be put back into her original position by the return of the deposit or the full price. Since Bess never took actual possession, much less made substantial improvements to the property, neither part performance nor equitable principles call for the transaction to be recognized.

Papers Everywhere

5. A writing to comply with the Statute of Frauds must (1) identify the parties, (2) describe the property being sold, (3) state the price or at least a method to determine the price, and (4) must be signed by the party to be bound.

   Even before the Statute of Frauds comes into play, there must be a final agreement between the parties. The party seeking to avoid the sale may argue there was no final agreement; that the parties were still in the negotiation stage. That argument is unavailable in this Example because the facts state Stan and Bob have agreed to the terms of the sale.

   The first issue under the Statute of Frauds is whether the attorney's notes can be used to satisfy the Statute. Ann's notes might well contain all the essential terms of the sale. (If Ann didn't ask about an essential term left out of the discussion, she might be acting unprofessionally.) Even if the notes were not made contemporaneously with the parties' discussion of those terms, they will suffice as long as they are made within a reasonably short time afterwards. (It's an attorney taking notes, after all!) At least one court has ruled attorneys' notes could constitute a writing for purposes of the Statute of Frauds. The problem here is neither party—Stan nor Bob—signed the attorney's notes.

If the notes do not suffice, then what about the deed left with Ann? If the deed with blanks is completely filled in, it will contain all the essential terms (perhaps except for the purchase price (a deed needs no consideration to be valid, being a conveyance, not a contract)), but giving it to Ann for safekeeping is not to say that it has been delivered by Stan to Bob. Many courts hold an undelivered deed is subject to modification before delivery and cannot satisfy the Statute. Other courts allow an undelivered deed to furnish some material terms, often the property description, but in and of itself, it does not satisfy the Statute of Frauds.

The loan application might contain the required information except perhaps the sales price, but the application will be signed only by Bob, not Stan. So if Stan sues Bob, the party to be bound has signed, but if Bob sues Stan, the "party to be bound" did not sign.

It's possible a court will allow two or all three writings to constitute a single writing that satisfies the Statute of Frauds if at least one of the documents references the others. There's not enough information in the Example to make this determination. The best solution would have been for Ann the attorney to have drafted the sales contract and had both Stan and Bob sign before the problem arose.

But You Promised

6. Leona will prevail. Even though Leona has fully performed by deeding her interest to Sly, she is not in a position to assert the part performance exception: She has not taken physical possession and she has not substantially improved the knoll. Under the equitable estoppel exception, however, Leona, in reasonable reliance on the oral contract and Sly's continuing assent, had so changed her position that injustice could be avoided only by ordering specific performance of the oral contract for the knoll. Leona changed her position by deeding her interest to Sly ten years earlier. But even deeding her interest in the property would be insufficient in itself since returning a one-eighth interest in the farm to Leona would undo any harm and Sly's use of the property over the previous ten years is consistent with his being Leona's tenant-in-common. However, Sly's subdividing and conveying away part of the farm prevents Leona's inheritance from being fully restored (leaving Leona with no adequate remedy but specific performance of Sly's agreement to convey the knoll).

Further, Leona's joining her siblings on the deed to Sly referred unequivocally to their oral contract. Thus not enforcing the oral contract under these facts would be unconscionable and amount to an equitable fraud on Leona.

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1. The Statute of Frauds is discussed more fully later in this chapter.

2. In major urban areas, both the listing and the selling broker are members of a multiple listing service (MLS) that shares listings among its members. Where available, MLSs are utilized for 80-90 percent of all residential listings.

3. ***Latent defects*** are those defects known to the broker and not discoverable by the prospective purchaser upon reasonable inspection. ***Patent defects*** are those defects not hidden which can be discovered upon reasonable, nonexpert inspection.

4. The seller's duty to disclose latent defects is covered in the next chapter.

5. A court will not order specific performance of an oral contract. An oral contract for real estate is said to be voidable, not void. The parties may perform it and, if carried through to closing, the transaction will not be undone.

6. Agent as used here does not refer to a real estate broker or real estate agent. It is used in the sense of agency law that one person (known as the principal) can appoint another person (known as the agent) to act on the principal's behalf and can bind the principal when the agent acts within the scope of his agency. The most common principal-agency relationship is the employer-employee relationship, but it can encompass much narrower relationships such as making an agent an "attorney-in-fact" to purchase or sell specific real estate.

CHAPTER 22

Executory Period Issues

INTRODUCTION

Once a seller and purchaser enter into a sales contract, each takes steps in preparation for closing. The interim period between the signing of the sales contract and the closing is called the ***executory period*** or ***gap period***.

Not all sales contracts close. The contract itself may condition the parties' obligation to close. A party's failure to satisfy a sales contract condition allows the other party to rescind the contract without liability, and in some cases the sales contract allows the party not meeting the condition to rescind. For example, a clause may allow the buyer to rescind the contract after consulting with an attorney. A common condition, known as the "subject to financing" clause, conditions the buyer's obligation to close on securing a loan commitment under suitable terms, including the amount, repayment schedule, and maximum interest rate. Those terms that are "suitable" are often included in the contract: a maximum interest rate, minimum term for the loan, and maximum monthly payment are often included. Implied in this clause is the buyer's obligation to make a good faith effort to obtain a commitment. Other clauses may condition the closing on the buyers' selling

their current residence, on a third-party inspection of the property, on its rezoning, on an appraisal or other report (e.g., a termite inspection report), or on the seller's removing a mortgage or other lien from its title.

MARKETABLE TITLE

(a) Definition of Marketable Title

Title to a property constitutes all the elements or attributes constituting ownership. However, a buyer wishes to know, before closing, that he is obtaining a useful title. To this end, unless the sales contract specifically stipulates a different standard, every land sales contract contains an implied condition that the seller will convey "marketable title" to the buyer.

Marketable or ***merchantable title***, while allowing for the possibility that the buyer's title might be successfully challenged, is a title secure enough that a reasonable person knowing all the facts would accept and pay for it. It is a title free from reasonable doubt as to its validity and reasonably free of the prospect of litigation.

A title is unmarketable if there is a reasonable probability the seller does not own the title alleged, the property is subject to an undisclosed encumbrance, or the buyer bears an unreasonable risk he would be subject to litigation related to it in its current condition. A buyer, in other words, is not required to take unreasonable risks or to "buy a lawsuit."

Unless the seller cures all defects before the closing, a prospective purchaser offered an unmarketable title can refuse to close and can rescind the contract. If the purchaser intends to rescind a sales contract based on unmarketable title, he must rescind before closing. If closing occurs, courts hold the title required by the sales contract ***merges*** with the title taken in the deed; the buyer is thereafter limited to rights flowing from the warranties of title included in the deed. Courts, however, at times fashion ways to enforce some sales contract provisions even after closing, such as promises concerning the physical condition of the property. These promises, regarded as collateral to the conveyance of the title, are not merged into the deed.

The seller and the purchaser may agree to provide for a title more rigorous than marketable title such as ***perfect title*** or ***marketable title of***

record, which requires not just marketability, but also that every link in the chain of title a seller presents the buyer at closing be of record—not necessarily recorded, but documented in some fashion, with affidavits or other written evidence admissible in court.

Because determining marketable title entails ascertaining a reasonable person's response to the likelihood a lawsuit may ensue, sellers sometimes promise to furnish ***insurable title***, which is satisfied if a title insurance company will insure the title. The title insurance policy contains a duty to defend the insured should the title prove of questionable marketability, thus anticipating the risk of a lawsuit. The insurable title standard also aids sellers because title insurers are sometimes willing to undertake the risk that litigation will arise over minor or technical defects in title.

(b) Examples of Unmarketable Title

Minor encumbrances or unlikely occurrences do not make a title unmarketable. Thus a mere possibility or suspicion that the title is flawed is not enough to make the title unmarketable.

Example 1: *A*, a single person with no siblings, died intestate 20 years ago. A chance exists some heretofore unknown or long-lost heir may appear claiming an interest in the property. The mere possibility that an unknown or missing heir survived the long-dead decedent and, after the probate decree was made final, has a claim to the property does not make a title unmarketable. Likewise, a lien or mortgage long past the statute of limitations on enforcement and involving creditors then dead probably would not make the title unmarketable.

Marketable title is not the same as a title without defects or encumbrances. Most property is transferred subject to some encumbrances. It is not the existence of an encumbrance or possible defect that causes a title to be unmarketable; it is the existence of an encumbrance undisclosed to the buyer and thus not made part of his bargain that makes the title unmarketable.

Typical encumbrances or defects in title are undisclosed co-owners (concurrent or future estates), mortgages or liens, easements,[1] real covenants or equitable servitudes,[2] leases, mineral rights, options, flaws in the deed

records, erroneous acreage designations, or ownership based on adverse possession. Violation of a federal or state or local statute, ordinance, or code may make a title unmarketable, but only if the violation is likely to be prosecuted. Thus the presence of toxic waste on a property does not render the title to it unmarketable unless a government agency threatens or pursues an enforcement action. The waste may affect the use of the property, but not its title.

Example 2: A buyer contracts to buy a residential property subject to a restrictive covenant restricting its use to residential purposes. The sales contract discloses the residential-uses-only restriction. The restriction does not make the title unmarketable because the buyer agreed to buy the property subject to the restriction. The buyer is legally bound by the sales contract.

Example 3: During the executory period, the buyer discovers a real covenant prohibiting multi-story homes on the property. The title is unmarketable because the sales contract did not disclose the covenant. The buyer can rescind the sales contract. It does not matter whether the buyer intends to build a one-story or two-story home, or whether the seller knew of the multi-story covenant. The buyer is not obligated to buy the property unless the seller removes the covenant by the closing.

Example 4: Assume the same facts of Example 3 and a second buyer contracts to purchase the property. The sales contract makes the transfer of title subject to both the residential-use-only restriction and the one-story-only restriction. The title as to this buyer is marketable because the buyer executed the sales contract aware of both encumbrances.

The buyer in Example 3 did not contract to purchase the property with a restriction that limits houses to one story, so the buyer is not required to complete a contract for something less than he bargained for. The buyer in Example 4, on the other hand, is purchasing exactly what he bargained for and what the contract described. The Example 4 buyer is thus liable on the sales contract.

Jurisdictions take wildly different approaches when evidence of an encumbrance or some other party’s interest, say as a tenant, is ***visible*** or ***apparent*** upon inspection. At one extreme, some jurisdictions require all encumbrances be disclosed in the sales contract for the title to be marketable.

The purchaser's actual knowledge or not of the visible or apparent encumbrance is irrelevant. Other states say title is not unmarketable if the purchaser has actual notice of the visible or apparent encumbrance—i.e., the purchaser is assumed to have contemplated purchasing the property subject to any use or structure of which they had actual knowledge.

A few of these jurisdictions look to the location of the undisclosed easements, and to whether the easement benefits the property, or reduces its value. Generally these courts find visible easements along the edge of the property do not make the title unmarketable whereas ones that run through the middle of the property do make the title unmarketable. Other jurisdictions falling on the opposite extreme hold undisclosed visible and apparent encumbrances do not make title unmarketable. This last rule puts a burden on the purchaser to inspect the property before entering into the sales contract.

Policy question: Here's a scenario: The seller and the purchaser have signed a sales contract but have not closed. The purchaser refuses to buy the property because open and visible electrical poles and power lines (or railroad tracks) are on the property, but were not disclosed in the sales contract. The seller wants to go through with the sale, and the purchaser wants to rescind the sales contract and have her earnest money refunded.

(a) Take some reflection time and decide how you would rule.

(b) Should it matter if the purchaser saw the poles and wires (or railroad tracks) before she signed the sales contract? Why or why not?

(c) Should it matter whether the encumbrance makes the property more valuable or less valuable? (Electrical poles and power lines may bring electricity to the property and make it more valuable; Railroad tracks may diminish the property's value). Why or why not?

Compare your answer with the Examples & Explanations question 4.

(c) Defective Deed Records

Deed records serve an important function in assuring purchasers their sellers in fact can transfer the title they promise to transfer. Deeds and other documents (liens, mortgages, etc.) affecting real property are filed ("recorded") in local government offices (usually in the county courthouse) where the land is situated. A person can resort to the county's deed records to trace all filed documents related to a particular piece of land back to the

original grant from the state or federal government (that is, he can establish a “chain of title”).

Because of the importance of the deed records to our society and to maintain the integrity of the system, the person who is the ***record owner***—i.e., the person who is deemed the landowner by looking solely at the deed records—often will prevail over the ***legal owner***—i.e., the person who would be owner if there was no official recording system and the history of all actual transactions is known.

Any flaw in the deed records that could lead to litigation makes the title unmarketable. Deed records can be defective in many ways. The property can be misdescribed in a prior deed, for example, or some names are different from one “link” to the next in the record “chain.” A deed may not be properly notarized or otherwise not legally authorized to be recorded, or recorded out of order; in either case the document will be deemed unrecorded and of no legal effect. A party to a deed may have lacked capacity to transfer the interest in the property (e.g., either being a minor, lacking mental capacity, or lacking authorization for a transfer from a legal entity like a corporation by one of its officers). Any serious flaw or missing link in the deed records makes the title unmarketable.

(d) Violations of Covenants, Ordinances, Regulations, or Other Laws

Special considerations surround zoning laws, building codes, and other government laws and regulations. In general, a seller is not required to disclose the applicability of any law or government regulation, including zoning laws and building codes. The failure to disclose these regulatory matters will not make the title unmarketable.

Example: In Example 3, above, an undisclosed restrictive covenant from an earlier deed limiting homes to one story made the title unmarketable. If, instead, the one-story restriction was part of the local zoning ordinance rather than a restriction in a prior deed, the sales contract’s not disclosing the zoning restriction would not make the title unmarketable.

The logic behind this seeming anomaly is fairly simple: All people are expected to know zoning laws apply to all property within a political subdivision, including a city or county. A reasonable person would research the zoning laws before entering into the sales contract. A person entering into a sales contract without reviewing the zoning laws risks being bound by an unanticipated zoning ordinance. The same logic applies to all federal and state statutes and local ordinances, including building codes. Only private restrictions must be disclosed in the sales contract.

A ticklish situation arises when the property in its current state violates a disclosed covenant or servitude, a zoning ordinance, a building code, or other federal or state statute. A violation of a ***restrictive covenant*** (that may be enforced) makes the title ***unmarketable***. Most courts hold that an undisclosed ***zoning code*** violation does not make a title unmarketable unless an enforcement action has been docketed, or is being pursued in litigation, against the seller. Courts seemingly agree that ***building code violations*** relate to the property's ***condition*** and not to ***title***. Thus an undisclosed building code violation does not make a title unmarketable.[3]

(e) Adverse Possession

Adverse possession complicates the determination of marketable title for both the record title owner[4] and the self-styled adverse possessor. Title acquired by adverse possession is marketable in most states, even if the claimant has not filed a quiet title action. At the same time, the mere allegation by a seller that he owns property by adverse possession is insufficient to establish marketable title. Adverse possession must be established by either a preponderance of the evidence or clear and convincing evidence. Thus, controversy as to any element of adverse possession prevents the seller from having marketable title. A seller claiming title by adverse possession bears the burden of proof that he can establish it. Similarly, a record title owner cannot convey marketable title if a third party, especially a present possessor, claims to own an interest in the property by adverse possession unless the claim is frivolous. In this instance, the seller holding a record title might be required to bring a judicial action to defeat the adverse possessor and eject him from the property, if need be, as a trespasser.

In this connection, some courts also find the title to be unmarketable if a structure on the property encroaches on bordering land or if property on bordering land encroaches on the property being transferred since, in either case, resolution of the matter could lead to litigation.

(f) Landlocked Property

Courts favor access to property. Thus, even though technically not a title defect, a court may find title to be unmarketable if there is no ***access*** to the property—i.e., if the property is ***landlocked*** (unless the sales contract discloses the lack of access or, in some jurisdictions, if the purchaser was aware of the access problem when he or she signed the sales contract). See, e.g., Howell v. Brozetti, 246 A.D. 929 (N.Y. 1998). Courts in at least two states have held property without access is still marketable. See, e.g., Sinks v. Karleskint, 474 N.E.3d 767 (Ill. App. 1985). In both those cases the courts alternatively held the purchaser was aware the property lacked access.

CAVEAT EMPTOR AND THE DUTY TO DISCLOSE DEFECTS

The seller's failure to disclose material latent defects is a basis for rescinding a sales contract. Courts imposing a duty to disclose material defects thus abrogate the long recognized doctrine of ***caveat emptor—let the buyer beware***. Where courts impose this duty to disclose, buyers can elect either to rescind the sales contract or seek damages from the seller.

(a) Caveat Emptor

In a minority of jurisdictions, caveat emptor still reigns. Absent some special fiduciary relationship with a buyer, a seller in a caveat emptor jurisdiction owes no duty to disclose either patent or latent defects to a buyer. The buyer should, all the more carefully, inspect the property before executing the sales

contract. A seller who remains silent escapes liability. Even where caveat emptor is the rule, however, sellers cannot mislead buyers by affirmatively misrepresenting facts or actively concealing facts. Thus a buyer of defective premises in caveat emptor jurisdictions may still bring a claim based on fraudulent misrepresentation.

The elements of fraudulent misrepresentation are (1) a representation of a fact, (2) which is material to the sale, (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true, (4) with the intent of misleading the purchaser into relying on the representation, (5) the purchaser justifiably relies on the representation, and (6) the purchaser suffers some injury proximately caused by his reliance on the misrepresentation (or injury would be suffered if the purchaser goes through with the purchase).

(b) The Duty to Disclose Material Latent Defects

Most states have adopted, judicially or by statute, a rule requiring sellers to disclose ***material latent defects*** to purchasers. Material defects are those that materially affect the property's value or could significantly impair the occupant's health and safety, or that the seller knows affect the desirability of the property to the buyer. Latent defects are those defects known to the seller and not discoverable by the buyer upon reasonable inspection.

Example: A buyer contracts to purchase a residence. The sales contract provides that the property is sold "AS IS." The seller misrepresents the condition of the roof—it is in fact leaky and requires replacement. The "AS IS" provision does not trump the seller's duty to disclose. The misrepresentation means that the buyer is not bound by the "AS IS" provision as to the roof. Only if the seller is silent about the roof and its defective condition is discoverable by the buyer upon reasonable inspection is the seller not liable: then the "AS IS" provision trumps the duty to disclose. Particularly when the duty of disclosure is mandated by statute, its waiver will not be lightly implied.

Courts and jurisdictions differ on the extent of the required disclosures. A few jurisdictions limit a seller's duty to disclose material latent facts relating

to conditions that affect the health or safety of the buyer (meaning that the condition affects the habitability of the property). Some only impose the duty to disclose defects on professional sellers—builders and developers—of new homes. A few extend this duty to all sellers, as well as to real estate brokers.

Courts requiring disclosure apply the seller's duty to material latent ***physical defects*** on the property, including leaky roofs, termites, cockroach infestation, or that the house is built on filled-in or swampy soil. Some courts also require a seller to disclose ***off-site conditions*** that may affect the property's value or the occupant's safety or health, such as nearby hazardous waste disposal sites, nearby landfills, noisy neighbors, underground gas pipelines, or proposed developments.

A small minority of courts require sellers to disclose nonphysical defects, both associated with the property itself and on nearby properties. In one famous case, sellers were required to disclose that a home had a reputation of being haunted by ghosts. Another court required disclosure that a mass murder occurred in the home. However, some state statutes, known as "stigma statutes," specifically absolve sellers from disclosing the home was occupied by a person with HIV or other disease unlikely to be transmitted through occupancy of the home; or that the home was the site of a homicide, suicide, felony, or death by accidental or natural causes.

Even when a seller must disclose latent defects, a seller does not have to disclose patent (or visible) defects or defects that aren't material. Sensibly, a seller must know of latent defects before the obligation to disclose arises.

This duty to disclose material latent defects does not extend to commercial properties. Courts reason commercial purchasers are more sophisticated and can professionally inspect the property. Off-site conditions and nonphysical defects, moreover, are not as crucial to commercial owners. Sellers of commercial property may still be liable for affirmative misrepresentations, but caveat emptor remains the rule for commercial properties.

TIME FOR PERFORMANCE

A purchaser cannot rescind a contract as soon as a title defect or physical defect is discovered. The seller has time to rectify or remove the defect.

Similarly, the buyer has time to obtain financing, inspect the property, secure government permits, etc. When the sales contract does not specify a time to remedy the defect, the parties have a “reasonable time” to perform or to close. A seller may even have time to bring an adverse possession suit without breaching the contract for unreasonably delaying closing. Even when the parties set a date for closing, courts in equity tolerate delays in closing unless the sales contract stipulates that “***time is of the essence***.” Even when time is of the essence, minor delays by one party are permitted if no harm to the other party occurs.

Example: *S* contracts to sell Whiteacre to *B* for $100,000 on January 1. The contract calls for a closing by March 31. Because of the large number of loans and real estate purchases being made, and consequent delays by surveyors, appraisers, and title researchers, *B*’s mortgage lender did not approve *B*’s loan until March 15. By the time all documents are drafted, the earliest the parties could close would be April 15. In late March, a second buyer offers *S* $125,000. *B* wants to close. *S* wants to rescind the contract and sell to the second buyer. A court should refuse to allow *S* to rescind and should grant *B* specific performance. Many unavoidable delays occur in real estate sales. Time ordinarily is not of the essence, absent an express stipulation to that effect. There is no such stipulation here: Setting a closing date does not make time of the essence. Unless circumstances indicate timing is critical, *B* has a reasonable time to close. This two weeks’ delay, brought on by factors beyond *B*’s control but clearly foreseeable in the contract, is reasonable.

REMEDIES FOR BREACH OF SALES CONTRACT

If the seller cannot deliver marketable title at closing, the purchaser may choose to go forward with the closing, and seek specific performance if necessary. Alternatively, the purchaser can elect to rescind the sales contract or seek an abatement (reduction) of the purchase price. If the purchaser is the breaching party—generally by refusing to close—the seller, like the purchaser, can seek specific performance; but while courts do order specific performance at the seller’s request, they normally limit the seller to monetary damages.

As to damages, a court could award either (1) nominal, out of pocket damages or (2) loss of bargain damages, the latter being equal to the difference between the fair market value at the time of the breach and the agreed upon contract price. In many cases, this is a negligible amount. In some cases, of course, the amount could be substantial.

Nominal damages are limited to closing and settlement costs associated with the sale (e.g., money spent on appraisers, surveyors, lawyers, fix-up costs, utilities, taxes, interest on loans, title examination fees, moving expenses, temporary housing expenses, and increased construction costs). These costs are, after all, incurred in reliance on closing the sales transaction and awarding them partly puts the nonbreaching party back in the financial position he or she would have been in had the parties not entered into the sales contract.

Most all jurisdictions give ***loss of bargain damages*** when the seller acts in bad faith. Jurisdictions split on whether a buyer can get loss of bargain damages when a seller acts in good faith, yet fails to deliver marketable title. The majority of courts giving loss of bargain damages allow them even if the seller believed the title was marketable when the sales contract was executed. Many jurisdictions, however, not wanting to penalize a seller who presented the title in good faith, allow the buyer to receive only restitution of the earnest money down payment and nominal damages.

In jurisdictions awarding loss of bargain damages, a nonbreaching party may also collect consequential damages for damages foreseeable by the breaching party. Generally, lost profits on anticipated resale of the property or lost rents would fall into this category, as long as they are proven and not merely speculative. Jurisdictions denying loss of bargain damages for good-faith defaults likewise will refuse to award consequential damages on good-faith defaults.

Example 1: *S* contracts to sell Blackacre to *B* for $400,000. During the executory period, *B* discovers an undisclosed easement making the title unmarketable.[5] Blackacre's value has increased to $450,000 since *S* and *B* executed the contract. In jurisdictions allowing loss of bargain damages, *B* can rescind the contract and also collect $50,000 loss of bargain of damages from *S*. If Blackacre's value had decreased to $375,000 during the executory period, *B* would not have suffered (and could not collect) any loss of bargain damages (and the seller would not be entitled to any damages under these

facts since the seller was legally the party at fault).

In this Example, if *B* breached the sales contract, *S* could sue for loss of bargain damages if Blackacre's value decreased between the date of the sales contract and the date of the breach. That is, only in a falling market is *S*'s suit for damages viable, and worth the time and trouble.

Example 2: *S* agrees to sell Whiteacre to *B*. *B* breaches the contract. *S* sues *B* for damages in a jurisdiction giving only nominal damages but in which *S* by custom pays the title examination fees associated with a sale. Part of *S*'s complaint asks for these fees. *B* does not have to pay them because *S* would incur the same fees in any resale of the property and can reuse the title abstract produced, thus making these fees not just incidental to the sale to *B*, but to any resale.

Example 3: *S* agrees to sell Blackacre to *B*. *S* breaches the sales contract. Between the date of the contract and the breach, the interest rate on the loan *B* was going to use to make the purchase rises steeply. In jurisdictions that award loss of bargain damages, the difference in mortgage payments reflecting the rate rise is recoverable as consequential damages when *B* has to finance the purchase of another property.

When damages may be difficult to prove or are speculative, parties (especially sellers) at times insert a ***liquidated damages*** clause, either as an option or as the exclusive remedy, into the sales contract. The clause fixes the amount of damages on default (often it will be the amount of the earnest money or down payment) and often provides that upon the purchaser's default the purchaser forfeits the down payment or earnest money to the seller. As long as the clause is a reasonable estimate of damages, arrived at during good-faith negotiations showing actual damages difficult to measure, and does not serve as a penalty, a court will enforce such a clause. If a court finds a liquidated damages clause unreasonable, the seller must then prove actual damages and refund any excess earnest money to the purchaser.

EQUITABLE CONVERSION AND RISK OF LOSS

Although the seller holds legal title to and the right to possession of the property until closing, some ownership risks and benefits pass to the buyer immediately upon execution of the sales contract. For example, the buyer suffers or benefits from any changes in the property's fair market value between the date the sales contract is executed and the closing. This shift of some of the incidents of ownership to the buyer is called ***equitable conversion***. The purchaser's interest is deemed an interest in ***real property***. Meanwhile, although the seller is still the legal and record owner, the seller no longer is deemed to own an interest in real property. His interest is in the sales contract, which is deemed to be ***personal property***. Thus, if a seller or buyer dies intestate during the executory period, the seller's interest passes according to the personal property provision of the intestate succession statute and the buyer's interest passes according to the real property provisions. Similar results follow if the testator's will transfers real property to one beneficiary and personal property to another beneficiary: The seller's interest passes as personalty, the buyer's interest as realty.

One troubling issue (unless the sales contract specifically addresses it) is which party bears the ***risk of loss*** during the executory period if the property is completely or partially destroyed by fire or by natural causes such as by flood, storm, or earthquake, or is affected by government actions such as rezoning, annexation, or condemnation. The answer varies depending on the jurisdiction, and sometimes on who has possession and on whether the property is insured. Consistent with the idea of equitable conversion that the purchaser is the equitable owner of the property, the traditional rule places the risk of loss from events in the executory period on the purchaser. In contrast, a growing number of states demand the seller deliver the subject of the contract—i.e., the building—and if the seller cannot deliver the building, there is a substantial failure of consideration. In these states, therefore, the seller bears the risk of loss. Yet other states—a dozen or so—place the risk of loss on the seller unless the purchaser goes into possession, at which point the purchaser bears the risk of loss. Using its equitable powers, a court may order specific performance but abate (reduce) the purchase price for the partial loss of value attributable to the damaged or destroyed building. Such an abatement might happen no matter which party, buyer or seller, seeks specific performance.

In all jurisdictions, both seller and buyer have insurable interests in the property during the executory period. Both parties might as a matter of

prudence carry insurance during the executory period, but if the party (usually the buyer) bearing the risk of loss carries no insurance, and the other party (usually the seller) carries insurance, some courts adjust the parties' rights accordingly. Some jurisdictions permit a seller both to receive insurance proceeds and collect the full sales price, but the majority require the seller to apply the insurance proceeds against the sales price or hold it in a constructive trust for the buyer's use. When the risk of loss is on the seller and the buyer carries insurance, some jurisdictions allow the buyer both to keep the insurance proceeds and to rescind the sales contract. Other courts impose a constructive trust on the buyer, requiring him to turn the proceeds over to the seller, but allowing an abatement in the purchase price if the purchaser closes the sale, or allowing the buyer to keep the proceeds but allowing no abatement in the purchase price. Still others prohibit the buyer from retaining the proceeds, deeming the seller as legal owner entitled to receive the proceeds as the third-party beneficiary of the insurance policy.

Equitable conversion has its limits. The seller, for example, has a duty to maintain the property until closing or transfer of possession, and is responsible for his allocated share of accrued property taxes up to closing. Similarly, any rental receipts on leased property or proceeds from severed minerals or timber before closing belong to the seller.

Examples

Restrictions of Record

1. *S* agrees to sell Blackacre to *B*. The sales contract says *S* will transfer the property "subject to all covenants, easements, restrictions, and encumbrances of record applicable to this property." While researching the deed records in the county courthouse, *B*'s attorney finds, among other documents, an easement to run a gas pipeline through the northeast corner of the property. Can *B* refuse to close?

Violation? What Violation?

2. *S* agrees to sell her home to *B*. *B* pays *S* a $2,000 down payment when executing the sales contract, which further provides that the balance of the purchase price is to be paid on delivery of a deed conveying marketable title, free of all encumbrances except those encumbrances enumerated in

the contract. One of the enumerated encumbrances was a recorded subdivision plat and its restrictions. The plat contains a restriction prohibiting any building or part thereof from being located within ten feet of an adjoining property line. *S*'s house is four feet from the north boundary line. *S* obtains written assurances from a title insurer that, for an additional fee that *S* paid, the insurer would insure the "over the building line" exception. *B* refuses to close, buying another home instead. *S* sells her home to another for $5,000 less than *B* would have paid. *S* sues *B* for damages. *B* countersues to recover the $2,000 down payment. What result?

What Violation? Part II

3. Sellit bought his home in 1955. In 2002, he contracted to sell the home to the Beyers. The sales contract provided Sellit would transfer to the Beyers "good and marketable title, free of liens and encumbrances except for use and occupancy restrictions of public record generally applicable to properties in the immediate neighborhood or subdivision." A covenant in every deed to every house in the subdivision, including Sellit's, contained the following restriction: "No home shall be erected within 75 feet of the streets and avenues designated in the subdivision plat." The front of Sellit's home was 44 feet from a designated avenue. The four homes closest to Sellit's were 40, 44, 45, and 45 feet, respectively, from the avenue. There never has been any litigation with regard to any of the violations. Two title insurers were willing to insure the property as marketable. A third insurer would guarantee the dwelling could remain as located, but would not guarantee or insure the property's marketability. The Beyers refuse to close. Sellit seeks specific performance. Beyers counterclaims for a return of their earnest money. Who prevails?

Stop, Look, and Pay Attention

4. *B* contracted to buy a 200-acre ranch he intended to use for grazing cattle. Before executing the sales contract, he walked the fence forming the boundary of the farm, at one point standing on railroad tracks while a ranch hand explained how the current owner used gates to rotate cattle from one field to another. The sales contract provided that *B* would receive "marketable title free from all restrictions, covenants, easements,

and encumbrances" except for a utility easement, an easement for an underground gas pipeline, and an easement across the easternmost part of the ranch in favor of a neighbor to reach the county road adjoining the ranch. The sales contract did not mention a railroad easement nor an outstanding $50,000 mortgage. Can *B* rescind the sales contract, claiming unmarketable title?

Buyer Beware: Caveat Emptor

5. *S* plans to sell her home. Which of the following must she disclose to prospective purchasers?
   - (a) Basement floods after heavy rains.
   - (b) Leaky basement water pipe.
   - (c) The home is to be connected to a new sewer system for which a tax assessment is likely.
   - (d) Empty, out-of-service underground petroleum storage tanks in backyard.
   - (e) The home was the site of a murder ten years ago.
   - (f) The home has a reputation for being haunted by the ghost of the murder victim.
   - (g) A landfill is located one-half mile from the home.
   - (h) A convicted child molester lives on the block.

Fire Sale

6. On March 15, *O* contracted to sell a cabin on five acres to *B*. *B* deposited $1,000 earnest money toward the $100,000 purchase price. The sales contract set May 1 as the closing date. On March 25, the cabin, through no fault of either party, was destroyed by fire.
   - (a) *B* refuses to close and demands a refund of the earnest money. *O* seeks specific performance. Who prevails?
   - (b) Under the sales contract, *B* was allowed immediate possession of the cabin and five acres. *B* moved his personal belongings into the cabin on March 20. Does this affect your answer?
   - (c) Assume the sales contract provided that "should the premises be materially damaged by fire prior to closing, this contract shall be voidable at the option of Buyer." Would this clause change the result in (a)?

(d) Assume *B* purchases property insurance on the cabin, $50,000 coverage on the cabin and $50,000 coverage on its contents. *B* is the insured, with *O* listed as another person having an interest in the property. Does the existence of the insurance affect your answer? Who receives the insurance proceeds?

Death and Other Incidental Matters

7. On May 1, *M* contracts to sell Blackacre to *B* for $100,000. Closing is set for July 1. On June 1, *M* dies. *M*'s will directed that all her real property pass to her husband and that all her personal property go to a trust for the benefit of her two children. Who receives the $100,000 at closing? What happens if *B* is able to rescind the contract?

Counsel Your Client

8. When *S* and *B* execute a sales contract for the sale of Blackacre, they agree that purchaser *B* will assume the risk of Blackacre's loss by fire during the executory period, subject to *S*'s restoration of the property. If *B* presents you with the contract to review, what advice would you give her?

Explanations

Restrictions of Record

1. No. The sales contract did not mention the easement. If the sellers in the sales contract had listed specific covenants, restrictions, easements, and other encumbrances on the property, accidentally omitting the gas line easement, the omission would have made the title unmarketable. In the Example, however, instead of listing covenants, restrictions, easements, and other encumbrances, the seller transferred the property subject to all restrictions of record. A transfer of this type means the purchaser is willing to accept the property subject to all documents filed in the deed records. Sellers are protected against inadvertent omissions by inserting the general reference to all documents in the deed records. Buyers, on the other hand, are best served by specific enumerations of the encumbrances.

Violation? What Violation?

2. *B* wins and is entitled to a return of the down payment. *S* must convey marketable title. Marketable title is not perfect title. It is a title that a reasonable person would accept because the indicated defect would not affect market value or subject the owner to an unreasonable risk of litigation. The title defect here is not the existence of the set-back restriction. *B* accepted this in the contract. However, the violation of the set-back restriction is a defect that every landowner in the subdivision has standing to enforce. A reasonable buyer understandably might be reluctant to buy the property for fear of future litigation. A reasonable fear of this potential litigation renders *S*'s title unmarketable. The title insurer's willingness to insure the "over the building line" exception does not change this result. Buying insurance would not cure the defect: It may reduce the financial burden of litigation, possibly the cost of reconstructing the home, but it does nothing to remove the specter of litigation. *B* contracted for marketable title, not the lower insurable title standard. Finally, unless market conditions changed, the purchase price reduction in *S*'s resale may be related to the new purchasers knowing about the violation, another indication the title is unmarketable.

What Violation? Part II

3. Sellit wins and obtains specific performance. Sellit agreed to transfer marketable title. Marketable title is a title that a reasonable purchaser, well informed as to the facts and their legal consequences, would accept. Here, as in Example 2, the defect is the violation of a restriction: the house being 44 feet from the avenue when a covenant mandates any home be 75 feet from it. Not every defect or threat of suit makes a title unmarketable. (Otherwise the doctrine of marketable title would provide an out for a title that a purchaser might prudently accept.) The issue in this Example turns on whether a reasonable purchaser would fear a lawsuit because of the violation. Here the homes have been so situated for more than half a century with no hint of litigation, so the statute of limitations on any lawsuit or its prescriptive analogue in the law of easements would preclude a lawsuit. Moreover, at least the four closest neighbors are estopped from enforcing the covenant since their homes too are in violation of the restriction. Unlike the situation in Example 2 (where a reasonable chance exists a lawsuit could occur since the house may have

been the only one in the neighborhood that substantially violated the ten-foot set-back), no reasonable purchaser here would anticipate being sued. The title being marketable, the Beyers must honor the sales contract. However, some jurisdictions do not look at the degree of risk of litigation for violations of restrictive covenants or of zoning ordinances. They find the title unmarketable because the *possibility* of a lawsuit exists, so the Beyers should not have to enter into a lawsuit to determine if a court would find a reasonable purchaser would purchase. In those jurisdictions, a court might rule in favor of the Beyers.

Stop, Look, and Pay Attention

4. The outstanding $50,000 mortgage does not make the title unmarketable. *B* must notify the seller of the defect and the seller has until (and including) closing to remove the mortgage. In most cases, the seller uses the sales proceeds to satisfy the $50,000 debt and the mortgage is released. Courts seldom if ever find a title unmarketable as long as the sales price exceeds the cumulative amount of outstanding debt against the property since it is so customary to use the sales proceeds to retire outstanding mortgages at closing.

   The railroad easement poses a more interesting question. *B* saw the railroad tracks. He even stood on them. Many states, probably the majority of states, hold visible easements do not make a title unmarketable. Courts following this approach conclude the purchaser was willing to purchase the property subject to the easement, and probably adjusted the sales price for the easement. At the other extreme, some courts, probably a minority of courts, would find the title unmarketable even though *B* admittedly saw the tracks. All encumbrances must be mentioned or referenced in the sales contract for title to be marketable in these states. A third grouping of cases seems to indicate visible easements on the edge of the property or that benefit the property such as roads and utility easements do not make the title unmarketable, but that other visible easements do make the title unmarketable. Since the railroad easement would not benefit *B*, under this third approach the title is unmarketable.

Buyer Beware: Caveat Emptor

5. In some jurisdictions, as long as *S* does not affirmatively deceive the

buyer or engage in any active concealment, she would not be required to disclose any of the listed items. Caveat emptor! Because she is selling a used home and is not its builder, she may not have a duty to disclose even in some states imposing a duty to disclose on developers and builders of new homes. In states judicially requiring disclosures, she could also avoid a duty to disclose several of the listed conditions because the buyer or his agent by reasonable inspection could spot them. As in Example 4, the risk that a reasonable inspection of the property would reveal the defect makes the visible defect here akin to the railroad easement there.

If the jurisdiction has a statutory disclosure law or form, the statutory provisions control. Under California law, to illustrate, a disclosure form (see West's Ann. Cal. Civ. Code §1102.6) would require disclosure of the following from the Example: flooding problems, including the basement flooding; plumbing problems, including the leaky pipes; sewer problems, which probably does not reach the prospective future sewer; fuel or chemical storage tanks, which probably reaches the empty, out-of-service tanks; and neighborhood noise problems or other nuisances, which may or may not reach the landfill. By statute, murders and ghosts are not material defects in California (but may be in other states). Compare these results to the discussion below when there is no statute on point:

(a) Basement flooding epitomizes defects that can be discovered upon inspection, even when no rain has fallen and the basement is dry. Courts find most basement flooding to be visible and not latent, so there is no duty to disclose.

(b) Leaky pipes in the basement are open and visible if the pipes are visible or if the evidence of previous damage is observable. On that ground, there is no duty to disclose.

(c) There is no duty to disclose future tax assessments if the buyer could have found out about the sewer and the tax assessment by inquiring of government officials, and a seller would not be liable even though the seller had acted deceptively and even if the jurisdiction requires disclosure of material latent defects, as long as the buyer could learn of the situation by inquiring of proper officials. Buyers are responsible for knowing what their duties as landowning citizens are.

(d) As long as the tanks are not being used and pose no health or environmental risks, no disclosure is generally required unless there is some proceeding involving the tanks brought by officials enforcing

environmental statutes.

(e) If the state has abolished caveat emptor for material latent defects, the seller may be required to disclose the facts of the murder. Clearly the fact of the murder is not observable by inspection. The remaining issue is whether the fact of the murder is material. Materiality is determined by whether the occurrence of the murder significantly affects the value of the house. The defect involved here is known as a psychological defect. Since some people would not want to live in a house where a murder occurred, and others would not want to have people constantly reminding them they live in the house where the murder occurred, a good case could be made that disclosure be made. However, in some jurisdictions, statutes provide that sellers are not required to disclose psychological or stigma conditions. Such a statute would result in no duty to disclose.

(f) If required to disclose under (e), the sellers would be required to disclose here also, particularly when the seller had publicized her haunted house and on this basis is obligated to disclose that reputation to prospective buyers. This obligation might extend to the disclosure of a general reputation in the community, whether or not the seller actively sought the publicity. So a cautious seller would be advised to disclose. In states where caveat emptor survives, no disclosure is required.

(g) Generally, a seller is required to disclose only on-site conditions, not off-site ones. Professional sellers—a developer or builder, or their brokers—might be required to disclose, but not nonprofessional sellers. But if the test is whether the condition is a material latent defect known to seller and important to a reasonable buyer, the status of the seller as a professional or nonprofessional should not matter. The Example also shows why statutory disclosure forms are being enacted in a majority of jurisdictions.

(h) A convicted child molester is not only an off-site matter. He or she is a person, not a condition. Some jurisdictions might require disclosure of noisy neighbors, a noisy nearby bar, or dogs, because they might be nuisances. Some jurisdictions have Megan's Laws, statutes designed to inform citizens of sex offenders residing in the community by making offenders register their presence with the government, but buyers as well as sellers can check such registries,

so the cases divide on whether there is a duty to disclose in this situation.

Fire Sale

6. Under the doctrine of equitable conversion, purchasers are deemed equitable owners of the property as soon as the parties enter into the sales contract, and bear the risk of loss should the property be destroyed or damaged during the executory period.
   (a) Under the traditional doctrine of equitable conversion, *O* obtains specific performance. The doctrine developed at a time when land tended to be more important to and a more valuable part of the transaction than the structures on it. Arguably, that situation is often reversed today. Thus the rule in jurisdictions placing the risk of loss on sellers: When the improvements are a substantial part of the bargain, the contract is voidable for a failure of consideration or impossibility of performance. In over 30 jurisdictions, however, equitable conversion prevails: *B* bears the risk of loss.
   (b) It might. It wouldn't in the majority of states, where the risk of loss passes to the purchasers on execution of the sales contract. *B* as purchaser would be liable with or without right of possession, even if *O* remained in possession.

   Possession is important in many states, however. In those states, a seller bears the risk of loss if the seller retains possession or no one takes physical possession. The risk of loss passes to the purchaser once the purchaser takes possession or at closing, whichever occurs first. In these states the purchaser in possession bears the risk of loss. The issue may turn on whether the state requires actual physical possession putting the purchaser in oversight control of the property, or if constructive possession indicated by moving *B*'s personal property into the cabin is enough.

   In some states, on the other hand, the risk of loss remains with the seller notwithstanding the purchaser's possession. In these states *O* must bear the risk of loss, and *B* would have the earnest money returned.

   Because the law on risk of loss is not what most buyers would expect, sales contracts should address the issue, usually by putting

the risk of loss on the seller and requiring the seller to maintain insurance up to closing.

(c) The clause could protect *B*. Equitable conversion is a default doctrine. The parties can override it by drafting a provision in the sales contract. The provision places the risk of loss squarely on the seller. *B* can void the contract and have the earnest money returned. The sales contract provides that *B* has the option of voiding the contract. If *B* chooses not to exercise this option, an issue arises whether *B* should receive an abatement in the purchase price, reducing the price by the decrease in value resulting from the destruction of the cabin. Most courts deciding this issue hold that the buyer may receive an abatement.

(d) The only easy part is B can collect and keep the insurance proceeds for the contents of the cabin. As to the cabin itself (land is not insurable), once *B* collects the policy's proceeds and closes the purchase, most jurisdictions either will refuse to abate the purchase price or will reduce the abatement by the amount of the proceeds paid to *B*. Otherwise *B* would receive a windfall ($50,000 insurance and $50,000 price abatement) and the sellers would suffer a $50,000 loss. Insured buyers electing to continue the transaction should pay full price.

If *B* is allowed to rescind the sales contract, most jurisdictions treat the insurance policy and the sales contract as unrelated agreements, allowing *B* both to void the sales contract and still collect the $50,000 on the policy. (For insurance purposes, *B*'s having a contract interest in the cabin at the time of the fire gives rise to an "insurable interest.") Some jurisdictions, in contrast, consider the two agreements to be related, so when buyers refuse to close, *B* or *B*'s insurer is required to pay the policy's proceeds to *O* in order to avoid his suffering a $50,000 loss; it is in this sense that *B* is said to take the proceeds in a constructive trust payable to the party holding the property. Some jurisdictions apply this theory only if the sales contract requires the buyer to carry insurance.

Death and Other Incidental Matters

7. Under the doctrine of equitable conversion, *M*'s contract right to the

proceeds passes as personal property. The $100,000 sales proceeds go to the trust for the benefit of *M*'s children. If *B* rescinds the sales contract because (say) *M*'s title was unmarketable or *B* refuses to close based on a clause in the contract, courts treat the property as real property and it would pass to *M*'s husband. On the other hand, if *B* breaches the contract, *M* had the option of either accepting liquidated damages or seeking specific performance, so the property passes to the trust benefiting the children. The theory is *M*, the seller, in equity is treated as the creditor of a note and *B*, the buyer, is regarded in equity as a debtor. When the buyer breaches, the property returns to the trustee for the children to satisfy the debt.

Counsel Your Client

8. Parties to a sales contract can agree to override the common law equitable conversion rules. The question here is, what does the contract provision do? Does *B* intend to be bound to buy the property even if Blackacre was damaged or destroyed by fire, with *S* being contractually obligated to rebuild the property, or is *S*'s obligation to restore the property a condition precedent to *B*'s obligation to close.

   Next, who decides if the property is "restored?"—i.e., if the provision is a contract term and *B* must purchase before *S* completes the restoration, *B* will be put to supervising *S*'s work to ascertain that it is performed in such a manner that the initial expectations of the contract are fulfilled—and suing on the contractual promise when *B* believes that *S* is cutting corners in fulfilling his duty or delaying too long. This will produce an arduous and perhaps a longer term relationship than *B* had expected.

   If the provision is a condition precedent, there is still the question of the quality of the restored building. Who decides if *B* is getting what *B* contracted to purchase? *S*, *B*, or some neutral expert? Depending on *B*'s expertise and time availability, perhaps *B* should be able to rescind the contract if fire destroys or substantially damages the building, and sign a new sales contract after completion if he then is satisfied with the restoration, or abate the sales price equal to the anticipated construction costs, and hire his own people to restore the building.

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1. Easements are rights of nonowners to use the land for particular purposes. The most common easements are private roads or driveways, utility easements for poles or wires, sewer easements, or for

railroad tracks. Easements are discussed in Chapter 27.

2. Real covenants and equitable servitudes are contractual restrictions and duties that affect the use of land. Examples include restrictions on businesses, limitations to residential use only, prohibitions on alcohol sales, and restrictions on building heights. Real covenants and equitable servitudes are discussed in Chapter 29.

3. A purchaser may be able to rescind a sales contract if the building code violation is serious and if the seller failed to disclose the material defect. See Caveat Emptor and the Duty to Disclose Defects, infra (a purchaser may rescind a contract if the seller fails to disclose material defects). Serious zoning violations also may constitute material defects required to be disclosed.

4. A record title owner is the owner of real property as determined by a search of the local deed records. That person may not be the same as the legal title owner.

5. Recall that a seller must present marketable title at closing. Although damages are measured on the date of the breach, that breach here occurs at closing and so the increase in value is calculated as of that date.

CHAPTER 23

Real Estate Closings

THE CLOSING OR SETTLEMENT PROCESS

A seller or grantor usually transfers title to property to the buyer or grantee at a ***closing*** or ***settlement***. Typically at closing, a mortgage lender or other financial institution loans the buyer money to complete the purchase, the buyer pays the seller, and the parties sign a series of documents required by the sales contract, the lender, and applicable law.

Residential closings differ by region. In the eastern, southeastern, and mid-western United States, the parties meet face to face and, in the presence of a representative of the lender, exchange the purchase money for the deed. Then the buyer executes a mortgage for the portion of the purchase money funded by the loan. In the inter-mountain and western states, the closing is handled “in escrow” by a closing agent who disburses the money and the deed when all preconditions to their disbursal to the seller and buyer are met; here the parties to the contract execute it but never meet thereafter. When they receive whatever documents are required to close, they execute them and send them back to the agent for distribution.

No matter the region, sales of commercial properties are often conducted

using an escrow of some type, sometimes with a title company arranging the mechanics of the closing, supervised by the attorneys for the parties.

Whether the transfer is a sale or gift, sellers transfer their interests in property by a deed. The deed must be in writing to satisfy the Statute of Frauds, and must contain (a) the grantor's name, (b) the grantee's name, (c) words that indicate an intent to convey the property or an interest in the property (the "words of grant"), (d) a description or identification of the property, (e) the interest being transferred (though a fee simple will be assumed unless the deed stipulates a lesser interest[1]), and (f) the grantor's signature. These elements are typically known as the ***premises***.

The premises are followed by what is known as the deed's ***habendum clause***. It typically starts with the phrase "To have and to hold" or "Together with." Here the deed recites any covenants, conditions, easements, equitable servitudes, leases, mineral rights, or other private encumbrances burdening the property. If the grantee is to assume a mortgage or take the property subject to a debt, that too is listed. Often a general reference, such as "subject to all restrictions of record," is adequate to subject the grantee to all restrictions found in the official deed records. The *habendum* usually contains the grantor's warranties of title (to be developed in the next chapter).

Finally, at the deed's end, comes the grantor's signature. The deed is a conveyance, not a contract, so only the grantor need sign it. However, when it contains promises by the grantee (say, not to use the property for commercial purposes), it is customary in some regions to have the grantee sign as well.[2]

Most deeds are "recorded" in a local government office, usually a county courthouse (to be developed in Chapter 25). State statutes require that all deeds and other documents accepted for recording be ***acknowledged*** before a notary public and, in a few states, be witnessed by one or two persons to authenticate the grantor's signature. Even though an unacknowledged and unattested deed transfers title, most purchasers insist on compliance with these further formalities since recording protects their interests.

Although the format of deeds varies from jurisdiction to jurisdiction, some common forms have evolved. The two most common are the "long form" and "statutory short form" deed. Both contain the essential parts set out above. The main differences between the two are (1) the statutory short form deed excludes (while the long form incorporates) an *habendum* clause, and (2) the long form contains express warranties of title, while the short form incorporates into the words of grant some but not all such warranties by

express reference to the statute authorizing this form of deed.

If the grantor is married, the deed should indicate the grantor owns the property as his or her separate estate (assuming that is the case). If the seller's spouse has an interest under community property laws, is a tenant by the entirety, joint tenant, or tenant in common, or has a marital or homestead interest, the nongranting spouse also must execute the deed in order to release the interest.

Nothing requires the deed to recite the consideration paid for the property. But often to show the buyer is a bona fide purchaser for value, most drafters include the consideration, or at least a symbolic consideration such as "one dollar and other consideration." Centuries ago in England, grantors embossed their seal onto the deed in lieu of or in addition to their signature. The seal was once a requirement for an effective deed. A few jurisdictions retain this requirement, but most have dispensed with it.

DELIVERY

In general, a deed transfers title only when (1) the grantor intends to convey an interest in property, (2) the grantor delivers a deed to the grantee, and (3) the grantee accepts the deed. Each element is necessary for proof of delivery. No deed is considered delivered if the grantor hands the deed to the grantee without the intent to transfer title.[3] Conversely, without handing the deed over to the grantee, a grantor's recording it may satisfy the second element of a delivery. Proof of these three elements is a question of fact. Of the three, an intent to convey an interest is the most important and the most difficult to prove. A grantor's handing over the deed physically demonstrates an intent to convey title, and delivery of a deed to and from an escrow agent adds objective, third-party evidence of that intent.

Courts often resort to ***rebuttable presumptions*** to resolve delivery issues. For example, a grantee's acceptance is presumed if owning the property would be beneficial to him. Courts will also presume a deed in the grantee's possession has been delivered to the grantee, will presume the grantor did not deliver the deed if the grantor retains possession of it, and will presume acknowledged and recorded deeds have been delivered. These are all rebuttable presumptions. In some jurisdictions, however, a recorded deed

gives rise to an irrebuttable presumption that the deed was delivered when one of the parties to a later dispute is a subsequent bona fide purchaser for value. Rebuttable presumptions merely establish who bears the burden of proof and persuasion in the controversy.

Delivery in many situations turns on whether the grantor retains control of the deed and can retrieve it before the grantee takes possession of it. A grantor's giving the deed to the grantor's agent or attorney, for example, is not a delivery until the agent gives the deed to the grantee. Conversely, a grantor's handing the deed to a grantee's agent does constitute its delivery.

SPECIALIZED DELIVERY PROBLEMS

(a) Escrow Transfers

In many commercial transactions and in residential transactions in the western states, the parties use a third party—an ***escrow agent*** or ***escrowee***—to hold the deed and pass the deed to the grantee after the grantee satisfies conditions set out in a valid sales contract. If the escrow is irrevocable and the grantor cannot retrieve or revoke the deed unless the grantee materially breaches the sales contract or fails to satisfy a condition within a reasonable time, the deed will be considered delivered on the date that the grantor deposits the deed in escrow. This is the ***doctrine of relation back***. It applies even if the grantor dies before the conditions are met: As soon as the grantee meets the conditions, the escrow agent delivers the deed to the grantee and the grantee's title "relates back" to the date of deposit.

(b) Donative and Testamentary Transfers

Problems occur more frequently in informal transfers epitomized by donative or gift transfers related to the grantor's death. A deed does not qualify as the vehicle for ***testamentary transfers***; only documents meeting all statutory formalities under a ***Statute of Wills*** serve to transfer property at a grantor's death. A deed to be effective must be delivered during the grantor's lifetime.

The deed does not have to guarantee present possession, and may delay the grantee's possession until the grantor's death, but the deed must grant an immediate interest in the property to the grantee (even if it's a future possessory estate). Thus, when a deed is delivered, it can convey either a present or future interest, so long as that interest passes immediately, not at some future time. If the facts surrounding the handing over of the deed indicate the deed is to take effect at a later date, there is no delivery until that later date. Delivery occurring after the grantor's death in donative transfers does not transfer title. Consider the following Examples.

Example 1: A grantor executes a deed but does not deliver the deed to the intended grantee. The grantee knows nothing about the deed until the deed is found after the grantor's death. A court will find the deed was not delivered. An executed deed still in the grantor's possession fails the delivery element.

Example 2: A grantor places a deed someplace under the grantee's control but does not tell the grantee about the deed, knowing the grantee will find the deed later (perhaps after the grantor's death). The grantee finds the deed after grantor dies. A court might find the requisite intent and delivery under these facts.

Example 3: A grantor places a deed in a safe deposit box used by both the grantor and the grantee. Grantee finds the deed after grantor dies. Because the grantee has access and control over the safe deposit box, many courts find the grantor's placing the deed in the safe deposit box indicates the grantor intended to deliver the deed and gave at least constructive possession to the grantee. Other courts find no delivery since the grantor's access and control over the safe deposit box indicates that he retained a right to revoke the deed simply by retrieving it before grantee takes actual possession.

Example 4: A grantor hands a deed to an intended grantee with instructions that the grantee is to record the deed if the grantee outlives the grantor. The grantor dies. Since the grantor attempted to pass an interest at some future date after his death rather than to pass a future interest immediately, the grantor had no intent currently to transfer title. The deed has not been delivered until the grantor died. The grantor cannot use the deed as a will substitute. Since the deed does not meet the statutory prerequisites of a

will, the deed cannot operate to effect a testamentary transfer.

Example 5: A grantor hands the deed to an intended grantee, telling the grantee to record the deed after the grantor's death. The grantor dies. Courts differ on the result. A court rationally could hold, as in the previous Example, that this was a failed testamentary transfer, but many courts uphold the deed as a present delivery of a future interest, holding the oral instruction void as inconsistent with the delivery of a deed. Thus the grantee could record the deed any time after receiving it. An oral condition is nullified by an actual delivery.

Example 6: A grantor hands the deed to an escrow agent with instructions to deliver the deed to a grantee after the grantor's death. Some courts find the arrangement is a failed testamentary transfer. A few hold the grantor's death terminates the agent's power to deliver the deed, so delivery is impossible. A majority of jurisdictions, however, hold that delivery occurs when the grantor hands the deed to the escrow agent or hold that the delivery relates back to the time the grantor handed the deed to the agent, as long as the grantor cannot revoke the deed and did not condition the agent's delivering the deed on the grantee's surviving the grantor.

Example 7: A grantor hands a deed to the grantee, the grantor reserving a life estate. The deed here is delivered since the grantee obtains a future interest in the remainder in the property immediately.

Example 8: A grantor gives a deed to a grantee, the grantor both reserving a life estate and retaining the power to revoke the deed. Some courts hold that the grantee holds no legal future interest: The grantor retains the life estate and current possession and has the power until the grantor's death to revoke the deed. The deed is little more than an expectation that does not ripen into an interest until the grantor dies or releases the power to revoke the deed. Until that time, no delivery occurs. This is especially true when the grantor continues using the property, paying property taxes, and collecting the rents and profits from the property. Other courts find the delivery good as long as the grantor intends to pass the interest immediately to the grantee, regarding the power to revoke as a condition subsequent, giving the grantee an interest until the grantor revokes. Since some interest is currently transferred to the grantee, the deed is delivered.

Either result is justifiable in theory. It appears the arrangement is a will substitute. If you believe the Statute of Wills' requirements trump the deed in order to protect decedents, heirs, and devisees from overreaching or fraud, and the grantor has a will, or his heirs are deserving, the deed should not be considered delivered. On the other hand, if the deed is a poor person's version of a trust, a trust being effective even if the grantor reserves a life estate and a power to revoke, the deed carries out the grantor's intent and fits into an overall estate plan, finding that a delivery has occurred is the proper conclusion.

MORTGAGES

(a) Mechanics of Mortgages

Purchasers often borrow money to buy real estate, especially real estate improved with homes or buildings. The most common sources of financing are the seller and financial institutions such as banks and other mortgage lenders. When a person borrows money to buy real property, he or she usually signs two documents. One document is the promissory note, a formal IOU by which the borrower (the debtor) obligates himself or herself to pay the money back to the lender according to certain terms, including the interest to be paid for the use of the money and the timetable for making payments. The other document is the mortgage, which provides collateral for or "secures" the debt: Should the mortgagor (the borrower) default on the loan (or otherwise breach the terms of the mortgage agreement), the mortgagee (the lender) can bring an action (foreclosure) to sell the home based on the lien created by the mortgage and apply the sales proceeds to retire the note. If the seller lends the money and becomes the mortgagee, the mortgage is called a take-back or purchase-money mortgage.

Ordinarily the property pledged as security in the mortgage is the purchased real estate, but other property may also serve as the collateral. To illustrate, a person buying a vacation home may pledge the purchased vacation home to secure the mortgage. Alternatively, for various reasons, the vacation home buyer may pledge his or her primary residence as the collateral underlying the mortgage. In this case, if the buyer defaults on the

note, the mortgagee (lender) under the mortgage has the right to foreclose on the buyer's primary residence, but not on the vacation home.

Sometimes the purchaser gives promissory notes and mortgages both to a financial institution and to the seller in order to purchase a home. The financial institution will demand that it receive the "first" mortgage and the seller will take a "second" mortgage. The ranking of mortgages—"first," "second," "third," etc.—establishes which mortgagees (creditors) have the first right (**priority**) to any sale proceeds should the property be sold. Mortgages and liens of a lower priority are known as junior liens or junior mortgages while those of a higher priority are senior liens or senior mortgages. Thus, if a person has given three mortgages, the second mortgage is senior to the third mortgage and junior to the first mortgage. A lender should record the mortgage in the local deed records office to protect its priority to the property.

The lender having first priority may use all proceeds from any sale of the home (foreclosure sale) if necessary to satisfy any amounts still owing to the lender. If any sales proceeds remain after satisfying the first mortgage, the money goes to the second mortgage holder, and so on. Any proceeds remaining after satisfying all notes secured by the mortgages belong to the property owner (the mortgagor).[4]

(b) Title Theory and Lien Theory

States fall into two camps concerning the legal ownership (as opposed to equitable ownership) of the mortgaged property. A small minority of states subscribe to the ***title theory of mortgages***, meaning the lender (mortgagee) has legal title to the mortgaged property until the debt is repaid. This means, for example, a lending institution holds legal title even though the purchaser has possession of the property. This theory developed at a time when the mortgagee (lender) actually took possession of the property or held its legal title in fee simple determinable until the underlying note was satisfied. Not so today. Today the borrower (purchaser) retains possession of the property.

The vast majority of states favor the ***lien theory of mortgages***, recognizing the mortgage as a security device or an inchoate lien, giving the mortgagee rights to the property when the mortgagor breaches some term of

the mortgage. In lien theory states, the mortgagor (borrower) has legal title and the mortgagee (the lender) has rights as a secured creditor in the property. If the property owner (mortgagor) fails to repay the loan interest and principal when due, for example, the creditor (mortgagee) may foreclose on the property, have it sold, and collect enough proceeds from the foreclosure sale to retire the debt.

Under neither the title theory or the lien theory can the mortgagee's (lender's) creditors force a sale of the collateral to satisfy the mortgagee's debts, and under both theories the mortgagor's (borrower/landowner) creditors can reach the proceeds from the sale of the mortgaged property after the mortgagee's claims have been satisfied. The major difference between the two theories in actual practice is that under the title theory a mortgagee in some states (but not all) can go into possession of the property as soon as there is a default and remain in possession during the foreclosure proceedings. In a lien theory state, on the other hand, the mortgagor retains possession until foreclosure proceedings are completed.

(c) Deed of Trust

The deed of trust resembles the mortgage. Under the ***deed of trust***, the borrower delivers the deed of trust to a third party (the trustee), often the lender's attorney, instead of directly to the lender. If the borrower defaults on the note, the trustee can foreclose on the mortgaged property on behalf of the mortgagee. The deed of trust allows mortgagees to sell the collateral more quickly and cheaply than under the traditional judicial foreclosure process. Traditional mortgages routinely achieve the same result by incorporating a power of sale in the mortgage, so that there are few differences between a deed of trust and a mortgage.

(d) Installment Land Sale Contract (Contract for Deed)

Under the ***installment land sale contract*** (or ***contract for deed***), the seller retains legal title and does not deed the property to the buyer until the purchaser pays the full purchase price. In the interim executory period, the

buyer takes possession and the parties act pursuant to the sales contract. The payment period under an installment contract may be as long as the normal deed and mortgage period—i.e., 10, 15, or more years. The buyer has an equitable interest in the property, but unless she records the installment sales contract or a memorandum of contract in the local deed records, she risks losing the property to the seller's creditors or to a bona fide purchaser for value. At one time, if a buyer missed a payment, she forfeited her interest in the property and the seller kept the property no matter how wide the disparity between the property's fair market value and the amount of the remaining outstanding indebtedness. Today many courts treat installment land sale contracts like a deed and mortgage transaction, restricting the seller to an amount of the proceeds of a foreclosure sale equal to the amount of the remaining debt obligation.

(e) Debt Satisfaction and Assumptions

Once a mortgagor (borrower) satisfies (pays) the underlying debt, the mortgagee releases the mortgage. This ***release*** should be recorded in the local deed records. Many mortgages and notes contain a ***due-on-sale clause*** requiring the entire note balance be paid before the seller can deed the property to a new purchaser. Alternatively, some mortgagees allow subsequent purchasers of the property to continue making payments on the note under the terms of the original note. The subsequent buyer can ***assume*** the note, meaning the purchaser becomes primarily liable on the note: If the underlying property cannot be sold for an amount great enough to retire the secured indebtedness, the mortgagee has recourse (except when denied this recourse by statute) to the subsequent buyer's other assets for the deficiency. Instead of assuming the note, a subsequent buyer may take the property ***subject to*** a note and mortgage. In this situation, the mortgagee is limited to taking the proceeds from the sale of the property and cannot go after the subsequent purchaser's other, nonpledged assets. In either situation, the initial mortgagor remains secondarily liable to the mortgagee for any unpaid amounts.

(f) Foreclosure

If the mortgagor (the borrower or debtor) defaults (generally by not making scheduled payments), a mortgagee (lender) has various options based on the mortgage's terms and state law. In earlier times, and in some states today under some circumstances, a mortgagee through an action known as ***strict foreclosure*** could petition a court to ***foreclose*** a mortgagor from redeeming his property after the foreclosure date: After that date, the mortgagee kept the mortgaged property and the mortgagor was barred (foreclosed) from asserting any rights to it.

The most common method of foreclosure today is ***judicial foreclosure***. It affords the mortgagor (debtor) all the procedural safeguards inherent in a judicial proceeding. The mortgagee files a complaint, the mortgagor answers, and a trial is conducted should the mortgagor (landowner/debtor) allege a foreclosure sale is inappropriate. The court has the title searched and determines what debts are to be paid from the foreclosure sales proceeds. Once the court orders the property sold, auction information must be posted and advertised as prescribed by statute. The sale usually is by auction (though an auction is not always mandated and in a few states other methods more closely resembling a voluntary sales transaction may be used). Mortgagees are entitled only to the sales proceeds up to the amount owed them. Sales proceeds remaining after all creditors who are parties to the foreclosure action are paid belong to the mortgagor (landowner). If the sales proceeds are inadequate to satisfy all debts and liens, creditors sue on the note and get a "deficiency judgment" against the debtor's nonpledged assets (if the underlying debt constitutes a ***"recourse" liability***).[5]

Mortgagees wanting to avoid the delay and cost of a judicial foreclosure action may try a ***private foreclosure sale*** if (a) the state allows it and (b) the parties incorporate a power of sale provision in the mortgage or deed of trust. The mortgagee or the trustee in a deed of trust sells the property in a private sale, often by auction, bypassing the full judicial process. Statutes dictate the process, usually providing for notice and advertising. Some states require a court to approve or confirm the private sale.

Mortgagors can have the private sale voided if the mortgagee or trustee does not adhere to the statutory requirements for a private sale or does not conduct the sale properly. As a general rule, the mortgagor cannot protest

solely because the sales price was below the property's fair market value unless the buyer at auction or the mortgagee (lender) acted fraudulently or did not comply with the statute or unless the sales price is so inadequate (usually in the 20–30 percent range of fair market value) it "shocks the conscience" of the court. Most courts uphold even very low foreclosure sale prices, recognizing that no involuntary auction sale will fetch what a traditional purchase and sale will.

The mortgagor enjoys a right or equity of redemption until the property is sold. Thus, a defaulting mortgagor can keep the property by paying off the loan *before* the foreclosure sale. About one-half of the states, by statute, also give the mortgagor a ***statutory right of redemption***, which arises *after* the sale. It gives the mortgagor the right to reimburse the high bidder at the sale, undo it, and take back the property. The time in which the mortgagor must exercise his statutory right of redemption, depending on the state, ranges from three months to two years.

Examples

Did He Deed It?

1. *S* agreed to sell a 1,000-acre ranch to *B*. They both executed a sales contract for the ranch. *S* signed not only the sales contract but also a warranty deed, intending to leave the deed with his attorney. The two documents were two of the many documents on the attorney's conference table when *B* picked up the deed, examined it, and put it with his papers. *B* left with the deed and a year later recorded it. Was the deed delivered?

Love You Like a Sister

2. Harry owns Whiteacre. He executes a deed conveying Whiteacre to his sister Sallie. Harry places this deed in his vault for safekeeping. Both Harry and Sallie live on Whiteacre. Harry tells Sallie about the deed and states that she is now Whiteacre's owner. Sallie thanks Harry, agreeing that keeping the deed in the vault is a good idea. Sallie has no access to the vault and has never seen the deed. Harry thereafter destroys the deed to Sallie and executes a new deed conveying Whiteacre to Harry's friend Gloria. Harry manually delivers Gloria's deed to her. Sallie sues Harry and Gloria to quiet her title to Whiteacre. In Sallie's suit, what result and

why?

Home Delivery

3. Beulah owns her home. For years Elizabeth helped Beulah around the house with repairs and yard work, driving her to the doctor's office and to social, cultural, and church functions. Beulah has two sons (who would be her heirs if she died intestate). Elizabeth moved in with Beulah. Five years later Beulah decided she wanted Elizabeth to have her home if Beulah died before Elizabeth. Who owns Beulah's home after Beulah's death in the following situations?
   (a) Beulah handwrites a deed giving her home to Elizabeth. She puts the deed with her important papers and tells Elizabeth to read the papers if Beulah dies. Beulah dies. Elizabeth reads the papers and finds the deed.
   (b) Beulah drafts and executes a deed. Beulah entrusts the deed to her minister with instructions to give the deed to Elizabeth if Elizabeth survives Beulah. Before Beulah dies, she executes and delivers a deed to one of her sons. When Beulah dies, the minister gives Elizabeth the deed in his possession.
   (c) Beulah hands Elizabeth a deed conveying the home to Elizabeth. Beulah orally instructs Elizabeth to hold the deed and to record it only if Elizabeth survives Beulah. Beulah dies.
   (d) Beulah drafts a deed granting the home to Elizabeth if she survives Beulah, otherwise the home is to pass to one of Beulah's sons at Beulah's death. Beulah reserved a life estate. Beulah hands the deed to Elizabeth. Beulah dies and Elizabeth is still alive.
   (e) Same facts as (d) except Elizabeth, one year after she received the deed, gave the deed back to Beulah (who was still alive). Beulah later dies survived by Elizabeth and Beulah's son.
   (f) Same facts as (d) except one year after Beulah's death, Elizabeth hands the deed to Beulah's other son (the one without the contingent interest).
   (g) Beulah deeded the home to her minister in trust. Beulah was the life beneficiary and retained the right to revoke the trust (and thus to have the home returned to her). Upon Beulah's death the minister (the trustee) was to deed the home to whomever Beulah designated in her

will, or, absent such designation, to Elizabeth if she survives Beulah, otherwise to one of her sons. Beulah dies intestate. The minister, Elizabeth, and the sons survive Beulah.

Foreclosing Options

4. Don bought a rental house for $100,000 from Trevor as an investment. Don paid Trevor the sales price by transferring $5,000 cash from his savings, borrowing $80,000 from First Bank and paying that money to Trevor, and giving Trevor an unsecured note for the remaining $15,000. At closing, Trevor deeded the house to Don, and Don signed and delivered a note and mortgage secured by the house to First Bank. (All these deeds and mortgages are properly recorded.)

   Five years later when the house's fair market value (FMV) was $150,000, Don borrowed $50,000 from Second Bank to remodel his personal residence. Don gave Second Bank a note for $50,000 and a mortgage to his rental house (and not to his personal residence).

   Two years later, Don sold the rental house to Zola for $170,000. Zola paid the sales price with $10,000 from her checking account, borrowing $50,000 from Third Bank and paying that money to Don, and agreeing to take the property subject to the notes to First Bank ($65,000) and Second Bank ($45,000). Don deeded the house to Zola. Zola signed and delivered a note and a mortgage secured by the house to Third Bank.

   One year later, the state suffered an economic recession. Real estate values dropped. Don and Zola each suffered financial set-backs. Assume the following facts:

Balance on Trevor note	$ 5,000
Balance on First Bank note	$ 60,000
Balance on Second Bank note	$ 40,000
Balance on Third Bank note	$ 50,000
FMV of Don's personal residence	$200,000
Cash in Don's bank account	$100,000
FMV of Zola's home	$ 90,000
Cash in Zola's bank account	$ 10,000

Please explain what happens in the following situations:

(a) Don stops making unsecured monthly note payments to Trevor.
(b) Zola continues monthly payments to Third Bank but stops making payments to First Bank and to Second Bank.
(c) Zola continues making payments to First Bank but not to Second Bank or Third Bank.

Explanations

Did He Deed It?

1. No. *B*'s possession of the deed raises a rebuttable presumption that *S* delivered the deed. The facts, however, easily rebut the presumption: *S* intended to hand the deed over to his attorney, not to *B*. No intent to deliver, hence no delivery. *B*'s recording does not alter the result. If *B* had transferred the property to a bona fide purchaser for value, there might arise an irrebuttable presumption of delivery to such a purchaser. *S* wins under the given facts.

Love You Like a Sister

2. Sallie loses—judgment for Harry and Gloria. There was no manual delivery and no clear and convincing evidence of intent. Sallie never saw the deed, never touched it, had no access to Harry's vault and without that access, she cannot even claim to be in constructive possession of the deed. No one changed their position after its execution—so no equities rise to defend Sallie. Her private conversation with Harry was no substitute for the deed's delivery. Sallie's continuing to live on Whiteacre shows her interest, but provides no evidence that the deed had any effect. Harry's access to the vault (and Sallie's lack of access) shows that Harry continues to exercise control and dominion over the property and the deed and raises a presumption of nondelivery. Moreover, without some contract binding Harry to hold the deed for Sallie, Harry cannot be presumed to be Sallie's agent. (Even if Sallie alleged an implied oral contract, it would be presumed revocable before the deed is delivered.)

Home Delivery

3. (a) The sons own the home. Beulah attempted a testamentary transfer,

using the deed as a will substitute. Elizabeth does not gain access to Beulah's important papers unless she survived Beulah. There being no delivery until after Beulah dies, the transfer is void. Beulah's home passes by intestate succession to her sons.

(b) The son owns home. The result in this Example depends on whether Beulah delivered the deed during her lifetime. Clearly Beulah delivered a deed to her son during her life. Whether the son prevails depends on the transfers for Elizabeth's benefit. If the deed transferring the home to Elizabeth is deemed delivered before the deed to the son is delivered, Elizabeth prevails over the son. Beulah cannot revoke a completed gift, and she would have nothing to transfer to her son.

If Beulah's entrusting the deed to her minister constitutes the present delivery of a future interest—i.e., a springing executory interest—the delivery is good and Elizabeth prevails over the son, even though the minister delivered the deed to Elizabeth after the son received his deed.

The determining issue in this Example is whether Beulah intended a present inter vivos transfer of a future interest or whether she intended a testamentary transfer. If Beulah intended a testamentary disposition, the delivery to the minister on Elizabeth's behalf is ineffective. The only good delivery under this interpretation is the one to her son, who would own the home. A court finding the minister to be Beulah's agent also would find there was no effective delivery since the agency ends at Beulah's death or, alternatively, since Beulah attempted a testamentary transfer without complying with the Statute of Wills.

Many courts, however, focusing on the donative aspect of the transfer would conclude the minister is a dual agent, that is, an escrow agent acting for both parties. In this situation, the delivery to Elizabeth is good unless Beulah imposed a condition on the transfer other than her death. If Beulah had instructed her minister only to hold the deed until after Beulah died, for example, these courts would deem the delivery good. In that case, Elizabeth would prevail over Beulah's son.

Beulah, however, did not instruct her minister to hold the deed until Beulah's death. She imposed a condition: Elizabeth must

survive Beulah before the minister was authorized to deliver the deed to Elizabeth. Moreover, as a practical matter, Beulah likely had the power to revoke the gift to Elizabeth by asking the minister to return the deed to her. Thus the attempted delivery to Elizabeth was ineffective. Beulah's son prevails since his is the only effective delivery.

(c) Beulah has attempted to condition the delivery. The oral condition, being inconsistent with the written deed, is void and unenforceable and does not delay or prevent an effective delivery when the deed is handed over; so the grantee Elizabeth owns the home even if she dies before the grantor Beulah. This rule also prevents fraud after a party's death (especially the grantee's death). Elizabeth owns the home.

(d) Beulah has transferred alternative contingent remainders to Elizabeth and the son. Even though the interest to Elizabeth is a contingent interest, Beulah's handing the deed to Elizabeth is still a present delivery of an interest (to Elizabeth and to the son, even though the latter may not have seen the deed), no matter that the interests are contingent future interests. Delivery is good.

Elizabeth survived Beulah, so Elizabeth owns the home after Beulah's death. If Beulah had survived Elizabeth, the son (or his heirs, devisees, or assigns) would take possession of the home after Beulah's death.

The deed contained the same condition Beulah put on Elizabeth's interest in (b) above: that Elizabeth survive Beulah before she takes a vested interest in the home. Yet the result is dramatically different. Elizabeth is not Beulah's agent, as the minister was in (b). Courts use the analysis in (b) only in situations involving a third party escrow agent.

(e) Elizabeth owns Beulah's home. Elizabeth's returning the deed does not undo the transfer. To transfer her interest back to Beulah (note that Elizabeth could not transfer the son's interest), Elizabeth must satisfy all the requirements for a valid deed, including those in the Statute of Frauds.

(f) Elizabeth owns Beulah's home. When Beulah died, Elizabeth's interest became vested and the alternate contingent remainder was extinguished. Elizabeth handed a deed to Beulah's other son, but

unless she gave him some writing (or wrote on the front or back of the original deed) signed by her indicating she was conveying the property to him, the delivery of the original deed transfers nothing to the other son.

(g) Elizabeth owns the home. The trust is a popular vehicle for individuals to avoid the cost, publicity, and delay of probate administration. Courts honor its terms and will hold Beulah delivered the deed to the trustee, even though she retained the right to revoke the trust and all remainder interests, and even though she retained the power to control who would take after her death. She even had the power to sell to a third party during her life simply by revoking the trust and then transferring the property. Nonetheless, the delivery is good. When Beulah died intestate, her home passed to Elizabeth under the terms of the trust.

Foreclosing Options

4. (a) Don is the primary obligor only on the unsecured $5,000 Trevor note. Trevor did not receive a mortgage on the rental house so he has no security interest in Zola's house. Trevor, as an unsecured creditor, may get a judgment lien against Don's other assets (but not against Zola's rental house or her other assets). Trevor may get his $5,000 from Don's cash in his bank account, depending on how many other unsecured creditors also are looking to it for payment. Don also is secondarily liable on the $60,000 First Bank note and the $40,000 Second Bank note. As long as Zola continues scheduled payments, the two banks have no action against Don.

(b) Zola has stopped making payments on the notes secured by the two senior mortgages (First Bank and Second Bank), and continued paying only on the Third Bank note secured by the junior mortgage. Mortgage agreements normally contain an **acceleration clause**, which allows mortgagees (lenders) to seek full payment of the entire outstanding note balance when there is a material default. Zola took title to the house subject to the First Bank and Second Bank mortgages. She did not assume any personal liability for the notes, however, so she is not legally obligated to pay the two banks. However, if no one pays off the notes, either of the two banks can

bring a judicial foreclosure action in which Zola's house will be sold to satisfy the debts secured by the house.

Zola took title to the house subject to the First Bank note and the Second Bank note. She did not assume any personal liability for the notes, however (The notes are nonrecourse notes to her, meaning the banks can only look to the proceeds from the sale of the mortgaged house for payment from her). Zola is not legally obligated to pay the two banks from her other assets. If no one pays the notes, however, the two banks can have her house sold to satisfy the debts since they have recorded mortgages secured by the house. Zola quit paying and, unless the banks can cajole Don into paying, the two banks will bring a judicial foreclosure action to compel a judicial sale of Zola's home. Assuming the house will bring its $90,000 fair market value at auction (probably not the case) and assuming the transaction costs associated with the foreclosure and sale are zero (definitely not the case), First Bank, which holds the first mortgage and enjoys the highest priority to the sales proceeds, will receive $60,000 to retire its note.

Second Bank will receive the remaining $30,000 from the sales proceeds. Second Bank is still due $10,000 under the note. Second Bank has no further action against Zola for the $10,000, however, since Zola has no personal liability on the note. Don is still personally liable, however. Second Bank will turn to Don, but they will be an unsecured creditor. If Second Bank is the only unsecured creditor, it likely will get $10,000 from Don's account. Otherwise, Second Bank must share pro rata with any other unsecured creditors.

Since no proceeds remain from the sale of Zola's house after paying off the First and Second Bank notes, Third Bank gets no money from the sale, and also loses all rights to Zola's house through the foreclosure sale. Nonetheless, Third Bank still has recourse against Zola personally for the $50,000 since Zola signed the original note. Third Bank is no longer a secured creditor, however, and must exercise any rights it might have as an unsecured creditor. Zola has only $10,000 in her bank account, so Third Bank will not get full payment immediately from Zola. Third Bank does have the option of paying off the notes to First Bank and Second Bank (thus "stepping into their shoes"), but because Zola's house's FMV is less than the

two notes' balances, that is not a rational solution for Third Bank under the facts. Third Bank's best hope is that Zola continues making the note payments.

Zola is out a home and still owes Third Bank $50,000. Can Zola demand Don reimburse Zola for the $90,000 value of the home lost in the foreclosure, or for the money Zola paid Don to buy the home? Answer: No. Zola's taking the house subject to the two bank notes was part of the consideration for the house. That is why Zola was able to buy a $170,000 home for $60,000 cash in the first place!

If Zola's taking the house subject to the two bank notes was consideration for the purchase of the house, can Don demand that Zola indemnify him for the $10,000 he must pay Second Bank from his personal funds? Answer: No, again. Zola did not obligate herself to pay the banks, Don, or anyone else for the two bank loans. Zola only risked losing the house, which is exactly what happens.

(c) Zola is no better off under this course of action and may fare worse than in (b). When Zola falls too far behind in her payments to Second Bank and Third Bank, the two banks on not being paid will accelerate the note balances due them, and foreclose on the loans. First Bank, however, maintains its senior mortgage status and has first priority to any proceeds from the sale of Zola's house. First Bank will insist on and receive the first $60,000 of any sales proceeds. The $30,000 of the sales proceeds that remain would go to Second Bank. Second Bank has recourse against Don as an unsecured creditor for the balance still owed it (but no more against Zola). Third Bank as an unsecured creditor has recourse against Zola for its note.

As an observation, Zola personally is worse off paying First Bank instead of Third Bank. Zola will lose the home either way, but she is personally liable for the Third Bank loan. Every dollar diverted from reducing the Third Bank loan balance prior to foreclosure to reducing the amount owed to First Bank does nothing to reduce how much Zola must pay. Paying down the principal on the First Bank loan reduces the amount owed to First Bank; but unless Zola reduces the amount owed to First Bank and Second Bank to less than her home's fair market value, she receives no benefit from her payments in a foreclosure proceeding. Under the given facts, she reduces the loan

principal, but on foreclosure she still loses her home and gets no money from any sale since all proceeds will go to reducing the First Bank and Second Bank loan balances. Meanwhile, Zola remains personally liable on the full loan balance owed to Third Bank. She must pay that loan from her personal funds.

Thus, under the facts of the Example, by reducing the First Bank loan rather than the Third Bank loan balance, Zola does not reduce the amount of her personal liability. If, on the other hand, Zola pays down the loan owed to Third Bank, on foreclosure she still loses her home, but she is not liable for any excess balance owed to First Bank and to Second Bank. She remains personally liable to Third Bank, but the amount owed to Third Bank is lower than if Zola had not reduced the principal.

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1. See Chapter 9, supra, Common Law Estates and Present Interests.
2. Most jurisdictions do not require grantees to sign even when the deed binds the grantee to honor covenants, conditions, easements, or other encumbrances included in the deed, or the grantee in the deed agrees to assume or take the property subject to a mortgage. The rationale is that, by accepting the deed's benefits, the grantee accepts all the obligations in it as well.
3. Occasionally someone purloins a deed or tricks the grantor into giving it to him. In these situations, there is no delivery unless the grantor intended to convey title when the ostensible grantee took possession of the deed.
4. Special Note: **Priorities** of mortgages are critical to creditors' rights; and is a recurring topic on Bar exams. It is recommended you master this concept and its related material on Recording Acts (in Chapter 25) that sets the priorities.
5. A debtor on a ***recourse liability*** is personally liable for a debt: A creditor can reach all of the debtor's assets to satisfy the debt. A debtor on a ***nonrecourse debt*** is liable on the debt, but if the debtor defaults, the creditor can reach only those assets pledged to secure the debt. The creditor cannot reach the debtor's nonpledged assets. To illustrate, suppose a debtor borrows $100,000 from Bank ***A*** on a recourse note and $100,000 from Bank ***B*** on a nonrecourse note, pledging $100,000 of common stock to each bank to secure the respective loans, and having $500,000 in cash. When the debtor defaults on both notes, the stock serving as collateral for the two loans falls in value such that the stock securing the note to Bank ***A*** is worth $70,000 and the stock securing the note to Bank ***B*** is worth $80,000. Since the note to Bank ***A*** is a recourse liability, Bank ***A*** can sell the $70,000 stock and can force the debtor to use $30,000 of her cash to pay off the rest of the note. But because the note to Bank ***B*** is nonrecourse, Bank ***B*** can sell the pledged stock for $80,000. That is all Bank ***B*** can get from the debtor. Bank ***B*** cannot reach any of the debtor's cash to satisfy the remaining $20,000 owed on its note.

CHAPTER 24

Post-Closing Title Assurances

MERGER DOCTRINE

The sales contract controls the relationship between the buyer and seller during the executory period, but traditionally the sales contract's provisions are no longer enforceable after closing. The contract's provisions for the transfer of title are said to ***merge*** into the deed (now the parties might more appropriately be called grantor and grantee) and the buyer's rights are limited to those warranties or covenants contained in the deed or other document transferring the title. ***Warranties*** are the grantor's promises that certain facts are true as of closing, or that the grantor will remedy the problem or pay damages if later a third party successfully asserts an undisclosed claim on the title to the property.

Today courts will enforce some sales contract provisions—even after closing—if the provisions do not pertain to the title or are not normally found in a deed. These ***independent*** or ***collateral agreements*** are not merged into the deed and are not subject to the doctrine of merger. They may, for example, pertain to the physical condition of the property, enabling a buyer to resort to the sales contract's provisions to remedy a seller's fraud.

Alternatively, the sales contract itself may provide expressly that a sales contract provision will survive closing.

TYPES OF DEEDS

Three types of deeds affecting warranties of title are used in this country: the "general" warranty deed, the "special" warranty deed, and the quitclaim deed. Under the ***general warranty deed***, the grantor warrants against all defects and encumbrances in title excluding those specifically excepted in the deed itself, no matter whether the grantor or a predecessor in title created the defect or whether the grantor even knows of the defect. The grantor in a ***special warranty deed*** also warrants against defects in title, but the grantor limits his or her warranty to those defects or encumbrances that are attributable to some act of the grantor: The grantor makes no warranties about defects or encumbrances created before he took title. The grantor may refer to any preexisting defect and encumbrance in the deed, but these representations will not make the grantor liable for them or for other unlisted preexisting defects or encumbrances.

Example: Two decades ago, *A* granted Company, Inc., a pipeline easement over Blackacre. *A* conveyed Blackacre to *B*, the deed mentioning the easement. *B* conveyed Blackacre to *C* without mentioning the easement. *C* then conveyed to *D*, who conveyed to *E*, all without mentioning the easement. Finally, *E* conveyed Blackacre to *F* by warranty deed. One year later Company notified *F* of its plans to dig up the land to place pipes in the easement. If the warranty deed from *E* to *F* were a general warranty deed, *E* would be liable to *F* for damages. On the other hand, *E* would not be liable to *F* if the deed were a special warranty deed since *E* did not create or grant the easement.

The ***quitclaim*** deed contains no warranties. The grantor conveys whatever interest he or she owns, but the grantor does not even warrant he or she has title. In the above Example, *E* would not be liable to *F* for any defect in title if the transfer was by quitclaim deed. You can recognize a quitclaim deed easily enough because the deed uses the word "quitclaim" or another verb conveying the property that indicates the transfer is without warranties.

Quitclaim deeds are especially useful in transfers between family members, short-term ownership situations, and boundary dispute resolutions.

DEED COVENANTS

Deed covenants or ***warranties*** are promises or representations that title is as presented at closing and no one will step forward later claiming an undisclosed interest in the property. There are six common deed covenants: seisin, right to convey, against encumbrances, warranty, quiet enjoyment, and further assurances. In some states, the grantor must list the covenants in the deed. The grantor is not obligated to make all covenants, and is held only to those covenants specifically included in the deed. Other states work from the other direction, concluding that deeds containing words of conveyance such as "grant" or "convey" carry some or all of the six covenants unless the deed expressly excludes them; if the grantor does not expressly limit or exclude these covenants, they are implied terms of the deed.

The first three covenants—seisin, right to convey, and covenant against encumbrances—are called ***present covenants***. A present covenant or warranty is breached or violated, if ever, the moment the deed is delivered. A grantor either has seisin and a right to convey the interest, or not, when delivering the deed. Thus present covenants protect against any undisclosed defect or encumbrance that already exists when the deed is delivered, and the grantee can immediately bring suit for breach of these covenants, even though no one has asserted a superior or paramount right to the property. The grantee's right lasts only until the statute of limitations, running from the delivery date, expires. Consequently, the statute may expire before the grantee discovers the breach—e.g., before a person having a higher priority exercises those rights.

In contrast, the ***future covenants***—warranty, quiet enjoyment, and further assurances—obligate the grantor to perform some act, such as defending against a third party asserting a higher claim to the property, upon some future event. Future covenants cannot be violated until the grantor refuses to act and the grantee has been ousted or evicted by someone having a paramount title or right. Future covenants are mirror opposites of the present covenants in two respects. First, the grantee cannot bring suit against the

grantor unless and until the future covenant is actually breached. Second, the statute of limitations does not begin to run until a third party asserts a paramount title or right (in the case of the covenants of warranty and quiet enjoyment) or the grantor refuses to execute a needed document (in the case of the covenant of further assurances).

A grantee may be protected against defects or encumbrances under both present covenants and future covenants. The grantee may assert a breach of the present covenant of the right to convey or of the covenant against encumbrances, for example, if the grantee discovers the encumbrance before the third party asserts a paramount title to the property. Likewise, he may assert either the breach of a present covenant or breach of the future covenant of warranty or quiet enjoyment as long as the statute of limitations on the present covenant has not expired. If the statute of limitations on the present covenant has expired, the grantee can resort to an action for the breach of a future covenant once the third party asserts his or her paramount title. Unfortunately, however, sometimes a grantee gets caught without any cause of action. Consider the following Example based on the case of Brown v. Lober, 389 N.E.2d 1188 (Ill. 1979).

Example: Landowners could not sell coal rights to a coal company because, unbeknownst to them, a predecessor in interest retained ownership of two-thirds of the mineral rights. The landowners sued their grantor for breach of both present and future covenants. The court concluded the landowners could not bring an action on present covenants because the statute of limitations had run—i.e., the landowners waited too long to assert their claim. The court also denied the landowners a claim based on breach of a future covenant because the third party had not attempted to mine the coal or to prevent the landowners from mining it, making the landowners' claim for a breach of the future covenant of warranty premature. The mere existence of the superior title and the consequent inability to sell the interest were not breaches of the future covenant.

PRESENT COVENANTS

(a) Seisin

A grantor by the ***covenant of seisin*** (often stating that the grantor is "well seised" of the interest of estate conveyed) warrants she owns the interest she is conveying. In most states, this means the grantor has legal ownership rights to the estate conveyed.

Example 1: A grantor, having no interest in Blackacre, attempting to convey its title to a grantee has breached the covenant of seisin.

Example 2: A grantor, owning Blackacre, conveys its title to a grantee while part of Blackacre is adversely possessed by a third party. The grantor has breached the covenant of seisin because it implies that the grantor is in possession of every part of Blackacre and if anyone else is adversely in possession of any part of it, the covenant is broken.

Example 3: A grantor, delivering a deed describing Whiteacre, but in fact deeding a parcel equivalent in size to Whiteacre and encompassing Greenacre and parts of Whiteacre, has breached the covenant of seisin. It is breached by a failure to convey the specific parcel described in a deed, even if the acreage is the same.

(b) Right to Convey

The ***covenant of right to convey*** parallels the covenant of seisin. By it the grantor warrants he has the right and power to transfer good title to the grantee. The grantor may breach this covenant when, for example, the purported grantor is not an authorized corporate officer; a trust's terms limit a trustee's right to convey; a covenant or restraint on alienation is included in the deed; or some other document restricts or forbids the transfer. The covenants of seisin and right to convey are in most jurisdictions regarded as equivalents, but sometimes not.

(c) Covenant Against Encumbrances

Under the ***covenant against encumbrances***, the grantor warrants no

encumbrances burden the title except for those mentioned or referred to in the deed. This covenant protects against many interests also covered by the covenant of seisin. Encumbrances include outstanding mortgages, judgment and tax liens, dower and other marital interests, easements, restrictive covenants, outstanding leases, and encroachments on or from an adjacent property.

Any interest or restriction mentioned in the deed cannot be the basis of a claim for a breach of this covenant against encumbrances. Neither can a government action pursuant to an ordinance or other law.

Example: Alex by general warranty deed transferred Blackacre to Betty, the deed mentioning an access easement permitting the owner of neighboring property to travel over Betty's land to reach a public road, but did not mention there was a covenant in effect prohibiting multi-story buildings on Betty's property. Betty learned of the easement and the covenant after closing. Betty has a valid claim against Alex for breach of the covenant against encumbrances because the deed did not mention the two-story building. She has no claim of a breach of the covenant against encumbrances for the access easement since it was disclosed in the deed.

One interesting difference between the definition of "encumbrance" during the ***executory period*** and during the ***post-closing period*** has developed concerning violations of a zoning ordinance or an environmental law. Whereas many courts will allow a purchaser during the executory period to rescind a sales contract because of a violation of a zoning ordinance or environmental law, courts tend not to find an encumbrance under the deed covenants in this situation. The apparent reason for this distinction is that a prospective purchaser during the executory period can rescind the sales contract, and the parties are returned to their original positions. Once closing occurs, however, judges apparently do not believe grantors should be liable for all potential violations of government regulations. Moreover, it's too complicated undoing the sales transaction months or years after the closing.

FUTURE COVENANTS

(a) Warranty

Giving a ***covenant of warranty***, the grantor covenants to defend against and compensate the grantee for any ***lawful*** claims made against the title that might arise under the covenant of seisin and against encumbrances. A grantee's cause of action under this covenant does not arise until the grantee has been sued, ousted, or evicted by a party asserting a superior interest: There must be either an actual or a constructive eviction first. The mere existence of the paramount interest is not enough. The grantor must pay attorneys' fees and damages resulting from successful claims of third parties actually owning the property, having any superior interest in the property, or having any interest by way of a lien, life estate, easement, restrictive covenant, equitable servitude, or lease. A third party's mere claim of a paramount interest is not enough. If a grantee prevails against the third party claimant, the covenant has not been breached and the grantor does not owe any damages.

Every defect in title or encumbrance breaching a present covenant can become a breach of the covenant of warranty, thus allowing the grantee to excuse a breach of the present covenant but saving the possibility of a claim against her grantor once there is an assertion or eviction by a third party.

(b) Quiet Enjoyment

The ***covenant of quiet enjoyment*** is treated in nearly all cases the same as the ***covenant of warranty***. The covenant of quiet enjoyment probably should not be listed as a separate covenant any longer. Note, however, that "quiet enjoyment" means no one with superior title will interfere with the grantee's possession. Contrary to its name, the covenant of quiet enjoyment has nothing to do with noise or freedom from noise.

Example: Here is a reproduction of the first Example in this chapter:

Two decades ago, *A* granted Company, Inc., a pipeline easement over Blackacre. *A* conveyed Blackacre to *B*, the deed mentioning the easement. *B* conveyed Blackacre to *C* without mentioning the easement. *C* then conveyed

to *D*, who conveyed to *E*, all without mentioning the easement. Finally, *E* conveyed Blackacre to *F* by warranty deed. One year later Company notified *F* of its plans to dig up the land to place pipes in the easement. If the warranty deed from *E* to *F* were a general warranty deed, *E* would be liable to *F* for damages. On the other hand, *E* would not be liable to *F* if the deed were a special warranty deed since *E* did not create or grant the easement.

If *E* gave *F* a general warranty deed, the claim against *E* would be for a breach of the covenant of warranty or covenant of quiet enjoyment since the pipeline company made a lawful claim to owning an easement in *F*'s land. *F* also might have brought a successful suit under the present covenant against encumbrances if the statute of limitations had not run.

(c) Further Assurances

The ***covenant of further assurances*** requires the grantor to execute any document or perform any action needed to cure a defect or encumbrance in the conveyance. It also requires a demand by the grantee on the grantor that the latter execute the needed document or perform the needed action. For example, when a technical defect exists in a previously signed document (say a deed was not notarized and acknowledged as it should have been), the grantee may invoke this covenant to have the grantor provide a corrected version. A grantor under this covenant must execute the new deed or other document and cannot demand additional compensation from the grantee for doing so. The grantor may also have delivered a deed to land before the grantor acquired it. A grantee in this situation may insist on the grantor's delivery of a second deed conveying the land from his grantor to him after his grantor purchases the land. This covenant alone among deed covenants can be enforced by ***specific performance***.

DAMAGES

A grantee can receive monetary damages from the grantor for the breach of a deed covenant. The amount of damages depends on which covenant has been breached. A court may allow nominal or actual damages for a violation of the

covenant of seisin or covenant of right to convey or may award the property's full value if the grantee transfers the property back to the grantor. The damages for a violation of the covenant against encumbrances will either be the cost of removing the encumbrance or, if that is impractical or too expensive, the decrease in the property's fair market value. Two caveats apply in calculating damages: First, the maximum the grantee can receive on the breach of a covenant is the ***original amount the grantee paid*** his grantor for the property; and second, the maximum the grantee can receive from a remote grantor will be the ***amount the remote grantor received*** from a bona fide purchaser.[1]

Example 1: Grantee pays $10,000 for a lot and later builds a $100,000 home on the lot. On the breach of a deed covenant, the maximum damages a grantor must pay Grantee will be $10,000.

Example 2: Grantee paid $100,000 for a lot and land, and the value increased to $150,000 before Grantee discovers the breach. The maximum Grantee can receive from a grantor is the $100,000 Grantee paid originally.

Example 3: Abel sells land to Baker for $100,000. When the land is worth $160,000, Baker learns that Cal owns a one-quarter interest in the property. How much in damages can Baker get from Abel? Since Baker's interest is one-quarter less than she expected, her damages presumably are one-quarter of the property's fair market value. The open question—on which jurisdictions differ—is which number is the fair market value, the price Baker paid for the property or the fair market value when the breach occurred or was discovered? In some jurisdictions, Baker's recovery is limited to $25,000, in others to $40,000.

Example 4: Assume the same facts as in the prior Example, except Cal actually owns a three-fourths interest in the land. What damages can Baker get from Abel? In jurisdictions using the $100,000 original sales price as the relevant fair market value, Baker's damages would be $75,000. In jurisdictions using the $160,000 fair market value on the date the breach occurs or is discovered as the relevant fair market value, Baker suffered $120,000 loss of value, but would be limited to $100,000 damages—the amount Baker paid for the property.

ATTORNEY’S FEES

In addition to other monetary damages, a grantee bringing a breach of a covenant of warranty or quiet enjoyment claim against her grantor after losing her title defense against a third party can collect attorney’s fees for the reasonable cost of defending against the third party’s ***lawful*** claim. The grantor is obligated to reimburse the grantee for the attorney’s fees that the grantee incurred in defending the claim because the grantor warranted no person had a superior interest in the property. The grantee cannot receive attorney’s fees incurred in a second action to collect the attorney’s fees incurred in the first action. Nor can the grantee collect attorney’s fees when successful in the first action. (Reminder: A grantee cannot collect attorney’s fees from her grantor if she successfully defends against a third party’s claim since the grantor warranted only against lawful claims.)

Example 1: Suppose in the immediately prior Examples that Baker spent $20,000 in an unsuccessful defense against Cal’s claim to a one-quarter interest. Baker’s actual loss of value damages were $40,000. In addition, Baker incurred $5,000 attorney’s fees in a suit against Abel to collect the damages and any attorney’s fees owed her. Baker should collect from Abel the $40,000 actual loss of bargain damages and the $20,000 attorney’s fees for the unsuccessful defense. Baker would not receive the $5,000 in attorney’s fees incurred in the suit against Abel.

Example 2: Baker incurred $20,000 in attorney’s fees in a *successful* defense against Cal’s claim to the one-quarter interest. In addition, Baker incurred $5,000 attorney’s fees in a second suit for attorney’s fees against Abel. Baker would not collect any attorney’s fees. Baker would not collect the $20,000 since she was successful in her defense. Thus Cal’s claim was not a lawful claim. Abel warranted no one had a superior interest in the property, but did not warrant no one would make an unfounded claim. Baker’s successful defense is proof Cal did not have a superior interest. So Baker can collect neither the $20,000 for the successful defense nor the $5,000 incurred in the second suit, which he could not collect whether he won or lost the litigation against Cal.

REMOTE GRANTEES

A grantee may transfer the property to other persons, known as ***remote*** or ***subsequent grantees***, who will own the property when the breach of a covenant made by a prior or remote grantor occurs or is discovered. To illustrate, assume *A* transfers land to *B*, who later transfers the land to *C*. As to *A*, *B* is the grantee and *C* is a remote grantee. As to *C*, *B* is the grantor and *A* is the remote grantor.

In all states, ***future*** covenants "run with the land," meaning that a remote grantee may seek relief against her immediate grantor or against any remote grantor in the chain of title who breached his or her deed covenants. As a corollary result, a remote grantor who pays a remote grantee because of a covenant has recourse against any prior warranting grantors (subject to the statute of limitations).

Jurisdictions differ as to the remote grantees' rights to enforce ***present*** covenants against remote grantors. Since present covenants are breached immediately on delivery of the deed, the cause of action vests in the first grantee (the nonremote grantee) immediately. At common law, causes of action were not assignable and because of this nonassignability, most jurisdictions held (and still hold) that remote grantees held covenants that were personal to them, did not run with the land, and so they could not bring actions against remote grantors for breaches of the present covenants. That is, a grantee's conveyance did not also assign the cause of action for breach of a present covenant. Only the grantee named in the original deed could enforce a present covenant. Other jurisdictions, by judicial opinion, allow remote grantees to sue remote grantors for breach of present covenants because today causes of action and contract rights are freely assignable, and deed covenants should be no different. A few state statutes embrace the rule that all covenants should run with the land. The statute of limitations for a breach of a present covenant as to remote grantors, however, begins running on the initial transfer from the defendant grantor, not when the remote grantee receives the deed.

As to maximum amount of damages a remote grantee can receive from a remote grantor when the amount the remote grantee paid differs from the amount received by the remote grantor, the general rule is that the remote grantee is limited to the lesser of (1) the remote grantee's actual damages, (2)

the remote grantor's sales price, or (3) the remote grantee's purchase price.

Example 1: *A* by general warranty deed sold Greenacre to *B* for $50,000. Later *B* by general warranty deed sold Greenacre to *C* for $40,000. The most *C* could collect from *A*, the remote grantor, for breach of a warranty would be $40,000, *C*'s purchase price.

Example 2: *A* by general warranty deed sold Greenacre to *B* for $50,000. *B* by general warranty deed sold Greenacre to *C* for $60,000. The most *C* could collect from *A*, the remote grantor, for a breach of a warranty would be $50,000, *A*'s sales price. *C* would be better off going against *B*, from whom *C* could collect $60,000, and once *B* paid *C* $60,000, *B* could sue *A*, but only up to $50,000, the amount *B* paid *A*, and not the $60,000 *C* paid *B*.

IMPLIED WARRANTY OF QUALITY

An implied warranty of quality (a/k/a the warranty of habitability), similar to that existing for leased property, exists in the sale of new and remodeled homes by developers and other commercial vendors. This warranty permits a purchaser to recover from the contractor, developer, or other commercial vendor for defective construction or construction not done in a workmanlike quality. It is yet another exception to the doctrine of *caveat emptor*. It extends to ***latent defects*** that are discovered within a reasonable period of time. The defect must be due to the builder's poor workmanship, and cannot result in whole or part from subsequent substantial changes to the structure, from misuse of the structure, or from normal deterioration. It extends only to residences and does not apply to commercial buildings.

Most jurisdictions hold that this warranty applies to the sale of new residences (including houses, townhouses, and condominiums), as well as to the sale of commercially renovated or remodeled used homes. So far courts have refused to extend the warranty to the sale of used residences by noncommercial homeowners. They imply this warranty based partly on tort law and partly on contract law.

Borrowing from contract law, most courts allow replacement or repair costs or the decrease in value of the building (known as economic losses) as

damages for breach of the implied warranty. If the defect renders the house uninhabitable, some courts allow the buyer to rescind the sale and grant her restitution of the whole purchase price.

Borrowing from tort law, a few courts do not allow any recovery of economic losses unless a person has been injured or is likely to be injured. So a latent defect that causes only economic damages does not give the buyer a claim for relief. Most courts question the wisdom of the tort approach, preferring the contract approach allowing economic damages even without physical injury.

Some developers or builders in their contracts try to disclaim or shorten the coverage period of any warranty of quality. Although some jurisdictions find a developer's or builder's attempts to disclaim void as against public policy, most honor disclaimers that are clear, unambiguous, and conspicuous (e.g., in bold, large, or different colored print), or are otherwise brought to the buyer's attention, particularly when the buyer is informed of the specific defect in advance. General disclaimers, such as a property being transferred "as is," do not suffice in most jurisdictions (although they are effective in some). Courts usually limit the "as is" general disclaimer to patent defects, not to the latent defects covered by this warranty.

In jurisdictions where this implied warranty of quality is based on public policy rather than implied contract, any express warranty of quality given by the builder generally supplements but does not negate or override the implied warranty. The implied warranty remains the minimum that the builder offers. In some jurisdictions, however, freedom of contract principles allows an express warranty to trump the implied one if both have the same subject matter, such as the roofing or the heating and air conditioning system.

The statute of limitations for the implied warranty of quality generally runs from the date construction is completed, or from the date (if later) that the property is sold to the first purchaser. Alternatively, some jurisdictions begin running the statute only when the buyer discovers, or should have discovered, the defect. Many jurisdictions toll the running of the statute from the time the buyer gives the builder notice of the defect.

In most jurisdictions where courts have addressed the issue, this implied warranty runs with the house to subsequent buyers. Other courts, borrowing from tort law, have ruled subsequent or remote purchasers are not in privity of contract with the builder and thus the warranty does not run to them. Some nonetheless allow subsequent buyers to proceed in negligence against the

builder. There are good arguments why the implied warranty of quality should run to subsequent buyers: Latent defects often take time to become apparent; subsequent buyers are no more likely than first buyers to discover them before purchasing; and the builder/vendor should expect that homes will be resold and is in a better position to prevent the defect and repair it when discovered.

In any event, the subsequent buyer must prove the vendor/builder caused the defect and show that the suit was brought within the relevant statutory period. The builder can defend by showing he did not cause the defect, that previous or current owners made substantial changes to the structure, or that the damages were the result of normal wear and tear or other natural causes.

AFTER ACQUIRED TITLE (ESTOPPEL BY DEED)

Sometimes a person conveys property or an interest in property without having legal title, but in anticipation of gaining that title later (this is rare but sometimes happens). Under the doctrine of ***after acquired title*** (a/k/a ***estoppel by deed***), the legal title to the property passes to the grantee as soon as the grantor gets the title. This doctrine applies only when the grantor warranted she had title. If the grantor quitclaimed the property to the grantee, the grantee acquires no interest if the grantor later acquires the property.

Examples

Remote Control Problems

1. Jen conveyed a building to Turner by general warranty deed. One year later Turner sold the building to Walter by general warranty deed. Walter later learns of a $100,000 note Jen owed Bay Bank. The note was secured by a mortgage on the building now owned by Walter. Bank's mortgage lien is properly recorded in the land records, but neither of the deeds mentioned it. Jen has made all the note payments to date. Bank has no plans to foreclose on the lien. Walter does not want his building to secure the Bank note. What should Walter do?

The Defective Subdivision

2. *S* owns 100 acres of land. He sold three acres to *A*. Later *S* sold two acres to *B* and three acres to *C*. All three deeds were general warranty deeds. *S* conveyed easements across his remaining property for egress and ingress to all three grantees' properties. *A, B,* and *C* all intended to build homes on their land.

   Two years later *C* applied to the County Planning Department for a permit to build his home. The county denied the permit because under its subdivision ordinance, more than one partial sale of land is a "subdivision," and it said it would continue to refuse to issue any building permit until *S, C,* and the other partial buyers subdivided *S*'s original property, secured a plat approval, and paved a road as required by the ordinance. When contacted, *S* refused to do anything about the matter.

   Do *A, B,* and *C* have any rights against *S* under the deeds' covenants?

A2B2C2D

3. Trudy Owner owned Blackacre. *A*, who had no connection to Trudy Owner, by general warranty deed conveyed Blackacre to *B* for $100,000. One year later, *B* quitclaimed his interest in Blackacre to *C* for $110,000. Two years later, *C* conveyed Blackacre by special warranty deed to *D* for $80,000. Six years after the *A* to *B* conveyance, Blackacre was worth $90,000 and Trudy Owner, the legal owner, evicted *D*. Under state law, present covenants do not run to remote grantees.
   (a) Explain how all resulting issues among *A, B, C,* and *D* should be resolved.
   (b) How would your answer change if *A* sold for $100,000, *B* sold for $80,000, *C* sold for $110,000, and Blackacre was worth $125,000 when Trudy Owner evicted *D*?
   (c) How would your answer change if the actual amounts paid were those set out in the facts but each deed recited consideration received as "$10 and other considerations"?

A Quality Issue

4. Flawless Construction built a residential townhouse, which it sold to Amos. After living there a few months, Amos noticed excessive humidity and dampness in his basement, accompanied by mold, mildew, and an offensive odor. Some of Amos's personal property stored there was

damaged. The moisture originated from the groundwater table underlying the basement. A $2,000 fix would eliminate the problem. Amos wants Flawless Construction to pay to fix the problem. Flawless Construction contends it bears no liability for this act of nature, especially since Amos can and does still live in the home. What result?

Implied Inference

5. Development Inc. contracted with Building Company to build several townhouses. Development Inc. sold one of the new houses to the Sotos. The form sales contract between Development Inc. and the Sotos, among other provisions, contained the following two provisions:

   17. ONE-YEAR WARRANTY: Development Inc. warrants that it will repair all defects due to faulty materials or workmanship if Development Inc. receives written notice of such defects within one year of the sale to Purchaser.
   18. ENTIRE AGREEMENT: This contract and the matters referred to herein constitute the entire agreement between the parties. No representations, warranties, undertakings, or promises, whether oral, implied, or otherwise, have been made by Development Inc. or Purchaser to the other unless expressly stated herein, or unless mutually agreed to in writing between Development Inc. and Purchaser.

   These provisions were on a standard printed form in like-sized small print. The form contained blanks for the purchaser's name, the house description, the sales price, and the financing terms, if appropriate.

   A year and a half after buying the home, the Sotos sold the house to Sabrina. A month after moving into the house, Sabrina discovered the exterior walls did not prevent water from coming into the house after a heavy rain and that the central heating system did not heat one of the bedrooms adequately. There was nothing to indicate previous water damage or heating problems. Sabrina called and wrote Development Inc. demanding Development Inc. repair the house. Development Inc. refused.

   (a) Sabrina sued Development Inc. Is Development Inc. the proper defendant under the implied warranty of quality?
   (b) Did Sabrina buy a "new" house for purposes of the implied warranty

of quality? Does Sabrina as purchaser from the Sotos have any rights against Development Inc.?

(c) How does Provision 17's express warranty affect the analysis? Does an express warranty covering the same subject matter as the implied warranty of quality displace the implied warranty?

(d) Was Provision 18 an effective disclaimer of the implied warranty of quality?

After Acquired Thought

6. Adam owned 700 acres. He contracted to sell all of them to Len. One month later, and two months *before* closing, Len by general warranty deed conveyed 10 of the 700 acres to Marty. Marty recorded his deed at the local county courthouse. Two months later, Adam and Len closed, Adam delivering a warranty deed to Len for the 700 acres. A year later Len contracted to sell the 700 acres to Nick. When Marty heard Len planned to include the 10 acres Marty had bought earlier in the sale, Marty protested. Who owns the 10 acres?

Explanations

Remote Control Problems

1. Walter wants Jen either to pay off the loan or to substitute other collateral to secure the Bay Bank note. Whether Walter can demand Jen do so under the deed covenants depends on whether the present covenants "run with the land." A mortgage is an encumbrance for purposes of the covenant against encumbrances. A few jurisdictions allow remote grantees like Walter to enforce present covenants. In those jurisdictions, Walter can enforce the covenant against encumbrances against Jen. Jen in that case can pay off the mortgage or obtain its release from Bay Bank either by Jen's retiring the debt or substituting different collateral.

   If the building is in a jurisdiction in which remote grantees cannot enforce present covenants, Walter has no standing to bring an action for breach of the present covenant against Jen and, in addition, Walter cannot bring an action for breach of the future covenant, which remote grantees can enforce in all jurisdictions, because Bay Bank has not evicted him. Even though Walter has no case against Jen, he may enforce the covenant

against encumbrances against Turner, who is liable since he gave Walter a general warranty deed not mentioning the mortgage. Turner then either would be required to pay off the mortgage, leaving him with an action against Jen, or be required to place funds in trust in case Bay Bank forecloses. Turner might make Jen a third-party defendant to resolve all matters in one proceeding, but that is beyond Walter's control.

If Walter cannot locate Turner (say he moved to another jurisdiction) or Turner is bankrupt, Walter may be left without a remedy unless and until Bank forecloses on the building. At that point, he has an action against Jen on the future covenants of warranty and quiet enjoyment.

The Defective Subdivision

2. No. *S* did not violate the present covenant of seisin: He owned the land in fee simple. Neither did *S* breach the covenant of right to convey: The violation of the subdivision ordinance is not a breach of that covenant. Neither did *S*, in most jurisdictions, breach the covenant against encumbrances: The existence of a subdivision or zoning ordinance does not breach that covenant, and the violation of the subdivision ordinance inherent in the land transfers would not change this result in most jurisdictions. In the majority of jurisdictions, therefore, *S* has not breached any present covenant. (Were this problem to arise during the parties' executory periods, this violation would be grounds for rescinding the sales contracts. During that period, the parties can be placed back into their original positions without much cost, and *S* could decide how or if to resolve the problem. After closing, however, the grantor's flexibility disappears and in addition, the cost may be too high for the grantor to bear based on the sales price, especially when, as with these facts, both buyer and seller had equal access to the ordinance in question.)

   A minority of jurisdictions, on the other hand, hold a violation of a land-use regulation like the subdivision ordinance breaches the covenant against encumbrances, especially after the state took action to enforce the provision.

   Likewise, future covenants of warranty and quiet enjoyment are not violated since they assure grantees that their enjoyment will not be disrupted by the grantor, by a person acting through the grantor, or by someone having paramount title. The county in denying the permits is

without any claim of title, so future covenants are inapplicable.

The covenant of further assurances also does not apply because the facts here do not require *S* to execute any document or perform some act to perfect the title conveyed. *S*'s deeds granted *A*, *B*, and *C* good title.

A2B2C2D

3. (a) *D* has no claim against *C* since *C*, by using a special warranty deed, warranted only against title defects that arose while *C* owned Blackacre, not any defects already in effect when she acquired her interest. Trudy has owned the land since before the relevant transactions began, so her interest in the land preceded *C*'s purchase. *D* also has no cause of action on the deed covenants against *B* since *B* quitclaimed his interest, meaning he made no warranties whatsoever as to title. Nothing in the facts indicates *B* (or anyone else) knew of Trudy's interest until the eviction, so no fraud claim arises from these facts.

   D can bring an action against *A* since *A* conveyed by general warranty deed. *D* cannot bring a claim based on the present covenants of seisin, the right to convey, or against encumbrances, however, since present covenants do not "run to" subsequent or remote grantees in this jurisdiction. Fortunately for *D*, however, future covenants do run; *D* can seek relief from *A* under the covenant of warranty or covenant of quiet enjoyment. *D* had rights under the covenants of warranty and quiet enjoyment as soon as Trudy evicted him. *A* owes *D* $80,000 in damages (the amount *D* paid) even though *A* received $100,000 when he sold Blackacre and Blackacre was worth $90,000 (when Trudy evicted *D*) because *D*'s damages are limited to the amount he paid.

   If *D* had litigated to defend his interest against Trudy and lost, *D* could under the covenants of warranty or quiet enjoyment recover reasonable attorney's fees and court costs from *A*. *D* cannot receive attorney's fees incurred in suing *A*. (Note: *D* would not be able to collect attorney's fees for the defense if he had prevailed against Trudy.) In addition, the court may also award *D* interest on the $80,000, running either from when *D* bought Blackacre, or when Trudy evicted *D*. The latter date seems the better rule here since

before the eviction *D* possessed and used Blackacre, especially when Trudy does not seek back rent or profits from *D*, an innocent trespasser on her property.

C has no claim against *B* since *B* quitclaimed Blackacre. *C* has no claim against *A* unless and until *C* becomes liable to either *D* (and *C* is not liable to *D* because she gave a special warranty deed) or to Trudy. Nothing in the facts indicates Trudy sought any damages from *C*, so *C* has no action against *A*.

C lost money on Blackacre, selling Blackacre for $30,000 less than she paid for it, but *C* cannot demand *A* reimburse her for this loss. There is a presumption that the loss resulted from a general decrease in Blackacre's market value and not from any title defect. Deed covenants do not warrant against general market changes.

For the same reasons, *B* has no action against *A* based on a breach of the future covenants. *B* may have a claim for breach of a present covenant since he is the only person who could enforce the present covenants against *A* in this jurisdiction. But *B* sold Blackacre for a profit before any title defect surfaced and thus he suffered no loss. And even if *B* sold Blackacre for a loss, since he and his purchaser, *C*, did not know of any title defect, the decreased value would have again been attributable to general market conditions, and not reimbursable as damages from *A*.

(b) The answer is the same as in (a), except that *D* can receive only $100,000 damages in the large majority of states. *D* cannot recover the full $110,000 he paid for the property or the property's current $125,000 value. His maximum loss of bargain damages is limited to the amount the defendant, *A*, received for the property. In a minority of states, *D* would be able to collect the $110,000 he paid for the property. In addition to the loss of bargain damages, *D* may recover reasonable attorneys' fees incurred in his unsuccessful defense against Trudy, with legal interest.

(c) This Explanation parallels Explanations (a) and (b). *D* should collect $100,000 in loss of bargain damages with interest and reasonable attorney's fees. The parol evidence rule makes oral testimony or other extrinsic evidence inadmissible to construe the plain terms of a contract or deed. This rule causes problems in some jurisdictions for remote grantees. A few jurisdictions adhere strictly to the rule,

looking only to the consideration stated in the deed. Some allow the original parties to offer parol evidence to contradict the deed, but will not allow remote grantees that same privilege. However, most jurisdictions allow parol evidence even as to remote grantees, apparently acknowledging a practice of parties' inserting token consideration amounts into deeds. Others feel obliged to honor the rule, yet admit parol evidence as to the actual consideration by treating the amount stated in the deed as a statement admitting receipt of the consideration rather than as a statement of the actual consideration paid, and thus allowing parol evidence to flesh out an unclear fact. This approach is especially likely to be used when the deed recites "$10 and other consideration received" or similar language. Here the $10 stated price was less than the actual consideration. In most jurisdictions, then, the grantor is estopped from limiting his liability to this lower amount.

A Quality Issue

4. A damp basement is not a title defect, so Amos's case hinges on the implied warranty of quality. Amos must *prima facie* prove (a) Amos bought a "new" home from Flawless; (b) Flawless was the builder/vendor of the townhouse; (c) the townhouse at the time of sale was not delivered in a workmanlike condition; and (d) Amos suffered damages as a result of the defect.

   The first two elements are not in dispute. Flawless is a builder/vendor and the townhouse is Amos's home. The townhouse is a new home. The $2,000 cost to fix the defect indicates Amos suffered some damages from the moisture. The damage issue in (d) depends on whether Flawless is responsible for damages caused by moisture from the surrounding groundwater table seeping into the basement. That issue follows from the resolution of the issue in (c), whether the townhouse was delivered in a workmanlike condition.

   Courts do not demand homeowners prove exactly how the builder failed to build the house in a workmanlike manner: Amos can show either that the home was not built in a workmanlike manner or that the home was not suitable for habitation. Amos proved Flawless did nothing to prevent groundwater from seeping into the basement. He also showed the mold,

mildew, and odors made part of his home unusable for its intended purposes.

The issue in the workmanlike manner alternative is a question of fact: whether builders in the community anticipate and prevent water seepage into the basement, or whether seepage protection is a nicety some homeowners will pay extra to have. A fact-finder might well find a builder should prevent water seepage into basements. Similarly, the alternative question whether the home was suitable for habitation is a fact question: The defect does not have to make the home completely uninhabitable. Instead, the test is whether the home's condition meets the reasonable homeowner's expectations for its intended use. A fact-finder here likely would find the leaky basement was ill suited for use as a bedroom or storage area. Thus the conclusion must be that Flawless did not deliver the home in a workmanlike condition.

Flawless could defend by arguing the leakage was a patent defect. The implied warranty of quality does not cover patent defects. Leaky basements might be deemed patent defects since an inspection would find water stains, molds, mildew, or odors of some sort. In a new house, however, the defect may not have occurred, or not been significant enough to leave such telltale evidence. Nothing here indicates Amos should have discovered the defects prior to closing. Flawless must fix or pay to have the basement fixed.

Implied Inference

5. (a) Yes, Development Inc. is a proper defendant. Unlike the situation in most cases, Development is not the builder/vendor, but it is a commercial vendor. Commercial vendors can be liable under the implied warranty of quality. Building Company was Development's agent. Development cannot escape liability by contracting out the work. As a public policy matter, Development is in a better position to monitor and discover the defects than are its customers.

   (b) Sabrina bought a "new" house for purposes of the implied warranty if she is seeking relief from Development Inc. The issue is whether the latent defect existed at the time Development Inc. sold the house to the Sotos. The sale from the Sotos to Sabrina would be deemed the sale of a "used" house if Sabrina tried to sue the Sotos, thus defeating

the implied warranty of quality claim against them. The second question is more than a restatement of the first question. Courts disagree as to whether a subsequent buyer can enforce the implied warranty of quality against a commercial vendor if the second buyer is not in privity of contract with the commercial vendor. Most courts support the legal conclusion that Sabrina, as a remote grantee, can enforce the covenant against Development Inc. Only a minority would hold Sabrina, as a remote grantee, did not have standing to sue Development Inc.

(c) Provision 17, "One Year Warranty" is an express warranty covering the repairs of all defects due to faulty materials or workmanship if the purchaser notifies Development Inc. in writing within one year of the sale. If the provision controls, Sabrina has no rights since she did not even buy the house until a year and a half after Development Inc. sold the house to the Sotos (even if we assume she qualifies as the "Purchaser" under the sales contract). The one-year period begins when Development Inc. sold the house to the Sotos. It does not start anew when the Sotos sold to Sabrina. Fortunately for Sabrina, courts likely would interpret the sales contract provision as applying only to *patent* defects, not to the *latent* defects at issue here; they fear a contrary ruling would lead to commercial vendors' effectively negating all warranties by conditioning the express warranty of quality to one year, or an even shorter time. Sabrina has the time set out in the statute of limitations under state law.

The next provision, Provision 18, seemingly disclaims all implied warranties, strengthening Development Inc.'s claim that the express warranty of Provision 17 constitutes Sabrina's sole remedy. A court might reject that claim since a reasonable consumer would not associate the two provisions nor appreciate their legal consequences.

(d) No. Development Inc. in Provision 18 attempts to disclaim all implied warranties. Most jurisdictions allow disclaimers or waivers, but they would not approve this one. The disclaimer is part of a boilerplate, preprinted form contract. Its print is small and no different from the rest of the document. To be effective, a disclaimer must be clear and conspicuous, containing some indication the buyer read and understood its legal consequences. Provision 18 did not mention habitability or quality. It is legally insufficient to disclaim

the implied warranty of quality.

After Acquired Thought

6. Marty owns the 10 acres. Under the doctrine of after acquired title or estoppel by deed, title to the 10 acres automatically inured to the earlier grantee, Marty, when Len acquired legal title. The legal title acquired by Len is said to "shoot instantly through" Len's hands into Marty's, and Len is estopped, by the fact of his earlier conveyance to Marty, to deny this. Thus Len did not have any interest in the 10 acres when he later contracted to sell them to Nick, so those acres were not included in his contract.

   The recording acts, discussed in the next chapter, might reverse the result in Nick's favor (if Nick is a bona fide purchaser). This is so because in some jurisdictions, Marty's deed, recorded before Len purchased the property, will be found to be out of the chain of title, a so-called wild deed, meaning that it is not properly recorded. Nick, if he is bona fide purchaser without notice, would prevail over Marty. This will become clearer to you later when you study the recording acts in the next chapter.

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1. Remote grantors are grantors to predecessor owners. For example, if ***A*** deeds to ***B***, and ***B*** deeds to ***C***, ***A*** is a remote grantor as to ***C***. Remote grantors and remote grantees are discussed later in this chapter.

CHAPTER 25

Recording Systems, Marketable Title Acts, and Title Insurance

INTRODUCTION

The recording system is the principal means by which the title to real property can be determined. Every United States jurisdiction has enacted a statute establishing a system for recording deeds. Deed records contain a copy of the documents relating to a parcel of land, typically placed in the records by a purchaser[1] or mortgagee seeking to protect the priority of title for a document—be it a deed, mortgage, lease, or other document. Persons using the system have an interest in property that they do not want future claimants to challenge. The statute underlying the system is called a ***recording act***. Though the recording acts are not uniform, they vary principally in three ways, as will be discussed in this chapter.

If the recording acts do not protect a person involved in a dispute, common law principles control. The following Examples illustrate these common law principles.

Example 1: *O* owns Blackacre in fee simple absolute and conveys it to *A*. *O* then conveys it to *B*. At common law, *A*'s title has priority over *B*'s.

Why? Because no vendor can convey more than he has, and having previously conveyed the fee away to *A*, *O* had nothing left to convey to *B*: The *O* to *B* deed was a nullity. First-in-time, first-in-right was the common law rule.

Example 2: *O* contracts to sell Whiteacre to *A*. *O* then conveys Whiteacre to *B*. At common law, *B* has priority of title over *A*. Why? Because *B* was the first to take legal title from *O*. Legal titles trump equitable titles, said the common law. *A* and *B* were, in effect, in a race to the closing table.

Example 3: *O* contracts to sell Greenacre to *A*. *O* then contracts to sell it to *B*. Two equitable interests, like the two legal interests in the first Example, make the first-in-time, first-in-right rule applicable again. *A* prevails over *B* because *O*'s right to sell by contract, once exercised, makes any second attempt to exercise the right a nullity.

Recording systems often reverse outcomes reached under the common law. A legal title owner under common law rules may lose all rights under a recording system, and a person with no interest under common law principles may prevail under a recording system.

Example 4: *O* holds title to Brownacre. *O* conveys it to *A*, who fails to record her deed. *O* then conveys it to *B*, who pays for Brownacre and promptly records the deed, without having any notice or knowledge of the deed to *A*. *B*'s deed prevails over the prior, but unrecorded, deed to *A*. The rule of the recording system is, first-to-record, first-in-right—quite different from the common law rule.

A recording system serves two practical functions. First, a recording system assures title or, more accurately, determines a priority of rights to a parcel of land. Generally, a person recording a document in the deed records takes priority over persons later recording an interest in the same property. Cases interpreting recording acts emphasize the concept of proper recording and discerning which persons are protected by the acts.

The system's second purpose is informational: A prospective purchaser or lender can search the records to determine whether the prospective seller or borrower has record title and to locate other recorded interests affecting the property. Gaining knowledge of other record owners, easements, restrictive covenants, co-tenants, leases, mortgages, liens, and other recordable

encumbrances to title, the prospective purchaser during the executory period may rescind the sales contract if the seller cannot deliver marketable title. These records are accessible to any member of the public: Thus, even before entering into a sales contract, a prospective purchaser can decide if he would be willing to purchase the property subject to the restrictions and encumbrances of record.

The assurance and informational purposes are related. First, a person recording an interest usually can rest assured a subsequent purchaser must honor the previously recorded interest. Second, with actual knowledge or "notice" of the previously recorded documents, a prospective purchaser will be bound by all recorded encumbrances and interests in the property, and cannot later protest he did not think he would be bound by any of the encumbrances. To encourage prospective purchasers to review the deed records, the prospective purchaser is also said to have ***constructive notice*** of all properly recorded documents regarding the property. Thus the prudent prospective purchaser checks the deed records and does not rely solely on a seller's representations because he is nonetheless bound by what he would have discovered had he searched the records.

The concept of the deed records providing constructive notice gives every purchaser or transferee of an interest in property great incentive to record. Why? Because recording protects a transferee by giving prospective purchasers constructive (if not actual) notice of the transferee's interest, and also safeguards his interest in the property from being dispossessed by a subsequent bona fide purchaser for value. The major takeaway from this chapter is a person receiving an interest as purchaser or creditor should record the document because anyone who fails to record takes the risk that a subsequent bona fide purchaser for value will not have to honor the prior person's interest either because that person did not qualify for protection under the recording act or because, of the two innocent parties, the prior person could have avoided the problem by recording.

Usually one office in each county—titled variously as a county clerk, clerk of the court, clerk of the register, registrar, recorder of deeds, or bureau of conveyances—maintains the deed and other records for all land in that county—or parish, in Louisiana. Each jurisdiction's recording act specifies the mechanics of the recording process, including the formal requirements needed before the recording office can accept a document for recordation. Once accepted, the recording office dates the document, assigns the

document a number, and notes the document in a log. The clerk makes a copy of the document and records pertinent data in appropriate indices, the ***grantor index*** and the ***grantee index*** being the most common.

Some recording acts give long lists of documents that may be recorded—e.g., "deeds, mortgages, agreements that convey, transfer, assign, encumber, or affect the title to real property." Other acts permit the recording of "every grant of an estate in real property." Some interests are not recordable. Short-term leases (less than one or two years) are often expressly excluded. In addition, interests that arise from possession (e.g., adverse possession and prescriptive easements) or involve marital property do not arise by written instrument, so there is nothing to record, and interests arising from possession will often trump written, recorded interests.

Before delving into the recording acts, you must be comfortable with the mechanics of a title search conducted by abstractors and the use of a grantor-grantee or tract index to create a chain of title. Governments are quickly placing documents and indices into an electronic format on computers, simplifying the title search. But computers are not changing the rules governing a search: Constructing a chain of title using the traditional indices is still necessary, often because the computerized version of the records is not the official one giving constructive notice of the documents and making it self-proving and admissible in evidence.

A ***chain of title*** means the series of documents affecting ownership of, rights to, and encumbrances on a parcel of land "linked" together in some manner. Generally, the links are organized by the grantors' and grantees' names. In "searching" title using a grantor-grantee index, the title searcher first checks the grantee indices (moving back in time). This gives him a list of past owners dating back however many years he needs to search. He then searches the grantor index for conveyances made by each past owner in the chain of title, tracing from the earliest grantor to the most recent. This second step tells him whether any owner rendered the title unmarketable in some way by creating an encumbrance on it. The next section discusses the mechanics of the search in more detail.

SEARCHING A CHAIN OF TITLE USING THE GRANTEE INDEX

The ***grantee index*** indexes by grantees' names alphabetically. The index includes the name of each grantee for all land in the county for a given period of time—one year, ten years, etc., depending on the volume of transactions. Along with the grantee's name (typically on the left-hand column of the page), the grantee index will contain a date and time, the type of document being indexed (deed, lease, easement, mortgage, release, lien, etc.), a brief legal description of the affected property, a reference to an instrument number or the page and book in the deed records where a copy of the original document is filed, and the grantor's name.

A title searcher or abstractor begins the search by locating the current owner in the grantee index. Since this index lists grantees' names alphabetically, if the current owner is Richard Gray, the searcher would look in the most recent grantee index under "G" or "Gr" for Gray, Richard. Richard Gray may have received several parcels so checking the brief legal description is important.

A prudent title searcher, looking through the grantor or grantee indices, will be on the lookout for similar names—for example, past owner Johnson Smith may have used the name Johnson A. Smith in a mortgage transaction in the chain of title. In some jurisdictions, when one name is inconsistent with another, checking the documents involving both may be required. Some others require that names that sound alike be treated alike: Thus a phonetic search may be required because Johnny Smith should also be searched under the name of John E. Smith.

Once the grantee's name is found, the searcher finds, copies, and reads the complete document (of whatever type—deed, mortgage, lease, etc.) indexed at that entry. The searcher will also locate and read all documents referenced in the indexed document. Next, if the found document was a deed, the searcher notes the name of the grantor and searches the grantee index again, this time using the grantor's name as the grantee. The searcher repeats this process back in time to the ***root of title***, which traditionally is the document by which the federal or state government granted the land to a private person, but which may also be a judicial proceeding (say a judgment awarding adverse possession) or some other transfer document treated in the jurisdiction as a root of title.

When the searcher cannot locate the prospective seller in the grantee index, or cannot complete some link back to the root of title, the searcher must inquire as to why the deed records are incomplete. The answer may be

found in a judgment or decree of court, a probate decree, a divorce proceeding, a bankruptcy, or some other type of public record. Thus a search (say) of the applicable judgment docket in the clerk's office may be necessary. A prospective purchaser will typically refuse to close a sale until the grantor has completed the chain of title. Why? Because, for the recording system to work, courts often favor maintaining the integrity of the system over using equitable rules in any individual case. This attitude puts the onus on the latest person in the chain of title (or her attorney) to verify that the chain of title is complete and documents are filed properly within it.

SEARCHING A CHAIN OF TITLE USING THE GRANTOR INDEX

The mechanics of searching the ***grantor index*** are similar to those to search the grantee index, except that the search is now conducted from the ***root of title*** forward in time. The title searcher begins with the root of title found using the grantee index and then searches chronologically for grantors up to the present day. A search of the grantor index is intended to disclose documents encumbering the title—easements, mortgages, leases, etc. As with the grantee index, the searcher should find, photocopy, and read each located document. The chain of title resulting from this search leads back to the seller. The title searcher must continue the search up to the day and time of closing to be sure the seller has not granted the property or an interest in the property to someone else.

Example: *O* agrees to sell Blackacre to Pete. Pete's title searcher finds deeds showing *A* conveying Blackacre to *B*, and *C* conveying Blackacre to *O*, but cannot find a deed from *B* to *C* in the records. The searcher may find documents to fill the gap in the judgment docket, probate records, divorce records, or bankruptcy records—but not always. Pete should not purchase Blackacre if there is an unexplained gap between record owners. He should promptly notify *O* of all such gaps because the burden is on *O* to search for, supply, and/or record proper documents to clean up the chain of title before the closing.

SEARCHING A TRACT INDEX

Some jurisdictions use a ***tract index*** instead of the grantor-grantee index, and many others supplement their grantor-grantee indices with a tract index. In a tract index, all documents affecting a parcel of land are indexed on a page for that parcel of land. A searcher in a tract index finds the page for the property in question and copies the page that summarizes all documents affecting the parcel. The searcher then can pull and read all referenced documents.

The majority of jurisdictions retain the grantor-grantee index as their official index. Why? First, most states began with the grantor-grantee index system and are reluctant to change. Second, the government employees in a grantor-grantee index system merely index the documents. They do not decide what properties are affected, and thus avoid claims, possible in a tract index system, that their negligence caused a title problem. Third, private ***abstract companies*** or ***title insurance companies*** usually maintain a “title plant” in which they reconstruct all public land records, creating the equivalent of a tract index. They update the plant daily for all documents filed that day in the county records. With the equivalent of a tract index available in the private sector, governments perceive no need to change their current recording system. Moreover, private abstractors and title insurance companies lobby zealously against changes.

TYPES OF RECORDING ACTS

Recording acts establish the priority persons have to a parcel of land. Purchasers and creditors must strictly comply with a jurisdiction’s laws regarding recording to be protected by the recording acts. With all the transactions, documents, people, and parcels of land involved, errors and other problems are sure to develop. The first step in resolving many problems is determining the type of recording act adopted in the jurisdiction. As noted previously, recording acts fall into three categories. They are known as race, notice, and race-notice acts. Categorizing an act before resolving any problems of interpretation or priority of title that arise under it is not always an easy task.

RACE STATUTES

Under a ***race*** or ***pure race*** act, when two persons hold competing claims to real property, the first person to properly record (not the first to close or receive the deed, mortgage, etc.) prevails. For example, N.C. Gen. Stat. §47-18 provides in part:

> §47-18 (a) No (i) conveyance of land, or (ii) contract to convey, or (iii) option to convey, or (iv) lease of land for more than three years shall be valid to pass any property interest as against lien creditors or purchasers for a valuable consideration from the donor, bargainor or lessor but from the time of registration thereof in the county where the land lies.…

Under a pure race act, the first person to record wins even if he knows about a previously unrecorded conveyance. The North Carolina act's key phrase is "but from the time of registration." The act does not mention the good faith of the parties protected by the act—the "lien creditors or purchasers." This omission indicates that the act is not a notice (and so not a race-notice) act.

The advantage of a race act is its certainty: The prevailing party is easily determined by seeing who recorded first. A person who delays recording risks having another person's claim to the property take a higher priority than her interest. In effect, a nonrecording owner gives her grantor the power to defeat the conveyance to her. She risks losing her entire interest. That potential for losing property to another purchaser or creditor serves as a strong incentive to record a document as soon as it is delivered.

Example 1: *O* conveys Redacre to *A*, who does not record. *B* learns *A* has failed to record, and convinces *O* to convey Redacre to *B*. *B* records. Under a race act, *B* will prevail because she recorded before *A* did.

Many states reject using a pure race act because *B* in the above Example was in a position to avoid the problem since *B* knew *A* already had an interest. *B*'s acquiring the property seems unfair at best, and fraud at worst, so most jurisdictions decided that anyone with notice of a prior interest cannot defeat that prior interest. Similarly, under a pure race act, a person purchasing without notice of a prior transaction because no notice is available is also unprotected by the act if the prior purchaser records first—a further reason to reject a pure race act.

Example 2: *O* conveys Blueacre to *A*. Before *A* records, *O* conveys Blueacre to *B*, *B* having no actual knowledge of *A*'s interest. *A* records before *B*. Under a race statute, *B*, the innocent subsequent purchaser, has no interest in the property since *A* was the first to record.

Many jurisdictions reject using a race act in this situation because *A* was in the better position to avoid the confusion simply by recording quickly and because *B*, being the more innocent of the two, should prevail. The jurisdictions that reject the race act model adopt one of the two recording acts with a notice component: notice or race-notice.

Today only Delaware, Louisiana, and North Carolina have generally applicable race acts, and a few states (e.g., Pennsylvania) have race acts only for mortgages and for transactions involving mortgage remedies. All other jurisdictions divide almost equally between either race-notice or notice acts.

NOTICE STATUTES

Under a ***notice*** act, a subsequent bona fide purchaser or creditor for value prevails over prior claimants as long as the subsequent purchaser acquires the interest without notice of the prior claim. A ***subsequent bona fide purchaser without notice*** prevails immediately upon closing and does not have to be the first to record. In fact, the subsequent purchaser is not required to record at all to prevail against prior unrecorded claimants (although the subsequent purchaser must record to protect his or her interest against any later subsequent purchasers). Tex. Prop. Code Ann. §13.001 is a notice act:

> (a) A conveyance of real property or an interest in real property or a mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed for record as required by law.
> (b) The unrecorded instrument is binding on a party to the instrument, on the party's heirs, and on a subsequent purchaser who does not pay a valuable consideration or who has notice of the instrument.

Subsection (a) says a deed or mortgage is void against subsequent creditors or purchasers for valuable consideration "without notice." The provision is not a race-notice act: The section does not say anyone must be the first to record. It merely indicates that the date the document gives ***constructive notice*** to potential purchasers and creditors is the date and time the document is recorded. Subsection (b) of the Texas act makes an important

point, one that courts recognize even if it is not expressly stated: The recording act does not affect the validity of a conveyance between the parties to it. This is important for all types of recording acts because the party not obtaining recording act priority will want to sue his grantor either for fraud or on the basis of deed covenants. The continuing validity of the "instrument" makes that possible.

Jurisdictions with a notice act reward bona fide purchasers without notice and refuse to condition that protection on the subsequent purchaser's winning the race to record. Under a notice act, a purchaser can rely on the deed records as they exist at closing.

Example 1: *O* conveys Blackacre to *A*, then to *B*, and then to *C*. None of these parties record their deeds. Neither *B* nor *C* has notice of *A*'s deed, and C does not have notice of *B*'s deed. *C*, as the "subsequent purchaser," is protected and *C*'s title has priority over *A* and *B*'s. If *O* had not conveyed to *C*, then *B* would be the "subsequent purchaser" protected by a notice act. Thus *B* has, even in a notice jurisdiction, an incentive to record her deed.

Example 2: *O* conveys Blackacre to *A*, who does not record. *O* later conveys Blackacre to *B*, who purchases without notice of *A*'s claim. Then *A* mortgages Blackacre to *C*, who does not have any notice of *B*'s interest. If *B* did not record before *C* acquired his interest, *C* prevails since he is a subsequent purchaser (creditor) for value without notice of *B*'s claim. If *B* *had* recorded before *C* received the mortgage, *B* would prevail since *C*, the subsequent purchaser (creditor), is charged with constructive notice of *B*'s recorded interest.

"Notice" under these acts can be actual, constructive, or inquiry notice.

(a) Actual Notice

Actual notice means the subsequent purchaser or her agent had actual notice or knowledge of a prior claim. The subsequent purchaser can gain this knowledge from personal observations, a document in the deed records, or hearing about it either during negotiations or from conversations outside the transaction itself.

(b) Constructive Notice

Constructive notice (a/k/a ***record notice***) refers to notice or knowledge that a purchaser could gain by searching the deed records. The purchaser is deemed to know all matters contained in documents legally recorded in the deed records, even though the purchaser did not search them. In fact, constructive notice or record notice typically is asserted when a purchaser did not search the records (a purchaser who searched the records likely has actual notice of prior recorded claims).

(c) Inquiry Notice

A prospective purchaser or creditor has ***inquiry notice*** when the purchaser hears or observes something that would cause an ordinarily prudent person to inquire further. If a prudent person would have investigated further and that investigation would have revealed some unrecorded interest in the property, the purchaser is deemed to have notice of the unrecorded claim.

The most important source of inquiry notice comes from visiting the property. A purchaser has inquiry notice of all rights belonging to possessors and users of the property. The user may be the owner or may be a tenant with a long-term lease or with an option to purchase, or the tenant's landlord may own the property (and not be the person trying to sell). If, as in the case of an apartment building, the property contains multiple units, the purchaser must inquire of each lessee.

Structures, railroad tracks, roads, and power lines may also prompt an inquiry. A prospective purchaser also may have inquiry notice based on a ***common scheme of development***, or may be required to check deeds to neighboring property if the properties were conveyed by a ***common grantor***. In summary, the prospective purchaser has a duty to view the property.

A second category of inquiry notice (though it can be considered a type of constructive notice) involves documents mentioned in properly recorded documents. A subsequent purchaser has inquiry notice of all matters specifically identified in properly recorded documents, whether or not the subsequent purchaser read the recorded documents.

RACE-NOTICE STATUTE

Under a ***race-notice*** act, a subsequent bona fide purchaser or creditor who first records prevails against a person claiming a prior, unrecorded interest as long as the subsequent purchaser did not have notice of the preceding interest *when she acquired* her interest (she can know about the interest when she records the document as long as she did not have notice when she purchased or closed). A race-notice act is a combination of a race and notice act. As with the race act, if the first purchaser in a race-notice jurisdiction records first, she prevails. The subsequent purchaser in a race-notice jurisdiction, to prevail, must acquire her interest *without notice* of the preceding interest *and* must *record first*. Thus the class of subsequent purchasers protected by a race-notice act is narrower than would be protected in a notice act. A race-notice act therefore resolves the issue of the unscrupulous subsequent purchaser in the race jurisdiction who knew about an unrecorded document and took unfair advantage of the situation. Cal. Civ. Code §1107 is a representative race-notice act:

> Every grant of an estate in real property is conclusive against the grantor, also against everyone subsequently claiming under him, except a purchaser or incumbrancer who in good faith and for a valuable consideration acquires a title or lien by an instrument that is first duly recorded.

The typical and significant phrases in this statute are "good faith" and "first duly recorded." They establish that the class of persons protected by the act must be without notice and record first.

Example: *O* conveys Blackacre to *A*, who does not record. *O* then conveys to *B*, who purchases without actual, constructive, or inquiry notice of *A*'s interest. *A* records. Then *B* records. In a race-notice jurisdiction, *A*'s title has priority over *B*'s because to be protected *B* must purchase without notice (which she did) and record first (which she did not). In a notice jurisdiction, in contrast, *B*, the subsequent bona fide purchaser, would prevail because she purchased without any type of notice of *A*'s interest. Who records first is irrelevant.

SUBSEQUENT PURCHASERS FOR VALUE

Notice and race-notice recording acts protect ***subsequent bona fide purchasers without notice***. "Purchasers" include purchasers in the usual sense, as well as mortgagees, lessees, and anyone else who gives value for any interest in the property. Persons who receive an interest as a gift, devise, or inheritance are not purchasers "for value" and thus the recording acts do not protect them or their interests against unrecorded prior transfers. Donees, devisees, and other persons not qualifying as a purchaser for value can prevail over later subsequent purchasers, however, by promptly recording since a subsequent purchaser will have constructive notice of the donee's interest and thus cannot be a protected purchaser without notice. Most acts provide that the subsequent purchaser must be a purchaser "for value" or "for a valuable consideration." Even if the act omits these phrases, almost all courts (except Colorado's) would imply it.

To be a protected subsequent purchaser ***for value***, the purchaser or creditor must furnish some value. It need not be fair market value. Money or other consideration less than the full value of a mortgage will suffice. A promise to pay consideration later is not value. Thus a purchaser who gives the seller a note for a substantial part of the purchase price has not given value yet. If the subsequent purchaser receives *actual* notice of a prior claimant before retiring the note, she loses to the prior claimant, but has right to be reimbursed for all consideration paid prior to learning of the prior claim.

Usually a financial institution that receives a mortgage to secure a loan, or a home seller who takes back a note and mortgage as part of the purchase price, qualifies as a ***purchaser for value*** (the loan or deed to the property being the value). However, this seemingly sensible rule does not apply to the creditor who is owed a ***preexisting debt*** and, seeking security for the debt, persuades the debtor to give the creditor a mortgage on land as collateral. The courts demand some new value be given for the mortgage before the mortgagee can qualify as a purchaser for value. The mortgagee (creditor) is not a purchaser for value because the creditor gave no new value for the mortgage and the mortgage was not part of the original loan. Most mortgagees in this situation would thus give the debtor extra time to pay: The time extension then constitutes the requisite "value." "Value" is not limited to more money. Thus an unsecured creditor with a demand note or a note due and payable who gives the debtor an additional year to pay in return for the mortgage can become a purchaser for value.

CHAIN OF TITLE PROBLEMS

The potential for problems in grantor-grantee recording systems is great indeed. One type of problem involves errors in the recorded documents, such as mistaken property descriptions or misspelled names of the parties, or documents that are improperly filed or indexed. Another type of problem involves chain of title problems, such as occurs when a property owner of two adjoining lots transfers one of the lots and incorporates an easement or covenant into the deed of the transferred lot that benefits or burdens the current and future owners of the retained lot.

(a) Restrictions and Easements on Retained Property Not in the Retained Property's Chain of Title

Example: *O*, the owner of Lot A and Lot B transfers Lot B to *X*, the deed to Lot B incorporating a provision that both Lot A and Lot B will be restricted to single-family residences (a covenant) and another provision giving the owners of Lot B the right to travel over Lot A to get to a specific road (an easement). Later *O* sells Lot A to *Z* without telling *Z* about the easement or the residence-only covenant. The owner of Lot B wants to enforce the covenant and easement against *Z* even though *Z* did not know about the covenant or the easement.

Here *Z* can dutifully search the grantor-grantee index and not find anything in the chain of title for Lot A that mentions the easement or the covenant. Is *Z* obligated to check out deeds to Lot B and other surrounding lots? If not, how is the owner of Lot B able to protect her bargain? About half the jurisdictions conclude *Z* prevails because he should not be obligated to check on all deeds to surrounding property or on deeds to lots transferred by *O*, the common grantor, or by other owners of Lot A in the chain of title. In the other half of jurisdictions, *X*, the owner of Lot B, prevails (and *Z* loses) because purchasers and their representatives should know many covenants and easements are included in only one deed from a ***common grantor***. Either way, somebody will be upset. If you see this on your exam, be ready to justify which approach you prefer.

(b) The Wild Deed

A familiar problem with grantor-grantee indices is the so-called ***wild deed***, a recorded deed or other document that cannot be found easily by a search of the grantor-grantee indices because a ***link in the chain of title*** is not recorded or is recorded out of order.

Example: *O* deeds Blackacre to *A*, who does not record. *A* later deeds to *B*, a purchaser for value, who records.[2] Still later *O* deeds Blackacre to *X*, a purchaser for value with no actual knowledge of the deeds to *A* and to *B*. *X* records. On the one hand, *B* purchased from *A*, the legal owner, and recorded, so *B* is the first of *B* and *X* to purchase and to record. On the other hand, though *X* recorded after *B*, if he searched the grantee index back from *O* to the root of title and searched the grantor index forward to the present, *X* would not find the deed from *O* to *A* since it was unrecorded and thus *X* would have no reason to know to look for a deed from *A* to *B*.

As between *B* and *X*, *X* prevails. Brushing aside the fact that *B* recorded before *X*, most courts conclude either that *X* does not have constructive notice of a deed following a missing link in its chain of title, or that *B*'s deed was not legally recorded. Favoring *X* is critical to maintaining the conclusiveness and integrity of the recording system. This result gives incentive to a purchaser's demanding a complete chain of title reflected in the records: If *B* had required *A* to record the *O*-to-*A* deed before *B* closed, *X* would have had constructive notice of *B*'s interest and *B* would have prevailed.

(c) Documents Recorded Out of Chronological Order

Documents recorded out of chronological order create more chain of title problems.

Example: *A*, anticipating his acquisition of Whiteacre, deeds Whiteacre to *B*, who promptly records the deed. *A* subsequently purchases Whiteacre from *O* and *O* deeds Whiteacre to *A*. *A* records. Later *A* deeds Whiteacre to *X*, a purchaser for value without notice of *B*'s deed. *X* records. Absent the

recording acts, *B* holds legal title. Even though *A* did not own Whiteacre when he transferred it to *B*, *B* takes legal title by the doctrine of estoppel by deed (after-acquired title) discussed in the last chapter. *B* also was the first actually to record. *X*, however, bought in good faith and, moreover, if *X* had searched the deed records, she would have found the *O*-to-*A* deed, but not the *A*-to-*B* deed. Courts differ on whether the *A*-to-*B* deed is legally recorded or whether *X* has constructive notice of the *A*-to-*B* deed. The majority of cases, including the more recent ones, reject the use of the doctrine of estoppel by deed and hold for *X*. The integrity of the recording system requires a purchaser, including *B*, to ensure all links in the chain of title are properly recorded in order before purchasing: The purchaser (*B* here) should have re-recorded the *A*-to-*B* deed after the *O*-to-*A* deed was recorded.

(d) Uncertainty Whether Prior Subsequent Purchasers Had Notice

Another problem inherent in the system of deed records is that the deed records do not disclose whether a subsequent purchaser had actual notice or inquiry notice of an unrecorded document or a wild deed, or whether a person in the chain of title bought knowing of an earlier claimant.

Example 1: Consider these transactions:

O deeds Greenacre to *A*. *A* does not record.

O deeds Greenacre to *B*, who has actual knowledge of the *O-to-A* deed. *B* promptly records.

Finally, *A* records.

At this point, *B* wins between *A* and *B* in a race jurisdiction, but loses in a notice or race–notice jurisdiction. The only issue is proving *B* had notice of the *O-to-A* deed.

Example 2: Same facts as in the previous Example except before the case is litigated or resolved, *B* sells and deeds Greenacre to *X*, a purchaser for value without actual notice of the *O-to-A* deed. When *X* searched the deed records she would have found the deed from *O* to *B* and would have concluded that *B* was Greenacre's legal and record owner. So who should

prevail between *A* and *X*? There is disagreement. In some notice and race-notice jurisdictions, courts favor *A* because the *O*-to-*B* deed is not deemed recorded since *B* had notice of the *O*-to-*A* deed. This legal fiction of the *O*-to-*B* deed not being legally recorded allows the *O*-to-*A* deed to be the first to be recorded and thus *A* prevails. If *A* were to prevail in these jurisdictions, a purchaser to be secure must search all previous owners' names down to the date of closing, a costly and formidable task, and still must prove *B* had notice of the *O-to-A* deed.

In some jurisdictions courts say *X*, as a bona fide purchaser without notice, should prevail because she likely would not find the *O*-to-*A* deed in a search of the deed records, the deed being recorded after the *O*-to-*B* deed. *X*'s chain of title appears complete and *X*'s prevailing maintains the certainty and integrity of the records and reduces the impact of what are, to *X*, off-record facts (here *B*'s actual notice of *A*'s deed). This is an instance of *B* being able to give a priority of title greater than he himself has.

(e) The Shelter Rule

The ***shelter rule*** is an important concept in recording acts. Under the shelter rule, a grantee (even one who has notice of an earlier conveyance to a stranger not in her chain of title) can piggyback (is sheltered by) her predecessor-in-interest's prevailing under the recording act. That is, once a grantee prevails under the recording act as a bona fide purchaser for value without notice, all persons taking the property through him also take good title.

Example: *O* deeds Brownacre to *A*, who does not record. *O* then deeds Brownacre to *B*, a purchaser for value who has no actual knowledge of the *O*-to-*A* deed. *B* records. Then *A* records. *B* later sells and deeds Brownacre to *X*, a purchaser for value who knows about the *O*-to-*A* deed. *X* records.

As between *A* and *X*, *X* prevails over *A* even though she has actual knowledge of the *O*-to-*A* deed and the *O*-to-*A* deed was recorded before *X* purchased because *B*, a prior owner in *X*'s chain of title, prevailed over *A*. As between *A* and *B*, *B* prevails in a notice jurisdiction because he purchased without notice of the *O*-to-*A* deed, and in a race-notice jurisdiction because

he purchased without notice and he recorded first. *B* therefore owned Brownacre. To protect *B* in his enjoyment of Brownacre, the shelter rule allows *B* to transfer Brownacre to whomever he desires, even to those persons knowing of the *O*-to-*A* deed. *B*, therefore, was free to transfer record title to Brownacre to *X* even though *X* knew of the *O*-to-*A* deed. The recording acts are, in this instance, protecting *B*'s right to alienate Brownacre.

MARKETABLE TITLE ACTS

About 20 jurisdictions have enacted marketable title acts to facilitate more efficient searches of the records and to annul some long-outstanding interests in land. These acts facilitate title searches by stipulating a document conveying title will be the act's ***root of title*** even though the common law root of title may have been decades, or even centuries, earlier. Generally, a marketable title act will specify a period of number of years, ranging from 20 to 50 years, as the marketable title search period. A searcher must trace back in a grantee index to the first document transferring title (the title transaction) that was recorded earlier in time than the earliest date in the marketable title search period. This title transaction becomes the act's root of title.

Example: A jurisdiction has a marketable title act similar to the Model Marketable Title Act, providing in substance as follows: "Any person having the legal capacity to own land in this state, who has an unbroken chain of title of record to any interest in land for forty (40) years or more, shall be deemed to have a marketable title to such interest [subject to some exceptions]." The following transactions apply to Whiteacre:

State gave a patent for Whiteacre to *A* in 1801.
A sold to *B* in 1825.
B sold to *C* in 1870.
C granted *D* an easement in 1900.
C died in 1910, devising the property to *E*.
E sold to *F* in 1940.
F mortgaged Whiteacre in favor of *G* in 1950.
F sold Whiteacre to *H* subject to the mortgage to *G* in 1955.
H sold Whiteacre to *I* in 1960, the deed not mentioning the 1950

mortgage or the 1900 easement.

I sold to *J* in 1987. *J* sold to *K* in 1998.

L in 2020 wants to purchase Whiteacre from *K*.

Without a marketable title act, the root of title is the patent from the state to *A* in 1801. Under the act, however, the searcher need only search to the title transaction recorded at least 40 years earlier. Since the search begins in 2020, the searcher must find a title transaction recorded prior to 1980—i.e., the deed from *H* to *I* recorded in 1960. *L* can search the grantor index back to 1960 and the grantee index forward to 2020. *L* has constructive notice of documents recorded or mentioned in documents recorded since 1960, but not of documents recorded before 1960 (unless, as discussed below, one of the act's exceptions applies).

Interests deriving from documents recorded before the act's root title cannot be enforced against a new purchaser unless the documents have been re-recorded after the new root of title or unless the old interest meets one of the exceptions to re-recording. In the Example, since the 1950 mortgage and the 1900 easement were recorded before the statutory root of title, *L* has no constructive notice of them. But if the 1960 "root of title" deed from *H* to *I* had mentioned the mortgage or easement, *L* would have been on inquiry notice of them. Similarly, *L* would have been on inquiry notice of the easement if he noticed it had he visited the land.

Statutory exceptions to the marketable title act diminish the effectiveness of the act. While the exceptions vary among jurisdictions the exceptions often include interests held by federal, state, and local governments; utility easements; railroad easements; water rights; and mineral interests. A few acts except reversions, remainders, rights of entry, and possibilities of reverter. A few acts except restrictive covenants. Further, rights acquired by adverse possession or prescription escape the reach of the marketable title acts. Since exceptions recorded long before the statutory root of title remain enforceable, a conscientious searcher will continue searching back into the deed records for them.

TITLE INSURANCE

Title insurance is part insurance, part indemnity contract. Its overriding

function, however, is to provide a system for disclosure of the state of a title. Private title insurance companies maintain “title plants” where they keep real estate records that are the equivalent of a tract index. Each day the insurer makes copies of all documents filed with the local government in accordance with the applicable recording act and incorporates this data into its own records.

(a) Informational Use

When some party to a real estate transaction requests title insurance, the title insurance company searches the title in its plant and issues a ***preliminary title report*** or ***binder*** setting out the status of the property’s record title (not its legal title). Because the title company can issue a preliminary title report, purchasers and creditors can review the record defects and encumbrances and decide during the executory period whether the property is marketable. In practice, the preliminary title report is more useful than the later-issued title insurance policy.

The information furnished in the preliminary title report is limited to information found in the local deed records. The preliminary title report and title insurance policy do not purport to furnish information about or insure defects or encumbrances created after the policy date; rights of persons in possession of the property; encroachments, boundary line disputes, and other matters that would be disclosed by an accurate survey; easements not shown by public record; mechanics’ liens; and taxes and special assessments not in the public records. Not all policies except all the above, and many companies will (for an extra premium) issue endorsements to a policy providing coverage for many of these matters. However, many policies limit the company’s liability solely to damages flowing from the company’s not finding documents filed in the deed records (so-called on record risks) and some defects in the title that do not appear on the face of otherwise valid looking documents (so-called off record risks—such as the fact that a grantor was incompetent, or that the document was forged, executed under duress, or was not delivered).

(b) Lender’s Policy and Owner’s Policy

There are two types of title insurance policies, based on who is the insured. Most title insurance policies insure a property’s lenders and mortgagees (via a loan policy), not the property’s owners (they need a separately issued owner’s policy). To facilitate the assignment of mortgages into the secondary market for mortgages, financial institutions condition their mortgage loans on the purchaser/borrower purchasing a loan policy for its benefit that can be assigned to secondary market purchasers and investors. A purchaser also may purchase (or the seller may purchase on behalf of the purchaser) an owner’s policy for an additional fee at the same time. Unless the seller is paying for the policy, most purchasers do not choose to purchase an owner’s policy.

(c) No Assignment or Running of Benefits

The named beneficiary is the only insured. Owner’s title insurance policies are not assignable and do not run with the land. Each new owner or mortgagee must buy a new policy. Each insured owner is, however, provided “warranty coverage” after selling the insured property: This coverage indemnifies the owner for any liability later incurred under deed covenants that he provides his purchaser.

(d) Insurer’s Duty to Disclose Excepted Defects

Title insurers argue, often successfully, that their title searches are done solely for their benefit to determine whether they will issue a policy. Under this view, the insured’s only rights are those provided in a title insurance policy. A substantial number (though not a majority) of courts, rejecting the title insurers’ contract theory, now hold that a title insurer searches the deed records both for its own benefit and for the insured’s benefit. The insurer’s failure to disclose defects in these jurisdictions makes it liable in tort for negligence in not finding the record defect or for breach of an implied contract to deal fairly and in good faith for not reporting the defect to the

insured.

(e) Damages

When a title insurer pays a claim under its policy, the amount of the claim is measured by the extent the insured property is damaged by the insurer's failure to discover or disclose a title defect. Damages are limited to the amount stipulated in the policy. Subject to the contract maximum, damages are based on the decrease in fair market value resulting from the defect. Most courts use the values as of the date the defect is discovered to calculate the damages. Other courts prefer the purchase date or even the trial date. Notwithstanding their duty to pay damages, title insurers usually reserve the right to cure any defect instead of paying for any loss of value.

(f) Other Benefits of Title Insurance

Title insurance policies offer some benefits that make a title insurance policy superior to relying solely on the grantor's warranties of title in the deed covenants. One such benefit is that the insurance company will pay attorneys' fees to defend the title against third-party claimants, whether or not the adverse claimant has a legitimate claim. Its policy provides for a "duty to defend" that is broader than its duty to pay a claim. Another benefit is that a title insurer provides a deeper pocket than a warrantor and is more readily found and available when a claim must be made. In contrast, a big hurdle in enforcing deed covenants often is finding the warrantor/grantor, and finding him solvent enough to pay a claim.

Title insurance is not, however, a solution for every problem, as the Examples below show.

Examples: In the following situations, *O* is the owner of Blackacre, whose fee simple absolute title is insured in a standard **owner's** title policy. Thereafter, the following events occur in the alternative:

1. *O* is evicted by Blackacre's true owner, who proves in court that a

deed in *O*'s chain of title was not delivered to its grantee. Does *O* have a claim against the insurer? Yes. The policy insures against some off-record risks. Nondelivery is such a covered risk. Here *O* is actually evicted (the eviction being shown by the court's judgment) and so can show the insurer an "actual loss" as required by the policy. It is an indemnity agreement, not a guarantee of title, so a loss must be more than theoretical or potential—it must be actual before the insurer will pay a claim.

2. An easement over Blackacre is recorded but does not appear as an exception to coverage in *O*'s policy. Does *O* have a claim against the insurer? Yes again. Under the policy, the insurer has a duty to discover and disclose what the records would reveal about the title, and it failed in that duty. Only if the easement or other defect were not in the public records would a claim based on the easement be excluded by the terms of the policy.
3. The county rezones Blackacre, substantially reducing its fair market value. Does *O* have a claim against the insurer? No, on two grounds: First, the policy provides title insurance, not fair market value insurance. It insures title, not the use of the property or the property itself. The insurer has no control over public regulation that affects the use of the property (as zoning does). The value of the property could fall to zero, but that would not affect the title insured or the insurer's liability. Second, the rezoning occurred after the policy was issued, and title insurance is retrospective in nature: It indemnifies the insured for defects in title that arose before the policy was issued, not thereafter.
4. *O* finds that the barn on Blackacre sits partially on a neighbor's land. Does *O* have a claim against the insurer? No. In its schedule (Schedule A) describing the coverage, the policy will use whatever legal description of the property appears on the insured owner's deed, and if the barn is beyond the boundaries of that description, it is not insured.

Examples

Name That Recording Act

1. Classify each of the following recording acts as either race, notice, or race-notice:
   (a) No sale, contract, counter letter, lien, mortgage, judgment, surface lease, oil, gas, or mineral lease, or other instrument of writing relating to or affecting immovable property shall be binding on or affect third persons or third parties unless and until filed for registry in the office of the … recorder … where the land or immovable is situated.
   (b) A conveyance of real property, within the state, on being duly acknowledged by the person executing the same … may be recorded in the office of the clerk of the county where such real property is situated, and such county clerk shall, upon the request of any party, on tender of the lawful fees therefor, record the same in … said office. Every such conveyance not so recorded is void as against any person who subsequently purchases or acquires by exchange or contracts to purchase or acquire by exchange, the same real property or any portion thereof, … in good faith and for a valuable consideration, from the same vendor or assignor, his distributees or devisees, and whose conveyance, contract, or assignment is first duly recorded.
   (c) Every such instrument in writing, … recorded in the manner herein prescribed, shall, from time of filing the same with the recorder for record, impart notice to all persons of the contents thereof and all subsequent purchasers and mortgagees shall be deemed, in law and equity, to purchase with notice. No such instrument in writing shall be valid, except between the parties thereto, and such as have actual notice thereof, until the same shall be deposited with the recorder for record.
   (d) All deeds, powers of attorney, agreements, or other instruments in writing conveying, encumbering, or affecting the title to real property, certificates, and certified copies of orders, judgments, and decrees of courts of record may be recorded in the office of the county clerk and recorder of the county where such real property is situated.…No such unrecorded instrument or document shall be valid against any person with any kind of rights in or to such real property who first records and those holding rights under such person, except between the parties thereto and against those having notice thereof

prior to acquisition of such rights. This is a race-notice recording statute. In all cases where by law an instrument may be filed in the office of a county clerk and recorder, the filing thereof in such office shall be equivalent to the recording thereof, and the recording thereof in the office of such county clerk and recorder shall be equivalent to the filing thereof.

(e) Every deed conveying lands shall be recorded in the office of the clerk of the superior court of the county where the land is located. A deed may be recorded at any time; but a prior unrecorded deed loses its priority over a subsequent recorded deed from the same vendor when the purchaser takes such deed without notice of the existence of the prior deed.

(f) A conveyance of an estate in fee simple, fee tail or for life, or a lease for more than seven years from the making thereof, or an assignment of rents or profits from an estate or lease, shall not be valid as against any person, except the grantor or lessor, his heirs and devisees and persons having actual notice of it, unless it …, or, with respect to such a lease or an assignment of rents or profits, a notice of lease or a notice of assignment of rents or profits …, is recorded in the registry of deeds for the county or district in which the land to which it relates lies.

A Common Problem

2. *O* conveys Blackacre, which he owns in fee simple absolute, to *A*. *A* does not record. *O* conveys Blackacre to *B*, who does not record. In what type of recording act jurisdiction does the act resolve the issue of who, *A* or *B*, owns Blackacre?

A Noted Inquiry

3. *M* sold her home to *A*. As part of the purchase price, *A* gave *M* a $100,000 note and a mortgage on the home as security for the note. *A* recorded her deed. *M* did not record the mortgage. A year later, during the negotiations to sell the home, *A* told *B* she still owed $100,000 on the home, but neither the sales contract nor the deed mentioned the note or the mortgage. *A* sold the home to *B* for $120,000, with *B* obtaining most of the purchase price by borrowing $105,000 from Bank. At closing *A* received the $120,000

and delivered a warranty deed to the home to *B*; Bank received a note and a mortgage on the home. The closing attorney promptly recorded *B*'s deed and then Bank's mortgage. Then *M* finally recorded her mortgage.

The state in which the home is located has a notice recording act. *B* and the Bank learn of *M*'s recorded mortgage and bring suit to remove the cloud from *B*'s title. In this suit, what result and why?

Doing the Wild Deed

4. *O* sold Blackacre to *A*, a bona fide purchaser. *A* did not record. A year later, *A* conveyed Blackacre to *B*, a purchaser for value who lives out of state. *B* promptly recorded. A year later, *O* conveyed Blackacre to *C*, a purchaser for value with no actual knowledge of *O*'s deed to *A* or *A*'s deed to *B*. *C* recorded. A year later, *B* inspected the property and saw *C* building a house on the land. *B* brought a lawsuit to evict *C*. Who prevails?

The Fashionably Late Recording

5. Oscar sold his home at its fair market value to Avery in Year 1. Avery did not record. In Year 5, Oscar sold the home for its fair market value to Mary, who knew about Avery's deed. Mary recorded promptly. Avery finally recorded his deed in Year 7. In Year 8, Mary sold to Nancy, a purchaser for value without actual knowledge of Avery's deed. Nancy recorded.
   (a) As between Avery and Nancy, who owns the home?
   (b) What result if Mary did not know about Avery's deed, but Nancy did?
   (c) What result on the original facts if Avery finally recorded in Year 10, not Year 7?

The Purchaser Who Recorded Too Early

6. Popp contracted to buy Whiteacre from Owner. Before closing on Whiteacre, Popp conveyed Whiteacre by general warranty deed to First Purchaser. First Purchaser recorded. Six weeks later, Owner deeded Whiteacre to Popp. Popp recorded. Three months later, Popp conveyed Whiteacre to Second Purchaser, a purchaser for value who had no actual

knowledge of the deed to First Purchaser. Second Purchaser recorded.

(a) As between First and Second Purchaser, who owns Whiteacre?

(b) What result if First Purchaser moved onto Whiteacre immediately after receiving his deed from Popp?

Search Me, Neighbor

7. Mike owned two lots (Lot 1 and Lot 2). He sold Lot 1 to Phil by a warranty deed containing the following covenant: “Grantor and Grantee covenant for themselves, their heirs and assigns, that Lot 1 and Lot 2 will be used for single-family residence purposes only.” Phil recorded the deed. Five years later, Mike sold Lot 2 to Sara by a warranty deed that did not mention the covenant. Sara wanted to build a shop on Lot 2. Phil protested, citing the covenant in his deed. Who prevails?

Schooling Daughter

8. (a) Dad conveyed five acres to Daughter as a gift. Daughter did not record. Daughter immediately moved out of town. Dad, feeling Daughter deserted him, *sold* the five acres to the local School District at its fair market value. The School District did not know about the prior transfer to Daughter. School District recorded. Who prevails as between Daughter and School District?

(b) Instead of gifting the land to Daughter, assume Dad sold the five acres to Daughter at its fair market value. Daughter did not record. Daughter immediately moved out of town. Dad, feeling Daughter deserted him, *donated* the five acres to School District. School District recorded the deed. Who prevails as between Daughter and School District?

(c) What result in (a) if Daughter recorded before Dad sold the five acres to School District?

(d) What result in (b) if School District sold the five acres to Farmer John for its fair market value and Farmer John promptly recorded?

Explanations

Name That Recording Act

1. (a) Race. This is La. Rev. Stat. Ann. §2721. It is a pure race act. Notice is never mentioned.

   (b) Race-notice. This is N.Y. Real Prop. Law §291. The first sentence sets out the requirement for an acknowledgment—essential to make any document recordable in almost all jurisdictions. The second sentence of the excerpt requires, first, that the subsequent purchaser must pay a "valuable consideration" for the interest. If a recording act does not state this expressly, most courts have implied that the person protected by the act must have received the interest "for value" or "for a valuable consideration" as here. Second, although this sentence never mentions notice, it does mandate that the purchaser must have purchased "in good faith"—the law equates the term "good faith" with "without notice." Finally, the subsequent purchaser's document must be "first duly recorded."

   (c) Notice. This is Mo. Ann. Stat. §§442.390 & .400. The first sentence expressly states that recorded documents impart constructive notice to subsequent purchasers and mortgagees, who in law and equity will have notice of the recorded document. According to the second sentence, a document is not binding on subsequent purchasers and mortgagees who do not have notice of the document. The last clause "until the same shall be deposited with the recorder for record" mentions "record" but not in the context of mandating a race to record. This last clause refers to a recorded deed giving constructive notice. Earlier language in the last sentence denies protection to subsequent purchasers with actual notice, leaving the last clause to refer to the constructive notice element.

   (d) Race-notice. This is Colo. Rev. Stat. Ann. §38-35-109(a). The second sentence mandates the subsequent purchaser be the first to record to be protected and then excepts from the act's protections those subsequent purchasers who acquired their interest with notice of the prior interest: the classic race-notice statute. To clear up the confusion in its case law, the legislature added the third sentence, startling in its directness: "This is a race-notice recording statute." All recording acts should be so clear! The last sentence, concerning the equivalency of filing and recording, states that the failure of the clerk or recorder to index a document properly does not affect the priority assigned the recorded document.

(e) Race-notice. This is Ga. Code Ann. §44-2-1. For a subsequent purchaser to prevail, the purchaser must acquire the deed without notice of the prior unrecorded deed and must be the first to record.

(f) Notice. This is Mass. Gen. Laws Ann. ch. 183, §4. Under this act, unrecorded deeds are void against all persons except the grantor, his heirs and devisees, and subsequent purchasers having actual notice of the deed, unless the deed is recorded, in which case the recorder of a deed prevails against all subsequent purchasers, whether they have actual knowledge or not. Until the deed is recorded, however, any subsequent purchasers without actual knowledge of the deed prevail over the holder of the unrecorded deed. Nothing in the act requires the subsequent purchasers to be the first to record; hence, no race element.

A Common Problem

2. Only a notice recording act resolves the conflict between *A* and *B*. Neither is protected under a race statute because neither has yet recorded—and the common law rule of first-in-time, first-in-right controls and gives *A* priority. Neither is protected under a race-notice statute because if neither is protected by a race statute, by definition neither is protected by a race-notice act either. Under a notice act, however, *B* could become a subsequent purchaser protected by the statute if he is without notice of *A*'s deed, and so achieves priority over *A*. Moreover, because it will be *A* who will have to allege and prove that *B* had notice, *A* is unlikely to prevail under such an act, leaving *A* to sue *O* either for fraud or on his deed's covenants of title.

A Noted Inquiry

3. Judgment for Bank. *B* recorded before *M*, so *B* did not have constructive notice of *M*'s mortgage. *B* was only told that *A* owed money "on" the home. This is not actual notice of *M*'s mortgage, but since the act is a notice statute, the remaining issue is whether *A*'s telling *B* of her note to *M* constitutes inquiry notice of *M*'s mortgage: Would this information induce a reasonably prudent person to inquire about a mortgage to secure the $100,000 debt? This may be a factual issue in some jurisdictions, but the answer is probably that it would give inquiry notice, putting the burden of

inquiry on *B*. If so, *B* would have notice of the mortgage when *B* acquired title and so not be protected by the notice recording act. So long as *B* owns the home, it would continue to secure the $100,000 note and mortgage. (NOTE: If *M* the mortgagee prevails, *B* still has an action against *A* based on the *A*-to-*B* deed covenant against encumbrances.)

If, instead, *B* has no inquiry notice, *M* still has a right to collect the note from *A*, but cannot foreclose on *B*'s home if *A* defaults on the note. *M* becomes an unsecured creditor, sharing rights with *A*'s other unsecured creditors.

None of this matters to Bank, however. Bank prevails over *M* in either situation: It took the mortgage without actual or inquiry notice of *M*'s mortgage since no one, according to the facts, told Bank about *M*. Also, since Bank received its mortgage before *M* recorded, Bank could not possibly have had constructive notice of *M*'s mortgage. So while *M* may have a higher priority than *B*, Bank has a higher priority than *M*. In a foreclosure action, *M* does not have any rights to the sales proceeds until Bank's note is satisfied. In effect, although the problem seems to pit *M* the mortgagee against Bank, *B*, *M* and Bank share a common goal of having *A* satisfy the debt to *M*.

Doing the Wild Deed

4. *C* prevails under all types of recording acts. *B*'s deed, though recorded, is a "***wild deed***," meaning it is not legally recorded. *B*'s deed will be deemed recorded only when all links needed for the chain of title to be traced to *B*'s deed are recorded. The deed from *O* to *A* is not recorded, so all conveyances out from *A*, including *B*'s recorded deed, also must be deemed unrecorded. In notice and race-notice jurisdictions, then, since *B*'s deed is deemed unrecorded, *B*'s deed cannot give constructive notice to subsequent purchasers like *C*. *B* could prevail if *C* in searching the deed records actually found *B*'s deed from *A*. Then *B* would have actual notice. The facts, however, say *C* did not have actual knowledge. *C* prevails in a notice jurisdiction. In a race jurisdiction, because *B*'s deed is still deemed unrecorded, *C* also prevails just by being the first to record. Being the first to record and not having notice, *C* would also prevail in a race-notice jurisdiction.

   Note that *B* was in the best position to prevent this problem by

requiring *A* to record *O-to-A* deed before *B* would agree to close. The integrity and workability of the grantor-grantee indices depends on each person in every real estate transaction demanding a complete chain of title.

The Fashionably Late Recording

5. (a) Nancy prevails in a race jurisdiction because, under the shelter rule, Mary was the first to record, and thus Mary wins the "race" as between Mary and Avery. Because Mary prevails, her successors continue forming the links in the chain. The principle that subsequent purchasers can profit from a predecessor's being protected by the recording statute is known as the ***shelter rule*** or ***shelter principle***. In effect, once a person, like Mary, has perfected her priority under the recording acts against a prior claimant, like Avery, all persons claiming through the perfected interest (Mary's interest) also prevail against the prior claimant (Avery). Nancy falls into that happy class, so she prevails in a race jurisdiction.

   The answers in notice and race-notice jurisdictions are more complicated. Note first, however, that unlike the situation under the shelter principle where Nancy's interest was secured as soon as Mary prevailed, Nancy does not lose because Mary is not a protected person under the recording statute: Nancy may prevail strictly on her own merits.

   Nonetheless, states disagree whether Avery or Nancy wins in notice and race-notice jurisdictions. One group would favor Avery because Avery recorded before Nancy purchased. Mary's deed is deemed not recorded so Avery was the first to record of him and Nancy. Also since he recorded, these courts would hold Mary had constructive notice of *A*'s deed.

   The other group of states would hold in Nancy's favor on the theory that Nancy was a purchaser without notice of Avery's deed, and Nancy's recording removed the taint from Mary's recording. With her taint removed, Mary's deed was the first recorded and Avery's deed, recorded outside the chain of title, did not constitute constructive notice. In addition, as between Avery and Nancy, Nancy was the most innocent. Avery's late recording was the reason the problem occurred. Thus, these courts could favor Nancy and

guarantee the integrity of the recording system at the same time.

If Avery had contested ownership before Mary conveyed to Nancy, Avery would have prevailed in notice and race-notice jurisdictions. Only when a subsequent purchaser without notice is introduced does the matter become more complicated.

(b) Nancy prevails in all types of jurisdictions because, under the shelter rule, Nancy prevails if Mary prevails. Mary prevails in a race state because she recorded before Avery. Mary prevails in a notice jurisdiction as soon as she receives her deed because she acquired her interest without notice of Avery's deed (which was still unrecorded when Oscar sold to Mary). Mary prevails in a race-notice jurisdiction because she bought without actual or constructive notice of Avery's deed and was the first to record.

(c) Nancy wins. Under race acts, both Nancy and Mary recorded before Avery. Under a notice statute, Nancy prevails because she acquired the property without notice of Avery's deed. The fact that Mary knew of Avery's adverse claim does not prevent Nancy from prevailing in her own right. Under race-notice acts, Nancy wins because she recorded before Avery and had no notice of Avery's deed.

The Purchaser Who Recorded Too Early

6. (a) A majority of jurisdictions would hold for Second Purchaser as the subsequent purchaser. On the one hand, First Purchaser, the first purchaser, properly recorded, and is deemed the legal owner under the doctrine of estoppel by deed (or after-acquired title). On the other hand, First Purchaser's deed is not in the chain of title and Second Purchaser likely would not find the deed in a search.

Most courts find in Second Purchaser's favor to ensure the integrity of the recording system (and to lessen the significance of the doctrine of estoppel by deed). As between First Purchaser and Second Purchaser, First Purchaser was in better position to avoid the problem by re-recording his deed after Popp acquired Whiteacre from Owner.

In race and race-notice jurisdictions, Second Purchaser was first to record within the chain of title. Further, Second Purchaser prevails

in a notice jurisdiction because she purchased without actual notice and with no constructive notice of First Purchaser's deed since First Purchaser's deed was filed outside the chain of title. A few jurisdictions would find in favor of First Purchaser by reading the recording acts literally as protecting persons who record, not just those who record in the chain of title, and it is the subsequent purchasers' duty to expand their search of the deed records if they want to be protected.

(b) Second Purchaser would now have inquiry notice of whatever interest First Purchaser possessed. That being so, Second Purchaser loses in both race-notice and notice jurisdictions, but prevails in a race jurisdiction since she was the first to record.

Search Me, Neighbor

7. Jurisdictions are evenly divided on this question. Owning both lots at one time, Mike is a common grantor. When searching the grantor index, a searcher would find Mike's name associated with his conveying Lot 1 to Phil. The property description in that index may mention the covenant as affecting Lot 2, but most typically the index's brief description will describe Lot 1 but not Lot 2. Assuming this is so, the issue becomes, does the subsequent purchaser of Lot 2 have the duty to search deed records for all transfers from a common grantor of neighboring properties? Restated, is the fact of a common grantor, coupled with the knowledge that many restrictive covenants and easements are contained in only one deed out from the common owner, enough to put all subsequent purchasers on inquiry notice of all restrictions in deeds of neighboring lands or of neighboring lands that at one time belonged to a common owner? If a jurisdiction places the burden on the subsequent purchaser to read deeds of neighboring lands from a common grantor, Sara would have constructive notice of the deed restrictions, and thus be bound by the covenant in notice and race-notice jurisdictions. Since Phil was the first to record, Sara also would be bound under a race statute.

   About half the jurisdictions in the country would rule in favor of Phil and hold Sara bound. The other half find the deed to Lot 1 outside the chain of title of Lot 2: There it is more efficient to require the person receiving the benefit in the first deed (Phil here) to be sure the deed was

properly indexed as affecting both Lot 1 and Lot 2 than to require subsequent purchasers to search old deeds from the common grantor. In these states, Sara as the purchaser of Lot 2 would not be bound by the covenant contained in the deeds to Lot 1.

The use of a tract index does not avoid this problem: The problem of indexing Lot 1's deed to Lot 2 remains.

This problem will be addressed again in Chapter 30, infra. That chapter explains that for the residential restriction to "run with the land" so as to bind the subsequent purchaser (Sara here), the subsequent purchaser must have notice of the restriction on her lot, either by its being recorded in the deed records (constructive notice) or by a common development scheme (inquiry notice).

Schooling Daughter

3. (a) Local School District prevails. Daughter did not record, so School District prevails in a race jurisdiction because it recorded first. School District has no actual or constructive or inquiry notice of the deed from Dad to Daughter, so School District also prevails in notice and race-notice jurisdictions.

   (b) Daughter prevails. School District as a donee is not a "purchaser for value." Thus it cannot seek protection under the recording act. Resort to common law principles favors Daughter since she acquired her title first.

   (c) Daughter prevails. Daughter would have been the first to record and School District would have had constructive notice of her interest. Her receiving the property as a gift is immaterial. Daughter as donee (protected) differs from the School District as donee in (b) above (not protected) because Daughter was the first to receive the property and sought protection against subsequent grantees: A prior grantee (even a donee) who records in the chain of title prevails against subsequent grantees. It is subsequent grantees who seek protection under a recording act that must be purchasers or creditors for value. Daughter having received and recorded her interest prevails against School District.

   (d) Farmer John prevails. Since he is a subsequent purchaser for value without actual notice of Daughter's unrecorded deed and he was the

first to record, he will prevail against Daughter under all types of recording statutes. Farmer John's rights are not tainted by School District's failure to qualify as a purchaser for value. He would have benefited from the shelter rule if School District was protected under the recording act, but he still can prevail even if the recording act does not protect School District. Farmer John qualifies for protection based on his own merits and prevails.

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1. Prior chapters routinely used the word "buyer" in regard to purchase and sale transactions, but in this chapter, because of the traditional use in recording acts of the word "purchaser"—as in "subsequent purchaser" or "bona fide purchaser"—that word is routinely used.

2. A possible real-life scenario: ***A*** buys Blackacre from ***O***. ***O*** deeds Blackacre to ***A***, who does not record. ***A*** later borrows money from Bank and gives Bank a mortgage on Blackacre. Bank records. Still later ***O*** sells and deeds Blackacre to ***X***, a good-faith purchaser for value.

UNDERSTANDING PROPERTY LAW

FOURTH EDITION

JOHN G. SPRANKLING

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Chapter 20

The Sales Contract

§20.01 Anatomy of a Sales Transaction

[A] Four Basic Stages

Millions of real property sales occur in the United States every year.[1] The vast bulk of these sales are relatively simple transactions involving *residential property*: single-family houses, condominiums, and other properties used as the owner's home. Transactions involving the sale of *commercial property*—office buildings, apartment complexes, farms, shopping centers, and the like—are typically more complex. Yet every real property sales transaction has four basic stages: (a) locating the buyer; (b) negotiating the contract; (c) preparing for the closing; and (d) closing the transaction.[2]

Consider a hypothetical transaction.[3] Suppose owner S wants to sell her house, Greenacre, for about $220,000. The key steps in S's sale are outlined below.

[B] Locating the Buyer

How can S find a buyer?[4] S selects real estate broker L to represent her in the transaction, and executes a written *listing agreement* that entitles L to a commission—probably 6% of the sales price—if he obtains a buyer willing to purchase Greenacre for $220,000 or another price acceptable to S (*see* §20.03[C]). L, who is called the *listing broker*, now begins marketing the property. He places advertisements, holds "open houses," contacts other brokers, and otherwise tries to attract potential buyers. L may also provide information about S's house to the local *multiple listing service*, which will circulate it to all other brokers who are members of the service. Suppose C, another broker in the community, learns that Greenacre is available and calls it to the attention of her client B, who is looking for a new home. B tours Greenacre, likes it, and decides to make an offer. C, who is known as the *cooperating broker* or *selling broker*, will share in L's commission if the transaction closes.

[C] Negotiating the Contract

The transaction now moves into its second stage: contract negotiation. B makes an offer to purchase Greenacre for $200,000 by executing a written contract that satisfies the Statute of Frauds (*see* §20.04[B]) and submitting it to S for signature; B also gives S a check for $2,000 as a good faith deposit. B might employ an attorney to draft the contract (*see* §20.02). But instead, B will probably use a preprinted form contract originally prepared by an attorney, and broker C will help B to fill in the blanks on the form (*see* §20.03).

Because B has not yet had the opportunity to investigate Greenacre thoroughly, he will be concerned about various issues, including the physical condition of the property (*see* Chapter 21), the availability of adequate financing (*see* Chapter 22), and the state of title (*see* Chapters 24–26). B will ensure that the contract contains various *conditions* that deal with these issues. For example, suppose B: (a) wants a licensed building contractor to confirm that Greenacre is structurally sound; (b) needs a $180,000 loan from a bank or other lender in order to purchase the property; and (c) wants to ensure that S holds valid title to Greenacre. The contract will provide that B is excused from performance if these conditions cannot be met (*see* §§20.06–20.07).

S might simply accept B's offer. But it is more likely that she will submit a counteroffer dealing with price and other issues. Attorneys might be involved in negotiating the transaction, but brokers L and C will probably undertake this role. Suppose S submits a written counteroffer that changes the selling price to $210,000 and B accepts. A valid contract has now been created.

[D] Preparing for the Closing

During the third stage—sometimes called the *executory period* or *executory interval*—steps are taken to prepare for the closing, such as inspecting the property, negotiating financing, and evaluating title. For example, B's contractor will inspect Greenacre and provide a written report about her conclusions. State law might require that a professional inspect Greenacre for termite infestation or mandate that S, L, or C disclose to B information that adversely affects the value or desirability of Greenacre (*see* Chapter 21).

Assisted by C, B will apply to several banks or other institutional lenders

for a $180,000 loan. Suppose that—after evaluating B's credit and appraising Greenacre—bank M agrees to make the loan on terms acceptable to B. M will insist that the loan be evidenced by a written *promissory note* signed by B and secured by a first priority *mortgage* that will encumber Greenacre at the closing (*see* Chapter 22).

Finally, B will evaluate the state of title to Greenacre. In many states, B's principal source of title assurance will be a *title insurance policy* issued at the closing (*see* §26.04). Before closing, B will receive a *title report* or similar document that states (a) whether the insurer will insure title to Greenacre and (b) the terms and conditions of the policy; this document will usually identify one or more specific title defects (e.g., existing easements or covenants, conditions and restrictions, *see* §34.05) that the insurer is unwilling to cover. Alternatively, B might retain an attorney to provide a legal opinion on the state of title (*see* §26.03).

[E] Closing the Transaction

The sales contract is fully and finally performed at the *closing*. In the eastern United States, an attorney often oversees the closing; in the West this function is usually performed by an *escrow agent* who follows written *escrow instructions* signed by the parties. At the closing, title is conveyed to the buyer, the purchase loan is made by the lender, the sales price is paid to the seller, the commission is distributed to the brokers, and various other tasks are performed.[5] Title is transferred by the seller's delivery of a *deed* (*see* Chapter 23) to the buyer.

Assuming all conditions are met, our hypothetical S-B transaction will successfully close. At the closing: (a) S will execute and deliver a deed conveying Greenacre to B; (b) M will loan $180,000 to B and B will give M the promissory note and the mortgage; (c) B will pay $210,000 ($180,000 from M's loan and $30,000 from B's savings) to S; and (d) S will pay the commission to L and C. The deed and mortgage will immediately be recorded (*see* Chapter 25), and B will receive a title insurance policy insuring his title to Greenacre (*see* Chapter 26).

§20.02 Role of the Attorney

At one time, the attorney was the key professional in almost every sales transaction. His activities generally included:

(1) negotiating the deal;

(2) drafting the sales contract;

(3) evaluating title documents;

(4) issuing a title opinion;

(5) advising the client about zoning, tax, and other issues;

(6) negotiating the terms of financing;

(7) helping the client fulfill contract conditions;

(8) handling the closing; and

(9) negotiating or litigating any disputes that arose.

Attorneys usually still perform many of these functions in transactions involving commercial property. As a general rule, the more complex the transaction, the more likely an attorney is involved.

But the attorney's role in home sales is rapidly diminishing. As one observer concluded, attorneys “are involved only in about forty percent of residential transactions, and ... their involvement is typically late and shallow.”[6] For example, in California, Texas, and most western states, attorneys are usually not involved in home sales at all, unless a dispute arises. As discussed in the hypothetical S-B transaction (*see* §20.01), the attorney's traditional tasks are divided among the brokers, the title insurance company, and the escrow agent. Even in the East, Midwest, and South—where the attorney is still sometimes involved in home sales—the role is typically limited to supervising the closing and resolving any disputes; attorneys rarely negotiate or draft contracts. The principal reason for this shift is the high cost of legal fees. In home sales transactions, brokers, title companies, and escrow agents generally provide adequate services for a lower price.

§20.03 Role of the Real Estate Broker

[A] The Unauthorized Practice of Law?

The real estate broker has replaced the attorney as the key professional in home sales transactions. Except in a handful of states, the broker negotiates the deal, prepares the contract, handles the transaction until the closing, and —in some regions—supervises the closing. Do these actions constitute the unauthorized practice of law?

Most jurisdictions agree that the broker who merely fills in blanks on a standard, attorney-drafted form contract is not practicing law.[7] On the other hand, although the case law is scant, it seems that drafting a sales contract, advising a client about contract terms, or handling closings—as some brokers do—are traditional legal functions. In an influential decision, the New Jersey Supreme Court confirmed that brokers who handled home sale closings were engaged in the practice of law; but it refused to prohibit this conduct.[8] Because the procedure causes no "demonstrable harm to buyers or sellers, ... saves money, and [was chosen by parties] of their own free will presumably with some knowledge of the risk, ... the public interest will not be compromised by allowing the practice to continue."[9]

[B] Duties of Broker

Suppose owner S selects listing broker L to represent her in selling S's property. What duties does L owe to S? A real estate broker is a specialized type of *agent*. Like any agent, a broker owes a variety of fiduciary duties to the *principal*, including the duties of care, skill, diligence, loyalty, and good faith.[10] For example, a broker cannot reveal the principal's negotiation strategy to the opposing party in the transaction; nor can a broker accept a secret profit or "kickback" from the opposing party. Similarly, a broker is obligated to "make a full, fair and prompt disclosure" to his principal of all facts that might affect the principal's interests.[11]

If L's marketing efforts attract cooperating broker C, whose client B enters into a contract to purchase S's property, what duties does L owe to B? At common law, the listing broker owed no duty to the buyer, except the

obligation to avoid intentional fraud. Today, in some jurisdictions, a listing broker must disclose known defects in the property to the buyer.[12] On the other hand, the listing broker is not generally required to inspect the property in order to determine whether defects exist.[13]

Who is broker C's principal? One might assume that C is the agent of buyer B, her apparent client. Yet technically the cooperating broker is usually deemed a subagent of the listing broker; this makes C an agent of the seller.[14] In many instances, the cooperating broker is a *dual agent*, who—at least in theory—owes fiduciary duties to both the buyer and the seller. In the same manner, if there is only one broker in the transaction, he will probably be deemed a dual agent, even though this might not match the expectations of the parties. In an effort to combat this dilemma, some states have adopted legislation requiring brokers to disclose in advance which party or parties they represent.[15]

[C] Broker's Right to Commission

The broker's right to a commission is governed by the listing agreement.[16] The listing agreement is a contract between the seller and the listing broker that authorizes the broker to procure a buyer for the property in return for a specified commission. There are three basic types of listing agreements: the *open listing*, the *exclusive agency listing*, and the *exclusive right to sell listing*. Under an open listing, the broker does not have any exclusive right to obtain a buyer; rather, it obligates the seller to pay a commission if the broker is the first person to procure a "ready, willing, and able buyer" for the property. The broker under an exclusive agency listing is designated as the only real estate broker authorized to procure buyers; thus, he is entitled to a commission if any broker produces a ready, willing, and able buyer, but not if the seller procures a buyer. Finally, under the exclusive right to sell listing, the broker receives a commission if anyone—including the seller—procures a ready, willing, and able buyer.

Suppose seller S enters into an exclusive right to sell listing with broker L; L produces B, a buyer who is ready, willing, and able to purchase the property. B and S enter into a sales contract, but B later refuses to perform. Is S obligated to pay a commission to L? Under the majority view, the commission is earned when the broker procures a buyer who is ready, willing, and able to purchase the property on terms acceptable to the seller,

even if the buyer later fails to complete the purchase. This rule is patently unfair to the seller. The average seller reasonably expects to pay a commission only if the sale is completed. For this reason, an increasing number of courts hold that the broker is not entitled to a commission unless the sale is actually completed.[17] This rule is subject to one major exception: a commission is still owed if the sale fails due to a wrongful act of the seller.[18]

§20.04 Requirements for Valid Contract

[A] Basic Elements

All types of contracts must satisfy the same minimum requirements of offer, acceptance, consideration, reasonably certain terms, and so forth. Like any other contract, a real property sales contract must meet these requirements.[19] However, a contract for the sale of an estate or interest in real property is enforceable only if it is also evidenced by a writing whose terms satisfy the Statute of Frauds.[20]

What terms are required for a valid real property sales contract? The overlap between general contract law and the Statute of Frauds complicates the answer to this question. Courts dealing with the question often fail to distinguish between these two bodies of law, creating a certain amount of confusion. But the basic elements appear to be the same under both: the contract must adequately identify the parties, manifest the intent to buy and sell, describe the property, state the purchase price (usually), and contain any other material terms. Most of the law governing the answer to this question has developed under the Statute of Frauds, which is discussed in detail below.

[B] The Statute of Frauds

[1] The "Most Important Statute Ever Enacted"?

The Statute of Frauds was originally enacted in England in 1677[21]—as its name suggests—to prevent fraud and discourage perjury. Its provisions governing real property sales contracts were adopted (with slight variations) in all states except Louisiana, and became a fundamental part of American law. The Statute has always been controversial. One nineteenth-century author lauded it as "the most important statute ever enacted in either country [England or the United States], relating to civil affairs."[22] Yet critics have long argued that the Statute of Frauds does more harm than good, by effectively permitting the sophisticated to defraud the innocent. Partly due to this concern, courts have increasingly eroded away the rule by creating equitable exceptions.

[2] A Typical Statute of Frauds

A typical Statute of Frauds provides: "The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent: ... (3) An agreement ... for the sale of real property, or of an interest therein."[23] What does this rather vague language mean? As interpreted by case law, the Statute of Frauds imposes three requirements: (1) the *essential terms* of the sales contract (2) must be contained in a *memorandum or other writing* (3) that is *signed* by the party against whom enforcement is sought.[24] Each of these requirements is discussed below.

What happens if a sales contract violates the Statute of Frauds? The contract is unenforceable, but not void. Compliance with the Statute is not required in order for the contract to be valid. The distinction between enforceability and validity is often significant. Suppose, for example, that B and S enter into an oral contract whereby B will purchase S's island for $500,000 in cash. When S later refuses to perform, B sues S for breach of contract. If S fails to raise the Statute of Frauds as a defense, it is deemed waived and B's lawsuit will succeed.

[3] Requirements for Enforceable Contract

[a] Essential Terms of Contract

Although the typical statute mandates that the "contract" be in writing, courts interpret this language to mean only that the "essential" or "material" terms must be in writing. What are the "essential" terms? In almost all transactions, there are only four essential terms. In general, the writing must:

(1) identify the parties;

(2) include words showing an intent to buy or sell;

(3) specify the purchase price; and

(4) adequately describe the property.[25]

Most courts insist that the purchase price be specified if the parties have agreed on the amount. Even without such agreement, the contract is enforceable if the writing establishes a procedure for establishing the price in the future (e.g., through appraisal). Absent an agreed price or procedure, some courts will still enforce the contract by requiring the buyer to pay a

reasonable price.[26] If the writing contains no provisions about financing terms, the buyer is obligated to pay the purchase price in cash.

The property description often causes difficulty.[27] The writing must be specific enough to identify the land with reasonable certainty, although a formal legal description (*see* §23.04[A][2]) is not required. For example, a street address or community nickname (e.g., “Johnson's swamp”) may suffice, because in each instance the land can be readily identified.[28] On the other hand, if S owns 20 acres and contracts to sell “10 acres of my land,” the description is too vague.[29]

Beyond this point, the law is rather unpredictable. Depending on the surrounding circumstances, additional terms may be highly important to the parties, and thus be deemed “essential” terms that must be in writing. This is quite common in complex transactions involving commercial property, but fairly rare in home sales. Minor terms such as the time for closing, the type of deed to be used, or the identity of the escrow holder are seen as nonessential; and if the parties have failed to agree, the court will fill in such gaps with reasonable terms customarily used in similar transactions.

[b] Contained in Memorandum or Other Writing

The essential terms of the contract must be contained in a memorandum or other writing. Where the parties execute a written sales contract—as is customary—the contract itself serves as the required writing. A Statute of Frauds issue usually arises where the parties have entered into an oral agreement. Yet even an oral agreement will be enforceable if its essential terms are set forth in an adequate memorandum or other writing. The writing: (a) need not be intended by the parties as an agreement; (b) may be prepared after the agreement; (c) may consist of more than one document;[30] and (d) may be quite informal. Any document will suffice as long as it contains the essential terms and is properly signed. Thus, for example, a letter,[31] check,[32] informal note, escrow instruction, or even a civil pleading[33] may serve as the required writing.

Is an electronic contract a “writing” for purposes of the Statute of Frauds? Under the federal Electronic Signatures in Global and National Commerce Act,[34] a “signature, contract, or other record” relating to a transaction in interstate or foreign commerce “may not be denied legal effect, validity, or enforceability solely because it is in electronic form.”[35] Because the vast

majority of real estate transactions affect interstate commerce, it appears that an electronic contract—or an electronic signature—would meet the Statute of Frauds.[36]

[c] Signed by Party against Whom Contract Is Enforced

The writing need not be signed by both buyer and seller. Rather, it must only be signed by the person *against whom* the contract is being enforced; this person is traditionally called the party "to be charged."[37] Suppose, for example, that B and S enter into an oral land sale contract; B then quickly writes down all the essential terms on the back of his business card and signs his name. The oral contract is enforceable by S against B, because B signed the writing. On the other hand, B cannot enforce the contract against S because S did not sign. Alternatively, the writing may be signed by an agent of the party to be charged. Statutes in many states mandate that the authority of such an agent must itself be in writing and signed by the principal.[38]

A formal signature is not generally required. For example, in most jurisdictions a party's initials or nickname will satisfy the requirement.

[4] Exceptions to Statute of Frauds

[a] Overview

Rigid application of the Statute of Frauds may produce harsh results. Suppose S and B enter into an oral contract whereby B agrees to purchase S's house Greenacre for $100,000 in three months. When B asks that the contract be reduced to writing, S replies: "Don't worry about it! I'm a man of my word." In reliance on the deal, B immediately (a) pays a $20,000 down payment to S, (b) hurriedly sells his current home Redacre for $10,000 less than its fair market value, and (c) moves into Greenacre to fix up the property. Over the ensuing weeks, B invests $50,000 to improve Greenacre. With Greenacre in pristine condition, S now enters into a written contract to sell the property to X for $200,000, its current market value. When B protests, S replies: "Sure, we had a deal, but it was only oral! Sorry."

Under the literal language of the Statute of Frauds, the B-S contract is unenforceable. This result imposes an inequitable loss on B, the innocent party. B will recover only his $20,000 down payment and $50,000 in out-of-pocket expenses. In the same manner, this outcome confers an unfair advantage on S, the breaching party. S will receive $200,000 from X, pay

$50,000 to B, and recover a net purchase price of $150,000 instead of the $100,000 he originally agreed to accept from B.

Confronted with similar sad sagas, courts gradually created two equitable exceptions to the Statute of Frauds which substantially soften its impact: *part performance* and *equitable estoppel*. These exceptions apply where a buyer or seller seeks specific performance of the sales contract, not in an action for damages.

[b] Part Performance

Courts consider three potential actions of the buyer in determining whether the part performance exception is satisfied: (1) taking possession of the property; (2) paying all or part of the purchase price; and (3) making improvements to the property.[39] If all three actions are present—as in the S-B hypothetical above—part performance is clearly established in virtually all states. Courts generally find part performance where only two of the specified actions occur, though they differ widely on which two are necessary.[40] One common formula requires that the buyer *both* (a) take possession of the property *and either* (b) pay part or all of the purchase price *or* (c) make improvements to the property. Conversely, some jurisdictions demand payment *plus either* possession *or* improvements. If part performance is established, either the buyer or the seller may seek specific performance.

What explains the part performance exception? The "evidentiary theory" views the buyer's actions as evidence of an oral contract to purchase the property; after all, a reasonable person would not have performed such acts unless such a contract existed. As Justice Cardozo summarized in a famous phrase, the buyer's acts must be "unequivocally referable to a contract for the sale of land."[41] Alternatively, the more modern "estoppel" or "reliance" theory explains the part performance exception as necessary to avoid serious or irreparable injury to a party who has substantially changed his position in reasonable reliance on the oral contract.[42] This rationale overlaps substantially with the separate estoppel exception (*see* [c], *infra*), and some courts seem to blend the two exceptions together.

[c] Equitable Estoppel

The modern status of the equitable estoppel exception is rather puzzling. The few jurisdictions that refuse to recognize part performance have long

accepted estoppel as an exception to the Statute of Frauds. Estoppel is applicable where (a) one party has been induced by the other to substantially change position in justifiable reliance on an oral contract and (b) serious or irreparable injury would result from refusing specific performance of the contract.[43]

More recently—influenced by the Restatement (Second) of Contracts—a growing number of courts have enforced oral agreements under an estoppel-based standard, while claiming to apply the part performance exception. The confusion stems from Restatement section 129, which blurs together the part performance and estoppel exceptions. It permits the enforcement of a land purchase agreement if “the party seeking enforcement, in reasonable reliance on the contract and on the continuing assent of the party against whom enforcement is sought, has so changed his position that injustice can be avoided only by specific enforcement.”[44] Comment d makes it clear that possession, payment, and improvement—the traditional hallmarks of part performance—are not required where the contract “is admitted or is clearly proved.”[45] Instead, any substantial act of reasonable reliance (e.g., selling other property, rejecting other offers, or providing personal care services) will justify enforcement of the contract.[46]

Hickey v. Green[47] illustrates the doctrine. In reliance on an oral agreement to purchase Green's lot as a future homesite, the Hickeys entered into a binding contract to sell their existing home to a third party. After receiving a better offer, Green breached. When the Hickeys sued for specific performance, Green did not deny the oral contract; she simply asserted the Statute of Frauds defense. Citing Restatement section 129, the court held that the Hickeys had reasonably relied on the contract by agreeing to sell their own home; thus, “principles of equitable estoppel” required enforcement of the contract.[48]

[5] Policy Rationale for Statute of Frauds

At least in theory, the Statute of Frauds serves three related purposes in the land sales context. These are sometimes described as the *evidentiary, cautionary* and *channeling functions.*[49] The Statute was originally enacted to serve the evidentiary function, and this remains its primary mission. Compliance with the Statute ensures clear evidence about the existence and key terms of the contract, thus avoiding the pitfalls of perjury and faulty

memory; this minimizes the need for litigation and helps to ensure a correct result if litigation does occur. Scholars suggest that the Statute also has a cautionary function; it requires a formal ceremony—the signing of a written document—which helps to caution the parties that they are entering into an important relationship. Finally, the Statute provides a simple mechanism for distinguishing between mere negotiations (oral) and an enforceable contract (written), and thereby allows the parties to express their intent in a legally effective manner; this is called the channeling function.

Critics suggest that judicial interpretation has so eroded the Statute of Frauds that it no longer serves these functions in any meaningful way—if indeed it ever did.[50] After all, a few words, numbers, and initials scrawled on a scrap of paper may constitute a sufficient memorandum of a real property sales contract, even though such an informal event is unlikely to serve the evidentiary, cautionary, or channeling functions very well. Moreover, the judicially-created exceptions have carved out huge loopholes in the Statute, significantly reducing its scope.

§20.05 A Typical Sales Contract

In most home sale transactions, the contract is a preprinted standard form. Because sales transactions are primarily governed by state law, these form contracts differ somewhat from state to state, and indeed, from region to region. The typical form is prepared by the local board of realtors, and—predictably—includes provisions that strongly protect the broker's right to a commission.

The buyer and seller usually focus on the price and other economic terms of the deal. The typical form contract contains appropriate blank spaces where the broker can insert these terms, along with the names of the parties and a description of the property. But the parties usually pay less attention to the non-economic terms of the form contract. These terms are typically buried in long paragraphs of small print, difficult to read and to understand, which tends to discourage amendments or revisions.

These non-economic terms fall into four basic categories:

(1) title, financing, inspection, and other contingencies that must be satisfied before the buyer is obligated to purchase (*see* §§20.06–20.07);[51]

(2) provisions governing the mechanics of the closing (e.g., time and place, type of deed, prorations of income and expenses, payment of commission) (*see* §20.08);

(3) provisions dealing with breach of the contract (e.g., liquidated damages clause, attorney's fees clause) (*see* §20.09); and

(4) miscellaneous “boilerplate” provisions (e.g., integration clause).

§20.06 Contract Provisions on Title

[A] Purchase of Title

Suppose B agrees to purchase Blackacre, a house situated on 20 forested acres, from S. What is B buying? S and B would probably characterize the transaction as the purchase of "land." But in reality, B is buying *title to the land*, not the *land* itself. There is an obvious risk that S's title to Blackacre may be somehow defective. S might not own the estate (presumably fee simple absolute) that she purports to be selling; she might own a lesser estate (e.g., a life estate) or no estate at all. And even if S does own the correct estate, it might be burdened with liens, easements, or other encumbrances that affect the value or desirability of the land.

The prudent buyer will negotiate an express contract provision that specifies the quality of title that the seller must deliver. If the sales contract is silent on the issue, the law provides a "default standard": an implied covenant that the seller must deliver *marketable title*. Thus, if the buyer discovers *before* the purchase is consummated that the seller cannot convey the required title, he may rescind the contract or use other remedies. Yet these express and implied title provisions in the contract expire when the transaction closes, under the doctrine of *merger*.[52] Accordingly, if the buyer discovers title defects *after* the purchase is consummated, he must rely on covenants of title in the deed or other sources of title assurance (*see* Chapter 26).

[B] Implied Covenant of Marketable Title

[1] General Rule

If the contract is silent about the quality of title that the seller must deliver, the law fills in the gap by requiring *marketable title*; this standard is sometimes also called *merchantable title*. The seller's obligation to provide marketable title is viewed as both an implied condition and an implied covenant. Thus, if the seller cannot deliver such title, the condition fails (excusing the buyer from all duties under the contract) and the covenant is breached (allowing the buyer to sue the seller for breach).

The marketable title doctrine is a compromise between two extreme alternatives. If the buyer foolishly fails to demand an express title covenant, the law might simply allow him to live with the bargain he struck: a contract to purchase whatever title the seller has, if any. A seller with seriously defective title could still enforce the contract. The law rejects this extreme position in order to honor the buyer's good faith expectation that the seller holds adequate title, and thereby protect the buyer from unfair surprise. Yet the doctrine does not demand that the seller deliver perfect title. In the real world, perfect title is extraordinarily rare. Virtually every title has at least a few minor blemishes or warts—insignificant defects which are highly unlikely to cause difficulty.

[2] What Is Marketable Title?

A precise definition of "marketable title" is surprisingly elusive. Different courts use widely differing language in attempting to describe the doctrine. Yet all definitions share the same basic idea: it is title "free from reasonable doubt, but not from every doubt."[53] So what is title "free from reasonable doubt"? Two clear rules govern the easy cases. First, title is unmarketable if the seller does not own the estate he or she purports to be selling (*see* [3], *infra*). Second, title is generally unmarketable if it is subject to any lien, easement, or other encumbrance (*see* [4], *infra*).

Beyond this point, what is the acceptable degree of "doubt" in marginal cases? In trying to distinguish between trivial doubt and significant doubt, judicial definitions usually focus on the quality of title that a reasonable buyer would accept. Thus, one court explained that marketable title was "title that a prudent person with full knowledge of all the facts and legal consequences would be willing to accept,"[54] while another described it as "a title not subject to such reasonable doubt as would create a just apprehension of its validity in the mind of a reasonable, prudent and intelligent person, one which such persons, guided by competent legal advice, would be willing to take and for which they would pay fair value."[55] A second theme in most definitions concerns the risk of future litigation. If "it is reasonably probable that the purchaser would be exposed to litigation not of a frivolous nature concerning the title,"[56] then title is unmarketable. In practice, these vague, fact-specific definitions provide little guidance to parties, attorneys, and courts.

[3] Seller Lacks Title

Title is unmarketable if the seller clearly does not own the estate he or she purports to be selling. Consider again S's proposed sale of fee simple absolute in Blackacre to B (*see* [A], *supra*). At the close of escrow, title is unmarketable if—for example—(a) S merely owns a life estate in Blackacre or (b) S owns fee simple absolute only in part of Blackacre.[57]

However, most cases are not so simple. More typically, the seller appears to hold valid title, but there is a small chance that that title may be defective. For example, suppose that S claims title to Blackacre based on adverse possession, but has not obtained a judgment quieting title in her favor. A number of states hold that title by adverse possession is marketable where the seller proves there is no real possibility that the record owner will ever succeed in regaining title.[58] The problem with this approach is that the decision does not bind a key non-party: the record owner. The buyer always confronts the risk that he might lose if the record owner eventually sues to quiet title. For this reason, a few jurisdictions hold that title derived from adverse possession is not marketable until it is confirmed by a successful quiet title action.

As its name suggests, the doctrine of marketable title concerns only the quality of the seller's title to land, not the physical condition or value of the land. For example, if the buyer discovers that the land is located in an earthquake zone, subject to flooding, covered with hazardous wastes,[59] or dangerously close to a nuclear reactor, title is still marketable. "One can hold perfect title to land that is valueless; one can have marketable title to land while the land itself is unmarketable."[60]

[4] Seller's Title Is Subject to Encumbrance

[a] Generally

As a general rule, title is unmarketable if the seller's title is subject to any *encumbrance.* An encumbrance is a right or interest in land—other than a present freehold estate or future interest therein—that reduces the value or restricts the use of the land. Mortgages, easements,[61] covenants, leases, tax liens,[62] encroachments,[63] options, judgment liens, mechanic's liens, and water rights are all examples of encumbrances. Suppose now that S holds fee simple absolute in Blackacre (*see* [A], *supra*), but her title is burdened by an

easement that allows G to cross Blackacre; S's title is unmarketable. Or suppose S's title is subject to a set of recorded covenants in favor of H; again, S presumably holds unmarketable title. What if Blackacre lacks access to a public road? Many courts would find S's title to be unmarketable, reasoning that litigation may be required to obtain an easement.

On the other hand, an insignificant blemish does not render title unmarketable. For example, suppose 25 years ago, S leased Blackacre to J for a 15 year term; a "memorandum of lease"—which merely recites the existence of the lease—was later recorded. Even though the lease lapsed 10 years ago, the memorandum of lease still appears in the public records. But because the S-J lease has no effect today, the memorandum of lease is a legal nullity and title is marketable.[64]

[b] Effect of Land Use Regulations

All jurisdictions agree that the mere *existence* of zoning, building, and other land use regulations does not make title unmarketable.[65] Why not? A cluster of reasons supports this rule. Most importantly, the law is not an encumbrance under the standard definition of the term. In addition, the normal buyer intends to use the land as it has been used in the past; if B purchases Blackacre, he presumably intends to use it as a residence, just as S did. If Blackacre is currently zoned for residential use, the existence of the zoning ordinance has little or no impact on a buyer like B. Moreover, a buyer should reasonably expect the land to be subject to land use regulations, because they affect virtually all parcels to some degree. Hence, the buyer who intends to devote the land to a new use will investigate the governing law in advance, without any need for the special protection afforded by the marketable title doctrine. The risk of title uncertainty or future litigation is remote.

Most courts hold that the *violation* of a zoning ordinance *does* render title unmarketable.[66] Suppose, for example, that the Blackacre house is set only 20 feet back from the road, while the local ordinance requires a setback of 25 feet. S's title to Blackacre is unmarketable under these conditions. If B purchased the land, he would be subject to the risk of civil or criminal litigation; the local zoning authority might compel him to move the house or to pay a fine. Although a buyer should expect the existence of zoning ordinances, he or she would not reasonably expect that the property currently

violates the law. The violation of a law is not an "encumbrance" in the traditional sense of the term, but courts have extended the scope of the marketable title doctrine to protect the unwary buyer.

However, the majority view is that the violation of a building code does not make title unmarketable.[67] The rationale for this rule is not well defined. Logically, if the construction of the Blackacre house violated the building code (e.g., by lack of adequate fire walls), buyer B would be subject to the risk of enforcement litigation after purchase, just as if the house's location violated the zoning ordinance. What accounts for the rule? Part of the answer lies in the common law's reluctance to hold the seller liable for defects in the physical condition of the property. Under the doctrine of caveat emptor (*see* §21.01), a seller had no duty to inform the prospective buyer about defects in the premises. If a building code violation rendered title unmarketable, this would mean that the seller effectively warranted the condition of the property, thus undercutting the caveat emptor doctrine. In addition, building code defects are generally more difficult to discover than zoning violations. Owner S might easily learn about the zoning violation by measuring the distance between her house and the street; but she is unlikely to cut inside the house walls to evaluate their fire resistance.

[c] Effect of Visible Encumbrances

Suppose that a paved lane crosses through the middle of Blackacre, connecting the public road to property owned by E; B observes E driving his car along the lane before agreeing to purchase Blackacre. Can B now rescind the contract on the basis that E holds an easement that renders title unmarketable? Many courts hold that visible easements for roads, power lines, sewer pipes, or other utilities do not affect marketability. If a buyer knows or reasonably should have known that an easement exists, and enters into a purchase contract that fails to mention the easement, he or she presumably agreed to accept title subject to the easement.

[C] Express Title Covenant

The prudent buyer will negotiate an express contract provision concerning title.[68] Most commonly, contracts specify that the seller will deliver *marketable title* (*see* [B], *supra*); vague phrases such as "good title" or "clear title" are usually construed to mean marketable title as well. Another

approach is to require *insurable title*;[69] this standard is met if a title company is willing to issue a policy insuring the buyer's title. This approach may not offer enough protection to the buyer because (a) all title policies contain extensive exceptions and (b) a title company may be willing to take the business risk of insuring a title that a reasonable buyer would not accept. Or the contract could require *record title*; this merely requires proof that the recorded chain of title shows the seller as holding title to the property, and does not guard against off-record defects (e.g., adverse possession) or encumbrances on title. Finally, the contract might simply contain a *buyer approval clause* (e.g., "title must be satisfactory to the buyer"); after reviewing the status of title shown by a title opinion or preliminary title report, the buyer must act reasonably in approving or disapproving title. Of course, two or more of these standards could be combined; for example, a contract could require "marketable and insurable title."[70]

Suppose S knows that her title to Blackacre is encumbered by (a) an easement for a future road held by City and (b) a short-term lease held by L. How can S possibly agree to deliver marketable title, or insurable title, or any other particular quality of title? The answer is that S and B can exclude certain known defects from the scope of the title clause. For example, the S-B contract could obligate S to deliver "marketable title except for (a) a road easement held by City and (b) a lease held by L."

What if the S-B contract requires S to deliver "marketable title except for easements and restrictive covenants of record"? Title clauses like this one which waive broad categories of potential defects may be a recipe for disaster: the buyer has agreed to take title even if major problems are later discovered. For example, under this language B is obligated to perform the contract even if investigation reveals that (a) the state holds a recorded easement to build a ten-lane freeway through Blackacre or (b) a recorded covenant requires that all of Blackacre (other than the house site) be devoted "only to forest use in perpetuity."[71] However, suppose instead that B learns that Blackacre is burdened by a recorded covenant that mandates that any house on the property be two stories in height; if the existing Blackacre house is only one story high, and thus violates the covenant, S's title is unmarketable.[72] B consented to the existence of recorded covenants, not to their violation.

[D] Breach of Title Covenant

The seller is obligated to deliver marketable title (or such other title as is specified in the contract) at the time of closing.[73] The buyer who learns of title defects before the closing must notify the seller and allow a reasonable opportunity for the seller to cure the defects.[74] For example, if the seller's title is encumbered by a mortgage, the seller can eliminate this defect simply by repaying the underlying debt and obtaining a release from the mortgagee. It is fairly common for mortgages and other liens to be paid at the closing.

If the seller fails to deliver the required title at closing, (a) the buyer is excused from performing the contract and (b) the seller is liable for breach of contract. The buyer now enjoys a choice of remedies. She may seek specific performance of the contract with an abatement; she may rescind the contact, recover the down payment, and obtain other restitution; or she may sue the seller for damages[75] (*see* §20.09).

§20.07 Contract Provisions on Financing

[A] Negotiating the Condition

The buyer is rarely willing or able to pay the entire purchase price in cash. Accordingly, he will try to ensure that the contract protects his ability to obtain adequate financing. Suppose B wishes to purchase S's property Redacre for $200,000, but has only $20,000 in cash. B and S might negotiate a contract that provides: (a) B will pay S a $20,000 cash down payment; and (b) B will give S a promissory note for the $180,000 balance, secured by a first-priority mortgage on Redacre.

Alternatively, B might choose to obtain the balance of the purchase price through a loan from a bank, savings and loan association, or other institutional lender. B will wish to insert a financing condition into the B-S contract, to ensure that he is not obligated to purchase if he cannot obtain a suitable loan. A sample clause might provide: “This contract is contingent on B obtaining a commitment from a bank or other institutional lender within 30 days for a new first-priority loan in the amount of $180,000, payable monthly at approximately $1,321 at a fixed interest rate not to exceed 5%, all due 30 years after origination.” If B cannot obtain such a loan, he is excused from performing the contract.[76]

[B] Vague and Indefinite Language

Financing conditions are a fertile source of litigation. One frequent issue is whether the language of the financing condition is so vague and indefinite that the entire contract is unenforceable. Suppose, for example, that the entire financing clause in the B-S contract reads: “Subject to B obtaining the proper amount of financing.”[77] What loan amount, interest rate, or payment schedule is appropriate? Where the parties adopt a vague clause, they have effectively failed to reach agreement on material terms of the contract. Modern courts are increasingly willing to fill in the gaps with “reasonable” terms—if possible—based on the circumstances of the transaction, local custom, or the expectations of the parties.[78] If this cannot be done, however, the contract is deemed illusory, and hence unenforceable.[79]

[C] Sufficiency of Buyer's Effort to Obtain Loan

Another common issue is whether the buyer made a sufficient effort to obtain the contemplated loan. This scenario might arise when the buyer—unable to obtain a loan—sues the seller to recover the deposit. The seller then defends the action by claiming that the buyer's activities were insufficient. Courts generally hold that a buyer must make a reasonable effort to satisfy the financing condition.[80] The precise phrasing of this implied covenant differs from state to state; “good faith” or “reasonable diligence” express the same theme.[81] The buyer's failure to make the required effort is treated as a breach of contract. Lurking beneath the surface here is judicial concern that the buyer—having changed her mind about purchasing the property—is trying to invalidate the contract. If the law imposed no duty, a buyer could always escape the contract by the simple expedient of failing to seek a loan.[82]

The adequacy of the buyer's effort to obtain financing is a question of fact. In one illustrative decision, the buyer applied only to one lender, and then canceled her application a few days later; when she sued the seller to retrieve her deposit, the court found this minimal effort to be insufficient.[83] Decisions vary widely on whether an application to only one lender is sufficient. On the other hand, the buyer who diligently but unsuccessfully applies to two or more lenders has probably met this burden.[84]

§20.08 Closing the Transaction

[A] Tender of Performance

Suppose S and B enter into a valid contract whereby B agrees to purchase S's property, with the closing set for July 1. S appears at the closing on July 1, but B fails to show up.[85] What are S's rights? In general, the seller's obligation to deliver the deed and the buyer's obligation to pay the purchase price are concurrent conditions. This means that the performance of each party is a condition to the performance of the other party. Until S performs—or *tenders* performance—B is not obligated to perform and thus has not yet breached the contract.[86] Of course, S could put B in breach by actually delivering the deed to B, but this approach carries unacceptable risk. Instead, S need only "tender" (or offer) performance. If S is (a) able to deliver title as required by the contract and (b) clearly offers to deliver such title, this constitutes a "tender."[87]

[B] Time for Performance

Suppose that when B fails to appear at the July 1 closing, S immediately sends B a hand-delivered letter tendering performance. The rights of the parties now turn on whether "time is of the essence" under the contract. Time may be deemed of the essence either because the contract includes an express provision (e.g., "Time is of the essence in this Agreement.") or because the circumstances of the transaction demonstrate that the parties so intended. If time is of the essence, the parties must perform at the time specified in the agreement.[88] Here, B is now in breach and cannot enforce the contract against S; S has a variety of remedies against B (*see* §20.09).

Conversely, if time is not of the essence, a party can still obtain specific performance of the contract if he performs or tenders performance within a reasonable time.[89] For example, if B performs on July 2, the next day, he can presumably still secure specific performance; however, B is liable to S for any actual damages caused by the delay (e.g, loss of interest on the sales price).

§20.09 Remedies for Breach of Contract

[A] Specific Performance

[1] General Requirements

A specific performance decree mandates that the breaching party perform the sales contract. For example, if the seller unjustifiably refuses to perform, the court will order the seller to convey title to the buyer, contingent upon the seller's receipt of the sales price. Specific performance is usually the best remedy for breach of a land sale contract, because it gives the non-breaching party exactly what she bargained for.[90]

Because specific performance is an equitable remedy, it is not always available. One limitation is that specific performance will be awarded only if the usual remedy of money damages is inadequate; as discussed below, this standard is always met when the buyer of real property seeks specific performance, and usually met when the seller seeks such relief. In addition, the court has broad equitable discretion in deciding whether to grant specific performance; for example, if this remedy would cause unusual hardship to the breaching party, the court may refuse to compel performance and only award damages. Finally, laches,[91] unclean hands, and the other usual equitable defenses may preclude the remedy.

When a title defect prevents the seller from conveying title as required, the buyer may compel specific performance of the contract with an *abatement*—that is, a reduction—of the purchase price. This tool is particularly useful when the title problem can be easily quantified. For example, if the seller contracts to sell ten acres, but can only deliver title to nine acres, the buyer can presumably obtain specific performance of the nine acres in exchange for only 90% of the contract price. Similarly, in one case the seller contracted to convey full title to a condominium unit, but was unable to do so because he only owned a one-half interest as a cotenant with his estranged wife, who refused to convey her interest; the court ordered the seller to convey his half interest, and abated half of the purchase price.[92]

[2] Inadequacy of Money Damages

Why are money damages an inadequate remedy for breach of a real property sales contract? When the buyer seeks specific performance, the conventional answer to this question is straightforward. Early English courts adopted the view that each parcel of land is "unique" as a matter of law. Under this approach, the location, size, amenities, appearance, condition, and other qualities of a particular parcel at issue cannot possibly be duplicated. If the buyer was awarded money damages, he could never purchase an identical replacement parcel. Hence, the rule arose that damages could never be adequate to compensate for the seller's refusal to convey title.

The logic of this blanket rule is questionable today. While each rural parcel in medieval England may indeed have been unique, the same cannot realistically be said for many modern parcels. For example, unit 10C—on the tenth floor of a hypothetical condominium development—may be identical to adjacent unit 10D for all practical purposes. However, courts still uniformly follow the traditional rule, without examining whether the particular property is in fact unique.[93] Thus, for example, a buyer can compel specific performance of a contract to purchase unit 10C, even though unit 10D is available for purchase at the same price.

As a general rule, damages are also deemed an inadequate remedy when the seller seeks specific performance. But why? The answer to this question is somewhat elusive. Suppose the fair market value of S's property Brownacre is $90,000; S enters into a contract to sell Brownacre to B for $100,000, and B breaches. If S obtains specific performance, he recovers the $100,000 sales price from B. If S is limited to damages, he still obtains $100,000 in value: (a) $10,000 in damages from B (the difference between contract price and fair market value) and (b) title to Brownacre, worth $90,000. So why is the damages remedy inadequate for a seller like S? The leading justification is that the seller may encounter problems in proving damages with reasonable certainty, because the fair market value of land is difficult to determine. Alternatively, the seller may have trouble reselling the land quickly, and thus lose the opportunity to invest the sale proceeds productively.

Both rationales collapse under scrutiny. Courts routinely use expert appraisal testimony to value real property for a variety of purposes (e.g., eminent domain actions), and most parcels can be resold within a short time. As evidenced by the New Jersey decision of *Centex Homes Corp. v. Boag*,[94]

there is a slight modern trend toward abandoning the automatic rule that damages are an inadequate remedy for the seller. On the facts of *Centex Homes*, the court found that the damages sustained by the seller—a condominium developer—could be easily measured and thus the damages remedy was adequate.

[B] Damages

[1] Loss of Bargain Damages

The basic measure of damages for breach of a real property sales contract is the difference between the contract price and the fair market value of the property at the time of the breach.[95] For example, suppose B enters into a contract to purchase Blueacre from S for $500,000, and then breaches four months later when the value of the property has fallen to $480,000. Under the general rule, B is liable to S for $20,000 in damages. Conversely, if the market value of Blueacre is $500,000 on the date of B's breach, S is not entitled to any damages under this standard.[96]

About half the states recognize an exception to this standard where the buyer sues the seller for breach. In these jurisdictions, under the so-called "English rule," the seller is not liable for loss of bargain damages if the breach was caused by good faith inability to convey marketable title; rather, the buyer only recovers any payments made to the seller, plus incidental damages.[97] Assume, for example, that O conveys Greenacre to B, who fails to record his deed or take possession; O then purports to convey Greenacre as a gift to C. C, unaware of the O-B deed, contracts to sell Greenacre to D in good faith. B now records. As between B and C, B owns Greenacre because his interest was acquired first in time, while C, as a donee, cannot qualify for protection as a bona fide purchaser (*see* Chapter 24). Under the good faith limitation rule, C is not liable to D for loss of bargain damages. The seller who knows or reasonably should know about the title defect at the time he enters into the contract is deemed to act in bad faith and receives no protection under this rule. Similarly, if the seller breaches for reasons *other than* inability to deliver good title, good faith is irrelevant; the buyer may recover normal benefit of the bargain damages.[98]

The original rationale for the good faith limitation—the difficulty in ascertaining land title in eighteenth-century England—no longer exists. The

comprehensive recording system in the United States makes it relatively easy for a landowner to confirm the validity of his or her title before entering into a sales contract, at least in most instances.[99] As a result, modern decisions reveal a growing trend toward the so-called "American rule," which allows the buyer to recover full loss of bargain damages regardless of the seller's good faith.[100]

[2] Incidental and Consequential Damages

Particularly when full loss of bargain damages are not available, the non-breaching party may receive *incidental damages*—compensation for the out-of-pocket expenses incurred in reliance on the contract. For example, the buyer can recover the costs of property inspections, escrow fees, title examination expenses, and attorney's fees.

Where the breach causes a special, foreseeable loss to the non-breaching party, *consequential damages* may also be available. The issue arises most frequently when the non-breaching buyer seeks to recover profits that would have been made from the property if the seller had fully performed, e.g., from continued operation of an existing business. Lost profits are awarded only if they can be proven with reasonable certainty. And most courts refuse to award them at all if the buyer obtains full loss of bargain damages.

[3] Liquidated Damages

The parties may supersede the usual rules governing damages by including a *liquidated damages clause* in the sales contract. As its name suggests, a liquidated damages clause specifies or "liquidates" the amount of damages due if the contract is breached. Liquidated damage clauses offer the benefit of certainty, because each party knows its maximum exposure for breach and can plan accordingly; they also serve to minimize litigation by eliminating the need for proof of damages.

The liquidated damages clause is most commonly used to deal with the buyer's breach of a home sale contract.[101] Suppose S and B enter into a contract by which B agrees to purchase S's house Whiteacre for $200,000; B immediately pays the $10,000 deposit required under the contract, and agrees to pay the balance at the closing. The contract provides: "If the Buyer fails to perform his obligations hereunder, the Seller shall retain the Buyer's deposit as liquidated damages." If B breaches, can S rely on this clause to keep the

$10,000 deposit?

Under the majority approach, a liquidated damages clause is valid if (a) future damages are difficult or impossible to determine in advance and (b) at the time the contract was signed, the specified amount of liquidated damages was a reasonable estimate of the future damages. The tension between these two criteria is obvious. If future damages are "impossible" to determine when the contract is signed, how can the estimate be "reasonable"? As a practical matter, courts largely seem to ignore the first element, and focus heavily on the second element—the reasonableness of the estimate.[102] Even here, the modern trend is to consider the reasonableness of the estimate in comparison to the actual damages incurred.[103] For example, suppose that S immediately resells Whiteacre to X for $250,000; on these facts, S has suffered no loss from B's breach, but rather has made a $50,000 profit. Can S still keep B's $10,000 deposit? Even if $10,000 was a reasonable estimate when the contract was signed, some courts will refuse to enforce the liquidated damages clause here because it has no relationship to the seller's actual damages and thus constitutes a penalty.[104]

[4] Role of Buyer's Deposit

Suppose B contracts to purchase Greenacre from S for $400,000 and, as part of the transaction, gives S a good faith deposit of $20,000; the contract does not contain a liquidated damages clause. Two days later, B repudiates the contract and demands that S return the deposit. Assuming that the fair market value of Greenacre at the time of breach is $395,000, what should S now do? Under these circumstances, the traditional rule is that the breaching buyer is not entitled to the return of his deposit, so S can retain the entire $20,000—which is more than his actual damages of $5,000. However, a number of modern courts—applying standard contract law principles—would allow B to recover $15,000 in this situation. As the New Jersey Supreme Court noted in *Kutzin v. Pirnie*,[105] "[w]henever the breaching buyer proves that the deposit exceeds the seller's actual damages suffered as a result of the breach, the buyer may recover the difference."

[C] Rescission and Restitution

Alternatively, the non-breaching party may rescind the contract and obtain restitution. *Rescission* cancels the contact, so that it has no further legal force

or effect; the non-breaching party is excused from further performance. The law now restores the parties to the positions they held before the contract was created—just as if no contract had ever been formed—by requiring each to return the performance of the other; this process is called *restitution.* Suppose K agrees to purchase L's property Brownacre for $300,000, and gives L a $15,000 down payment; L allows K to take possession of Brownacre before the closing. Two months later, L breaches and K rescinds the contract. Under the restitution remedy, L must return the $15,000 deposit to K and K must pay L the fair rental value of Brownacre for two months.

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1. *See generally* Ann M. Burkhart, *Real Estate Practice in the Twenty-First Century,* 72 Mo. L. Rev. 1031 (2007).

2. In the United States, the standard real estate transaction is largely a local matter, regulated by state law; and, despite the growth of electronic commerce generally, the typical transaction still relies heavily on paper documents. In contrast, England has developed a national land sale system which is entirely based on electronic documents. *See* John G. Sprankling et al., Global Issues in Property Law 115–20 (2006). This approach may well be the wave of the future.

3. A more complex transaction, such as one concerning commercial property, might involve an option or a right of first refusal. A person holding an *option* has the right to purchase the property within a specified time period, but is not obligated to do so—until and unless she exercises the option; her exercise of the option creates an enforceable sales contract. In contrast, a *right of first refusal* gives the holder the first right to purchase the property if and when the owner decides to sell it.

4. The Fair Housing Act, 42 U.S.C. §3601 et seq., prohibits discrimination based on race, color, religion, sex, familial status, national origin, or handicap by sellers, brokers, lenders, or others in connection with the sale of a home or other "dwelling." The Fair Housing Act is discussed in detail in connection with leases at §16.02[B].

5. The Real Estate Settlement Procedures Act, 12 U.S.C. §§2601–2617, imposes detailed procedural requirements on almost all closings involving residential real property.

6. Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn from Real Estate Conveyancing,* 62 Mo. L. Rev. 241, 241 (1997).

7. *See, e.g.,* Cultum v. Heritage House Realtors, 694 P.2d 630 (Wash. 1985).

8. *In re* Opinion No. 26 of the Committee on the Unauthorized Practice of Law, 654 A.2d 1344 (N.J. 1995).

9. *Id.* at 1358. *But see* State v. Buyers Service Co., 357 S.E.2d 15 (S.C. 1987) (prohibiting title company from handling real estate closings); Bowers v. Transamerica Title Ins. Co., 675 P.2d 193 (Wash. 1983) (holding title company liable in damages for failing to meet the standard of care required of an attorney conducting a closing).

10. *See, e.g.,* Haymes v. Rogers, 222 P.2d 789 (Ariz. 1950) (listing broker cannot disclose to prospective buyer that seller will accept less than listing price for property). *See generally* Craig W. Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause,* 54 Fla. L. Rev. 395 (2002).

11. Licari v. Blackwelder, 539 A.2d 609 (Conn. App. Ct. 1998); Estate of Eller v. Bartron, 31 A.3d 895 (Del. 2011).

12. *See, e.g.,* Strawn v. Canuso, 657 A.2d 420 (N.J. 1995) (listing broker obligated to disclose presence of nearby hazardous waste dump site to home buyers).

13. *See, e.g.,* Kubinsky v. Van Zandt Realtors, 811 S.W.2d 711 (Tex. Ct. App. 1991); Thomson v.

McGinnis, 465 S.E.2d 922 (W. Va. 1995). *But see* Easton v. Strassburger, 199 Cal. Rptr. 383 (Ct. App. 1984) (requiring listing broker to inspect residential property listed for sale and to disclose to buyers all material facts revealed by investigation); Cal. Civ. Code §§2079–2079.4 (codifying *Easton* rule).

14. *See, e.g.*, Stortroen v. Beneficial Fin. Co. of Colorado, 736 P.2d 391 (Colo. 1987); Licari v. Blackwelder, 539 A.2d 609 (Conn. App. Ct. 1988).

15. *See, e.g.*, Cal. Civ. Code §§2079.13–2079.24.

16. *See* Roger Bernhardt & Dale A. Whitman, *When Is a Commission Due? Problems with Broker Listing Agreements*, 27 Prob. & Prop. 30 (2013).

17. *See, e.g.*, Drake v. Hosley, 713 P.2d 1203 (Alaska 1986); Margaret H. Wayne Trust v. Lipsky, 846 P.2d 904 (Idaho 1993); Tristam's Landing, Inc. v. Wait, 327 N.E.2d 727 (Mass. 1975). *But see* Frady v. May, 23 S.W.3d 558 (Tex. App. 2000) (broker entitled to commission where parties to original sales contract released each other from liability, apparently to defeat commission claim, but then entered into and performed a nearly-identical replacement contract).

18. *See, e.g.*, Dworak v. Michals, 320 N.W.2d 485 (Neb. 1982).

19. *See, e.g.*, Phoenix Mut. Life Ins. Co. v. Shady Grove Plaza Ltd. Partnership, 734 F. Supp. 1181 (D. Md. 1990) (parties did not intend to be bound by sales contract); King v. Wenger, 549 P.2d 986 (Kan. 1976) (same).

20. *See, e.g.*, King v. Wenger, 549 P.2d 986 (Kan. 1976); Hickey v. Green, 442 N.E.2d 37 (Mass. App. Ct. 1982); Ward v. Mattuschek, 330 P.2d 971 (Mont. 1958); Cash v. Maddox, 220 S.E.2d 121 (S.C. 1975).

21. Statute of Frauds, 29 Car. II, c. 3, §4 (1677).

22. Joel Bishop, The Doctrines of the Law of Contract 177 (1878).

23. Cal. Civ. Code §1624(a)(3).

24. In most jurisdictions, however, an agreement to rescind a sales contract is not subject to the Statute of Frauds. *See, e.g.*, Niernberg v. Feld, 283 P.2d 640 (Colo. 1955).

25. *See, e.g.*, Sterling v. Taylor, 152 P.3d 420 (Cal. 2007) (price term ambiguous); Wiley v. Tom Howell & Assoc., 267 S.E.2d 816 (Ga. Ct. App. 1980) (price not specified); Baliles v. Cities Service Co., 578 S.W.2d 621 (Tenn. 1979) (property description insufficient).

26. *Cf.* Goodwest Rubber Corp. v. Munoz, 216 Cal. Rptr. 604 (Ct. App. 1985) (enforcing contract for sale at “fair market value”).

27. *See, e.g.*, Cash v. Maddox, 220 S.E.2d 121, 122 (S.C. 1975) (deposit check that referred to “15 acres in Pickens, S.C.” did not describe property with sufficient certainty).

28. *But see* Ray v. Frasure, 200 P.3d 1174 (Idaho 2009) (street address insufficient because it gave “no indication of the quantity, identity, or boundaries of the real property”).

29. *But see* Crawley v. Hathaway, 721 N.E.2d 1208, 1209 (Ill. App. Ct. 1999) (where contract described property as “100 Acres More or less,” court admitted extrinsic evidence to identify the property).

30. *See, e.g.*, Ward v. Mattuschek, 330 P.2d 971 (Mont. 1958).

31. *See, e.g.*, Estate of Younge v. Huysmans, 506 A.2d 282 (N.H. 1985).

32. *Cf.* Hickey v. Green, 442 N.E.2d 37 (Mass. App. Ct. 1982) (court notes that deposit check endorsed by plaintiffs in connection with sale of their property to a third person—not party to case—was probably sufficient to satisfy Statute of Frauds).

33. *See, e.g.*, Timberlake v. Heflin, 379 S.E.2d 149 (W.Va. 1989) (wife's complaint for divorce deemed sufficient memorandum of prior oral agreement).

34. 15 U.S.C. §7001 et seq.

35. 15 U.S.C. §7001(a)(1). For more information about the Act, see Michael J. Hays, Note, *The E-Sign Act of 2000: The Triumph of Function Over Form*, 76 Notre Dame L. Rev. 1183 (2001).

36. In addition, almost all states have expressly adopted the Uniform Electronic Transactions Act,

which contains similar provisions, but without any link to interstate commerce. *See also* Brantley v. Wilson, 2006 U.S. Dist. LEXIS 17722 (question of fact whether e-mail messages satisfied Statute of Frauds); Shattuck v. Klotzbach, 2001 Mass. Super. LEXIS 642 (Statute of Frauds satisfied by e-mail messages); Rosenfeld v. Zerneck, 776 N.Y.S.2d 458 (Sup. Ct. 2004) (e-mail did not satisfy Statute of Frauds because material terms were missing).

37. *Cf.* Ward v. Mattuschek, 330 P.2d 971 (Mont. 1958) (discussing rule).

38. *See, e.g.*, King v. Wenger, 549 P.2d 986 (Kan. 1976) (statute required written authority for agents of all parties).

39. *See* Burns v. McCormick, 135 N.E. 273 (N.Y. 1922) (oral promise to devise home in return for lifetime care was not enforceable under the part performance exception).

40. *See, e.g.*, Shaughnessy v. Eidsmo, 23 N.W.2d 362 (Minn. 1946).

41. Burns v. McCormick, 135 N.E. 273, 274 (N.Y. 1922).

42. *See, e.g.*, Hickey v. Green, 442 N.E.2d 37 (Mass. App. Ct. 1982).

43. For an overview of the estoppel exception, see Philip W. Wile et al., *Estoppel to Avoid the California Statute of Frauds*, 35 McGeorge L. Rev. 319 (2004).

44. Restatement (Second) of Contracts §129 (1981).

45. Restatement (Second) of Contracts §129 cmt. d (1981).

46. *But see* Burns v. McCormick, 135 N.E. 273 (N.Y. 1922) (refusing to apply part performance exception to enforce oral promise to devise home in exchange for lifetime care).

47. 442 N.E.2d 37 (Mass. App. Ct. 1982).

48. *Id.* at 40. *See also* Gardner v. Gardner, 454 N.W.2d 361 (Iowa 1990) (finding part performance).

49. *See generally* Joseph M. Perillo, *The Statute of Frauds in the Light of the Functions and Dysfunctions of Form*, 43 Fordham L. Rev. 39 (1974).

50. *See, e.g.*, Michael Braunstein, *Remedy, Reason, and the Statute of Frauds: A Critical Economic Analysis*, 1989 Utah L. Rev. 383.

51. *See, e.g.*, Hubble v. O'Connor, 684 N.E.2d 816 (Ill. App. Ct. 1997) (contract contingent on attorney's approval as to form).

52. Under the doctrine of merger, the seller's covenants in the sales contract concerning the state of title, the amount of land being conveyed, and occasionally other matters are traditionally said to be “merged” into the deed and thereby extinguished, unless they are expressly set forth in the deed. But the doctrine is often ignored. *See, e.g.*, Loveland Essential Group, LLC v. Grommon Farms, Inc., 251 P.3d 1109 (Colo. App. 2010) (allowing buyer to sue for breach of contractual title warranty after close of escrow). Under the traditional approach, contract promises that would not normally be contained in a deed (e.g., the seller's warranty that home is in “good condition”) are seen as collateral promises that continue to exist after the deed is delivered. *See, e.g.*, Mallin v. Good, 417 N.E.2d 858 (Ill. App. Ct. 1981).

53. Norwegian Evangelical Free Church v. Milhauser, 169 N.E. 134, 135 (N.Y. 1929).

54. King v. Knibb, 447 A.2d 1143, 1145 (R.I. 1982).

55. Seligman v. First Nat'l Invs., Inc., 540 N.E.2d 1057, 1060 (Ill. App. Ct. 1989).

56. Keown v. West Jersey Title & Guaranty Co., 390 A.2d 715, 717 (N.J. 1978).

57. *See, e.g.*, Tri-State Hotel Co. v. Sphinx Invest. Co., 510 P.2d 1223 (Kan. 1973) (title held unmarketable where seller did not hold title to small sliver of land within tract to be conveyed).

58. *See, e.g.*, Conklin v. Davi, 388 A.2d 598 (N.J. 1978).

59. *Cf.* Lick Mill Apartments v. Chicago Title Ins. Co., 283 Cal. Rptr. 231 (Ct. App. 1991) (presence of hazardous substances did not render title unmarketable for purposes of title insurance coverage).

60. Hocking v. Title Ins. & Trust Co., 234 P.2d 625, 629 (Cal. 1951).

61. *See, e.g.*, Haisfield v. Lape, 570 S.E.2d 794 (Va. 2002) (view easement rendered title unmarketable).

62. In contrast, pending litigation about whether additional property taxes should be assessed does not render title unmarketable because no tax lien has arisen yet. Princeton South Investors, LLC v. First Am. Title Ins. Co., 97 A.3d 1190, 1196 (N.J. Super. Ct. App. 2014) (observing that "[i]f a property's potential for the future assessment of taxes were considered a cloud on title, it would be impossible to pass marketable title to any property").

63. *See, e.g.*, Bethurem v. Hammett, 736 P.2d 1128 (Wyo. 1987).

64. *Cf.* G/GM Real Estate Corp. v. Susse Chalet Motor Lodge, 575 N.E.2d 141 (Ohio 1991) (improperly recorded memorandum of lease intended to give notice of lease that had lapsed did not render title unmarketable).

65. *See, e.g.*, Voorheesville Rod & Gun Club v. E.W. Tompkins Co., 626 N.E.2d 917 (N.Y. 1993).

66. *See, e.g.*, Lohmeyer v. Bower, 227 P.2d 102 (Kan. 1951) (violation of zoning ordinance requirement that house be at least three feet from lot line rendered title unmarketable).

67. *Cf.* Frimberger v. Anzellotti, 594 A.2d 1029 (Conn. App. Ct. 1991) (illegal construction of bulkhead and filling of tidal wetlands did not constitute encumbrance for purpose of deed covenant against encumbrances).

68. *But see* Wallach v. Riverside Bank, 100 N.E. 50 (N.Y. 1912) (buyer's agreement to accept quitclaim deed did not waive seller's duty to deliver marketable title).

69. *Cf.* Laba v. Carey, 277 N.E.2d 641 (N.Y. 1971).

70. *See, e.g.*, Conklin v. Davi, 388 A.2d 598 (N.J. 1978).

71. *Cf.* Laba v. Carey, 277 N.E.2d 641, 642 (N.Y. 1971) (buyers who agreed to take title subject to "[c]ovenants, restrictions, utility agreement and easement of record, if any" could not refuse to perform after later discovering recorded easement and recorded covenant).

72. *Cf.* Lohmeyer v. Bower, 227 P.2d 102 (Kan. 1951) (violation of covenant requiring two-story house rendered title unmarketable).

73. *See* Luette v. Bank of Italy Nat. Trust & Sav. Ass'n, 42 F.2d 9 (9th Cir. 1930) (vendor's lack of title long before closing did not entitle vendee to rescind installment land contract).

74. This may extend the closing date for a reasonable period, particularly if the contract contains no provision that time is of the essence (*see* §20.08[B]).

75. *See, e.g.*, Warner v. Denis, 933 P.2d 1372 (Haw. Ct. App. 1997).

76. *But see* Bruyere v. Jade Realty Corp., 375 A.2d 600 (N.H. 1977) (where buyers obtained adequate financing commitment, but later decided to divorce, leading to lender's cancellation of commitment, buyers were still obligated to perform contract).

77. *Cf.* Gerruth Realty Co. v. Pire, 115 N.W.2d 557, 558 (Wis. 1962) (contract that was "contingent on the purchaser obtaining the proper amount of financing" was too indefinite to enforce).

78. *See, e.g.*, Smith v. Vernon, 286 N.E.2d 99 (Ill. App. Ct. 1972) (where condition failed to specify loan amount, local business practice and custom should determine reasonable amount).

79. *See, e.g.*, Homler v. Malas, 494 S.E.2d 18 (Ga. Ct. App. 1997) (condition too vague and indefinite); Gerruth Realty Co. v. Pire, 115 N.W.2d 557 (Wis. 1962) (same).

80. *See, e.g.*, Smith v. Vernon, 286 N.E.2d 99 (Ill. App. Ct. 1972) (plaintiff-buyers failed to prove they made a reasonable effort to obtain a mortgage, and could not recover deposit).

81. *See, e.g.*, Liuzza v. Panzer, 333 So. 2d 689 (La. App. Ct. 1976) (buyer who submitted one unsuccessful loan application did not make "good faith" effort); Lynch v. Andrew, 481 N.E.2d 1383 (Mass. App. Ct. 1985) (buyers failed to exert reasonable "diligence" by refusing to agree to lender's requirements).

82. *Cf.* Sechrest v. Safiol, 419 N.E.2d 1384, 1385 (Mass. 1981) ("The provision [conditioning the buyer's obligation on his ability to obtain permits for construction] cannot be viewed as creating a mere option in the buyer to purchase without any requirement of affirmative action on his part.").

83. Bushmiller v. Schiller, 368 A.2d 1044 (Md. Ct. Spec. App. 1977). *But see* Barber v. Jacobs, 753

A.2d 430 (Conn. App. Ct. 2000) (application to only one lender was sufficient effort where lender denied loan due to wetlands problem and other lenders would be reluctant to approve loan for same reason).

84. *See, e.g.*, Proctor v. Holden, 540 A.2d 133 (Md. Ct. Spec. App. 1988).

85. What happens if B died before the closing? The contract is still valid. Under the doctrine of equitable conversion, B's heirs or devisees are entitled to the property and his estate is liable for the purchase price.

86. *Cf.* Century 21 All Western Real Estate & Inv., Inc. v. Webb, 645 P.2d 52 (Utah 1982) (buyers' specific performance action dismissed because buyers failed to tender).

87. Tender is excused under limited circumstances, e.g., if the other party has previously repudiated the contract or if it is impossible for the other party to perform. *See, e.g.*, Cohen v. Kranz, 189 N.E.2d 473 (N.Y. 1963) (buyer's anticipatory breach of contract excused seller's tender).

88. *See, e.g.*, Doctorman v. Schroeder, 114 A. 810 (N.J. 1921) (recognizing rule, but finding waiver on facts).

89. *See, e.g.*, Kasten Constr. Co. v. Maple Ridge Constr. Co., 226 A.2d 341 (Md. 1967) (allowing specific performance despite delay).

90. *See generally* Tanya D. Marsh, *Sometimes Blackacre Is a Widget: Rethinking Commercial Real Estate Contract Remedies*, 88 Neb. L. Rev. 635 (2010); Steven Shavell, *Specific Performance Versus Damages fo Breach of Contract: An Economic Analysis*, 84 Tex. L. Rev. 831 (2006).

91. *See, e.g.*, Estate of Younge v. Huysmans, 506 A.2d 282 (N.H. 1985) (specific performance refused due to laches).

92. Sanders v. Knapp, 674 P.2d 385 (Colo. Ct. App. 1983).

93. *See, e.g.*, Giannini v. First Nat'l Bank of Des Plaines, 483 N.E.2d 924 (Ill. App. Ct. 1985); Pruitt v. Graziano, 521 A.2d 1313 (N.J. Super. Ct. App. Div. 1987). *But cf.* Centex Homes Corp. v. Boag, 320 A.2d 194 (N.J. Ch. 1974) (criticizing rule in dicta). *See also* Schwinder v. Austin Bank of Chicago, 809 N.E.2d 180 (Ill. App. Ct. 2004) (allowing specific performance where evidence showed condominium unit was unique).

94. 320 A.2d 194 (N.J. Ch. 1974).

95. *See, e.g.*, Jones v. Lee, 971 P.2d 858 (N.M. Ct. App. 1998) (recognizing rule and remanding case for determination of market value at time of breach); Donovan v. Bachstadt, 453 A.2d 160 (N.J. 1982) (applying rule to reject buyers' claim to measure loss of bargain damages based on interest rate differential); White v. Farrell, 20 N.Y.3d 487 (2013) (recognizing rule).

96. The standard measure of damages works well in a market where property values are relatively stable. But what if property values fall rapidly? Suppose that B agrees to purchase Blueacre for $500,000; the property is worth $490,000 when B breaches; but the value declines to $440,000 by the time S is able to resell it to a replacement buyer. Under the usual rule, S receives only $10,000 in damages, not $60,000. *But see* Kuhn v. Spatial Design, Inc., 585 A.2d 967 (N.J. Sup. Ct. App. Div. 1991) (awarding seller the difference between contract price and eventual resale price).

97. *See, e.g.*, Kramer v. Mobley, 216 S.W.2d 930 (Ky. Ct. App. 1949) (following English rule).

98. *See, e.g.*, Beard v. S/E Joint Venture, 581 A.2d 1275 (Md. 1990).

99. For example, even the most careful search of record title would not reveal B's prior, unrecorded deed, which prevails over C's later interest.

100. *See, e.g.*, Donovan v. Bachstadt, 453 A.2d 160 (N.J. 1982) (repudiating English rule, adopting American rule); Smith v. Warr, 564 P.2d 771 (Utah 1977) (adopting American rule).

101. *See, e.g.*, Lynch v. Andrew, 481 N.E.2d 1383 (Mass. App. Ct. 1985); Orr v. Goodwin, 953 A.2d 1190 (N.H. 2008); Mahoney v. Tingley, 529 P.2d 1068 (Wash. 1975).

102. *See, e.g.*, Wallace Real Estate Inv. v. Groves, 881 P.2d 1010 (Wash. 1994).

103. *See* Restatement (Second) of Contracts §356 (1981). *But see* Roscoe-Gill v. Newman, 937 P.2d 673 (Ariz. Ct. App. 1996) (rejecting seller's claim that amount specified in clause was an unenforceable

penalty because it was unreasonably small compared to actual damage amount).

104. *Cf.* Colonial at Lynnfield, Inc. v. Sloan, 870 F.2d 761 (1st Cir. 1989) (refusing to enforce $200,000 liquidated damages clause against buyer where seller made a $251,000 profit by reselling after the buyer's breach).

105. 591 A.2d 932, 942 (N.J. 1991).

Chapter 21

Condition of the Property

§21.01 "Let the Buyer Beware"?

Suppose B contracts to purchase a home from S for $200,000. S is aware that the home is perched over a huge underground cavern, but withholds this information from B. The day after escrow closes, the earth gives way and the home tumbles into the cavern, a total loss. What are B's rights?

The common law afforded the buyer of real property virtually no remedy for defective conditions, whether discovered before or after the close of escrow. The law presumed that a buyer could conduct a pre-purchase investigation and protect his rights by negotiating an express warranty or other contract terms. *Caveat emptor*—in Latin, "let the buyer beware"—summarized the law's approach. Under this approach, B has no remedy against S. Although the conduct of S may be morally or ethically reprehensible, S had no legal duty to inform B about the probable collapse of the house.

Over the last 60 years, the law has moved steadily away from caveat emptor, driven by the same consumer-oriented currents that brought revolutionary change to the traditional rules governing landlord-tenant law and product liability. There is a clear national trend toward holding sellers, brokers, and in some instances builders responsible to buyers for significant defects in homes and other residential property. Similarly, a growing minority of jurisdictions require that the seller bear the loss caused by fire, flood or other injury to the property that occurs after execution of the contract but before close of escrow.

§21.02 Seller's Duty to Disclose Defects

[A] Common Law Approach

Under caveat emptor, the seller of real property had no duty to disclose latent defects to the buyer absent unusual circumstances (e.g., a fiduciary relationship between seller and buyer). Like S in the cavern hypothetical, the common law seller was permitted to remain silent, even if aware of facts that would be crucial to any reasonable buyer. Some states still cling to this view. In the common law tradition, these states distinguish sharply between inaction (“nonfeasance”) and wrongful action (“misfeasance”). Thus, the seller can remain silent, but cannot mislead the buyer by words or conduct.

The seller cannot intentionally misrepresent facts about the property to induce the buyer to buy; this is fraud. A fraudulent misrepresentation is:

(1) a false statement of material fact made by the seller to the buyer,

(2) known to the seller to be false,

(3) made with the intent to induce the buyer to purchase,

(4) which the buyer justifiably relies on in deciding to purchase,

(5) to the buyer's detriment or loss.

Suppose that before the cavern house purchase, S had said to B: “Don't ever worry about this house! It's built on solid rock.” This statement would probably meet the elements of misrepresentation, allowing B to either rescind the purchase contract or recover damages from S. The line between statements of fact and expressions of opinion or standard sales “puffery” is often hard to draw. What if S had merely said “This is a great house” or “You're getting a very good deal!”?[1]

Suppose instead that before B inspects the home, S fills in a few foundation cracks caused by the cavern and covers these patched areas with fresh paint. S says nothing at all to B about the house. Does B have any recourse against S when the house collapses? The common law imposed liability for fraudulent concealment or suppression of facts. S's act of concealing the cracks would be seen as the equivalent of an affirmative misrepresentation.

[B] Modern Trend Toward Requiring Disclosure

[1] General Principles

Today most states require the seller of residential property to disclose known latent defects to the buyer under certain conditions.[2] If the seller breaches this duty, the buyer can either rescind the contract or recover compensatory damages.

There is broad agreement on the basic disclosure standard, although states vary somewhat on detail. In general, a seller of residential property who knows of a hidden or "latent" defect in the property that substantially affects the value or desirability of the property must disclose it to the buyer.[3] In California, for example, a seller who "knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer" has a duty to disclose them to the buyer.[4] In addition to this emerging common law duty, statutes in most states require the seller of residential property to provide the buyer with a written disclosure form listing certain types of defects.[5] However, most jurisdictions still follow the rule of caveat emptor for commercial property transactions.[6]

Johnson v. Davis[7] illustrates the national trend. The Johnsons, aware that the roof on their Florida home leaked badly, agreed to sell it to the Davises without disclosing the problem. Shortly after the Davises paid the $31,000 deposit required by the contract, they inspected the home again, only to find rain water "gushing" in through the ceiling and around the windows. When the Davises sued the Johnsons to recover their deposit, the Johnsons asserted the traditional Florida rule of caveat emptor. The Florida Supreme Court—observing that cases following caveat emptor were "not in tune with the times and do not conform with current notions of justice, equity and fair dealing"[8]—jettisoned the old rule. Following the California formulation of the disclosure duty, it held that the Johnsons were obligated to disclose the leaky roof to the Davises before the contract was signed. Thus, the Davises were entitled to rescind the contract and recover their deposit.

[2] Why Require Disclosure?

Most of the landmark decisions abandoning caveat emptor—like *Johnson*

v. Davis—are remarkably laconic about the underlying policy rationale. Exactly what are "current notions of justice, equity and fair dealing"? The policy debate surrounding the issue is more complex than the phrase suggests.

Consider an analogy. F, a widget manufacturer, sells 100,000 widgets to G at a price of $50.00 each. Before entering into the contract, F is fully aware that the market price of widgets is about to fall sharply (because F is about to open a new widget factory that will glut the market) but fails to inform G. We might say that F made a "good business deal," while G made a mistake. This is a pattern in many business transactions. One side, armed with superior information, is able to strike a superior bargain. Should the law intervene to require business entities like F to disclose advantageous bargaining information before a contract is reached?

If not, libertarian theorists would argue, why should real property transactions be treated differently? The buyer may demand the opportunity to inspect the land, using whatever experts he thinks appropriate, and may protect against uncertainty by insisting that the seller provide an express warranty as to the condition of the property. Because of the number of properties available, the seller is unlikely to own enough properties so as to exercise market control. The buyer and seller are free to negotiate an arms-length sales contract. Moreover, if the law requires seller disclosure, would it logically impose a parallel disclosure duty on buyers? For example, if the geologist buyer knows the property is situated over an oil deposit, must he disclose this information to the seller before entering into the contract?

So why require disclosure? A variety of policy strands underlie the emerging majority rule. Law and economics scholars focus on the parties' comparative access to information concerning the defect. The seller already knows about the defect. Yet unless the law mandates seller disclosure, the prudent buyer will be forced either to (1) pay for an expert inspection, or (2) negotiate for the seller to provide an express warranty on the home's condition,[9] both of which impose unnecessary transaction costs on the buyer. As Judge Posner observes, the disclosure duty saves "the expense of the self-protective measures that buyers would have to take if there were no legal remedies."[10] Moreover, in some instances, (1) the buyer reasonably believes that the seller will disclose known defects (presumably equating nondisclosure with the moral equivalent of lying), or (2) the defect is so

well-concealed that it cannot be discovered through inspection.

The unique nature of the family home—as opposed to other types of property—is also relevant in the policy calculus. A home is the biggest investment that most families will ever make. Moreover, perhaps reflecting the personhood perspective to some degree, the law has increasingly recognized the social value of affording enhanced protection for the family home.[11]

[3] What Must Be Disclosed?

[a] Material Defects Generally

The principal challenge in applying the standard is determining whether a particular defect is significant enough to require disclosure. The line is easy enough to draw in the abstract: the seller need disclose only significant or material defects, not those that are minor or trivial. Most states use an objective standard to assess materiality; some require disclosure if a reasonable person would consider the defect an important factor in the decision to purchase, and others mandate disclosure if the defect has a significant effect on the property's market value. A few jurisdictions appear to utilize a subjective standard, requiring disclosure if the defect would be material to the particular buyer. In practice, these standards are often difficult to apply, especially in marginal cases.

[b] Physical or Legal Defects

The paradigm nondisclosure case involves a latent physical defect in the house or lot, such as a leaky roof, crumbling foundation, termite-damaged structure, or sliding hillside lot.[12] Physical defects of this magnitude are universally seen as material. A number of states also compel disclosure of zoning violations, building code violations, and other legal conditions affecting the use or enjoyment of the property.

[c] Off-Site Conditions

Off-site conditions that may affect the property pose a particular problem. For example, if the property adjoins a toxic waste dump, presumably the potential for future injury is sufficiently real to require disclosure; but what if the dump is five blocks away or two miles away?[13] Similar dilemmas are posed if the house is, for example, near an airport, in an earthquake zone,

near a local "crack house," in a high-crime area, near a nuclear power plant, or across the street from noisy neighbors.[14] These are difficult, fact-intensive cases, which usually hinge on factors such as the proximity of the condition, the magnitude of the risk it presents, and the gravity of the threatened harm.

[d] "Psychologically Impacted" Property

[i] The Issue

Suppose a former resident contracted AIDS or a mass murder occurred in the home.[15] Must a seller disclose such "intangible" or psychological factors, which might stigmatize a particular house?[16]

[ii] Stambovsky v. Ackley

The leading case on point is *Stambovsky v. Ackley*,[17] where the buyer sought to rescind the contract for the purchase of a New York house due to the seller's failure to disclose that the house had a reputation for being haunted by ghosts. The plaintiff-buyer alleged that the seller had created the reputation by publicizing her sightings of "spectral apparitions" to Reader's Digest and local newspapers, and that this stigma greatly reduced the market value of the property. Because New York still followed caveat emptor, however, the trial court dismissed the complaint. In an amusing, tongue-in-cheek decision, the New York appellate court reversed, holding that on these facts the seller was obligated to disclose.

The *Stambovsky* court's rationale is somewhat strained. At least superficially, it reached its result by distinguishing prior New York caveat emptor cases on the basis that the buyers' prudent inspection might have revealed the defects, whereas in *Stambovsky* "the most meticulous inspection and search would not reveal the presence of poltergeists at the premises or unearth the property's ghoulish reputation in the community."[18] Yet this is an obvious overstatement. Although the court humorously muddled the issue, plaintiff was seeking to rescind based on the house's reputation for being haunted, not because the house was actually haunted. This "ghoulish reputation" was in fact easily discoverable by the simple expedient of asking any neighbor about the house in general terms, e.g. "Is there anything special I should know about that house?" More fundamentally, the result in *Stambovsky* stems from the same policy factors that have fueled the national movement away from caveat emptor. The court refers to these policies only

obliquely, noting that “fairness and common sense” compel an exception to caveat emptor.

[iii] Reflections on **Stambovsky v. Ackley**

At bottom, *Stambovsky* is a transitional case, a stepping stone for future New York courts between caveat emptor and the modern disclosure standard. Consider the new test that the case offers: “Where a condition which has been created by the seller materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care with respect to the subject transaction,” the seller's nondisclosure allows the buyer to rescind.[19] This is reasonably close to the national standard except for the odd requirement (clearly linked to the facts of *Stambovsky*) that the seller must have created the condition. After *Stambovsky*, how would a New York court resolve the cavern hypothetical which began this section? Logically, the court would hold that the cavern home seller had no duty to disclose, because he did not create the cavern. Such an unusual distinction seems unlikely to endure in the long run.

Decisions that allow rescission based on nondisclosure of an intangible defect threaten one of the enduring policy themes underlying American property law: protecting the stability of land title. As *Stambovsky* illustrates, courts often attempt to mitigate the impact of rescission in such instances by requiring proof that the stigmatizing defect in fact reduces the property's market value. In a broad sense, a reduction in market value can reflect a public consensus that the particular defect is material.

[iv] Statutory Restrictions on Duty to Disclose Intangible Defects

The judicial movement toward requiring disclosure of such intangible defects has sparked restrictive legislation in many states. The typical statute provides that matters such as the following need not be disclosed by the seller: (1) a past occupant of the property was infected with HIV or contracted AIDS; or (2) the property was the site of a homicide or suicide.[20]

[4] Waiver of Duty

Can the parties expressly agree to relieve the seller of the common law disclosure obligation? A clear, specific waiver will be enforced in most jurisdictions. The law is less clear on the effect of the simple “as is” clause,

yet some courts will find a waiver here as well.[21] Consistent with libertarian theory, an express waiver presumably indicates that the buyer has (1) consciously considered the risk of unknown defects and (2) reduced the purchase price to compensate for these unknown risks. Yet even such a knowing waiver undercuts the utilitarian policies that support the disclosure duty.

[C] Special Rules for Disclosure of Hazardous Substance Contamination

Federal law mandates disclosure of hazardous substance contamination in two special situations. A seller of residential property constructed before 1978 who is aware his property contains lead-based paint must so inform the buyer and provide the buyer with a "lead hazard information pamphlet" issued by the federal government.[22]

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980[23] ("CERCLA") or "Superfund" law may have a similar impact on the owner of property known to be contaminated with a hazardous substance.[24] An owner who innocently purchases contaminated property, without actual knowledge of the contamination or any reason to know about it after conducting a diligent, pre-purchase investigation, will qualify for the "innocent purchaser" or "innocent landowner" defense if he later discovers that the land is contaminated, and, accordingly, will not be held strictly liable for cleanup costs.[25] However, the innocent owner will lose the protection of this defense if he sells the property without fully informing the buyer about the known contamination.

§21.03 Broker's Duty to Disclose Defects

Under basic principles of agency law, the real estate broker representing the buyer has long been required to disclose known defects or other material facts. The buyer's broker, as an agent, owes a fiduciary duty to his principal, the buyer, which includes the obligation of full disclosure. However, under the caveat emptor regime, the seller's agent—like the seller—was not obligated to disclose.

The trend toward mandating disclosure by the seller has produced a similar (if slower) movement toward imposing the same disclosure duty on the seller's agent. California has even gone so far as to require the seller's agent to conduct a visual inspection of the property and to report to the buyer any defects that are discovered.[26] In effect, this provides the buyer with a cause of action for negligent nondisclosure if the seller's agent breaches his duty. The vast majority of states, however, still follow the traditional rule, which imposes no such inspection duty.[27]

§21.04 Builder's Implied Warranty of Quality

[A] The Warranty in Context

At common law, the builder who constructed a new home and then sold it to a buyer was shielded from liability by caveat emptor, even if the home was negligently constructed. Only the rare buyer protected by an express warranty in the sales contract had any legal recourse against the builder.

Over the last 30 years, however, a clear majority of states have repudiated this rule.[28] Most jurisdictions now hold that—as a matter of law—an implied warranty accompanies the sale of a new home by a builder, developer, or other “merchant” of housing.[29] The warranty is typically termed the implied warranty of quality, implied warranty of fitness, implied warranty of suitability, or implied warranty of habitability. Yet, however denominated, the basic protection afforded by the warranty is generally the same in each state: the builder impliedly warrants that the house has been constructed in a workmanlike manner and is fit for human habitation. In most states, the implied warranty does not impose strict liability on the builder, and thus does not guarantee that the home is free from all defects. Rather, it allows the buyer to recover if the builder failed to exercise the standard of skill and care customarily exercised by professional builders. Although some courts find that even minor problems breach the implied warranty, a majority of courts—aware that virtually every new house contains a few imperfections—extend the warranty only to significant defects.[30] Most courts also apply the warranty only to latent or hidden defects, not to obvious defects that an inspection would easily reveal.[31]

The rapid development of the implied warranty undoubtedly reflects the growing view that a new home is merely a specialized type of product.[32] Just as the adoption of the Uniform Commercial Code abolished caveat emptor in the sale of goods, courts increasingly see little reason to retain the rule in the context of new homes.[33] Even as expanded duties are imposed on the manufacturer of goods, the same policies support finding an implied warranty by the manufacturer of new housing:

(1) the buyer's prepurchase investigation is unlikely to reveal the defect

both because the buyer lacks sufficient expertise and because many defects will not become apparent for years;

(2) the buyer reasonably expects that the builder will construct a suitable home;

(3) the builder's expertise allows him to avoid defects through careful construction; and

(4) the builder has the ability to spread any loss by increasing prices to the public.

Moreover, two factors unique to the family home buttress the implied warranty: (1) the home is the biggest investment that most families will make and (2) from the personhood perspective, the family home merits special protection. Because the purchase of commercial property does not trigger these policy concerns in most instances, the implied warranty does not extend to such transactions.[34]

Suppose B purchases a new home from builder S pursuant to a contract that provides that “Purchaser hereby waives and disclaims all implied warranties of any kind or nature whatsoever.” Two months after B takes title to her new home, the roof collapses. Can B sue notwithstanding the disclaimer? Scholars argue that the public policies that support the implied warranty in the first instance should equally prevent its disclaimer.[35] Yet courts appear to enforce disclaimers that are clear and unambiguous, while largely ignoring “boilerplate” disclaimer clauses.[36]

[B] Rights of Successor Owners

One major unsettled issue is whether the implied warranty extends to successor owners. Suppose A purchases a new home from builder-developer D in 2010, and A resells to B. If the home foundation later crumbles, can B sue D based on the implied warranty?

The issue reveals widespread judicial disagreement about the theoretical basis for the implied warranty. Some courts reason that it is founded on tort concepts; others conclude that it is based on contract; and still others echo Dean Prosser's view that it is “a freak hybrid born of the illicit intercourse of tort and contract.”[37] Courts that justify the implied warranty under contract law often refuse to extend the warranty to a subsequent purchaser (like B) who lacks privity of contract with the builder (here D).[38]

The modern trend, however, is to recognize that a subsequent purchaser may sue the builder[39] under the implied warranty,[40] based on the same public policies that apply to the initial purchaser. “[T]he contractor should not be relieved of liability for unworkmanlike construction simply because of the fortuity that the property on which he did the construction has changed hands.”[41] Further, barring the subsequent buyer's recovery might encourage sham first sales to shield builders from liability. The main counterweight to these policy arguments is the burden of perpetual liability. If the builder is liable to subsequent purchasers, will he be liable forever? Courts usually deal with this concern by holding that the builder is liable only for a “reasonable” period.

§21.05 Risk of Loss before Conveyance

[A] Equitable Conversion

Suppose that on July 1, S and B enter into a contract for the sale and purchase of Greenacre—a single-family home—with escrow to close on July 31. The contract is silent on risk of loss. On July 4, an errant firecracker set off by an unknown person sparks a fire that destroys the Greenacre house. Is B still obligated to purchase?

Perhaps incredibly, in most states the answer is "yes." Under the common law doctrine of *equitable conversion*, the buyer is deemed the equitable owner of the land until close of escrow unless the contract specifies otherwise.[42] It is an ancient maxim that "equity regards as done that which ought to be done." Thus, English courts developed the rule that once a sales contract was signed, the buyer was considered the owner in equity, while the seller merely retained a right to receive the purchase price.[43] The later injury or destruction of the property by fire, flood, hurricane, earthquake or other disaster after the contract date was irrelevant to the parties' obligations. Courts have extended the doctrine to include post-contract zoning amendments, eminent domain proceedings, and similar developments affecting the legal status of the property.[44]

Modern scholars condemn equitable conversion.[45] It is fundamentally inconsistent with the expectations of the ordinary buyer and seller. Moreover, because the seller usually retains possession until close of escrow, he is better situated to protect the property. Law and economics scholars note the "moral hazard" issue posed by the rule; already entitled to receive the sales proceeds, the seller has little incentive to preserve the property from injury. Finally, in most instances the seller still has casualty insurance on the property until close of escrow, and thus may not need the protection that the rule affords, while the buyer rarely insures before the closing.

Why is this seemingly inequitable doctrine still the majority rule? Two factors obscure the need for reform. First, virtually all sales contracts contain a "risk of loss" clause, which expressly assigns the risk of loss in the event the property is damaged or destroyed before the close of escrow; an express

clause supersedes the equitable conversion doctrine, which is merely a default rule.[46] Such clauses typically provide that the risk of loss remains with the seller until escrow closes. Thus, the use of equitable conversion as a "gap-filling" rule is comparatively rare. Second, courts have often mitigated the harshness of the rule in the standard situation where only the seller has insured the property. In theory, equitable conversion would allow the seller to receive both the purchase price and the insurance proceeds, a double recovery. Most courts, however, will impose a constructive trust on the policy proceeds, requiring the seller to apply them for the benefit of the buyer.[47]

[B] Alternative Approaches to the Risk of Loss Dilemma

There is a clear trend away from equitable conversion.[48] The most widely-accepted alternative is the Uniform Vendor & Purchaser Risk Act, adopted in New York, California and a number of other states. Under the Act, the risk of loss due to physical destruction or eminent domain remains with the seller until either possession or title is transferred to the buyer. For example, if the Act applies to the Greenacre hypothetical above, the fire renders the contract unenforceable, and B may recover any monies already paid to S. Another group of states reaches much the same result under the "Massachusetts Rule." These states recognize an implied condition that the contract will not be binding if (a) the building is destroyed or significantly damaged and (b) the terms of the contract demonstrate that the building was an important part of the subject matter of the contract.[49]

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1. *See, e.g.*, Lyons v. McDonald, 501 N.E.2d 1079 (Ind. Ct. App. 1986) (seller, aware his house was infested with termites, committed fraud when he told the buyer that he was not aware of any "particular problems" with the house).

2. *See generally* Florrie Young Roberts, *Disclosure Duties in Real Estate Sales and Attempts to Reallocate the Risk*, 34 Conn. L. Rev. 1 (2001); Alex M. Johnson, Jr., *An Economic Analysis of the Duty to Disclose Information: Lessons Learned from the Caveat Emptor Doctrine*, 45 San Diego L. Rev. 79 (2008). *But see* Alan M. Weinberger, *Let the Buyer Be Well Informed?—Doubting the Demise of Caveat Emptor*, 55 Md. L. Rev. 387 (1996). *See also* Teer v. Johnston, 60 So. 3d 253 (Ala. 2010) (using *caveat emptor* standard).

3. *See, e.g.*, Logue v. Flanagan, 584 S.E.2d 186 (W. Va. 2003). Note that the doctrine applies only when the seller actually *knows* about the defect; whether the seller *should have known* about it is irrelevant. Jensen v. Bailey, 76 So. 3d 980 (Fla. Dist. Ct. App. 2011).

4. Lingsch v. Savage, 29 Cal. Rptr. 201, 204 (Ct. App. 1963); *see also* Johnson v. Davis, 480 So. 2d 625 (Fla. 1985) (following California standard).

5. *See generally* Robert M. Washburn, *Residential Real Estate Condition Disclosure Legislation*, 44 De Paul L. Rev. 381 (1995).

6. *But see* Lingsch v. Savage, 29 Cal. Rptr. 201 (Ct. App. 1963) (disclosure required in sale of apartment complex). *See generally* Kathleen M. Tomcho, Note, *Commercial Real Estate Buyer Beware: Sellers May Have the Right to Remain Silent*, 70 S. Cal. L. Rev. 1571 (1997).

7. 480 So. 2d 625 (Fla. 1985).

8. *Id*. at 628. *But see* Teer v. Johnston, 60 So. 3d 253 (Ala. 2010) (caveat emptor rule applies to sale of used home).

9. Even the buyer who believes he has successfully negotiated for an express warranty may ultimately receive little protection. *See, e.g.*, P.B.R. Enters. v. Perren, 253 S.E.2d 765 (Ga. 1979) (oral warranty lost through merger).

10. Richard A. Posner, Economic Analysis of Law 111 (6th ed. 2003).

11. *See* D. Benjamin Barros, *Home as a Legal Concept*, 46 Santa Clara L. Rev. 255 (2006).

12. *See, e.g.*, Tusch Enters. v. Coffin, 740 P.2d 1022 (Idaho 1987) (seller failed to disclose that duplexes were built on uncompacted "fill soil," and thus that foundation problems were likely). *But see* McCollam v. Cahill, 766 N.W.2d 171 (S.D. 2009) (where seller discovered only one snake in house over 30 years, he had no duty to disclose "snake problem" to buyers).

13. *See, e.g.*, Strawn v. Canuso, 657 A.2d 420 (N.J. 1995) (developers obligated to disclose nearby hazardous waste dump site).

14. *See, e.g.*, Alexander v. McKnight, 9 Cal. Rptr. 2d 453 (Ct. App. 1992) (obnoxious neighbors). *See also* Shelley Ross Saxer, "*Am I My Brother's Keeper?": Requiring Landowner Disclosure of the Presence of Sex Offenders and Other Criminal Activity*, 80 Neb. L. Rev. 522 (2001).

15. *See, e.g.*, Reed v. King, 193 Cal. Rptr. 130 (Ct. App. 1983) (seller had duty to disclose that mass murder had occurred in house ten years earlier).

16. *See generally* Paula C. Murray, *AIDS, Ghosts, Murder: Must Real Estate Brokers and Sellers Disclose?*, 27 Wake Forest L. Rev. 689 (1992). *See also* Van Camp v. Bradford, 623 N.E.2d 731 (Ohio Ct. Cm. Pl. 1993) (suggesting seller might have duty to disclose rapes that occurred in house and neighborhood). *But see* Milliken v. Jacono, 60 A.3d 133 (Pa. 2012) (seller was not obligated to disclose that murder/suicide occurred in house).

17. 572 N.Y.S.2d 672 (App. Div. 1991).

18. *Id*. at 676.

19. *Id*.

20. *See, e.g.*, Mo. Ann. Stat. §442.600. *See also* Stuart C. Edmiston, Comment, *Secrets Worth Keeping: Toward a Principled Basis for Stigmatized Property Disclosure Statutes*, 58 UCLA L. Rev. 281 (2010).

21. *See, e.g.*, Donnelly v. Taylor, 786 N.E.2d 119 (Ohio Ct. Cm. Pl. 2002) (due to "as is" clause, sellers had no duty to disclose latent defect to buyers).

22. Residential Lead-Based Paint Hazard Reduction Act, 42 U.S.C. §§4851 et seq.

23. 42 U.S.C. §§9601 et seq.

24. *See* §38.07.

25. *See, e.g.*, United States v. A & N Cleaners, 854 F. Supp. 229 (S.D.N.Y. 1994) (defense asserted but not proven).

26. Easton v. Strassburger, 199 Cal. Rptr. 383 (Ct. App. 1984); *see also* Cal. Civ. Code §§2079–2079.4 (codifying *Easton* standard); *see also* Note, *Imposing Tort Liability on Real Estate Brokers Selling Defective Housing*, 99 Harv. L. Rev. 1861 (1986).

27. *See, e.g.*, Kubinsky v. Van Zandt Realtors, 811 S.W.2d 711 (Tex. Ct. App. 1991) (seller's broker not liable to buyer for failing to inspect home); Thomson v. McGinnis, 465 S.E.2d 922 (W. Va. 1995) (seller's broker owed buyer no duty to investigate condition of home, but broker who volunteered to

secure expert inspection of home for benefit of buyer could be liable for negligently selecting inspector).

28. In contrast, efforts by home buyers to impose liability for defects on the bank or other lender who financed the construction project have been almost always unsuccessful. *See, e.g.*, Parker v. Columbia Bank, 604 A.2d 521 (Md. Ct. Spec. App. 1992) (bank that made construction loan owed no duty of care to borrowers regarding quality of construction, and thus was not liable for fraudulent concealment, negligent misrepresentation, negligence, or breach of fiduciary duty).

29. *See, e.g.*, Albrecht v. Clifford, 767 N.E.2d 42 (Mass. 2002).

30. For example, in Petersen v. Hubschman Constr. Co., Inc., 389 N.E.2d 1154 (Ill. 1979), the Illinois Supreme Court held that the implied warranty of habitability is breached when a home contains latent defects that interfere with the buyers' legitimate expectation that the home will be reasonably suited for its intended use.

31. Although the implied warranty stems from judicial action in most states, certain states have imposed the requirement by statute. *See, e.g.*, N.Y. Gen. Bus. Law §§777–777b.

32. Significantly, the warranty is implied only in sales of new homes by professional builders, developers, and other “merchants.” *See* Frickel v. Sunnyside Enters., Inc., 725 P.2d 422 (Wash. 1986) (implied warranty of habitability did not apply to later sale of 40-unit apartment complex that builder initially constructed and operated for investment purposes). In most jurisdictions the warranty is inapplicable to the resale of a used home by an ordinary seller. *See also* Vetor v. Shockey, 414 N.E.2d 575 (Ind. Ct. App. 1980).

33. For a useful discussion of the policies underlying judicial recognition of the implied warranty, see Petersen v. Hubschman Constr. Co., Inc., 389 N.E.2d 1154 (Ill. 1979).

34. Frona M. Powell & Jane P. Mallor, *The Case for an Implied Warranty of Quality in Sales of Commercial Real Estate*, 68 Wash. U. L.Q. 305 (1990). *But see* Tusch Enters. v. Coffin, 740 P.2d 1022 (Idaho 1987) (applying implied warranty where buyer purchased three duplexes as an investment).

35. *See, e.g.*, Frona M. Powell, *Disclaimers of Implied Warranty in the Sale of New Homes*, 34 Vill. L. Rev. 1123 (1989).

36. *See, e.g.*, Tusch Enters. v. Coffin, 740 P.2d 1022 (Idaho 1987) (disclaimer must be “clear and unambiguous”). *But see* G-W-L, Inc. v. Robichaux, 643 S.W.2d 392 (Tex. 1982) (boilerplate integration clause that included disclaimer of any “warranties, express or implied” held sufficient).

37. William L. Prosser, *The Assault Upon the Citadel*, 69 Yale L.J. 1099, 1126 (1960).

38. *See, e.g.*, Conway v. Cutler Grp., Inc., 99 A.3d 67 (Pa. 2014).

39. *Cf.* Tusch Enters. v. Coffin, 740 P.2d 1022 (Idaho 1987) (allowing buyer who purchased from developer to sue original builder under implied warranty despite lack of privity).

40. Speight v. Walters Dev. Co., Ltd., 744 N.W.2d 108 (Iowa 2008); Lempke v. Dagenais, 547 A.2d 290 (N.H. 1988); Nichols v. R.R. Beaufort & Assocs., Inc., 727 A.2d 174 (R.I. 1999).

41. Lempke v. Dagenais, 547 A.2d 290, 294 (N.H. 1988), *quoting* Aronsohn v. Mandara, 184 A.2d 675, 689 (N.J. 1984).

42. *See, e.g.*, Ross v. Bumstead, 173 P.2d 765 (Ariz. 1946) (after fire destroyed packing plant and warehouse on property, buyer held liable for damages when he refused to perform); Bleckley v. Langston, 143 S.E.2d 671 (Ga. Ct. App. 1965) (buyers still liable to perform contract after fire destroyed pecan orchard on land). However, if the seller's duty to convey title is subject to a condition precedent, the equitable conversion doctrine does not apply. Southport Congregational Church v. Hadley, 128 A.3d 478 (Conn. 2016).

43. Thus, in a related application of equitable conversion, some courts hold that the vendor's interest in property subject to an installment land contract is personal property, not real property to which a judgment lien could attach. *See, e.g.*, Cannefax v. Clement, 818 P.2d 546 (Utah 1991).

44. *See, e.g.*, Grant v. Kahn, 18 A.3d 91 (Md. Ct. Spec. App. 2011) (where judgment lien arose against seller after contract was signed, it did not attach to property because buyer held equitable title);

DiDonato v. Reliance Standard Life Ins. Co., 249 A.2d 327 (Pa. 1969) (buyer bears risk of zoning change under equitable conversion). *But see* Clay v. Landreth, 45 S.E.2d 875 (Va. 1948) (refusing to apply equitable conversion in seller's specific performance action where property was rezoned before close of escrow to bar the buyer's intended use).

45. *See, e.g.*, George R. Nock et al., *Equitable Conversion in Washington: The Doctrine That Dares Not Speak Its Name*, 1 U. Puget Sound L. Rev. 121 (1977).

46. *See, e.g.*, Bryant v. Willison Real Estate Co., 350 S.E.2d 748 (W. Va. 1986).

47. *See, e.g.*, Holscher v. James, 860 P.2d 646 (Idaho 1993). *See also* Skelly Oil Co. v. Ashmore, 365 S.W.2d 582 (Mo. 1963) (affirming judgment requiring seller to apply fire insurance proceeds to purchase price where buyer sought specific performance of sales contract). *But see* Raplee v. Piper, 143 N.E.2d 919 (N.Y. 1957) (observing that only proceeds from insurance purchased by the buyer need be applied to the purchase price).

48. *See, e.g.*, Brush Grocery Kart, Inc. v. Sure Fine Market, Inc., 47 P.3d 680 (Colo. 2002) (refusing to apply equitable conversion where buyer was not in possession when premises were damaged).

49. *See, e.g.*, Skelly Oil Co. v. Ashmore, 365 S.W.2d 582 (Mo. 1963) (endorsing the Massachusetts rule in case where grocery store building was destroyed by fire); *see also* Sanford v. Breidenbach, 173 N.E.2d 702 (Ohio Ct. App. 1960) (adopting similar rule).

Chapter 22

The Mortgage

§22.01 The Role of Security for Debt

Modern American society is founded on the availability of credit. Virtually all large transactions—such as the purchase of a family home, the development of a new shopping center, or the expansion of a profitable factory—are financed with borrowed money. The lender in such a transaction will demand that the borrower post security for the loan. Most commonly, this security takes the form of a mortgage, deed of trust, installment land contract, or similar device that encumbers real property.[1]

Why do lenders insist on security? Suppose B borrows $1 million from L—without security—in order to purchase Blueacre. B signs a promissory note agreeing to repay the loan, with interest, in five years, and then uses the money to buy Blueacre. Consider the difficulties that L might encounter in collecting the loan. B might lose Blueacre in a wild poker game and file bankruptcy, leaving L and other creditors unpaid. Or B might sell Blueacre quickly and flee with the proceeds to a remote country that will not extradite him to the United States. The lender holding a mortgage, however, avoids these risks. If the loan is not repaid as promised, the lender forecloses on the mortgage, sells the land, and uses the sales proceeds to pay off the debt.

The law governing mortgages and related security devices is primarily oriented toward dual utilitarian goals: shielding the borrower against unfair or inequitable treatment by the lender, while ensuring an adequate supply of credit. If mortgage law were skewed toward complete borrower protection, interest rates would rise dramatically and credit would be less available. Conversely, under a pure free-market approach, the lender could dictate virtually any terms and the borrower might receive harsh treatment.

In seeking to strike an appropriate balance between the competing interests of lenders and borrowers, the law has become both complex and technical. This area is governed by a bewildering combination of case law and state statutes, differing widely from state to state, with only limited federal involvement. The Restatement (Third) of Property: Mortgages, adopted in 1996,[2] is bringing more uniformity to this legal patchwork.

Today the United States is still recovering from the impacts of the subprime mortgage disaster that began in 2007. Borrowers defaulted on their

loans, foreclosures skyrocketed, and home values plummeted—causing the worst financial crisis since the Great Depression of the 1930s.[3] The laws governing mortgages have already been reformed in some states in reaction to this disaster, and this trend will continue in coming years.

§22.02 What Is a Mortgage?

A *mortgage* is the conveyance of an interest in real property as security for performance of an obligation.[4] The obligation is almost always a loan of money evidenced by a *promissory note*. In general, if the borrower (the *mortgagor*) fails to make the payments required by the note or otherwise defaults on the obligation, the lender (the *mortgagee*) may cause the secured property to be sold and apply the sales proceeds to satisfy the unpaid debt.[5] This process is called *foreclosure*.

This pithy definition of the mortgage, however, masks conceptual complexity. There are three separate theories concerning the nature of the mortgage. About two-thirds of the states follow the *lien theory*. Under this prevailing view, the mortgage is seen as a lien on the secured property. Thus, the lender merely holds a security interest, not title; the lender is entitled to foreclose on the property if a default occurs, but is not entitled to possession before foreclosure.[6] Some states cling to the common law concept that the mortgage is the transfer of title to the lender until the debt is repaid. In these *title theory* states, the lender has the theoretical right to take possession of the secured property—and thus obtain its rents and profits—without foreclosure. In practice, however, this right is rarely exercised until a default has occurred. Finally, a few states follow the *intermediate theory*, under which the lender is entitled to possession of the property upon the borrower's default but before foreclosure is completed.

§22.03 Evolution of the Mortgage

The lineage of the modern mortgage[7] may be traced to fourteenth-century England. The medieval English mortgage took the form of a conveyance of fee simple subject to a condition subsequent. B, the borrower, transferred title to his property to L, the lender, subject to the condition that if B repaid the loan on a specified day (called the *law day*), L would transfer title back to B. If B failed to repay the entire loan precisely on time, his interest in the property automatically ended, leaving L with fee simple absolute. Even though L was entitled to possession of the property during the loan period, he would customarily allow B to retain possession.

This rigid system sometimes produced harsh results. A minor or technical error in the borrower's performance—such as a payment that was a few days late—would result in forfeiture of the property. And the borrower who failed to perform because of fraud, duress, or excusable mistake also lost the land. As a result, defaulting borrowers began to petition the King's Chancellor for redress. If fairness and equity warranted, the Chancellor ordered the lender to reconvey the property after receiving full payment. By the seventeenth century, the Chancellor's court (or chancery court) routinely allowed the borrower to recover or *redeem* the property if the entire loan was repaid within a reasonable period after the due date, regardless of the reason for late payment. This right became known as the borrower's *equity of redemption*.

The equity of redemption placed the lender in a dilemma. Every defaulting borrower might someday seek to redeem, and thereby nullify the lender's title to the land. How long would this danger last? The solution to the lender's difficulty was the foreclosure action. A concerned lender could petition the chancery court to end or *foreclose* the borrower's equity of redemption. The court would establish a final date for payment of the loan; if the borrower failed to meet this deadline, the equity of redemption ended. Later transplanted to the United States, this proceeding was called *strict foreclosure*.

Strict foreclosure was inequitable to the borrower when the value of the security exceeded the debt. Suppose, for example, that B borrowed $100 from L, secured by a mortgage on land worth $1,000, and then defaulted.

Strict foreclosure allowed L to retain the entire parcel, worth 10 times the debt. During the nineteenth century, most states adopted legislation that imposed a new requirement on the lender seeking a judgment to foreclose the equity of redemption. Under court supervision, the foreclosing lender was forced to sell the property at a public auction, and distribute any surplus sales proceeds to junior lienholders and the borrower. This process became known as *judicial foreclosure*.

The nineteenth century brought another milestone in mortgage history—the evolution of the *power of sale mortgage* (also called the *mortgage with power of sale*). Originating in the efforts of English lenders to avoid chancery court, it quickly spread to the United States. The power of sale mortgage contains express provisions by which the borrower consents to foreclosure of the equity of redemption by a public auction sale, but without any judicial involvement. This method is called *nonjudicial foreclosure*.

§22.04 Creation of a Mortgage

[A] The Loan Process

The standard loan transaction is relatively straightforward. B, a prospective borrower, completes a written loan application and supplies it to L, the prospective lender. L reviews the loan application, investigates B's creditworthiness and financial condition, and commissions an appraisal of the property offered as security. The amount of the loan B has requested will be less than the fair market value of the security (e.g., 90% of the value), because L, as a prudent lender, both (1) wants to ensure that B has a financial incentive to maintain the property and (2) needs protection against fluctuations in property value.[8] If L wishes to make the loan, L will probably issue a *loan commitment* to B that states the terms and conditions L will require. The loan commitment is usually viewed as an acceptance of the borrower's offer (embodied in the loan application), and accordingly creates an enforceable contract that binds both parties to the loan transaction.

The loan process is regulated by federal laws that govern banks, savings and loan associations, and other institutional lenders. The federal Truth-In-Lending Act,[9] for example, requires extensive disclosure to the prospective residential borrower concerning the true costs associated with the loan. Further, the federal Fair Housing Act[10] bars lenders from discriminating in the financing of residential real property based on race, color, religion, sex, familial status, national origin, or handicap (*see* §16.02[B]). Still, the widespread practice of *redlining* effectively discriminates against racial and ethnic minorities. Redlining is the denial of mortgage financing because the property involved is located in an older, low-income neighborhood. Rather than considering each application on its individual merits, some lenders follow a blanket policy of refusing to make any loans—or, alternatively, imposing more onerous loan terms—in regions perceived as particularly risky. The plethora of federal and state statutes expressly enacted to eliminate redlining has reduced but not eliminated the problem.

[B] Execution Formalities

The mortgage is viewed as the transfer of an interest in real property.

Thus, the formalities required for an effective deed (*see* §23.04) also apply to mortgages in most states. Although some states impose additional requirements, at a minimum: (a) the material provisions of the mortgage (names of parties, description of secured property, words manifesting intent to use property as security, etc.) must be set forth in a written document executed by the borrower, and (b) the mortgage must be delivered to the lender.

Until recently, there was little standardization of mortgage forms. Lenders in different localities tended to use different forms. But today almost all residential loans made by institutional lenders utilize standard mortgage forms developed by two federally-sponsored entities, the Federal National Mortgage Association (FNMA or "Fannie Mae") and the Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac"). Why? Mortgage loans are typically created by local lenders who then sell these loans to Fannie Mae, Freddie Mac, and others—in what is called the *secondary market*—in order to obtain capital to make additional loans. Because these entities will only purchase loans made with their forms, the use of such forms has become standard industry practice. In contrast, the commercial mortgage is still often individually drafted to suit the particular transaction.

An unrecorded mortgage is fully valid and binding. However, it is customary to record the mortgage in order to provide notice to the world of the lender's interest, and thus preclude later purchasers, lenders, and others from claiming that their interests take priority.

[C] Protecting the Equity of Redemption

Suppose the mortgage contains a clause by which the borrower waives her equity of redemption—surrendering the right to redeem and allowing the lender to take title to the secured property without foreclosure. Is this clause enforceable? American law answers this question with a resounding "no." It is a fundamental principle that courts will not allow "clogging" of the equity of redemption. As the Restatement (Third) of Property: Mortgages explains, "any agreement in or created contemporaneously with [the] mortgage" that purports to waive the equity of redemption is ineffective.[11]

§22.05 The Secured Obligation

[A] Role of the Obligation

The mortgage is a legal nullity unless it secures an obligation. In a very real sense, the mortgage merely provides a *remedy* to compel performance of the obligation. Suppose L holds a mortgage on Blackacre to secure B's repayment of a $100,000 promissory note. If B fails to pay as required by the note, L may foreclose her mortgage, sell Blackacre at auction, and use the foreclosure sale proceeds to pay the $100,000 debt. What if L merely holds a mortgage on Blackacre that does not secure any obligation (e.g., because the promissory note it once secured has been repaid)? Under these circumstances, L's mortgage has no legal force or effect.

Most commonly, the mortgage secures repayment of a loan evidenced by a written *promissory note*.[12] The $100,000 note that B executed in favor of L presumably provides that B will make monthly payments to L until the debt is fully repaid. The note (or the mortgage itself) would typically impose related obligations on B that are designed to preserve the security, such as the duty to insure the property against casualty loss, to avoid waste, and so forth. L may foreclose if B fails to perform any of the specified obligations.

[B] The Promissory Note

[1] A Specialized Contract

The promissory note is simply a specialized form of contract between the lender and the borrower. The note—usually a standardized Fannie Mae or Freddie Mac form in simple residential transactions—identifies the borrower and lender, contains the borrower's promise to repay the loan on stated terms and conditions, recites that its repayment is secured by a mortgage or deed of trust, and is signed by the borrower. Beyond these basic provisions, the note contains four key components: (a) the amount; (b) the interest rate; (c) the term; and (d) the amortization schedule.

[2] Key Components

[a] Amount

The amount of the loan is usually limited by the applicable *loan-to-value ratio*. For example, where a loan will be secured by a mortgage on a single-family residence, banks, savings and loan associations, and similar lenders are typically willing to lend up to 90% of the value of the property. Thus, if Blackacre is a house worth $200,000, such a lender would be willing to loan up to $180,000 (90% of $200,000).

[b] Interest Rate

The interest rate may be either a fixed rate (which remains the same during the entire life of the loan) or an adjustable rate (which varies over the life of the loan). In an adjustable rate mortgage, the interest rate is equal to (1) a specified external index rate that fluctuates according to market conditions (e.g., the federal reserve discount rate) *plus* (2) a fixed margin (usually about 2%).[13] For example, if the index rate is 5.5% during a particular month, and the margin is 2%, then during that month the interest rate on the loan is 7.5%; if the index rate drops to 5% by the next month, that month's loan interest rate is 7%.

Can a lender charge the highest interest rate that the borrower is willing to pay? In the early medieval period, the Roman Catholic Church considered the charging of any interest to be a mortal sin. Over time, this tradition led to the widespread passage of state *usury* laws, which place a legal ceiling on the interest rate a lender may receive. The apparent modern purpose of the usury laws is to prevent “loan-shark” lenders from taking unfair advantage of vulnerable borrowers. Almost by definition, however, these laws restrict the supply of available credit. Unsurprisingly, the usury laws are riddled with exclusions and exemptions. For example, secured loans exempt from these laws in most jurisdictions include: (1) loans to corporations; and (2) loans that the seller of land extends to the buyer to help finance the purchase, so-called *purchase money loans*. And—as the result of federal preemption—almost all loans secured by first-priority mortgages on residential property that are made by banks, savings and loans associations, and other institutional lenders are entirely exempt from state usury laws. Accordingly, the usury laws are relatively ineffective today.

[c] Term

The typical residential loan has a term of 25 or 30 years. This simply means that the entire loan amount plus interest must be repaid within the

term, according to the agreed-upon amortization schedule (*see* [d], *infra*). Modern borrower-lender disputes involving the term of the loan usually arise in one of two contexts: (1) prepayment of the loan[14] or (2) sale of the secured property.[15]

[d] Amortization Schedule

The amortization schedule specifies the method by which the borrower repays the loan; it sets forth the amount and due date for each loan payment. Most fixed-rate residential loans are fully-amortized, requiring a fixed monthly payment over the entire term (e.g., $734 per month). The payment amount is established so that the entire loan balance will be repaid when the final payment is made. A payment of $734 per month over a 30-year term, for instance, will fully repay an 8% loan of $100,000. Other loans (e.g., certain commercial loans or second-priority mortgage loans on residential property) are not fully-amortized and, accordingly, one or more balloon payments are required to pay the loan balance.

§22.06 Priority of the Mortgage

[A] Overview

A property may be encumbered by multiple mortgages. In this situation, the proceeds from the foreclosure sale may not be large enough to fully repay all the secured loans. Foreclosure sale proceeds are distributed according to the *priority* of each mortgage.[16] The principles governing mortgage priority are generally the same as those governing the priority of competing deeds and other interests in land, which are discussed in Chapter 24. The mortgage that was created first-in-time has priority, unless a subsequent lender is protected either (1) as a bona fide encumbrancer or (2) under the shelter rule. A first-priority mortgage is called a *first mortgage*; a second-priority mortgage is called a *second mortgage*; and so forth.

Special priority rules apply to two types of mortgages: the future advance mortgage and the purchase money mortgage.

[B] Future Advance Mortgage

A *future advance mortgage* contains a clause providing that it will be security both for (1) the current loan and (2) future loans that the lender makes to the borrower. The priority of such a future loan turns on whether it is *obligatory* or *optional*. If the lender is obligated to make the future loan, it takes priority from the date of the original mortgage. But if the lender merely has the option to make the loan and it has notice that a third party acquired an interest in the secured property after the original loan, then the future loan has priority only as of the time it was made.

For example, suppose that L1 makes a $100,000 loan to B in 2017, secured by a mortgage on Redacre under which future advances are optional. L2 makes a $200,000 loan to B in 2018, also secured by a mortgage on Redacre. Fully aware of L2's mortgage, L1 makes a $75,000 future advance to B in 2019 based on the future advance clause in the 2017 mortgage. On these facts: (1) L1's $100,000 loan has first priority; (2) L2's $200,000 loan has second priority; and (3) L1's $75,000 future advance has third priority. Thus, if L1 eventually forecloses and Redacre sells for $300,000, the proceeds will only be enough to repay L1's $100,000 loan and L2's $200,000

loan.

[C] Purchase Money Mortgage

Another special rule governs the priority of a *purchase money mortgage*—a mortgage given to the seller of real property to secure repayment of the unpaid portion of the purchase price.[17] Suppose that G contracts to purchase H's property Blueacre for $100,000, paying $10,000 in cash and the balance in the form of a $90,000 promissory note payable to H secured by a mortgage on Blueacre. J holds a judgment lien, which already encumbers all of G's real property, and which will also attach to Blueacre when G receives title. Once escrow closes on the G-H transaction, which lien has priority—H's mortgage or J's judgment lien?

As a general rule, a purchase money mortgage takes priority over all liens that attach to the property through the buyer-borrower. Because J's judgment lien here arises out of G's actions, it is junior in priority to H's purchase money mortgage. Although the issue arises most commonly with judgment liens, dower and homestead claims are also included within the scope of the rule.

§22.07 Transfer of the Mortgage

[A] Transfer by Borrower

[1] Due-on-Sale Clause

Freedom of alienation is a core principle of American property law. Thus, if borrower B owns property encumbered by a mortgage securing repayment of a $500,000 loan from L, B is fully entitled to sell the property to T, a third party. Normally, an existing loan will be paid off when the property is resold. But suppose that this does not occur in the B-T transaction. How does the sale affect L's rights?

Almost certainly, the promissory note that B executed contains a *due-on-sale clause*. The standard due-on-sale clause provides that the lender may demand repayment of the entire loan if the mortgaged property is sold or otherwise transferred. During the 1970s, a few outraged borrowers were successfully able to attack the due-on-sale clause as an invalid restraint on alienation.[18] Since 1982, however, state court rulings on the issue have been preempted by federal law that validates the due-on-sale clause in almost all loans.[19] As a result, once B sells to T, L has the right to demand repayment of the entire $500,000 loan. Of course, L may choose not to exercise this right, based on prevailing interest rates, T's creditworthiness, and other factors.

[2] Liability of Borrower's Successor

Can a later buyer “take over” an existing mortgage loan? In the example above, suppose that T purchases the property from B, and L chooses not to enforce the due-on-sale clause. Who is obligated to repay the loan? Borrower B is still personally liable on the loan because she signed a contract—the promissory note—promising to do so. The real question is whether T, the buyer, is also liable.

T's potential liability turns on his agreement with B. If T agreed to *assume* the loan, he is personally liable to repay it. Thus, if the required payments are not made, lender L can sue T, B, or both of them and collect the judgment from their personal assets.[20] On the other hand, if the B-T agreement merely

provides that T will take title *subject to* the loan, then T is not personally liable. In this situation, L is entitled to foreclose the mortgage if payments are not made—so T may lose his interest in the property—but L cannot reach T's other assets.

[B] Transfer by Lender

The lender that holds a promissory note secured by a mortgage is also free to transfer its rights. In fact, most banks and other institutional lenders sell their loans in the secondary market. This is typically done by an *assignment* of the loan to a third party. Thus, in the example above, lender L is entitled to sell its loan to investor I. Once this occurs, I succeeds to all of L's rights, including the rights to receive loan payments and to foreclose if a default occurs.[21]

§22.08 Discharge of the Mortgage

[A] Repayment of Loan

Most secured loans are eventually repaid. Once repayment occurs, the mortgage is automatically extinguished. In order to clear up title, however, the lender must provide the borrower an appropriate document in recordable form proving that the mortgage has been discharged.[22] This document is variously called a *discharge*, *release*, or *satisfaction*, depending on the jurisdiction.

What if the borrower wants to repay the loan before it is due? There is no common law right to prepay a loan. However, promissory notes often contain a *prepayment clause* that permits the borrower to prepay the loan in return for payment of a monetary penalty (e.g., six months interest on the amount prepaid) or which precludes prepayment for a specified period (e.g., the first seven years of the term).[23] These prepayment clauses are generally enforced, unless they constitute an unreasonable restraint on alienation[24] or impose an unconscionable penalty.

[B] Deed in Lieu of Foreclosure

Suppose that the borrower defaults on his payments, and the lender begins foreclosure proceedings. At this point, the lender might be willing to accept a *deed in lieu of foreclosure* from the borrower, which avoids the need for a foreclosure sale; the borrower simply conveys title to the lender as part of a negotiated settlement between them. This arrangement does not violate the prohibition on clogging the equity of redemption because it occurs *after* the mortgage was created.

The lender may be unwilling to accept a deed in lieu of foreclosure for several reasons. Unlike a foreclosure sale, for example, a deed in lieu of foreclosure does not eliminate junior interests. Such an arrangement also raises the risk that the mortgage might be extinguished under the merger doctrine.

§22.09 Foreclosure of the Mortgage

[A] Foreclosure in Context

Two methods of foreclosure are commonly used in the United States.[25] *Judicial foreclosure* is available in all jurisdictions, and is the dominant method in about half of the states. The other principal method is *nonjudicial foreclosure*, which predominates in the remaining states.

The broad outline of the foreclosure process is similar for both judicial foreclosure and foreclosure by power of sale, despite the very real differences between them. Five points of similarity can be identified in most jurisdictions. First, the borrower receives written notice that foreclosure is beginning, and thus has the opportunity either to pay off the debt or to contest the foreclosure through litigation. Second, the borrower retains the rights to (1) *reinstate* the loan or (2) *redeem* the property by repaying the entire debt. Third, the foreclosure process culminates in a public sale, where the property is sold at auction to the highest bidder, usually the lender. Fourth, any surplus sales proceeds are paid to junior lienholders or the borrower. Finally, if the sale fails to produce enough money to satisfy the loan, the borrower may be liable for a *deficiency judgment*.

[B] Borrower's Rights before Foreclosure

[1] Reinstatement

The typical promissory note contains an *acceleration clause*, which allows the lender to demand full payment of the loan if the borrower fails to make even one installment payment. In general, the borrower in default has the right to *reinstate* the loan—and thus avoid foreclosure—by making the late payments before the lender elects to accelerate the debt. In some states, the borrower can reinstate the loan for a specified period of time even after acceleration occurs.

[2] Equitable Redemption

In every state, the borrower is entitled to fully repay the loan during the period (a) after a default occurs and (b) before the foreclosure sale. This right

is called *equitable redemption*. It reflects the traditional rule that the lender cannot eliminate the borrower's equity of redemption except through foreclosure. As a practical matter, however, this right has little value to most defaulting borrowers; the borrower who could not even make monthly loan payments is unlikely to be able to repay the entire loan within a brief period.

[3] Other Approaches

Some courts used innovative measures to slow the tidal wave of foreclosures that resulted from the subprime mortgage crisis. For example, *Commonwealth v. Fremont Investment & Loan*[26] involved a Massachusetts lender that made thousands of subprime loans between 2004 and 2007 with features that rendered repayment unlikely: (a) adjustable rate mortgages with an artificially low interest rate for the initial loan period; (b) loan-to-value ratios of 100% (or substantial prepayment penalties); and (c) borrowers with a debt-to-income ratio of more than 50%. The Massachusetts Attorney General brought a consumer enforcement action against the lender, alleging that these practices were unfair and deceptive in violation of state law. Finding that these loans were probably "doomed to foreclosure,"[27] the trial judge issued a preliminary injunction that required the lender to work with the Attorney General to restructure the loans or, in the alternative, to secure judicial approval for foreclosure if the loan could not be restructured. The state Supreme Judicial Court upheld the decision as striking an appropriate "balance between the interests of borrowers who face foreclosure and loss of their homes under home mortgage terms that are at least presumptively unfair ... and the interest of the lender in recovering the value of its loans."[28]

[C] Foreclosure Procedure

[1] Judicial Foreclosure

Judicial foreclosure—the traditional method—is a specialized type of litigation. It may be a slow, expensive, and complex process. For this reason, lenders usually prefer the quick, cheap, and simple process of nonjudicial foreclosure if it is available in the jurisdiction.

The lender, as plaintiff, begins the judicial foreclosure process by filing a complaint against the borrower, junior lienholders, and other persons holding interests in the property that are subordinate to the mortgage.[29] The

complaint alleges that a default has occurred in the obligation secured by the mortgage (usually the borrower's failure to make required payments) and requests that the mortgage be foreclosed in a court-supervised sale. After service of process is completed, the borrower and other defendants have an opportunity to answer the complaint and raise any appropriate objections to foreclosure (e.g., no mortgage exists or no default exists). In the vast majority of proceedings, no answer is filed and the plaintiff-lender obtains a judgment by default. Otherwise, a hearing is conducted to determine whether foreclosure is justified.

The successful lender receives a judgment that states the amount due on the mortgage, directs the property to be sold at public auction within a specified period if the debt is not paid, and establishes the terms of the sale. Notice of the pending sale is given to the public, usually through newspaper advertisements.

The sale is held in a public location (e.g., the courthouse steps) during normal business hours and is usually conducted by a court-appointed official (e.g., the sheriff). The borrower, the lender, junior lienholders, and any member of the public may bid at the sale. The lender, however, enjoys an important advantage in the process: it can bid without cash, using instead the unpaid loan balance owed to it. In general, all other bidders—including the borrower—can bid only in cash. As a practical matter, the lender is usually the only bidder, and thus the successful bidder, at the sale.

The final step is judicial confirmation of the sale. In theory at least, the court has the discretion to refuse confirmation if necessary to protect the borrower's legitimate interests. Despite this power, confirmation is routinely granted absent evidence that the sale was conducted in an unfair or inequitable manner. Statutes in a few jurisdictions impose a minimum sale price requirement (e.g., two-thirds of appraised value), but in most states the mere inadequacy of the sales price is not a basis for refusing confirmation. Upon confirmation, the responsible official executes and delivers the deed to the highest bidder. If bid proceeds remain after the debt and sales expenses are paid, the court determines how the surplus is allocated.

[2] Nonjudicial Foreclosure

Nonjudicial foreclosure (also called *power of sale foreclosure*) is a purely private procedure, without judicial involvement or approval. While judicial

foreclosure is a remedy provided by statute, a nonjudicial foreclosure arises from contract. It is permitted only when authorized by the express terms of the mortgage. This lack of judicial involvement creates the potential for abuse.[30] Without judicial oversight, what prevents the lender from taking unfair advantage of the borrower? States that allow nonjudicial foreclosure usually provide statutory safeguards for the borrower.

One safeguard is adequate advance notice to the borrower. If foreclosure is unjustified (e.g., if no default has occurred), the alerted borrower can file suit to enjoin any sale. Alternatively, he can avoid foreclosure by paying the debt or selling the property. The notice requirements for nonjudicial foreclosure vary widely. In a typical state, the process begins when the lender provides a written notice of intent to foreclose to the borrower and other affected parties.[31] State law may require that the notice be personally delivered, printed in a local newspaper, or both. After a fixed period of time (e.g., five weeks) elapses, the lender provides a second notice, which announces the date, time, and place of the sale. In some states, these two forms of notice are combined into a single document.

The sale itself is conducted by the lender or a designated official (e.g., sheriff) in a public location, and follows a format similar to the judicial foreclosure sale. As a general rule, anyone may bid, but all bidders other than the lender can bid only with cash. The property is sold to the highest bidder, which is normally the lender. Judicial confirmation is not required. Rather, the sale is complete—and the borrower's equity of redemption ends—when the bidding is over.

[3] State of Title after Foreclosure

A completed sale eliminates the mortgage that is foreclosed and all interests with junior priority, including junior mortgages. Suppose that B's property Greenacre is encumbered by three mortgages: a first mortgage held by L1, a second mortgage held by L2, and a third mortgage held by L3. When L2 forecloses, the sale eliminates its mortgage and L3's junior mortgage. But because a foreclosure sale does not affect interests that are senior to the mortgage, the sale has no impact on L1's first mortgage. Thus, the successful bidder at L2's sale takes title to Greenacre subject only to L1's mortgage.

Why does a sale eliminate junior interests but not senior interests? This

result is necessary to protect the good faith investment expectations of lenders, and thereby give them confidence to make credit available to borrowers. In the example above, L1 bargained for the security of a first mortgage. A borrower like B cannot be allowed to increase the lender's risk through later transactions. Similarly, in order to protect the expectations of L2 that its loan will be repaid, its sale must necessarily eliminate L3's junior mortgage. L3 can hardly complain, because it was on notice of the mortgages held by L1 and L2 before it made its own loan. Moreover, a junior mortgage holder such as L3 can protect itself by bidding at the foreclosure sale of a senior mortgage.

[4] Distribution of Sales Proceeds

Suppose that B's property Redacre is subject to mortgages held by three different people: a first mortgage securing a $100,000 loan from L1; a second mortgage securing a $50,000 loan from L2; and a third mortgage securing a $200,000 loan from L3. Assume that B fails to make the required loan payments and L1 forecloses. If Redacre is sold for $250,000, who gets the sales proceeds?

As a general rule, the net foreclosure sale proceeds (after deducting sales expenses) are distributed according to the priority of each mortgage. In the example above, the proceeds are enough to repay the loans secured by the first and second mortgages. But this leaves only $100,000 to help repay the $200,000 loan secured by the third mortgage, so L3 will not be fully repaid.

This is the main reason that a loan secured by a junior mortgage is more risky than one secured by a first mortgage. Accordingly, it normally commands a higher interest rate.[32]

Suppose instead that Redacre sells for $400,000 at the foreclosure sale. The sales proceeds are now large enough to repay all three loans, leaving a balance of $50,000. The surplus proceeds are paid to B, the prior owner, to help compensate him for the loss of his equity in Redacre.

§22.10 Rights after Foreclosure

[A] Borrower's Rights

[1] Potential for Abuse by Lender

The borrower-lender relationship is inherently unequal. Particularly in an era of economic recession—as the Great Depression of the 1930s evidenced—the lender may be able to gain an unfair advantage over the borrower through the foreclosure process. In the wake of the Depression, many states intervened to provide special statutory protections for the borrower. These statutes focus on cushioning the homeowner, farmer, or other small-scale owner from the effects of an economic downturn, when employment is scarce and property values are depressed.

However, the safety net created by these statutory protections proved to be insufficient in the aftermath of the subprime mortgage debacle. Pressure to reform the nation's mortgage laws so as to provide greater protection for borrowers will continue in coming years.

[2] Statutory Redemption

Approximately half of the states allow the borrower to redeem the property after foreclosure in a process called *statutory redemption*.[33] In these jurisdictions, the borrower may regain title by paying a set amount (typically the foreclosure sale price plus other expenses) to the successful bidder within a specific period (normally ranging from 6 to 24 months). During the redemption period, the borrower remains in possession of the property. If the borrower fails to redeem, any junior lienor may redeem instead.

Scholars debate whether statutory redemption serves its intended purpose of protecting the borrower.[34] In theory, the doctrine helps to prevent underbidding at the foreclosure sale, thereby preserving the borrower's equity. Suppose M's home Redacre is worth $100,000; the home is encumbered by a mortgage securing a $90,000 loan, so M has an equity of $10,000. M defaults on his loan, and bidder X attends the resulting foreclosure sale. Advocates of statutory redemption argue that X now has an incentive to bid a high price in order to preclude M from redeeming. If X

bids $99,000, for example, the mortgage is repaid in full and M receives the remaining proceeds after deducting the costs of sale. Because M has recovered most of his equity, he is unlikely to exercise his right of statutory redemption.

Critics suggest that in reality, however, statutory redemption encourages underbidding, which injures the borrower. Why? Consider the viewpoint of X, the bidder. Although X must pay the bid price immediately, he cannot take possession until the lengthy redemption period ends. Moreover, X will be justifiably concerned that M may not maintain the property in good condition. M might be tempted out of spite to damage or even destroy the improvements on the property; and M is probably insolvent, which will preclude X from recovering compensatory damages from him. Finally, if M eventually does repurchase the property, X may suffer a net loss caused by an interest rate differential; while X will receive back the sales price he paid plus interest, the interest rate set by state statute is often below the market interest rate. Because of these risks, bidders like X are reluctant to offer a fair market value bid at the sale. Do borrowers or junior lienors respond to the resulting low sale prices by redeeming, as the theory underlying the doctrine predicts? No! In practice, post-sale redemption is fairly rare.[35]

[3] Setting Aside the Sale

In most states, the borrower can sue to set aside a nonjudicial foreclosure sale only when (a) the sale price is so grossly inadequate as to "shock the conscience" of the court[36] or (b) a major procedural irregularity occurred in the sale (such as the failure to give required notice or conduct the sale in the designated location).[37] More commonly, both elements are present: the price is far below market value and some type of irregularity occurred.[38] As a practical matter, the vast majority of foreclosure sales are immune from attack under these standards.

Suppose that lender L forecloses its mortgage on borrower B's $200,000 home to collect on a $50,000 debt. L, the only bidder, purchases the property with a $10,000 bid—only 5% of its fair market value. Can B set aside the sale? The case law varies wildly on the important question of when a foreclosure sale price is so low as to "shock the conscience," but in most states a sale for 20% or less of fair market value will be set aside.[39] As the Restatement (Third) of Property: Mortgages observes, "a court is warranted

in invalidating a sale where the price is less than 20 percent of fair market value and, absent other foreclosure defects, is usually not warranted in invalidating a sale that yields in excess of that amount."[40] Accordingly, B will probably be able to set aside the sale.

A few states have gone much farther, imposing a duty on the lender to obtain a fair and reasonable price under the circumstances.[41] This "good faith" standard may require, for example, that the lender exert diligent efforts to attract third-party bidders or adjourn the sale if a fair price is not offered.[42] The goal is to increase bid prices, and thereby shield the borrower from the forfeiture of equity and the imposition of a deficiency judgment.

Yet critics suggest that the uncertainty produced by the good faith standard may actually produce lower bid prices. Under the traditional "shock the conscience" standard, the bidder has reasonable assurance that the sale is unlikely to be later nullified by a court, and thus may bid with confidence. If the good faith standard applies, however, critics argue that a bidder may bid less simply to compensate for the risk that the sale might later be set aside. Perhaps a more compelling argument against the good faith standard lies in its potential to increase overall interest rates charged to borrowers. If a sale is adjourned, loan repayment is delayed, and the lender loses the interest that could have been earned by making a new loan immediately to a replacement borrower. Further, the lender who must try to conduct a sale on two, three, or more occasions before obtaining an adequate bid will incur higher advertising and administrative costs. Under the good faith standard, the extra costs caused by defaulting borrowers will arguably be passed along to all borrowers in the form of higher interest rates.

[B] Lender's Rights

[1] Deficiency Judgments

What happens if the foreclosure sale price is not enough to fully repay the loan? Suppose that B borrows $200,000 from L, secured by a first mortgage on B's home, Greenacre. The market value of homes in the region falls, and by the time B defaults on the loan, Greenacre is worth only $180,000. L is the only bidder at the foreclosure sale and acquires title to Greenacre for a bid of $180,000. Under traditional law, L is now entitled to sue B for breach of contract (failure to repay the loan) and receive a *deficiency judgment* for

the unpaid loan balance of $20,000. In theory, L can now collect the judgment from B's other assets. In practice, however, most defaulting borrowers like B do not own other assets that a creditor can reach.

[2] Limits on Deficiency Judgments

But what if the fair market value of Greenacre in the example above was $250,000? If so, L has received value equal to $270,000 (the $250,000 value of Greenacre plus the $20,000 judgment) for a $200,000 loan. There is an obvious risk that a lender may be able to take unfair advantage of the borrower by underbidding at a nonjudicial foreclosure sale.

The most common response to this dilemma is *fair value* legislation. Such statutes limit the amount of the lender's deficiency judgment to the difference between (a) the unpaid loan balance and (b) the fair market value of the property.[43] Applied to the above example, the fair value limitation would permit a deficiency judgment of zero, because the property's fair market value at the time of foreclosure ($250,000) exceeds the unpaid balance ($200,000).

Ten states—mainly in the West—completely bar deficiency judgments in certain situations.[44] Within this group, some preclude such judgments after any nonjudicial foreclosure, apparently concerned about abuses that may occur in the absence of judicial supervision. A few states—notably California—prohibit deficiency judgments on purchase money mortgages, regardless of the foreclosure method involved; this reflects a policy judgment in favor of encouraging home ownership by restricting the borrower's personal liability.[45] Suppose that Greenacre is located in California and that its fair market value has fallen to $15,000, less than the amount due on the loan. Under these circumstances, B may abandon the property and stop making payments on the loan, with no further liability to L.

Judicial doctrines also restrict deficiency judgments in some states. In these jurisdictions, the standard for obtaining a deficiency judgment is more demanding than the standard for conducting a valid nonjudicial foreclosure sale. For example, in *Wansley v. First National Bank of Vicksburg*, the Mississippi Supreme Court held that a lender could obtain a deficiency judgment only if "[e]very aspect of the sale, including the method, advertising, time, place and terms, [was] commercially reasonable."[46] Under this approach, the borrower may be able to avoid a deficiency judgment,

even though he cannot set aside the sale.

[C] Cost of Borrower Protection Laws

The utilitarian value of borrower protection laws such as anti-deficiency statutes is hotly debated. Some scholars conclude that such laws simply increase the average interest rate paid by all borrowers.[47] In effect, they argue, lenders pass on the added cost of these protections to borrowers in general, and thus responsible borrowers end up subsidizing irresponsible borrowers. Other commentators—viewing these statutory protections as a form of insurance against catastrophic loss—maintain that they are economically desirable.[48]

§22.11 Other Security Devices

[A] Overview

Although the mortgage is the traditional tool used to provide security for debt, a variety of other security devices may be used as mortgage substitutes. The *deed of trust* is the main form of security used in many states; modern law treats the deed of trust like a power of sale mortgage. The *equitable mortgage* arises in equity when the parties actually intend a deed or other instrument to function as a mortgage. Finally, the law increasingly views the *installment land contract* as a security device, rather than a contract.

[B] Deed of Trust

The *deed of trust* is particularly popular in states allowing nonjudicial foreclosure. While the mortgage involves two parties (mortgagor and mortgagee), the deed of trust creates a three-party relationship (trustor, trustee, and beneficiary). Historically, the deed of trust was seen as the conveyance of title to the secured property in trust. The borrower (the *trustor*) executed a written instrument conveying legal title to a neutral third party (the *trustee*), as security for an obligation owed to the lender (the *beneficiary*). If the borrower duly repaid the loan, the trustee would *reconvey* title. On the other hand, if the borrower defaulted on the debt, the trustee would conduct an auction sale of the property; after the sale, the trustee would repay the lender and junior lienors and distribute any remaining sales proceeds to the borrower.

What accounts for the widespread use of the deed of trust? Before the birth of the power of sale mortgage, it was the only financing device that could be foreclosed through a quick and inexpensive nonjudicial sale. Further, the deed of trust was thought to be exempt from various debtor protection statutes enacted to regulate mortgages. Over the decades, however, the gap between the mortgage and the deed of trust has been virtually eliminated by statutes and judicial decisions. The deed of trust persists largely due to custom.

Today, the deed of trust is governed by the same rules as a power of sale mortgage. Although the outdated terminology is still utilized, the modern

deed of trust is not deemed to create a true trust, and the trustee is not bound by the obligations of a true trustee.[49] In lien theory states, the deed of trust—like the mortgage—merely transfers a lien to the beneficiary. It may be foreclosed through judicial foreclosure or through a private nonjudicial sale conducted by the trustee.

[C] Equitable Mortgage

Suppose O—burdened with a poor credit record—asks his acquaintance S for a $100,000 personal loan, offering his home Blueacre as security. S is willing to make the loan, but only if O is willing to pay a usurious (and thus illegal) interest rate of 50% per year. To avoid the usury laws, S disguises the transaction as a sale. O conveys Blueacre to S for $100,000, receiving in return (1) an option to repurchase the property one year later for $150,000 (the $100,000 loan amount, plus $50,000 in interest) and (2) a one-year lease of Blueacre. If O cannot raise the funds necessary to exercise his option, what remedy does he have?

Courts of equity developed the *equitable mortgage* (or *absolute deed as mortgage*) doctrine to resolve such situations. If the parties actually intend a deed or other instrument to be security for debt, courts will treat it as a mortgage, regardless of the *form* of the transaction.[50] Equity, after all, traditionally looks through form to substance. Thus, in the above example, O can eliminate S's security interest in Blueacre by repaying the loan principal and whatever interest is legally due under the state's usury law.

[D] Installment Land Contract

[1] Generally

The *installment land contract* is also used as an alternative to the mortgage. Under such a contract, the buyer (or *vendee*) agrees to pay the purchase price in installments to the seller (or *vendor*) over a period of years (sometimes up to 20 or more years). The contract provides that the vendor retains title to the property until all payments are made, at which time the vendor is required to transfer title to the vendee. The vendee usually receives possession of the property during the contract period. The contract typically provides that in the event of any default by the vendee, the vendor may cancel the contract, retake possession of the land, and retain all installments

paid by the vendee, without any foreclosure sale or judicial action.

The parallel to the mortgage is clear. The vendee is the equivalent of the mortgagor, while the vendor is the counterpart of the mortgagee. The vendor retains title if the vendee fails to perform, which is similar to the mortgagee's right to foreclose (and thus obtain title) if the mortgagor defaults.

[2] Impact of Vendee's Breach

American courts traditionally viewed the installment land contract simply as a variety of contract. Accordingly, they routinely enforced the standard clauses providing for forfeiture upon the vendee's default.[51] Suppose that in 1950, vendee E entered into an installment land contract to purchase a 100-acre forest tract from vendor R, promising to pay R $1,000 each month for 20 years. Struck by a lengthy illness in 1960, E lost his job and missed one payment. R then unilaterally canceled the contract, retaining both title to the land and the $120,000 that E had already paid. Relying on freedom of contract rhetoric, courts were unwilling to shelter E and other defaulting vendees from the forfeiture provisions to which they had originally assented. And because the installment land contract was—in form at least—not a mortgage, the broad range of safeguards available to the mortgagor (including equitable redemption, foreclosure protections, and the right to receive excess foreclosure sale proceeds) did not protect the vendee.

Modern courts are far more sympathetic to the plight of the defaulting vendee.[52] Particularly where the vendee has already paid a substantial part of the purchase price, forfeiture seems inconsistent with contemporary standards of fairness and equity. Another factor is the average vendee's lack of legal sophistication. One major use of installment land contracts has been to finance the purchase of housing by low-income families who are unable to qualify for bank loans or other standard financing. These relatively unsophisticated vendees are particularly vulnerable to the risk of forfeiture.

Today there is a clear trend toward treating the installment land contract as a mortgage, and, accordingly, extending the mortgagor's protections to the vendee. Courts in Indiana[53] and New York[54] spearheaded this effort by expressly holding that an installment land contract will be equated with a mortgage, at least where the vendee has paid a substantial part of the purchase price before default.[55] Where the vendee has merely paid a minimal sum, or abandons the property after default, forfeiture provisions can

seemingly still be enforced even in these states.[56] A small but growing number of jurisdictions have adopted statutes that require the installment land contract to be foreclosed under the general provisions governing mortgages.[57] The Restatement (Third) of Property: Mortgages adopts this position as well.[58]

In many jurisdictions, the movement toward mortgage equivalence is more gradual. Some states, for example, provide the defaulting vendee with a right of redemption, especially if a substantial portion of the purchase price has been paid.[59] The vendee effectively receives one last chance to pay off the entire remaining balance of the contract price. Others extend the remedy of restitution to the vendee; after default, the vendee receives back the difference between: (a) the total amount of installment payments made to the vendor and (b) the compensatory damages suffered by the vendor due to the breach, plus the fair rental value of the property during the period of the vendee's occupancy.[60]

[3] Evaluating the Installment Land Contract

The installment land contract is a legal dinosaur, destined to be superseded by the modern mortgage. As a financing device, the installment land contract offers no real advantages over the mortgage, yet subjects both parties to unnecessary risk and uncertainty.

From the vendee's viewpoint, there are two main dangers. If the vendee defaults, he will probably receive less protection than a mortgagor, depending on the jurisdiction. In extreme instances, the forfeiture provisions of the contract might be enforced. The vendor's other creditors present a different risk. Depending on state law—and whether the contract is timely recorded—the vendee's interest may be junior in priority to mortgages and other post-contract encumbrances placed on the property by the vendor.

The vendor's principal problem is the legal uncertainty surrounding the installment land contract. In most jurisdictions, litigation may be required in order to ascertain the respective rights and duties of the parties upon the vendee's default, and to clear record title so that the vendor can resell the property.

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1. *See generally* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073 (2009); Lawrence Berger, *Solving the Problem of Abusive Mortgage Foreclosure Sales*, 66 Neb. L. Rev. 373 (1987); Eric T. Freyfogle, *Vagueness and the Rule of*

Law: Reconsidering Installment Land Contract Forfeitures, 1988 Duke L.J. 609; Morris G. Shanker, *Will Mortgage Law Survive? A Commentary and Critique on Mortgage Law's Birth, Long Life, and Current Proposals for Its Demise*, 54 Case W. Res. L. Rev. 69 (2003).

2. Restatement (Third) of Property: Mortgages (1996).

3. *See* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Mismanagement of the Housing Crisis*, 45 Wake Forest L. Rev. 971 (2010).

4. Restatement (Third) of Property: Mortgages §1.1 (1996).

5. For clarity, this chapter will usually refer to the mortgagor as the "borrower" and the mortgagee as the "lender."

6. *See also* Restatement (Third) of Property: Mortgages §4.1(a) (1996) (adopting lien theory).

7. The term "mortgage" literally means "dead pledge" in Norman French, which reflected the nature of the early mortgage.

8. In the years immediately preceding the subprime mortgage crisis (2001–06), many lenders deviated from these traditional practices and made highly risky loans. An increasing number of "subprime loans" were made—loans to borrowers with poor credit (e.g., who had filed bankruptcy during the last seven years or missed multiple loan payments within the last year); many of these borrowers did not have enough income to repay their loans. Some lenders made loans with little or no documentation and without checking the borrowers' credit. Finally, a number of lenders loaned more than 90% of the value of the property, so they had little or no equity cushion if a default occurred. *See, e.g.*, Commonwealth v. Fremont Investments & Loan, 897 N.E.2d 548, 551 (Mass. 2008) (lender made loans with "characteristics that made it almost certain the borrower would not be able to make the necessary loan payments").

9. Truth-In-Lending Act, 15 U.S.C. §§1601 et seq.

10. Fair Housing Act, 42 U.S.C. §§3601 et seq.

11. Restatement (Third) of Property: Mortgages §3.1 (1996).

12. Although the Statute of Frauds mandates that a mortgage be evidenced by a writing, in most states the mortgage could secure an oral debt.

13. Another problem contributing to the subprime mortgage crisis was that most subprime loans used a low interest rate for an initial period (usually two years), and a higher rate for the rest of the loan term. As a result, the monthly payments required for most subprime loans increased significantly after about two years; many borrowers could not afford the higher payments and defaulted on their loans. *See, e.g.*, Commonwealth v. Fremont Investment & Loan, 897 N.E.2d 548, 554 (Mass. 2008) (lender made loans with initial period of three years or less, charging an interest rate for that period "that was at least three percent below the fully indexed rate").

14. *See* §22.08[A].

15. See §22.07[A][1].

16. The distribution of foreclosure sale proceeds is discussed in more detail in §22.09[C][4].

17. In many states, a mortgage given to a third party (such as a bank) that makes a loan to finance the borrower's purchase of property also qualifies for protection as a purchase money mortgage.

18. The leading case on point is Wellenkamp v. Bank of Am., 582 P.2d 970 (Cal. 1978).

19. *See, e.g.*, McCausland v. Bankers Life Ins. Co., 757 P.2d 941 (Wash. 1988) (finding that federal law validating due-on-sale clauses preempted prior Washington state law).

20. Many states limit the lender's ability to collect such a deficiency judgment. *See* §22.10[B][2].

21. In the wake of the subprime mortgage crisis, there has been extensive litigation concerning the right of purported assignees to foreclose. *See, e.g.*, U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40 (Mass. 2011) (entities that failed to prove they were holders of mortgages at time of foreclosure were not entitled to judgment confirming their titles).

22. Restatement (Third) of Property: Mortgages §6.4(b) (1996).

23. *See generally* Frank S. Alexander, *Mortgage Prepayment: The Trial of Common Sense*, 72 Cornell L. Rev. 288 (1987).

24. *See, e.g.*, McCausland v. Bankers Life Ins. Co., 757 P.2d 941 (Wash. 1988) (prohibition on prepayment of a commercial loan for 7 years was not unreasonable restraint on alienation).

25. *See generally* Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. Mich. J.L. Ref. 639 (1997).

26. 897 N.E.2d 548 (Mass. 2008).

27. *Id.* at 554.

28. *Id.* at 562. *See also* M & T Mortg. Corp. v. Foy, 858 N.Y.S.2d 567 (Sup. Ct. 2008) (requiring lender to prove that mortgages for purchase of property in minority area which carried high interest rates were not the product of unlawful discrimination before lender would be allowed to foreclose).

29. As one court explained, the lender must bring suit against "all parties which it knows or should know are making some claim to the property in question." Citizens Bank & Trust v. Brothers Constr. & Mfg., Inc., 859 P.2d 394, 399 (Kan. Ct. App. 1993). If such a party is not joined in the lawsuit, its interest will not be affected by the foreclosure.

30. For a discussion of proposed reforms, see Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 Duke L.J. 1399 (2004).

31. *See, e.g.*, Williams v. Kimes, 949 S.W.2d 899 (Mo. 1997) (holder of contingent remainder was an "owner" who was entitled to notice of foreclosure).

32. How can L3 collect the remaining $100,000 that it is owed? It may be able to obtain a deficiency judgment against B. *See* §22.10[B][1].

33. It is important to distinguish between *equitable redemption* (which can only occur before the foreclosure sale) and *statutory redemption* (which can only occur after the sale).

34. *Compare* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 Va. L. Rev. 489 (1991) (suggesting that statutory redemption promotes efficiency), *with* George M. Platt, *Deficiency Judgments in Oregon Loans Secured by Land: Growing Disparity Among Functional Equivalents*, 23 Willamette L. Rev. 37 (1987) (criticizing doctrine as inefficient).

35. *See* Patrick B. Bauer, *Statutory Redemption Reconsidered: The Operation of Iowa's Redemption Statute in Two Counties Between 1881 and 1980*, 70 Iowa L. Rev. 343 (1985) (discussing empirical studies of redemption rates ranging between 1% and 18%).

36. *See, e.g.*, Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403 (Miss. 1983) (sale set aside based on price inadequacy where mortgagee purchased property with bid of $1,458.86, and sold property 12 days later for $4,000).

37. *See, e.g.*, Baskurt v. Beal, 101 P.3d 1041 (Alaska 2004) (bulk sale of two parcels was improper where sale of either one would have produced enough money to pay debt).

38. The borrower whose property is sold in a judicial foreclosure sale may raise the same objections, but at a different point in the process—when the lender requests the court to confirm the sale.

39. *See, e.g.*, Baskurt v. Beal, 101 P.3d 1041 (Alaska 2004) (15% of fair market value was inadequate); Fagnani v. Fisher, 15 A.3d 282 (Md. 2011) (about 50% of fair market value was adequate).

40. Restatement (Third) of Property: Mortgages §8.3 cmt b (1996).

41. *See, e.g.*, Murphy v. Fin. Dev. Corp., 495 A.2d 1245 (N.H. 1985).

42. *See, e.g.*, United States v. Chappell, 2000 U.S. Dist. LEXIS 13095 (D.N.H. 2000) (finding question of fact re whether lender was obligated by good faith standard to foreclose sooner than it did).

43. *See, e.g.*, Cal. Civ. Proc. Code §580a; N.Y. Real Prop. Acts. Law §1371.

44. *See, e.g.*, First State Bank v. Chunkapura, 734 P.2d 1203 (Mont. 1987) (no deficiency judgment following foreclosure of deed of trust on small parcel). *But see* Mid-Kansas Fed. Savings & Loan Ass'n v. Dynamic Dev. Corp., 804 P.2d 1310 (Ariz. 1991) (Arizona law barring deficiency judgment after

nonjudicial sale of property used as one-family dwelling did not apply to commercial developer of subdivision whose "spec" homes were still under construction).

45. *See, e.g.*, Cal. Civ. Proc. Code §580b.

46. 566 So. 2d 1218, 1225 (Miss. 1990).

47. *See, e.g.*, Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. Econ. & Bus. 143 (1982) (concluding that anti-deficiency protection and statutory redemption together increase average interest rates by .31%).

48. *See, e.g.*, Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 Va. L. Rev. 489 (1991).

49. Monterey S.P. P'ship v. W.L. Bangham, Inc., 777 P.2d 623 (Cal. 1989) ("Just as a panda is not a true bear, a trustee of a deed of trust is not a true trustee.... Regrettably, it appears to be too late in the development of our vocabulary to rename deeds of trust.").

50. *See, e.g.*, Koenig v. Van Reken, 279 N.W.2d 590 (Mich. Ct. App. 1979) (lease-option was equitable mortgage); Zaman v. Felton, 98 A.3d 503 (N.J. 2014) (same).

51. *See, e.g.*, Stonebraker v. Zinn, 286 S.E.2d 911 (W. Va. 1982) (enforcing forfeiture clause despite vendees' argument that clause was an unenforceable penalty rather than a true liquidated damages provision).

52. *See generally* Eric T. Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 Duke L.J. 609 (discussing modern approach to forfeiture provisions).

53. Skendzel v. Marshall, 301 N.E.2d 641 (Ind. 1973).

54. Bean v. Walker, 464 N.Y.S.2d 895 (App. Div. 1983).

55. *But see* Daugherty Cattle Co. v. General Constr. Co., 839 P.2d 562 (Mont. 1992) (refusing to provide any relief for defaulting vendee who had paid 71% of purchase price). *See also* Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979) (treating all installment land contracts like mortgages, regardless of amount paid by vendee).

56. *But see* Slone v. Calhoun, 386 S.W.3d 745 (Ky. Ct. App. 2012) (extending mortgagor protections to vendee who abandoned property).

57. *See, e.g.*, Okla. Stat. Ann. tit. 16 §11A.

58. Restatement (Third) of Property: Mortgages §3.4 (1996).

59. *See, e.g.*, Petersen v. Hartell, 707 P.2d 232 (Cal. 1985); Lewis v. Premium Inv. Corp., 568 S.E.2d 361 (S.C. 2002).

60. *See, e.g.*, Union Bond & Trust Co. v. Blue Creek Redwood Co., 128 F. Supp. 709 (N.D. Cal. 1955), *aff'd*, 243 F.2d 476 (9th Cir. 1957).

Chapter 23

The Deed

§23.01 The Deed in Context

The deed is the basic document used to transfer an estate or other interest in land during the owner's lifetime. Suppose S owns Greenacre and wishes to transfer her title to B. S, the *grantor*, will use a deed to convey title to B, the *grantee*. Of course, title can be transferred by other methods, such as through adverse possession (*see* Chapter 27), by a will effective upon the owner's death (*see* Chapter 28), or through an eminent domain lawsuit (*see* Chapter 39). But the deed is routinely utilized to transfer title in virtually every real property sale or gift transaction other than testamentary gifts. Millions of deeds are executed and delivered each year in the United States.

The law governing deeds is reasonably well-settled, attracting little scholarly attention. One theme dominates the subject: what are the requirements for a valid deed? The long-term trend in this area is simplification. For example, while the deed in common law England was an intricate, painstakingly drafted document, the modern American deed is typically a short standard form.[1] Similarly, while disputes still sometimes arise on questions such as the adequacy of the deed's property description or whether the deed was "delivered"—particularly in family gift transactions—they are increasingly rare.

Perhaps the most difficult problem is to resolve the competing title claims of two "innocent" parties: the original owner who never intended to transfer title and the later purchaser who bought the land without knowledge of any title defects. The central question here is whether "invisible" deed defects (such as forgery or lack of delivery) may be asserted against an innocent purchaser. Should the law respect the existing property rights of the true owner or protect the reasonable expectations of the innocent later buyer? The answer reveals much about the policies underlying American property law.

§23.02 Evolution of the Deed

In feudal England, a fee simple estate in land was transferred through an elaborate ritual known as *feoffment with livery of seisin*, which faintly resembles the modern marriage ceremony. The *feoffor* (transferor), *feoffee* (transferee), and their witnesses assembled together on the affected land. The feoffor orally declared that he was transferring title to the feoffee, and gave the feoffee a branch, twig, stone, clod of earth, or other token that represented ownership of the land. No deed or other document was used in the process. In an era when most members of society were illiterate, this ritual was an effective method of providing proof of the transfer if any title dispute later arose. The parties and witnesses would long remember such a dramatic event, and could testify accordingly. Less important interests in land—for example, nonfreehold estates and easements—were transferred through a written instrument known as a *grant*, which was informally handed to the recipient.

As feudalism waned, the traditional ritual became anachronistic, particularly given the convenience of employing a simple document to transfer title and the widespread use of written records. Under the Statute of Uses in 1536, it became possible to convey a fee simple estate by means of a written instrument—most notably the "bargain and sale" deed—without livery of seisin.[2] For more than a century, an English landowner could transfer title through either method. The deed finally emerged victorious from this rivalry in 1677, when the Statute of Frauds mandated that every conveyance of an interest in land must be in writing. Thus, the body of English property law inherited by the new United States recognized only one method for conveying land title: the deed.

§23.03 Types of Deeds

[A] Three Basic Types

Three types of deeds are commonly used in the United States: the *general warranty deed*, the *special warranty deed*, and the *quitclaim deed.* The main difference among them is the extent to which the grantor warrants the quality of title. Although the parties are free to negotiate which type of deed will be used, it is customary in about two-thirds of the states to employ general warranty deeds; special warranty deeds are the norm in a few states; and both types are utilized in the remaining states.

[B] General Warranty Deed

A general warranty deed provides the most title protection. It contains[3] six specific covenants of title that warrant against any defect in the grantor's title (*see* §26.02). For example, in the *covenant against encumbrances*, the grantor warrants that there are no mortgages, easements, liens, or other encumbrances on the property as of the time the deed is delivered. If one of these title covenants is breached, the grantor is liable in damages. The prudent grantee who is paying full fair market value for the property—and thereby assuming the grantor's title is near perfect—will demand a general warranty deed.[4] If the purchase price has been reduced to compensate for a known title defect (e.g., an easement for sewer pipes under the land), a general warranty deed can still be used, with a specially-drafted provision that the title covenants do not extend to that defect.

[C] Special Warranty Deed

The special warranty deed usually contains[5] the same six title covenants found in the general warranty deed, but applies them only to defects caused by the *acts or omissions of the grantor* (*see* §26.02). Suppose S conveys title to B pursuant to a special warranty deed. B soon discovers that the property is burdened with an easement that allows sewer pipes to cross under the land. If S created the easement, she is liable for breach of the covenant against encumbrances. But the special warranty deed affords no protection against the *acts or omissions of third parties*. So if the easement was granted by an

owner who held title to the property before S, B has no recourse under the deed covenants. Similarly, in effect, the seller using a special warranty deed does not even warrant that he owns the property.

Why would a prudent buyer accept such inadequate protection? Local custom plays a role here, but the dominant reason is probably the availability of a superior form of protection: title insurance. In some states where title insurance is common—notably California and Pennsylvania—the special warranty deed is used in most sales transactions. In practice, even the general warranty deed may afford only limited title protection (*see* §26.02).

[D] Quitclaim Deed

The quitclaim deed contains no title covenants. By its use, the grantor does not warrant that he owns the property or—if he has any title—that his title is good. A quitclaim deed merely conveys whatever right, title, or interest the grantor *may have* in the property. So why would a buyer ever accept a quitclaim deed? One common use is to release a doubtful title claim. Suppose A has undeniably fulfilled all legal requirements to adversely possess O's property Greenacre. A could obtain record title to Greenacre by bringing a quiet title action against O. But A can avoid the cost and delay of litigation by simply asking O to convey title to her. O will be unwilling to warrant title, but should reasonably be willing to quitclaim any theoretical interest he retains. Or assume B is about to purchase land in a community property state that is believed to be the separate property of seller H, a married man; to preclude any later claim that the land was community property, B may insist that H's wife, W, execute a quitclaim deed in favor of B. The quitclaim deed is also used to transfer title following an involuntary sale of property (e.g., a foreclosure sale on a judgment or tax lien).

§23.04 Requirements for Valid Deed

[A] Essential Deed Components

[1] General Principles

The basic requirements for a valid deed are simple and noncontroversial. In general, a deed must:

(1) be in writing,

(2) be signed by the grantor,

(3) identify the grantor and grantee,

(4) contain words of conveyance, and

(5) describe the property.

The first four elements are discussed below, while the property description element is discussed separately in [2], *infra*. Some states impose additional requirements by statute (*see* [3], *infra*).

The first two elements stem from the Statute of Frauds. In general, a conveyance of any interest in real property must be memorialized in a writing that is signed by the grantor.[6] No particular form of deed is required, although statutes in many states authorize a "short form" of deed that parties may voluntarily choose to use. Even a letter or other informal document may meet the Statute of Frauds requirement.[7] The standard exceptions to the Statute of Frauds, notably part performance and estoppel, may obviate the need for a writing (*see* §20.04[B][4][a]).

The third requirement—identification of the grantor and grantee—is rarely problematic. But what if the grantor executes and delivers a deed that leaves the name of the grantee blank? If the grantor expressly or impliedly authorizes the recipient of the deed to insert the name of the ultimate grantee, most courts find the deed valid *after* the name is added.[8] Until that point, the deed is considered void.

The fourth requirement—words of conveyance—is straightforward. The law does not require use of technical language. Any words indicating the grantor's intention to immediately convey title (e.g., "grant," "convey,"

"transfer," or "give") will suffice.[9]

[2] Description of Land

[a] Methods of Describing Land

A deed must identify the land to be conveyed in sufficient detail that it can be distinguished from all other parcels. At common law, this requirement was strictly enforced; for example, a conveyance of land described as "the Jones farm" was inadequate because the property could not be located by using only the deed language. Modern courts are more willing to admit extrinsic evidence to clarify an ambiguous description. But the traditional insistence that the deed must contain a complete description retains much vitality.[10]

A property description is essentially a method of locating the boundary lines of a parcel of land on the surface of the earth. Three methods of describing land are commonly used in the United States: (1) metes and bounds; (2) government survey; and (3) plat or subdivision map. The development of global positioning systems that can precisely locate any point on the earth's surface allows a parcel to be identified by latitude and longitude, which may well replace these traditional systems.

[b] Metes and Bounds

The most rudimentary method is the metes and bounds description. Adopted by the original 13 colonies before American independence, it is still the dominant technique used in eastern states and is used to some extent in all states.

A metes and bounds description begins at an identifiable geographic location or "point of beginning" on the boundary of the parcel. It then proceeds to describe each boundary line in sequence, until the last boundary line returns to the point of beginning, and thus creates a closed geometric figure. An early metes and bounds description might begin: "Beginning at the big pine tree 2 miles north of Smith's farm, thence approximately 500 feet north to the creek, thence northeasterly along the creek approximately 800 feet, etc." Over time, using natural features of the land such as trees and watercourses to establish boundaries proved unreliable: the tree could die and the stream could change course. Modern metes and bounds descriptions are much more precise, usually beginning at identifiable manmade

monuments, and then proceeding to describe each boundary line with a *course* (a statement of direction in degrees) and a *distance* (e.g., "thence South 41 degrees 32 minutes East 112.6 feet") until the boundary line returns to the point of beginning.

What if the metes and bounds description is internally inconsistent due to human error, destruction of monuments, or the like? Over time, courts have developed a priority list for choosing between inconsistent components of a description, from most reliable to least reliable:

(a) natural monuments,

(b) artificial monuments,

(c) adjacent tracts or boundaries,

(d) courses or directions,

(e) distance,

(f) quantity or area, and

(g) place names.[11]

For example, if the courses and distances in a metes and bounds description enclose a 50-acre tract, this will prevail over the description of the parcel as containing "65 acres."[12]

[c] Government Survey

Hoping to encourage western settlement and aware of the inadequacies of the metes and bounds system, Thomas Jefferson spearheaded the adoption of a government survey program in 1785. Virtually all land added to the United States thereafter—excluding Texas—was surveyed by the federal government. Most land in the United States can be described by reference to these surveys.[13] This method is routinely used to describe large tracts of land, typically rural or agricultural parcels.

The government survey system (or "rectangular system") is essentially a series of rectangles. The system is based on a national network of survey lines: *principal meridian lines* (which run north-south) and *base lines* (which run east-west). Using the locations where these lines intersect as starting points, land was divided into square tracts called *townships*, each measuring six miles by six miles, and containing 36 square miles. Each township was further subdivided into 36 square tracts called *sections*, each containing one

square mile. Almost any square mile in the nation can be identified by ready reference to this system. For example, “Section 10, Township 3 South, Range 4 West, Michigan Meridian” refers to only one particular square mile. Because each section contains 640 acres, portions of a section can be described with equal ease.[14] The “southwest quarter of the northwest quarter of Section 10, Township 3 South, Range 4 West, Michigan Meridian” designates only one 40-acre parcel. A metes and bounds description can be combined with a government survey description to identify an irregularly-shaped parcel.

[d] Plat or Subdivision Map

Today a plat or “subdivision map” description is used in conveying most urban and suburban land, particularly in residential subdivisions. A plat is simply a map depicting the lots in a new subdivision, usually prepared by a surveyor employed by the subdivider. The plat depicts the location and dimensions of each lot, together with planned streets and other improvements. Each lot in the subdivision is assigned a particular number. The plat also includes information that allows the subdivision as a whole to be located, usually by reference to an external monument or the government survey system.

Once the plat is approved by the local planning commission or other responsible government agency, it is recorded in the official land records. Thereafter, each lot can be conveyed using a brief description that incorporates the plat by reference.[15] For example, a deed could simply specify: “Lot 26, as shown on that certain Plat recorded in Book 212, Page 36, Records of Golden County, Colorado.”

[3] Nonessential Deed Components

Consideration is necessary for a valid contract, but not for a valid deed.[16] Gifts of real property, such as gifts among family members or gifts to charity, are quite common. A deed delivered to a donee is equally effective as one delivered to a purchaser. However, the absence of consideration may have other legal consequences, notably: (1) a donee does not share the title protection accorded to the bona fide purchaser (*see* §24.04[C]); and (2) the measure of damages for breach of the grantor's title covenants will probably be zero (*see* §26.02[D]). Accordingly, if consideration was paid, this fact is customarily recited in the deed. While not conclusive on the point, such a

recital creates a presumption that consideration was paid.

Recordation of a deed is irrelevant to its validity. An unrecorded deed is fully effective and binding. It is customary, however, to record the deed in order to give notice to the world of the grantee's title, and thereby preclude adverse title claims by bona fide purchasers (*see* §23.06).

Acknowledgment by a notary public is routine and usually required in order to record a deed, but is not necessary for validity (*see* §25.04[A]).

Witnesses to the execution of the deed are also unnecessary, except in a few states. In contrast, witnesses to the testator's signature are generally required for a valid will.

A *seal* is required only in a handful of states. The old adage that a deed must be "signed, sealed, and delivered" is archaic. When illiteracy prevailed, the grantor's personal seal served to help identify the grantor and thus to authenticate the deed.

[B] Delivery

[1] General Principles

A deed is not effective until it is "delivered." An undelivered deed is void and passes no title to the grantee or his successors even if they are bona fide purchasers. In order to deliver a deed, the grantor must manifest by words or actions an intent that the deed be immediately effective to transfer an interest in land to the grantee.[17] The typical grantor delivers a deed through the act of physically handing it to the grantee, with words indicating the grantor's intent to transfer the interest immediately. Indeed, it is not a coincidence that this common form of delivery resembles the ancient ceremony of feoffment with livery of seisin.

Yet delivery may be found in cases that are far less clear than this usual pattern.[18] It is important to understand that *either* words or actions may suffice to evidence the grantor's intent. As Lord Coke observed in a famous dictum: "As a deed may be delivered to the party without words, so may a deed be delivered by words without any act of delivery." Consider an example of manual delivery without words. Suppose O enters into a contract to sell Blueacre to B for $500,000; on the day selected for the transfer of title, B hands O a cashier's check for $500,000 and O silently hands B the deed to Blueacre. Despite O's silence, all courts would find delivery here,

given the factual circumstances surrounding O's act of physically handing over the deed.[19] Delivery by words alone is also possible. Suppose O executes a deed conveying Blueacre to B, but learns that B is on vacation in Alaska when he attempts to hand over the deed to B. O reaches B by telephone, saying: "Congratulations! You're the new owner of Blueacre. I just conveyed it to you!"

Delivery issues mainly arise in the context of family gifts.[20] In the routine sales transaction, there is no doubt of the grantor's intent and the escrow agent, attorney, or other professional supervising the transaction can easily ensure that a valid delivery occurs. But these safeguards are sometimes absent in a gift transaction. The most common delivery problems are presented by the grantor who manifests an intent to retain some control over the deed or the property itself after execution of the deed. Is this an immediately effective transfer of title to the grantee (and thus a valid delivery) or a disguised substitute for a will (and thus an ineffective delivery)? The question often surfaces in title litigation between the grantee and the residual devisees under the grantor's will. If the grantor intends the deed to take effect only upon death, no delivery has occurred; thus, the deed is a nullity, and the property is legally part of the grantor's estate, where it will be distributed according to the will.[21] Some courts find valid delivery by construing the deed as an immediate transfer of a future interest that merely becomes possessory upon the grantor's death.

Once a deed is validly delivered, title vests in the grantee. Suppose O duly delivers a deed conveying Blueacre to G, but then changes his mind and demands that G return the deed to him, which G does. Or suppose that G burns the deed at O's request, in order to undo the conveyance. In both instances, G still owns Blueacre. Once delivery has occurred, the fate of the deed document is irrelevant. In order to transfer title back, G must execute and deliver a new deed to O.[22]

[2] Why Require Delivery?

In theory, delivery serves essentially the same evidentiary and cautionary functions that underlie the Statute of Frauds (*see* §20.04[B][5]). The ceremony of delivery in the presence of witnesses might facilitate testimonial evidence of the conveyance, which minimizes the risk of later dispute. Yet because a valid delivery can occur without any witnesses, the requirement

often fails to provide such evidence. Similarly, the requirement might help impress the grantor with the significance of his actions, like the Statute of Frauds requirement that the grantor execute the deed, thus safeguarding against the accidental or inadvertent loss of title. Unless the owner demonstrably intends to make an immediately effective conveyance, the deed is ineffective. Suppose, for example, that O executes a deed conveying his land Redacre to his favorite niece A, intending to deliver the deed to A as a present for her birthday; but two days before her birthday, A dies, leaving all her property to her odious husband B. If a deed was effective upon execution, without a delivery requirement, then B would own Redacre, a result contrary to O's intent. Yet perhaps O's execution of the deed should have alerted him to the legal significance of his conduct. In short, if the delivery requirement is aimed at goals already fulfilled by the Statute of Frauds, its benefit is quite limited.

Does the cost of the delivery rule outweigh its benefit? In some respects, the doctrine is quite inconsistent with the law's overall concern for ensuring the stability of land title through the use of clear, “bright line” rules. It poses a particular danger for future purchasers in the chain of title. Suppose O executes a deed conveying Blueacre to R, but intentionally fails to deliver it; R obtains the deed, records it, and conveys to S; S conveys to T. In most jurisdictions, O still holds title, even if T is a bona fide purchaser. How can later buyers like T reasonably be expected to know that the O-R deed was invalid? As between O and T, two innocent parties, it would make more sense to place the loss of title on O, who was best situated to prevent the loss in the first place, by analogy to the rule governing deeds induced by fraud (*see* §23.08[A]). If the grantor's carelessness allowed the deed to be placed into the stream of commerce, why shouldn't downstream purchasers be protected? In operation, this rule is rarely as draconian as it might appear, because (1) the disappointed purchaser will recoup the loss through title insurance or deed warranties, or (2) the culpably negligent grantor will be deemed estopped from challenging the bona fide purchaser's title.

[3] Presumptions

Delivery is a question of fact. The typical delivery dispute involves intricate and often conflicting evidence about the grantor's intent. Courts have developed a set of rebuttable presumptions to resolve these difficult cases. In most states, delivery will be presumed if (1) the deed is recorded, or

(2) the grantee has physical possession of the deed.[23] Suppose O executes a deed in favor of his nephew N. N ultimately obtains physical possession of the deed and records it. If O now brings suit to cancel the deed based on nondelivery, he will confront a judicial presumption that delivery occurred. O can overcome this presumption with affirmative evidence demonstrating a lack of delivery (e.g., if N stole the deed from O's office).[24]

[4] "Deed in a Box" Cases

The most persistently troublesome (and inconsistent) delivery cases involve the "deed in a box." Suppose O executes a deed conveying Brownacre to B, and places it in a safe deposit box (or other locked box) where it is discovered after O's death. So far, courts all agree that O has not manifested the requisite intent for delivery.[25] But the addition of even a single fact to this basic scenario may bring uncertainty. For example, suppose O gives B a key to the safe deposit box; this might be seen as a symbolic act that gives B control and dominion over the deed.[26] Or what if B is O's wife? Courts are more likely to find delivery where the grantee is a close relative, on the theory that the conveyance is consistent with prudent estate planning. Or suppose O announces to his family while signing the deed: "I want B to own Brownacre." Such a public statement is usually viewed as strong evidence of delivery.[27] Predicting the outcome of these fact-specific cases is extraordinarily difficult.

[5] Conditional Delivery to Grantee

Suppose O executes a deed conveying title to Greenacre to G "effective when G reaches the age of 25"; O then hands the deed to G, his 22-year-old daughter. Has a valid delivery occurred? Most jurisdictions still follow the common law view that a grantor may not condition delivery to the grantee. Yet there is a split of authority on how this rule is applied. Some courts hold that any condition prevents a valid delivery; they reason that delivery requires that the grantor intend an immediate transfer of title, not a transfer that becomes effective at some later date when the condition is fulfilled.[28] Under this view—which closely tracks the logic of the common law rule—the grantee receives nothing at all.[29]

Surprisingly, a majority of courts deals with this situation by ignoring the condition and vesting absolute title in the grantee. As one court summarized:

“Conditional delivery to a grantee vests absolute title in the latter.”[30] Why? The majority rule reflects the law's historic concern to protect the certainty of land title. If the identity of the owner hinges on whether a condition has been fulfilled, it may be difficult to ascertain who holds title. Given this uncertainty, title claimants will be reluctant to invest their time and resources in enhancing the productive value of the land, and lenders will be unwilling to extend credit based on such doubtful collateral.[31]

Despite the rule against conditional delivery, the creative grantor can accomplish the same result in most instances by unconditionally delivering a conditional future interest. Consider the phrasing in the example above: “effective when G reaches the age of 25.” Depending on the surrounding facts, this same language might alternatively be construed as an immediate transfer of an executory interest to G, which merely becomes possessory in the future. If so, a valid delivery of a future interest has occurred. The key—and perhaps artificial—distinction turns on when the grantor intends the deed to be effective: now or later?

Disputes arising from conditional delivery to the grantee arise most commonly in connection with a “death condition.” Suppose O conveys Greenacre “to G effective upon my death.” Despite the general rule discussed above, in this special context many courts find that no delivery has occurred, reasoning that O did not intend her deed to be immediately effective. Other courts construe this situation as an immediate transfer of a future interest to G, which merely becomes possessory upon O's death, and thus find valid delivery. Of course, O could avoid this difficulty by expressly conveying only a vested remainder to G, and reserving a life estate in himself.

What if the grantor reserves a right to revoke the deed? O could convey Greenacre “to G, but in O's sole and absolute discretion O can revoke and cancel this deed at any time.” Arguably, G receives an immediate transfer of an unusual fee simple subject to a condition subsequent in Greenacre: G enjoys fee simple in Greenacre until and unless O changes her mind. Of course, O could change her mind as long as she lives; thus some courts find no delivery, on the rationale that G has not effectively received any interest at all until O dies without changing her mind. Probably the majority of courts—albeit reluctantly—finds a valid delivery under these circumstances.[32] These courts usually rely on the formalistic argument that a grantee like G

has received an immediate interest, even if it is speculative and uncertain. The better explanation for this outcome focuses on the policies underlying the delivery requirement. If the grantor executes a deed that includes written conditions and manually delivers it to the grantee, the evidentiary and cautionary policies that the requirement is intended to serve are both met. The grantor is fully aware she is performing a legally binding act, while the deed and the surrounding circumstances clearly evidence the grantor's intent. With the modern acceptance of revocable will substitutes such as inter vivos trusts, life insurance policies, and joint tenancy bank accounts, courts are increasingly reluctant to invalidate the revocable deed.

[6] Delivery to Third Party

[a] Sale Escrow

In many real property sales transactions, the deed is conditionally delivered to an escrow agent with instructions that it be delivered to the grantee when the contract conditions are met. Although a deed cannot be conditionally delivered directly to a grantee, it may be conditionally delivered to a third party. The escrow agent is essentially a neutral third party who is retained to facilitate the transaction, usually an attorney, title insurance company, escrow company, or financial institution.[33]

Suppose O contracts to sell fee simple absolute in Redacre to B for $500,000. O executes and delivers his deed to an escrow agent with instructions that it be delivered to B once B's payment is received in escrow. B deposits the sales price into escrow with parallel instructions. When all conditions of the parties' instructions are met, the deed is delivered and title passes; the escrow agent disburses the deed to B and the sales price to O.[34]

When is delivery through escrow effective? Assume O delivers his deed into escrow on January 1, but all conditions of the parties' instructions are not met until March 1; the escrow agent delivers the deed to B on March 1. Here a curious legal fiction arises. Once the conditions of delivery are fulfilled, and delivery occurs, the effective date of the delivery is said to “relate back” to the original deposit into escrow if required to prevent injustice. Under this relation back doctrine, the law deems that O's deed was delivered to B on January 1, not March 1. The effective date of delivery is often important. For example, if O's creditor attempts to impose a $300,000 judgment lien on Redacre on February 1, the lien has no effect on Redacre or on B's rights if

the doctrine applies. The doctrine operates in a similar fashion where the grantor dies or becomes incompetent after delivering the deed into escrow.

The rare escrow agent who violates instructions by giving the deed to the buyer before all conditions are met creates an unfortunate mess. In one celebrated decision,[35] the seller gave an executed deed to the buyer's real estate broker, to hold as an escrow agent pending the seller's inspection of an apartment building that the buyer proposed to trade for the seller's property. Before this condition was met, the buyer obtained possession of the deed, recorded it, and resold the property to an innocent purchaser for value. Citing the standard rule that any delivery of a deed from escrow before conditions are fulfilled is void, the court noted—quite properly—that the deed was ineffective as between the seller and buyer. Yet, with little further analysis, the court mechanically applied this same principle to nullify the deed as between the original owner and the innocent purchaser for value. Most American courts still follow this view, except where the grantor was clearly negligent in selecting the escrow holder or unduly delayed in asserting his claim. However, scholars argue strongly that the innocent purchaser should always be protected in this situation, relying on the familiar adage that when a loss must fall on one of two innocent parties, it should fall on the party who best could have prevented the loss.[36] Under this reasoning, the original owner—who participated in selecting the culpable escrow agent—should bear the loss.

[b] "Death Escrow"

Can delivery to a third party be conditioned on the grantor's death? Suppose (a) O executes a deed conveying title to her property Blueacre to G, (b) hands the deed to T, and (c) tells T to deliver the deed to G when O dies. Has the O-G deed been delivered? There is widespread judicial agreement that the answer turns on O's ability to retrieve the deed from T. If the grantor can recover the deed from the third party (e.g., if the third party is an agent of the grantor), most courts reason that this is sufficient retained control to preclude delivery.

This rule may produce harsh results. In one case, for example, an elderly, childless couple executed a deed conveying their family farm to a nephew and announced that they wanted him to have "the place."[37] The grantor-couple asked the nephew to leave the deed at their bank until they died; and

the banker assured the nephew that he would put the deed in an envelope and keep it in the vault until the nephew called for it. After the couple died, the deed was discovered in the bank vault inside an envelope that a bank employee—without the knowledge of the parties—had labeled with the names of *both* the grantee and one grantor. Because the bank's standard practice would have allowed the grantors to retrieve such an envelope and thus revoke the deed—even though the grantors were apparently unaware of this—the court found no delivery had occurred. Results like this that frustrate a grantor's clear and unambiguous intent have prompted strong criticism of the ban on revocable escrows. The grantor-couple could have achieved their objective here by simply transferring title to the property into a revocable trust and naming the nephew as its sole beneficiary; indeed, a prudent attorney would have recommended this procedure. Given the modern acceptance of revocable trusts as an estate planning device, scholars suggest that revocable "death escrows" should similarly be permitted.

On the other hand, the irrevocable death escrow is usually held valid. When the grantor delivers a deed to a third party with instructions to deliver it to the grantee upon the grantor's death—without retaining any power to retrieve the deed—the delivery requirement is satisfied.[38] A judicial fiction is employed to mute the logical inconsistency of this result with the common law standard. In most states, although the deed appears on its face to convey fee simple absolute, it is construed to *immediately* convey a future interest to the grantee, which becomes possessory when the grantor dies.

[7] Transfer-on-Death Deed

Many states have adopted statutes that authorize the transfer-on-death deed, which becomes effective at the death of the grantor.[39] This is a useful tool in estate planning because it allows title to real property to be transferred without the need for probate.[40]

In general, a transfer-on-death deed must (a) contain the essential elements of a recordable deed, (b) state that the transfer of title will occur at the grantor's death, and (c) be recorded before the grantor dies. Delivery is not required for a valid transfer-on-death deed, because the deed has no legal effect until the grantor dies. After the creation of a transfer-on-death deed, the grantor retains the normal rights of any owner, including the right to sell or mortgage the property. The grantor may revoke the deed at any time

before death, and it is automatically revoked if the property is sold.

[C] Acceptance

In theory, the grantee must accept the deed in order for a conveyance to be effective. Yet, in practice, acceptance is rarely important. The law presumes that a grantee will accept a beneficial conveyance. On the other hand, suppose O conveys Greyacre (a toxic waste dump) to G without G's knowledge, hoping to avoid statutory liability for cleanup costs (*see* §29.08). The acceptance element allows G to disclaim the conveyance, and thus avoid the cleanup liability that may accompany title. A disclaimer must be made within a reasonable period of time after the grantee becomes aware of the conveyance.

§23.05 Interpretation of Deeds

The ambiguous deed poses a special problem. The central rule in deed interpretation is to follow the intent of the parties.[41] Initially, a court will attempt to ascertain this intent from the "four corners" of the deed itself, considering all of its provisions. If the ambiguity remains, extrinsic evidence (e.g., statements and conduct of the grantor and grantee) will be examined.

The classic scenario involves a deed that is so ambiguous that the parties dispute the nature of the estate or interest it conveys, as where a deed could be interpreted as conveying either fee simple absolute or an easement. If the basic rules above fail to resolve the problem, courts usually presume that the grantor intended to convey his entire interest in the property, not merely a portion.[42] This rule of construction minimizes quiet title suits and prevents fragmentation of property ownership.

Suppose O owns a life estate in Blueacre; he then executes and delivers a deed which appears to convey fee simple to X. What does X receive? The general rule is that a deed transfers whatever interest the grantor has in the land—even if this varies from the interest described in the deed—unless the deed clearly manifests a contrary intent. Accordingly, X receives a life estate in Blueacre.

§23.06 Recordation of Deeds

Virtually all deeds are “recorded.” The mechanics of recording are simple. The grantor must execute the deed in the presence of a notary public or similar official; the notary will then sign an acknowledgment form attesting under penalty of perjury that the grantor in fact executed the deed. Once a deed has become effective through delivery, the grantee (or the grantee's agent) presents the original deed to the recorder's office or similar agency and pays a small fee. A clerk stamps an identification number on the deed, places a copy of the deed (often on microfilm or microfiche) into the official land records, lists information about the deed in various public indices so that it can be located by title searchers, and returns the original deed to the grantee.

Why are deeds recorded? Recordation is not required for a deed to be valid. An unrecorded deed is fully effective. Yet the prudent grantee will immediately record his deed in order to protect his title against later claimants. As discussed in more detail in Chapter 24, under some circumstances the law will vest title in a *bona fide purchaser*—a later purchaser for value who has no notice or knowledge of previously-created interests. Recording a deed gives “notice to the world” of the grantee's title, and effectively eliminates this risk.

§23.07 Effect of Forgery

A forged deed is completely *void*.[43] It conveys nothing to the grantee or any subsequent grantee in the chain of title, including any later bona fide purchaser. Assume F forges a deed that purports to convey fee simple absolute in Whiteacre from its true owner, O, to F, and duly records the deed. After confirming through a title search that F holds record title, innocent buyer B—unaware of the forgery—purchases F's interest for $300,000 and F conveys title to B. Even though B paid fair market value, and had no notice of O's continued claim to the property—the hallmarks which protect the bona fide purchaser—B has no interest at all in Whiteacre. The forged O-F deed is void, and hence the F-B deed is similarly void.

Why is a forged deed void even as to an innocent purchaser? A contrary rule might well tend to encourage forgery, as innocent buyers became less careful or as forgers collusively transferred title to “innocent” conspirators. Further, as between the true owner and the later purchaser, the purchaser is in a somewhat better position to protect himself through careful inquiry and inspection if only because (unlike the true owner) the purchaser is aware that a sales transaction is underway. In any event, standard title insurance policies protect the insured purchaser against forgery, so most purchasers will suffer little or no loss.

§23.08 Effect of Fraud

[A] Fraud in the Inducement

F offers to trade his ancient and valuable vase to O, in exchange for title to O's vacation cabin known as Greenacre; O accepts. O executes and delivers a deed conveying title to F, and F hands O the vase together with a bill of sale. Three days later, O takes his vase to an appraiser, who informs him that it is merely a modern reproduction, worth almost nothing. It is well-settled that a deed induced by the grantee's fraud is *voidable* in an action brought by the true owner against the grantee.[44] Thus, O could sue F to rescind the transaction and recover title.

But what if F conveys Greenacre to innocent purchaser B one day after F acquires title? Under these circumstances, B prevails over O. When one of two innocent parties must incur a loss due to a third party's fraud, courts usually allocate the loss to the party who was in the best position to avoid the loss in the first place.[45] Here, O knew he was conveying title to his land; he could have discovered F's fraud through prudent pre-purchase investigation, such as by demanding an appraisal of the vase before the conveyance occurred. B, on the other hand, had no opportunity to know that the deed was induced by fraud, and has the normal equities associated with any bona fide purchaser (*see* §24.03).

[B] Fraud in the Factum

A different result flows from fraud in the factum (also called fraud in the inception), where fraud prevents the grantor from knowing that he is executing a deed. Suppose F knocks on widow O's door, pretending to sell magazine subscriptions. When O agrees to subscribe, F tells her she is signing a subscription form, but F takes care to ensure that O's signature is actually placed on the bottom of a deed protruding below the subscription form. In this situation, many courts hold that a deed procured by fraud in the inception is *void* for all purposes, and treat it like a forged deed, particularly if the grantor is elderly, infirm, or unsophisticated.[46] On the other hand, where the grantor is capable of protecting his own interests, a court is more likely to conclude that his conduct was negligent and estop him from

challenging the rights of a later bona fide purchaser.

§23.09 Estoppel by Deed

Suppose O conveys title to Redacre to G, using a warranty deed. At the time, O does not own title to Redacre but G is unaware of this fact. One month later, O acquires title to Redacre. What happens? Under the doctrine of estoppel by deed, G owns Redacre. The doctrine applies when a grantor uses a warranty deed to purportedly convey title to land he does not own to an innocent grantee. If the grantor later acquires title to the land, it automatically passes to the grantee.[47] Why? In equity, the grantor is estopped to claim title that is superior to that of his grantee. Moreover, the grantee could bring suit against the grantor for breach of deed warranties in any event, so the doctrine shortcuts the process.

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1. To minimize the risk of dispute, most states have adopted legislation approving the use of short statutory deed forms.

2. *See generally* French v. French, 3 N.H. 234 (1825).

3. The title covenants may not actually be written on the deed. Most states have adopted some type of statutory "short form" deed; the use of this form automatically incorporates certain specified statutory warranties. For example, in Michigan a deed that merely includes the phrase "conveys and warrants" is considered a general warranty deed. Mich. Comp. Laws Ann. §565.151.

4. *See* David M. Brasington & Robert F. Sarama, *Deed Types, House Prices and Mortgage Interest Rates*, 36 Real Est. Econ. 587 (2008) (noting that average price for house sold with general warranty deed was significantly higher than house sold with limited warranty deed).

5. Title covenants may be incorporated by reference where a statutory deed form is used. For example, in California a deed containing the term "grant" is a type of special warranty deed. Cal. Civ. Code §1113.

6. Would an electronic deed satisfy the Statute of Frauds? Under the Uniform Electronic Transactions Act, now adopted by a majority of states, the answer is "yes." Unif. Electronic Trans. Act §7. *See also* §20.04[B][3][b] (discussing use of electronic documents under the federal Electronic Signatures in Global and National Commerce Act).

7. *See, e.g.*, Metzger v. Miller, 291 F. 780 (N.D. Cal. 1923) (mother's letters to son were a valid deed).

8. *See, e.g.*, Womack v. Stegner, 293 S.W.2d 124 (Tex. Ct. Civ. App. 1956).

9. *See, e.g.*, Harris v. Strawbridge, 330 S.W.2d 911 (Tex. Ct. Civ. App. 1959) (language of habendum clause construed as words of grant). *But see In re* O'Neill's Will, 185 N.Y.S.2d 393 (App. Div. 1959) (letter that stated claimants "are welcome to live as long as they wish in the ... house—as long as they wish" did not create a life estate).

10. *See, e.g.*, Bowlin v. Keifer, 440 S.W.2d 232 (Ark. 1969) (instrument that contained no property description was not an effective deed); Grand Lodge v. City of Thomasville, 172 S.E.2d 612 (Ga. 1970) (deed held void because land description was indefinite); Fears v. Texas Bank, 247 S.W.3d 729 (Tex. App. 2008) (deed conveying "20 acres off of the West end" of a 100-acre parcel was unenforceable because no information was given about the "length, breadth, or shape" of the tract).

11. *See, e.g.*, Doman v. Brogan, 592 A.2d 104 (Pa. 1991) (monument prevails over distance). *But see* Pritchard v. Rebori, 186 S.W. 121 (Tenn. 1916) (based on extrinsic evidence of parties' intent, course and distance prevail over adjacent boundary).

12. *Cf.* Parr v. Worley, 599 P.2d 382 (N.M. 1979) (center of highway, as monument, prevailed over acreage statement in deed).

13. The principal exceptions are the Atlantic states and Kentucky, Maine, Tennessee, Texas, West Virginia, and Vermont.

14. *See, e.g.*, Bybee v. Hageman, 66 Ill. 519 (1873) (using government survey to describe 1-acre parcel).

15. Because lots created by a plat may be irregularly shaped, confusion may arise when later attempts are made to divide them further. *See, e.g.*, Walters v. Tucker, 281 S.W.2d 843 (Mo. 1955).

16. Chase Fed. Sav. & Loan Ass'n v. Schreiber, 479 So. 2d 90 (Fla. 1985) (following general rule, despite dissent's plea that allowing gift deeds among non-relatives "provides a means to protect title to real property for gigolos, mistresses, and con artists").

17. *See, e.g.*, Pipes v. Sevier, 694 S.W.2d 918, 926 (Mo. Ct. App. 1985) (grantor must part "with the instrument with the intention to relinquish all dominion and control over it so as to make the deed a presently effective and operative conveyance of title to the land"); Caruso v. Parkos, 637 N.W.2d 351, 357 (Neb. 2002) ("The vital inquiry is whether the grantor intended a complete transfer—whether the grantor parted with dominion over the instrument with the intention of relinquishing all dominion over it and making it presently operative as a conveyance of title to the land.").

18. Is it possible to deliver an electronic deed? For an analysis of the issue, see Derek Witte, Comment, *Avoiding the Un-Real Estate Deal: Has the Uniform Electronic Transactions Act Gone Too Far?*, 35 J. Marshall L. Rev. 311, 322–25 (2002).

19. But delivery does not necessarily occur when the grantor hands the deed to the grantee. *See, e.g.*, Martinez v. Martinez, 678 P.2d 1163 (N.M. 1984) (no delivery occurred where grantors gave deed to grantees with instructions to place deed in escrow until mortgage was paid, but grantees recorded deed instead).

20. *See, e.g.*, Capozzella v. Capozzella, 196 S.E.2d 67 (Va. 1973).

21. *See, e.g.*, Johnson v. Johnson, 760 S.E.2d 618, 619 (Ga. Ct. App. 2014) (no delivery occurred where grantor placed deed in car trunk, devised car to grantee, and told grantee that deed would be "right there in the trunk with [the] important papers"); Rosengrant v. Rosengrant, 629 P.2d 800 (Okla. Ct. App. 1981) (no delivery occurred where grantors did not intend deed to take effect until their death). *But see* Vasquez v. Vasquez, 973 S.W.2d 330 (Tex. App. 1998) (valid delivery where grantor gave deed to her attorney with instructions to deliver it after her death, "without reserving a right to recall the deed"). Delivery disputes are highly factual and may produce results which appear to be inconsistent. *Compare* Blancett v. Blancett, 102 P.3d 640 (N.M. 2004) (no delivery where grantor told grantee not to record deeds unless he "died without a will or did something 'crazy,'" and later executed estate planning documents inconsistent with deeds) *with* Salter v. Hamiter, 887 So. 2d 230 (Ala. 2004) (delivery found where grantor told grantee not to record deeds until after her death, and grantor continued to act as owner for 33 years, including leasing, mortgaging, and selling portions of property).

22. As one scholar explains: "Delivery of a deed is like squeezing toothpaste out of the tube—the grantor can't put it back in again." Dale A. Whitman, *Teaching Property—A Conceptual Approach*, 72 Mo. L. Rev. 1353, 1358 (2007).

23. Hoefer v. Musser, 417 S.W.3d 330 (Mo. Ct. App. 2013).

24. *See, e.g.*, Lenhart v. Desmond, 705 P.2d 338 (Wyo. 1985) (grantor overcame presumption of delivery by showing that grantee had taken deed from safe deposit box without his knowledge or consent).

25. *See, e.g.*, Williams v. Cole, 760 S.W.2d 944 (Mo. Ct. App. 1988); Wiggill v. Cheney, 597 P.2d 1351 (Utah 1979).

26. *See, e.g.*, Kresser v. Peterson, 675 P.2d 1193 (Utah 1984) (delivery valid where, inter alia, grantees were cotenants in safe deposit box); Montgomery v. Callison, 700 S.E.2d 507 (W.Va. 2010) (valid delivery where grantor placed deeds in safe deposit box and gave all his box keys to grantees, "thus demonstrating his intent to relinquish any control and right to possession of the contents of the box").

27. *See, e.g.*, *id*. at 1194 (at time of signing deed, grantor stated that she intended her sons to have the property).

28. *See, e.g.*, Martinez v. Martinez, 678 P.2d 1163 (N.M. 1984) (no delivery occurred where grantors handed deed to grantees with instructions to place deed in escrow until mortgage on property was paid, but grantees instead recorded deed).

29. *But see* Chillemi v. Chillemi, 78 A.2d 750 (Md. 1951) (permitting conditional delivery to grantee, but finding that condition was not met, so title did not pass).

30. Sweeney v. Sweeney, 11 A.2d 806 (Conn. 1940) (oral condition—that deed would take effect only if grantor died before grantee—held invalid).

31. *See also id.* at 808 ("The safety of real estate titles is considered more important than the unfortunate results which may follow the application of the rule in a few individual instances. To relax it would open the door wide to fraud and the fabrication of evidence.").

32. *See, e.g.*, St. Louis County Nat'l Bank v. Fielder, 260 S.W.2d 483 (Mo. 1953).

33. An unconditional delivery to the grantee's agent is deemed a valid delivery to the grantee. For example, in Caruso v. Parkos, 637 N.W.2d 351, 358 (Neb. 2002), the grantor gave the deed to her attorney so that it could be recorded; the attorney later testified that he considered himself to be acting as an agent of the grantees for the "limited purpose of filing the deed," and the court found this to be a valid delivery.

34. *Cf.* Ferguson v. Caspar, 359 A.2d 17 (D.C. 1976) (buyers breached their contractual duty by imposing additional conditions to payment).

35. Clevenger v. Moore, 259 P. 219 (Okla. 1927).

36. John Mann, *Escrows—Their Use and Value*, 1949 U. Ill. L.F. 398.

37. Rosengrant v. Rosengrant, 629 P.2d 800 (Okla. Ct. App. 1981).

38. *See, e.g.*, Pipes v. Sevier, 694 S.W.2d 918, 921 (Mo. Ct. App. 1985) (grantor gave deeds to her attorney with instructions to deliver them after she died, aware that she "could not thereafter cancel the deeds or change my mind"). *But see* Chandler v. Chandler, 409 So. 2d 780 (Ala. 1981) (where grantor gave deed to bank to deliver to remainderman upon grantor's death, court found valid delivery, even though grantor could retrieve deed from bank).

39. *See, e.g.*, Cal. Prob. Code §§5600 et seq. Many of these statutes are based on the Uniform Real Property Transfer on Death Act (2009).

40. Dennis M. Horn & Susan N. Gary, *Death Without Probate: TOD Deeds? The Latest Tool in the Toolbox*, 24 Prob. & Prop. 12 (2010).

41. *See, e.g.*, Grayson v. Holloway, 313 S.W.2d 555 (Tenn. 1958) (rejecting common law rule that granting clause in deed prevails over inconsistent habendum clause, in favor of modern rule that interprets deeds in accordance with intent of parties).

42. *See, e.g.*, First Nat'l Bank v. Townsend, 555 P.2d 477 (Or. Ct. App. 1976) (applying presumption, court construes deed as conveying fee simple absolute, not merely timber and mineral rights).

43. *See* Brock v. Yale Mortg. Corp., 700 S.E.2d 583 (Ga. 2010).

44. *See* Delsas v. Centex Home Equity Co., LLC, 186 P.3d 141 (Colo. App. 2008) (recognizing rule). A deed is also voidable if it is procured through undue influence. *See* Caruso v. Parkos, 637 N.W.2d 351 (Neb. 2002).

45. *See, e.g.*, McCoy v. Love, 382 So. 2d 647, 649 (Fla. 1979) (illiterate, elderly owner executed deed in reliance on buyer's false representation that it conveyed only part of her property, when in

reality it conveyed all; because the "law charged her with the responsibility of informing herself as to the legal effect of the document she was signing," subsequent parties would hold title if they were bona fide purchasers).

46. *See* Delsas v. Centex Home Equity Co., LLC, 186 P.3d 141 (Colo. App. 2008) (recognizing rule).

47. *See, e.g.*, Schwenn v. Kaye, 202 Cal. Rptr. 374 (App. 1984) (grantor purported to convey fee simple absolute to grantees via warranty deed, even though grantor did not own all mineral rights in the property; when grantor later received certain oil and gas rights in the land, they automatically passed to grantees).

Chapter 24

Fundamentals of Land Title

§24.01 The Problem of Conflicting Title Claims

How does the law resolve conflicting title claims?[1] Suppose O first conveys fee simple absolute in Redacre to A, and a month later conveys the same estate to B. Who owns title to Redacre? Or suppose L grants an easement burdening Greenacre to C, and then transfers title to Greenacre to D. Does D take title subject to C's easement?

Title disputes commonly arise in three situations. First, two or more claimants may dispute who holds the present possessory estate in a particular tract of land; in the above hypothetical, both A and B claim to hold fee simple absolute in Redacre. Second, a title dispute may arise between the holder of the present possessory estate and someone claiming a nonpossessory interest (e.g., a lien, easement, or covenant) in the same land; in the above hypothetical, D might claim that his title to Greenacre is unaffected by C's easement, while C might insist that his easement still burdens Greenacre. Finally, two or more holders of nonpossessory interests may dispute their respective priority. Assume, for example, that Blueacre is only worth $40,000, but is burdened by two mortgages: a $30,000 mortgage held by E, and a $25,000 mortgage held by F. If a foreclosure sale occurs, whose mortgage is paid off first?

American property law uses the same principles to resolve all types of conflicting title claims. In a nutshell, the system consists of *one general rule* and *two exceptions to the rule.* The traditional common law rule is that the person whose interest is first delivered prevails over anyone who acquires an interest later (*see* §24.02). All states have modified this general rule through legislation known as *recording acts.* The recording acts in almost all states create a major exception to the general rule: in a title dispute between a first-in-time claimant and a later *bona fide purchaser for value*, the bona fide purchaser prevails (*see* §24.03). The general rule is usually subject to a second, minor exception called the *shelter rule*: one who acquires an interest from a bona fide purchaser also prevails over a first-in-time claimant (*see* §24.07).

The law in this area is a compromise between two goals. On the one hand, it seeks to provide security and stability by respecting the property rights of

current owners; the general first-in-time rule reflects this goal. On the other hand, the law also seeks to facilitate the transfer of property rights to new owners. Accordingly, virtually all states protect the later buyer who innocently paid value without any notice of prior claims. Absent this special protection, the purchase of interests in land would be extraordinarily risky, and buyers would be less willing to buy (*see* §24.09).

§24.02 General Rule: First in Time Prevails

Suppose O conveys fee simple absolute in Redacre to A, and later conveys the same estate to B. Who owns Redacre, A or B? The common law used a first-in-time rule to resolve this title conflict: the person whose interest is first delivered prevails.[2] For example, if A's deed was delivered on Monday, and B's deed was delivered a day later on Tuesday, then—all other things being equal—A owns Redacre. Whether A paid value for Redacre or received it as a gift is irrelevant; the first-in-time rule protects purchasers and donees alike.

Conflicts between possessory estates and nonpossessory interests are resolved in the same fashion. For example, if L grants an easement burdening Greenacre to C, and later conveys fee simple absolute in Greenacre to D, C's easement is first in time. Thus, although L's conveyance to D is valid, D takes title to Greenacre burdened by the easement. Conversely, if L conveys fee simple absolute in Greenacre to D, and thereafter grants an easement to C, D's deed is first in time under the basic rule. Accordingly, D takes title to Greenacre free and clear of the easement; C has no interest in Greenacre.

This traditional first-in-time rule is still a starting point for resolving title conflicts. But its significance has been greatly reduced by legislation. The recording acts adopted in most states carve out two exceptions to the basic first-in-time rule.

§24.03 First Exception to General Rule: Subsequent Bona Fide Purchaser Prevails

[A] Nature of the Exception

Almost all states recognize a major exception to the first-in-time rule: the *bona fide purchaser* doctrine. In general, a bona fide purchaser is one who purchases an interest in land for valuable consideration without notice of an interest already held by a third party. In a title dispute between a first-in-time owner and a later bona fide purchaser, the bona fide purchaser prevails.[3]

Suppose O conveys title to Blueacre to A, who fails to record his deed or take possession of the land. A few days later, B approaches O about buying Blueacre. O expresses interest in selling the land and fails to disclose his prior conveyance to A. B searches record title and inspects Blueacre, without detecting any adverse title claim. At close of escrow, (1) B pays O for the land, (2) O conveys title to B, and (3) B records her deed. B takes possession of Blueacre. Two weeks later, B first learns about the unrecorded O-A deed. Who owns Blueacre? In all states, B is the owner. B, the subsequent bona fide purchaser, prevails over A, the first-in-time owner.

The recording act in each state defines the precise requirements for bona fide purchaser status. Although the statutory language varies widely from state to state, there are three basic types of recording acts: notice; race-notice; and race.[4] Roughly half of the states are *notice* jurisdictions, which use the general bona fide purchaser definition described above (*see also* §24.04). And about half of the states are *race-notice* jurisdictions, which add the requirement that the bona fide purchaser must also be the first to record (*see* §24.05).[5] Finally, two states are *race* jurisdictions, which do not recognize the bona fide purchaser exception at all (*see* §24.08).

[B] Relativity of Title

At this point, a reader considering the above hypothetical might mentally protest: “But O first conveyed Blueacre to A. He had nothing left to transfer to B. So how can B be the owner?” The short answer to this question is that property rights are defined by law, not by the intentions of private parties.

Property rights exist only to the extent that they are recognized by our legal system. The law may choose to recognize different persons as the "owner" of the same property, depending on the circumstances. A basic precept of American property law is that title is *relative*, not absolute (*see* §4.05[C]).

In the above hypothetical, the O-A deed is fully effective *as between O and A.* In any title contest between O and A, the law will recognize A as the owner of Blueacre. However, *as between A and B*, the law chooses to recognize B as the owner of Blueacre for policy reasons (*see* §24.09). After all, A carelessly failed to record his deed or otherwise warn later buyers, while B is an innocent party who paid value for the land. As between negligent A and diligent B, the law vests title in B.

§24.04 Who Is a Bona Fide Purchaser? Notice Jurisdictions

[A] A Subsequent Purchaser for Value without Notice of the Prior Interest

In notice jurisdictions, a bona fide purchaser is a subsequent purchaser who pays valuable consideration for an interest in real property, without any notice of an interest that a third party already holds in the land. The definition has three key parts:

(1) a subsequent purchaser,

(2) for value,

(3) without notice of the prior interest.

[B] "A Subsequent Purchaser"

In ordinary usage, nonlawyers equate "purchaser" with someone who acquires "ownership" of land. But the recording acts use the term in a broader sense: a *purchaser* is almost any person who acquires any interest in land. Of course, someone who obtains fee simple or another freehold estate is considered a purchaser. The term also encompasses any person who acquires an easement, lease, lien, mineral interest, mortgage, restrictive covenant, or other possessory or nonpossessory interest.[6]

It is important to understand that only a *subsequent* purchaser requires the shelter of the recording acts. A *prior* purchaser is first-in-time, and accordingly protected under the common law rule unless there is a *subsequent* bona fide purchaser.

[C] "For Value"

[1] Defining Value

In order to qualify for bona fide purchaser status, the purchaser must pay *value*. The recording acts seek to protect the reasonable expectations of persons who make economic investments in good faith reliance on the state of record title, not those who merely receive gifts. Thus, donees, devisees,

and heirs are not purchasers for value.

How much must a grantee pay to be considered a purchaser for value? It is clear that the grantee need not pay full market value. And almost all courts agree that a grantee must pay more than mere nominal value.[7] Between these two extremes, however, the law is remarkably unclear. Some courts require a “substantial” amount in relation to market value;[8] others simply insist that the purchase price cannot be “grossly inadequate”; and still others merely require an amount that is greater than nominal consideration.[9]

Assume, for example, that B is about to purchase fee simple absolute in Greenacre, an apple orchard worth $300,000. In order to qualify as a purchaser for value, B need not pay $300,000 or any amount even close to this sum. On the other hand, a nominal payment of $1.00 or $5.00 is insufficient in most jurisdictions. Presumably, even $50,000 or $10,000 constitutes “value.” But what about $1,000 or $500? Only a vague guideline can be offered: the smaller the purchase price, the greater the risk that it will be held inadequate.

The confusion in this area probably stems from two sources. First, courts are attempting to distinguish between the purchaser who negotiated a bargain price, on the one hand, and the donee, on the other. The buyer who pays $100 for property worth $300,000, for example, seems more like a donee than a true purchaser for value, and does not merit protection under the recording laws. In many instances, the line between “bargain purchaser” and “donee who paid token consideration” requires a case-by-case adjudication. Second, courts are aware that the effective operation of the recording system requires both certainty and low administrative costs. The system cannot function if litigation is commonly necessary to determine a party's status as a bona fide purchaser. Accordingly, there is a clear judicial tendency to find that even very low amounts of consideration—such as $5,000 for a $300,000 property—constitute “value.”

[2] Debt as Value

In general, the mortgagee or other creditor who makes a loan and receives an interest in real property to secure repayment of the debt is considered a purchaser for value. Thus, if O borrows $10,000 from L, and in return gives L a promissory note for $10,000 secured by a mortgage on O's property Blueacre, L is protected by the recording acts.

There are two main exceptions to this rule. In most states, a pre-existing debt is not seen as value.[10] Suppose O borrows $7,000 from N and in return gives N an unsecured promissory note for $7,000. Six months later, N demands that O provide a mortgage on Blueacre to secure the debt, without giving O any new value; O complies. Under these circumstances, N is not a purchaser for value. The same logic applies to the creditor who obtains a judgment lien.[11] Suppose O injures P in a traffic accident; P sues O for personal injury and obtains a $10,000 judgment. P records his judgment, creating a judgment lien that encumbers O's property Blueacre. In most states, P is not considered a purchaser for value because he gave no new value in return for his lien. Thus, P is not protected by the recording acts.[12]

[3] Notice after Partial Payment

On May 1, B contracts to purchase title to Redacre from O for $100,000; B gives O a down payment of $20,000 and agrees to pay the balance on August 1. On May 15, B learns that O had previously conveyed Redacre to S on April 1. What are B's rights in Redacre?

In most jurisdictions, the buyer who receives actual notice of a prior interest after paying part of the purchase price is considered a bona fide purchaser *pro tanto*: payments made before notice are protected, but not later payments.[13] Here, B is a bona fide purchaser to the extent of her $20,000 down payment. In litigation between B and S, a court would have discretion to protect B in any one of three methods: (1) award all of Redacre to S, but require S to repay B's $20,000 down payment; (2) award a one-fifth interest in Redacre to B; or (3) allow B to obtain full title to Redacre by paying the $80,000 balance to S. A more difficult situation arises if the buyer is merely charged with record notice. Suppose that S records his deed from O on May 15, but B never actually learns about S's interest until August 2, after B has paid O in full. Under these circumstances, many courts hold that the buyer is a bona fide purchaser as to the entire purchase price, while others merely protect the buyer *pro tanto*.

In one illustrative case, the buyers paid $350,000 in advance, received a deed from the seller, and paid the $1,950,000 balance of the purchase price a year later. A third party, who had recorded a lis pendens before the buyers made this final payment, then claimed title to the land. The court found that the buyers were bona fide purchasers as to the entire purchase price, noting

that otherwise a buyer who already held title would have to undertake a title search before making each later payment; "[s]uch an obviously absurd result is fundamentally contrary to the whole purpose of the recording statutes."[14]

[D] "Without Notice of the Prior Interest"

A notice statute protects the subsequent purchaser for value who has *no notice* of the prior interest. The purchaser's knowledge is measured when the deed or other instrument is delivered, not later. As discussed below (*see* §24.06), a purchaser might receive notice in four different ways.

Suppose O conveys fee simple absolute in Blueacre to A. Two weeks later, on May 1, O conveys the same estate to B in exchange for valuable consideration. The next day, May 2, B receives a phone call from A, in which A informs B about the O-A deed. On May 3, B records the O-B deed. Who owns Blueacre? A is first-in-time, so B can prevail only if B is a bona fide purchaser. In notice jurisdictions, the key question is: did the subsequent purchaser for value have notice of the prior interest? As applied to these facts, we would ask: did B have notice of A's interest on May 1 (the day when B obtained delivery of the O-B deed)? No! The fact that B received actual notice on May 2—after the O-B deed was delivered—is irrelevant.

[E] Application of Rule

Consider a hypothetical. O, holding fee simple absolute in Greenacre, conveys a road easement to A on June 1; A fails to record his easement deed. On July 1, O encumbers the property with a mortgage in favor of B; B records on the same day. Finally, on August 1, O conveys fee simple absolute in Greenacre to C, a purchaser for value. In a notice jurisdiction, who holds what interest in Greenacre?

Suppose B forecloses on his mortgage and purchases Greenacre at the foreclosure sale. Does B take title with A's easement in place? A's interest is first in time, so B can prevail only if he qualifies for bona fide purchaser status. Thus, the question becomes: did B have notice of A's easement when the mortgage was delivered? On these facts, the answer appears to be "no." Because A's easement deed was never recorded, B is not charged with record notice; and B had no actual notice. Perhaps A used the easement in such an obvious and frequent manner that B is charged with inquiry notice. Otherwise, B qualifies for bona fide purchaser status and takes title free and

clear of A's easement.

But what about O's deed to C? As between B and C, B's interest is first in time, so C can prevail only if she qualifies for bona fide purchaser status. C is a subsequent purchaser for value. However, B's mortgage was recorded before C acquired her interest. This record notice bars C from protection as a bona fide purchaser. Accordingly, B owns fee simple absolute in Greenacre after the foreclosure.

§24.05 Who Is a Bona Fide Purchaser?: Race-Notice Jurisdictions

[A] A Subsequent Purchaser for Value without Notice of the Prior Interest Who Records First

In a race-notice jurisdiction, a bona fide purchaser is a subsequent purchaser for value without notice of the prior interest who records her interest first. The first three elements are the same ones required in a notice jurisdiction: *a subsequent purchaser ... for value ... without notice of the prior interest* (*see* §24.04).[15] Thus, race-notice jurisdictions merely add on a fourth requirement: the subsequent purchaser must be the first one to record.[16]

[B] Application of Rule

Assume O, holding title to Redacre, conveys the mineral rights to D on June 1; D fails to record the mineral deed. On July 1, O executes a lease in favor of E, who fails to record his lease or take possession of Redacre. On July 15, D records. Finally, on August 1, O conveys title to Redacre to F, a purchaser for value, who records. E then records. In a race-notice jurisdiction, who holds what interest in Redacre?

On these facts, D prevails over E. D is first-in-time, while E cannot qualify for bona fide purchaser protection because D recorded first. F also prevails over E. As between E and F, E was first in time, but here F is a bona fide purchaser for value who recorded before E did. Accordingly, E has no remaining interest in Redacre.

What about the respective rights of D and F? As between the two, D was first-in-time. Thus, F can prevail only if he both (1) is a bona fide purchaser for value and (2) recorded first. F is a purchaser for value. However, D recorded on July 15, before F obtained his interest on August 1. F accordingly had record notice of D's mineral deed, and cannot be a bona fide purchaser; in any event, D recorded before F did. Thus, F holds title to Redacre subject to D's mineral deed.

§24.06 What Constitutes Notice?

[A] Sources of Notice

The law recognizes four different types of notice:

(1) actual notice,

(2) record notice,

(3) inquiry notice, and

(4) imputed notice.

A later purchaser who is charged with notice from any one of these sources cannot qualify for protection as a bona fide purchaser.

[B] Actual Notice

Actual notice simply means knowledge of the prior interest. A person who knows that a prior interest exists has actual notice.[17] Suppose O first conveys Redacre to A; O then tells B, "I just conveyed Redacre to A." B now has actual notice of A's interest in Redacre. If B foolishly proceeds to purchase Redacre from O, B will not qualify for bona fide purchaser status in a later title dispute with A. A subsequent purchaser might obtain actual notice through any method of written, oral, or nonverbal communication (e.g., deed, letter, newspaper, phone call, radio broadcast, e-mail, personal conversation, or sign language) or by personal observation.

[C] Record Notice

Record notice (sometimes called *constructive notice*) means notice of any prior interest that would be revealed by an appropriate search of the public records affecting land title. A subsequent purchaser is charged with notice of such a prior interest, even if she never conducts a title search. Assume O conveys Greenacre to C, who promptly records his deed. Two months later, without first searching the public records, D purchases title to Greenacre from O. D could have found the recorded O-C deed in the public records. D has record notice of C's interest and cannot qualify for protection as a bona fide purchaser.

Which public records impart record notice? Deeds, mortgages, liens, easements, and other documents appropriately recorded in the local land records office provide record notice, under a complex maze of rules described in detail in Chapter 25. In addition, certain public records maintained by agencies other than the land records office (e.g., court files and property tax records) impart notice in many jurisdictions.

[D] Inquiry Notice

[1] Defined

Inquiry notice is based on the purchaser's duty to investigate suspicious circumstances. If a purchaser has actual notice of facts that would cause a reasonable person to inquire further, he is *deemed* to know the additional facts that inquiry would uncover *whether he inquired or not*.[18] The purchaser who performs the required investigation will receive actual notice. Thus, inquiry notice usually arises when the purchaser fails to investigate suspicious circumstances. Of course, if prudent investigation would not have revealed a fact, the purchaser is not charged with notice of that fact.

Inquiry notice issues arise most commonly in two situations: (1) notice from possession of land and (2) notice from a reference in a recorded document. Traditionally, courts found inquiry notice in a third situation: notice from a quitclaim deed. Any conveyance by a quitclaim deed was considered inherently suspicious, giving inquiry notice of all unrecorded interests to the grantee and successors in the chain of title. Most jurisdictions have either abandoned or restricted this rule.[19]

[2] Notice from Possession of Land

[a] General Principles

In most states, the purchaser is obligated to make a reasonable inspection of the land before purchase. And if a person other than the grantor is in possession, the purchaser is usually obligated to inquire about the possessor's rights.[20] Why? Possession by a stranger is suspicious. The possessor might be a friend or relative of the grantor, or perhaps a trespasser. But the possessor might hold an unrecorded interest in the land. As one court summarized, “[p]ossession of land by one under claim of title is notice to the world of such claim.”[21]

Suppose B purchases Blueacre from O, its record owner, at a time when X is in possession. Possession by X is inconsistent with record title. If B neglects to inspect the land at purchase, and thus fails to discover X's possession, he is charged with inquiry notice of any interest X may hold in Blueacre (e.g., an unrecorded deed or contract to purchase). If B does inspect the land, but neglects to inquire about X's status, he is similarly charged with inquiry notice.

Conversely, assume that O and X are sharing possession of Blueacre; X is O's daughter. Under these circumstances, B is not obligated to inquire. B may reasonably assume that X will vacate Blueacre along with O when the sale is complete.

[b] Tenants in Possession

Inquiry notice issues frequently arise when a tenant is in possession of the property. Suppose L plans to sell her 100-unit apartment complex to B; one of L's tenants is T, who rents unit #23. L gives B copies of the leases for all units, including T's lease. Each lease is a standard form document providing for a five-year term. Must B inquire further? In most jurisdictions, the answer is "yes." The purchaser is charged with inquiry notice of the rights of tenants in possession, whether or not they are reflected in written leases.[22] Thus, a purchaser like B has a duty to question T and all other tenants about their interests in the property.[23] For example, it is possible that T has entered into a new 50-year lease with L at a bargain rent, which L concealed from B; or perhaps T holds an unrecorded right of first refusal to purchase the apartment complex. This rule imposes an enormous (and expensive) burden on purchasers of multi-unit buildings.

What if the tenant's lease is recorded? Some courts hold—quite appropriately—that if the tenant's possession is consistent with a recorded lease, the purchaser has no duty to inquire further.[24] A fundamental precept of the recording acts is that a purchaser is entitled to rely on recorded documents. For example, if the tenant's recorded lease is merely a standard term of years lease, the purchaser is not charged with inquiry notice of the tenant's unrecorded option to purchase the property.[25]

[c] Acts Constituting Possession

There is little judicial agreement about the acts that constitute sufficient possession to put a purchaser on inquiry notice. Many courts seem to

analogize to the law of adverse possession by requiring conduct that is visible, open, notorious, exclusive, and so forth. For example, *Wineberg v. Moore*[26] involved competing title claims to an 880-acre tract of forest land, mainly suitable for growing timber, hunting, and fishing. One Barker, the original owner, first conveyed title to Wineberg, who failed to record. However, Wineberg (1) posted several “no trespassing” signs bearing his name; (2) occupied the cabin on the land occasionally for recreation; and (3) left items of personal property in the cabin that could be identified as his. When Barker later transferred interests in the land to two other parties, the court held that Wineberg's actions were enough to place the later purchasers on inquiry notice.[27]

At the other extreme, some courts hold that even minor and inconspicuous acts—which realistically would not afford notice—are enough to place a purchaser on inquiry.[28] The leading case is *Miller v. Green*.[29] After purchasing a 63-acre farm from Green, Miller plowed two acres and hauled a pile of manure to the land. Green later sold the farm to other buyers. Upon inspection, the buyers would have seen the plowed ground and the manure pile. These facts were held sufficient to afford inquiry notice. Why? Why shouldn't the later purchasers reasonably assume that Green or her agents had performed these acts?

[3] Notice from Reference in Recorded Document

In most states, a reference in a recorded document to an unrecorded document is sufficient to give inquiry notice.[30] For example, in *Harper v. Paradise*[31] a recorded 1928 deed recited that it was made to “take the place of” a 1922 deed that had been “lost or destroyed and cannot be found.”[32] In fact, the provisions of the 1928 deed differed significantly from those of the original deed. The Georgia Supreme Court held that later purchasers for value were on inquiry notice of the contents of the 1922 deed.

[E] Imputed Notice

Imputed notice arises from a special relationship between two or more persons; if one has actual knowledge of a fact, the others are also deemed to know the fact. For example, in some situations, an agent's knowledge is imputed to the principal, just as the knowledge of one general partner is imputed to the other partners.

§24.07 Second Exception to General Rule: The "Shelter Rule"

Under the *shelter rule*, a grantee from a bona fide purchaser is protected as a bona fide purchaser, even though the grantee would not otherwise qualify for this status.[33] In effect, a bona fide purchaser transfers this protected status to later grantees. The shelter rule is necessary to make bona fide purchaser protection meaningful. Without it, a bona fide purchaser might well be unable to sell the property.

Assume O first conveys fee simple absolute in Greenacre to A, and later conveys the same estate to B, a bona fide purchaser for value who records first. In all jurisdictions, B owns Greenacre. When B lists Greenacre for sale ten years later, A stands outside waving a huge banner that reads: "I obtained title to Greenacre before B did. I'm the real owner!" Prospective buyer C sees A's banner, and thereby obtains actual notice of A's prior interest. In a notice or race-notice jurisdiction, C and other potential buyers who see A's banner cannot qualify for bona fide purchaser status on their own. A's conduct might well prevent B from selling Greenacre—and thus recovering his economic investment in the property—unless B can pass on his protected status to his ultimate buyer. The shelter rule allows B to transfer his bona fide purchaser protection to later grantees.

§24.08 Special Rule for Race Jurisdictions: First Purchaser for Value to Record Prevails

Under a race recording statute, the first purchaser for value to *record* prevails. Suppose O conveys title in Blueacre to buyer A on Monday, and then to buyer B on Tuesday. If buyer B records her deed first, the law recognizes her as the owner of Blueacre. Conversely, if buyer A records first, he holds title. Priority is determined simply by which purchaser wins the "race" to the recorder's office. Thus, the race approach is a variant on the common law first-in-time rule. Race jurisdictions afford no special protection to the donee or other interest holder who fails to pay value. For example, assume O first conveys title to Blueacre to buyer C, and then conveys the same estate to donee D as a gift. Even if D records before C, C still owns Blueacre.

Notice is irrelevant in a race jurisdiction. Suppose that O conveys title to Blueacre to buyer A on Monday, and A fails to timely record. When B inquires about buying the land on Tuesday, O fully informs her about A's prior interest. Despite this actual notice, B proceeds to purchase Blueacre from O; O conveys title to Blueacre to B on Tuesday afternoon. If B records before A, B is deemed the owner of Blueacre.

The importance of the race approach is dwindling. Only a few states still apply the race approach to all transactions. A handful of other states use this approach only for mortgages or deeds of trust.

§24.09 Why Protect the Bona Fide Purchaser?

The first American recording acts were simple race statutes. Yet today almost all states extend special protection to the bona fide purchaser. And the handful of lingering race statutes seems destined for extinction. Why?

One reason is that the bona fide purchaser doctrine prevents fraud and quasi-criminal conduct, while a race statute allows the sophisticated to plunder the naive. Suppose O first conveys title to Greenacre to N for $200,000; O immediately conveys the same estate to his henchman S, who takes care to record the O-S deed before N does. O vanishes; S owns Greenacre; and N loses $200,000. O and S later split their ill-gotten gains. As one court summarized, "[t]he fundamental purpose of the recording statutes is to protect potential purchasers of real property against the risk that they may be paying out good money to someone who does not actually own the property that he is purporting to sell."[34]

A second theme might loosely be described as comparative negligence. When one of two innocent people must suffer a loss, the law usually allocates that loss to the person who had the best opportunity to avoid the problem in the first place. Suppose O first conveys title to Redacre to N, who carelessly fails to record his deed; one year later, O then conveys the same estate to P, who performs a careful title search before completing the transaction and recording his deed. N then records. As between N and P, who should suffer the loss of title? Prudent P did everything reasonably possible to avoid the loss. Negligent N, in contrast, could have prevented the loss by the cheap and simple expedient of recording his deed promptly. As law and economics theorists might explain it, allocating the risk of loss to the first-in-time buyer is economically efficient because he or she can avoid the loss at the cheapest cost.

A third rationale is that the notice variant of the bona fide purchaser doctrine encourages the commercial transfer of land, which in turn tends to allocate land to its most productive use. Suppose S owns a sheep pasture suitable for use as a factory site. In a race jurisdiction, prospective buyer B may be unwilling to take the risk of buying S's property. B might pay S $100,000 for title to the land at 9:00 a.m. on Monday, only to learn later that

P had purchased the same land from S on Sunday and recorded his deed at 9:01 a.m. on Monday. P prevails over B in a race jurisdiction because P's deed was recorded first. Conversely, in a notice jurisdiction, B is a bona fide purchaser and prevails over P; when B acquired her interest at 9:00 a.m. on Monday, she had no notice of S's prior deed. All other things being equal, as the argument goes, the bona fide purchaser doctrine shelters the prudent investor from unknown adverse claims, and thereby encourages socially-beneficial investment.

The principal criticism of the bona fide purchaser doctrine comes from the law and economics movement. A central precept of law and economics is that transaction costs impair the free transfer of property rights, and thus undercut efficiency (*see* §2.05[A]). Bona fide purchaser protection certainly increases transaction costs. To qualify, a buyer must diligently search record title, carefully inspect the property, and investigate any suspicious circumstances; all three steps consume time and money. Yet even a thorough pre-purchase inquiry cannot guarantee the buyer's title. Adverse title claimants may argue in later litigation that the buyer's inquiry was insufficient. The buyer who defeats this argument still suffers the expense and inconvenience of litigation, while the unsuccessful buyer loses title entirely. Law and economics theorists suggest that the race approach offers a “bright line” standard that reduces transaction costs.

A related argument is that the bona fide purchaser doctrine tends to undercut certainty of title. The new buyer's title is subject to potential challenge by prior adverse claimants. For example, suppose B purchases a farm from O. Adverse claimant A might later assert that B should be charged with inquiry notice of A's prior interest merely because A placed a haystack on the farm before B purchased. Because notice is always a question of fact, it is possible—though unlikely—that A might prevail. In any event, litigation would be required to resolve the dispute. Thus, as the argument goes, buyers like B may be less willing to invest in improving their lands. Why should B invest $1 million to build a new factory on the land, for example, if he may someday lose title? In contrast, a race statute provides a “bright line” test to determine who holds title: the first purchaser to record prevails. This standard arguably enhances the confidence of buyers to invest in socially-beneficial improvements.

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1. *See generally* Donald J. Kochan, *Dealing with Dirty Deeds: Matching Nemo Dat Preferences with*

Property Law Pragmatism, 64 Kan. L. Rev. 1 (2015); Taylor Mattis, *Recording Acts: Anachronistic Reliance*, 25 Real Prop. Prob. & Trust J. 17 (1990); John H. Scheid, *Down Labyrinthine Ways: A Recording Acts Guide for First Year Law Students*, 80 U. Det. Mercy L. Rev. 91 (2002).

2. The equity courts recognized one main exception to this rule: the later bona fide purchaser of a legal interest prevailed over one holding a prior equitable title.

3. *But see* Mugaas v. Smith, 206 P.2d 332 (Wash. 1949) (holding that record owner's conveyance of title to bona fide purchaser did not extinguish title held by adverse possessor).

4. *See* Argent Mortgage Co., LLC v. Wachovia Bank, 52 So. 3d 796 (Fla. Dist. Ct. App. 2010) (discussing types of recording statutes); Spickler v. Ginn, 40 A.3d 999 (Me. 2012) (same).

5. *See, e.g.*, Messersmith v. Smith, 60 N.W.2d 276 (N.D. 1953).

6. A person who pays value in good faith for a mortgage or other lien is commonly called a *bona fide encumbrancer*, but is governed by the same principles that affect bona fide purchasers.

7. *See, e.g.*, Hood v. Webster, 2 N.E.2d 43 (N.Y. 1936) (deed recital of $1.00 “and other good and valuable consideration” was inadequate). *But see* Strong v. Whybark, 102 S.W. 698 (Mo. 1907) ($5.00 was adequate).

8. *See, e.g.*, Anderson v. Anderson, 435 N.W.2d 687 (N.D. 1989).

9. *See, e.g.*, Horton v. Kyburz, 346 P.2d 399 (Cal. 1959) (holding that installation of fences, wells, and other improvements was more than mere nominal consideration and thus adequate); Holmquist v. King Cnty., 328 P.3d 1000, 1007 (Wash. Ct. App. 2014) ($10 payment was a “nominal amount” and thus inadequate).

10. *See, e.g.*, Gabel v. Drewrys Ltd., U.S.A., 68 So. 2d 372 (Fla. 1953).

11. *See generally* Dan S. Shechter, *Judicial Lien Creditors Versus Prior Unrecorded Transferees of Real Property: Rethinking the Goals of the Recording System and Their Consequences*, 62 S. Cal. L. Rev. 105 (1988).

12. *But see* Osin v. Johnson, 243 F.2d 653 (D.C. Cir. 1957) (holding that judgment creditor who could show reliance on record title should be treated as a purchaser for value); Rowe v. Schultz, 642 P.2d 881 (Ariz. Ct. App. 1982) (protecting judgment creditor as bona fide purchaser).

13. *See* Daniels v. Anderson, 642 N.E.2d 128 (Ill. 1994). *See also* Tomlinson v. Clarke, 803 P.2d 828 (Wash. Ct. App. 1991) (subsequent vendees under installment land contract who learned about prior unrecorded installment land contract 6 years later were bona fide purchasers).

14. Lewis v. Superior Court, 37 Cal. Rptr. 2d 63, 81 (Ct. App. 1994).

15. *But see* Eastwood v. Shedd, 442 P.2d 423 (Colo. 1968) (interpreting Colorado statute to protect subsequent donee).

16. *See, e.g.*, Simmons v. Stum, 101 Ill. 454 (1882) (prior mortgage had priority over later unrecorded deed); Gregerson v. Jensen, 669 P.2d 396 (Utah 1983) (prior grantee under unrecorded deed took property free and clear of claims based on later unrecorded contract). *See also* Spickler v. Ginn, 40 A.3d 999 (Me. 2012) (construing statute as creating race-notice system).

17. *See, e.g.*, Caruso v. Parkos, 637 N.W.2d 351 (Neb. 2002).

18. *See, e.g.*, *In re* Weisman, 5 F.3d 417 (9th Cir. 1993) (charging bankruptcy trustee with inquiry notice); Horton v. Kyburz, 346 P.2d 399 (Cal. 1959) (finding no basis for inquiry notice on facts); Swanson v. Swanson, 796 N.W.2d 614 (N.D. 2011) (uncle's statement at funeral put nephew on inquiry notice).

19. *But see* Schwalm v. Deanhardt, 906 P.2d 167 (Kan. Ct. App. 1995) (A sold a house to B, conveying title by a recorded quitclaim deed, and receiving part of the purchase price in the form of a note secured by an unrecorded mortgage; B mortgaged the house to C, who later claimed BFP status; the court held that C was on inquiry notice of A's mortgage because of the use of a quitclaim deed in the A-B sale and other suspicious circumstances).

20. *See, e.g.*, Waldorff Ins. & Bonding, Inc. v. Eglin Nat'l Bank, 453 So. 2d 1383 (Fla. Dist. Ct. App. 1984) (possession of condominium unit gave inquiry notice of occupant's unrecorded purchase

contract). *See also* Methonen v. Stone, 941 P.2d 1248 (Alaska 1997) (lot purchaser who saw water lines running from well on lot to adjacent properties was on inquiry notice of neighbors' water rights).

21. Russell v. Scarborough, 124 So. 648, 648 (Miss. 1929).

22. *Cf.* In re Clare House Bungalow Homes, LLC, 447 B.R. 617 (E.D. Wash. 2011) (lender was on notice of occupancy of units in senior living facility and had duty to inquire about terms of that occupancy).

23. *See, e.g.*, Cohen v. Thomas & Son Transfer Line, Inc., 586 P.2d 39 (Colo. 1978); Martinique Realty Corp. v. Hull, 166 A.2d 803 (N.J. Super. Ct. App. Div. 1960).

24. *See also* Raub v. General Income Sponsors, 176 N.W.2d 216 (Iowa 1970) (where grantor delivered deed, which was recorded, but retained possession of property, her possession did not impart notice).

25. *See, e.g.*, Gates Rubber Co. v. Ulman, 262 Cal. Rptr. 630 (Ct. App. 1989).

26. 194 F. Supp. 12 (N.D. Cal. 1961).

27. *See also* Bank of Mississippi v. Hollingsworth, 609 So. 2d 422 (Miss. 1992) (fencing of land by first buyer placed later lender on inquiry notice).

28. *See generally* John G. Sprankling, *The Antiwilderness Bias in American Property Law*, 63 U. Chi. L. Rev. 519, 540–44, 574–77 (1996).

29. 58 N.W.2d 704 (Wis. 1953).

30. *See, e.g.*, Jefferson County v. Mosley, 226 So. 2d 652 (Ala. 1969) (unrecorded right-of-way referenced in deed); Mister Donut of America, Inc. v. Kemp, 330 N.E.2d 810 (Mass. 1975) (recorded "notice of lease" gave notice of option to purchase contained in unrecorded lease); Gagner v. Kittery Water Dist., 385 A.2d 206 (Me. 1978) (recorded deeds which referenced right of water district to maintain pipes across land put buyers on inquiry notice of unrecorded easement).

31. 210 S.E.2d 710 (Ga. 1974).

32. Harper v. Paradise, 210 S.E.2d 710, 711–12 (Ga. 1974).

33. *See, e.g.*, Hatcher v. Hall, 292 S.W.2d 619 (Mo. Ct. App. 1956).

34. Swanson v. Swanson, 796 N.W.2d 614, 619 (N.D. 2011) (quoting from earlier decision).

Chapter 25

The Recording System

§25.01 The Recording System in Context

O owns Greenacre, a ranch worth $500,000. What prevents O from defrauding buyers by “selling” Greenacre two or more times? Consider the following scenario. O conveys title to A in exchange for $500,000; two days later O conveys title to B for the same price; finally, a week later, O conveys title to C for the same price. O pockets $1,500,000 and flees to a foreign paradise. While possible in theory, this scenario is highly unlikely in practice, thanks primarily to the recording system.[1]

In concept, the recording system is simple. Deeds, mortgages, CC&Rs (covenants, conditions and restrictions, *see* §35.03), judgments, and other documents affecting title to real property may be brought to a government office and placed in the public record for the world to see. As discussed in Chapter 24, the recording acts in almost all states generally provide that a later purchaser is charged with notice of the recorded prior interest—*even if she fails to search the records*—and accordingly cannot qualify for protection as a bona fide purchaser (*see* §24.03). In the remaining states, the later purchaser loses if she fails to record first as required by statute (*see* §24.08).

Yet the recording system is confusingly complex in practice. The difficulty can be summarized in a sentence: *not all recorded documents give notice*.[2] The rules governing which documents do provide notice—and which do not—are quite intricate. In large part, this law developed in reaction to the difficulty of searching voluminous paper records before the development of computers. Title documents that can be discovered only by unusually burdensome search methods do not provide notice in most jurisdictions.

§25.02 Purposes of the Recording System

The recording system serves two basic purposes. First, it *protects existing owners* from losing their property to later purchasers. For example, if A immediately recorded her deed from O in the above scenario, both B and C would be charged with notice of the O-A deed in a notice or race-notice jurisdiction. Because neither B nor C is a bona fide purchaser, A—the first-in-time owner—holds title to Greenacre (*see* §24.02). A also prevails in a race jurisdiction because she recorded first. The title protection arising from the recording system encourages owners like A to undertake the investment necessary to maximize the productivity of their lands, and serves other utilitarian goals.

Second, the recording system *protects new buyers*. A prudent buyer can commission a search of the public records before completing the purchase and thereby determine whether the seller is able to convey clear title. For example, if B hires an attorney to examine title to Greenacre, the attorney will quickly discover the recorded O-A deed and advise B not to proceed with the transaction. On the other hand if the O-A deed was never recorded, B's title search will not uncover any adverse claim to Greenacre. B can now proceed to buy the land as a bona fide purchaser, secure in the knowledge that the law will protect her title against any unknown prior interests.[3] In this manner, the recording system gives buyers the confidence necessary to invest.

§25.03 Anatomy of the Recording System

The recording system functions much like a specialized library. Imagine that almost anyone can write a book and place it on the library shelves, without any investigation by librarian L to determine if the book is accurate. Because the library contains so many books, L maintains a written catalogue or index that lists each one. Now suppose that student S wants to conduct research to answer a question. S consults the library catalogue, locates the books that appear relevant, examines these books, evaluates their accuracy, and ascertains the answer to her question, all without any assistance from L.

Like our hypothetical librarian, government officials have little control over which documents are recorded. A clerk briefly examines the form of documents submitted for recording (*see* §25.04[A]) but does not investigate their validity or accuracy. Did the grantor ever own title to the property? Did the grantor intend to deliver the deed? Did the grantee forge the grantor's signature? Is the property description correct? Government makes no effort to answer substantive questions like these; rather, it functions as a passive custodian. Inevitably, some recorded documents are ineffective or inaccurate.

Much like our hypothetical student, a title searcher must:

(1) examine official indexes to discover the documents that affect the parcel at issue;[4]

(2) read the relevant documents; and

(3) *independently* evaluate their legal significance to determine the state of title (*see* §25.05).

The government makes no representations about title. Instead, it leaves the process of determining title exclusively to private searchers.[5]

It is important to understand that the recording system extends to *all* interests in real property, not merely freehold estates. Thus, a person holding a recorded easement, mortgage, or other interest receives the same protection against later claims as the person holding record title. In the same fashion, a person who is planning to acquire an easement, mortgage, or other interest is charged with notice of previously-recorded documents, and thus must

undertake the same title search as someone planning to purchase title.

§25.04 Procedure for Recording Documents

[A] Mechanics of Recording

Suppose O conveys title to Blueacre to A. What steps must A take in order to record the O-A deed?

In order to qualify for recordation, a deed or other title document need only satisfy a few minimal requirements. First and foremost, virtually all states require that the document be acknowledged before a notary public or similar official. An acknowledgment is a declaration (1) by the grantor that he actually signed the deed or other document or (2) by a witness that he saw the grantor sign it. The acknowledgment is evidenced by a written certificate of acknowledgment, duly executed by the notary and physically attached to the deed. A second basic requirement is that the document must—at least loosely—take the form of a type of document that affects the title to or possession of real property, and, accordingly, is authorized to be recorded under state law (e.g., a deed, mortgage, or judgment). For example, a newspaper or theater ticket does not qualify for recording. Some jurisdictions impose additional requirements, such as affixing a seal or paying a transfer tax.

The actual recording process is quite simple. A presents the original deed to a clerk in the appropriate county agency (usually called the *recorder*) and pays a small fee. The clerk stamps the date and exact time of receipt onto the deed, together with its assigned document number. For example, if A's deed is the 10,347th document recorded in that county during 2017, it probably bears the document number “2017-10,347.” The clerk provides A with a photocopy of the stamped deed, and retains the original deed temporarily. A copy of the deed is then placed in the official county records and the deed is “indexed,” as described in [B], *infra*. After processing, the original deed is returned to A by mail.

As this example illustrates, the traditional recording process relies on paper documents. Today the electronic deed is valid in most states, though it is not widely used in practice. While some recorder's offices now permit electronic recording, the transition away from paper documents has been slow (*see* §25.09). However, electronic transactions will become

increasingly common in the next decade.

[B] Filing and Indexing

After a document is accepted for recording, it is entered into the county land records and noted in the appropriate index. Consider the hypothetical O-A deed again. Once grantee A leaves the recorder's office, a photocopy of the O-A deed is placed in the official records. The traditional method is to insert title documents into bound volumes (often called *deed books*) in the sequence of their recording. For example, if the most recently recorded document was placed on page 123 of book 86, then the photocopy of the O-A deed will be placed on page 124 of the same book; the original deed will be stamped to indicate that it was recorded at “Book 86, Page 124.” Today many recorder's offices store new title documents on microfilm rolls or microfiche. Despite the advent of the digital era, most offices do not utilize computerized data bases. Thus, the heart of an average recorder's office is a huge collection of paper records, often containing millions of title documents.

How can a later title searcher discover the O-A deed without examining every document? Each recorder's office maintains a book-like finding aid, known as an *index*. Most offices—about 75%—use the *grantor-grantee index*. In a grantor-grantee index, data about each deed or other title document is organized alphabetically according to the names of the parties involved and the year the transaction occurred. For example, if O's full name is Olivia P. Owner, information concerning the O-A deed will be entered into the grantor-grantee index under “Owner, Olivia P.” in the volume that covers the year 2017, when the O-A deed was recorded. An entry normally lists:

(1) the type of document (e.g., deed, lease, or mortgage),

(2) the grantor's name,

(3) the grantee's name,

(4) the document number,

(5) the recording date,

(6) the location where the document can be found in the records (e.g., the book and page number), and

(7) a brief legal description of the parcel.

The same information—organized under the name of the grantee—is contained in a counterpart index, called the *grantee-grantor index*.

Some recorder's offices utilize a *tract index*. In a tract index, information concerning each document is organized based on the legal description of the parcel involved.

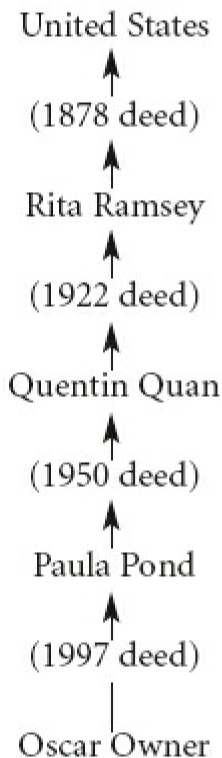
§25.05 Procedure for Searching Title

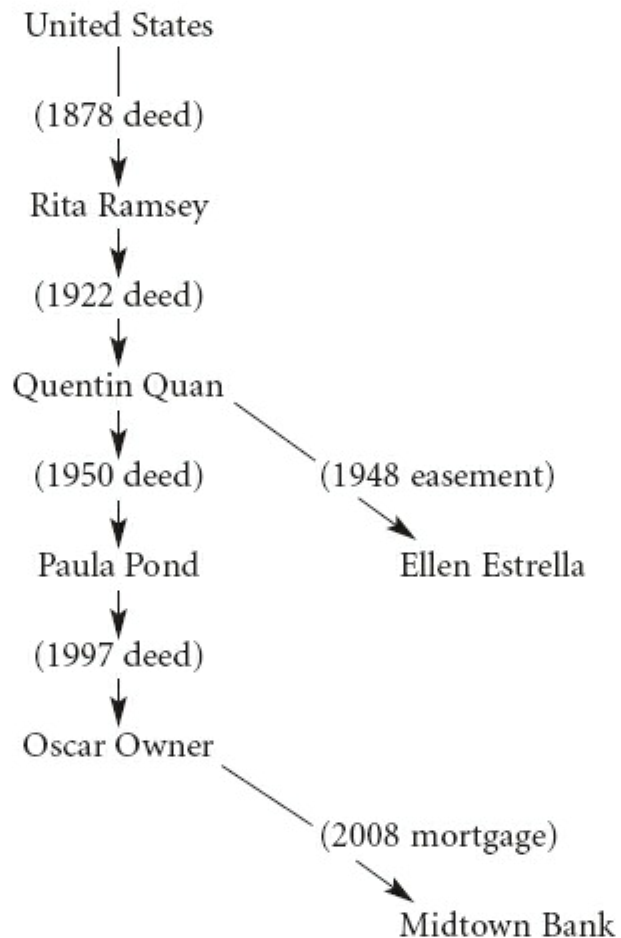
[A] Goals of Title Search

Prospective buyer A is thinking about purchasing Greyacre from Oscar Owner, its apparent owner. Before consummating the purchase, A prudently decides to investigate record title to Greyacre. A would probably retain an attorney, title company, or other agent to act on her behalf. But for the sake of simplicity, let us assume that A will personally perform the title search. We will further assume that A is not charged with actual, inquiry, or imputed notice of any adverse claim to Greyacre (*see* §24.06).

What are A's goals in searching title? First, A wants to ensure that Owner owns the estate he purports to be selling—presumably fee simple absolute in Greyacre. If title to Greyacre is held by someone else, A will discontinue negotiations. Second, A wants to identify and evaluate any liens, easements, and other encumbrances on Owner's title that may affect the value or desirability of the land. For example, if Greyacre is encumbered by a recorded covenant that limits its use to growing crops—thereby precluding residential or commercial development—it may be worth far less than an unrestricted parcel. Under these circumstances, A will either offer a lower price for Greyacre or refuse to purchase it at all.

Table 4: Title Search Using Grantor-Grantee Index





[B] Title Search Using Grantor-Grantee Index

[1] Overview

Assume that A's jurisdiction uses the grantor-grantee index. A will search title in three steps. First, A will search *backward* in time using the grantee-grantor index to locate each past conveyance of title, in order to find a historical starting point for the title search, as shown in Table 4. A will then search *forward* in time using the grantor-grantee index, examining each link in the chain of title shown in Table 4, to learn whether any grantor made any conveyances during his period of ownership other than the known conveyances. Finally, A will then read the documents discovered during her search of the grantor-grantee index and evaluate their legal significance.

[2] Step One: Search Backward in Time in Grantee-Grantor

Index

Where does A begin? A knows that Owner claims ownership of Greyacre. If so, then at some time, a prior grantor must have conveyed Greyacre to Owner, as grantee. But when? A's first step is to locate the entry for that conveyance in the *grantee-grantor index*. Assume A's search begins in 2017. Because A is unsure when Owner received title, A will search the grantee-grantor index backward in time under Owner's name (“Owner, Oscar”) as grantee for each year until she locates the entry. Suppose A searches the indexes for 2017, 2016, 2015, and so forth, year by year, and finally locates the entry in the 1997 index. The index entry indicates that Owner acquired title to Greyacre from someone called Paula Pond in 1997.

A now repeats the process, searching the grantee-grantor index backwards in time, year by year, under Pond's name to determine when Pond obtained title. Suppose A finally locates an entry in the 1950 index that shows that Pond obtained title from Quentin Quan. A again repeats the process, searching the grantee-grantor index backwards under Quan's name until she discovers in the 1922 index that Quan acquired title from Rita Ramsey. A again searches the grantee-grantor index backwards each year, under Ramsey's name, and locates an entry in the 1878 index that indicates that Ramsey acquired title to the land from the United States, under the nineteenth-century homestead laws.

In theory, a searcher should examine title backwards until the point where the land was owned by a “sovereign”—the federal government, a state government, the English crown, or another foreign government. Yet many searchers routinely limit their searches to a period of 40 to 50 years, because (a) the cost and difficulty of searching are high and (b) “stale” claims are unlikely to pose a serious title challenge. Marketable title acts in force in many states now limit the required scope of search to between 20 and 40 years (*see* §25.08). Having traced title to Greyacre back to the federal government—as shown in Table 4—A has gone far enough. She is now ready to shift her search to the grantor-grantee index.

[3] Step Two: Search Forward in Time in Grantor-Grantee Index

A now searches the grantor-grantee index under Ramsey's name to determine whether Ramsey made any conveyances during the period she

held title before the 1922 conveyance to Quan.[6] Thus, A will examine each index covering the period between 1878 and 1922 to locate any conveyances by Ramsey as grantor. Assume A finds that Ramsey made no conveyances before the 1922 deed to Quan. Should A search the indexes under Ramsey's name before 1878 (when Ramsey acquired title) or after 1922 (when Ramsey conveyed title to Quan)? Most jurisdictions do not require such an extensive search (*see* §25.07[B]), and we will assume that A's jurisdiction follows the majority approach.

A now repeats the process for each of the later grantors in the chain of title—Quan, Pond, and Owner—to determine whether any of them made any conveyances *during their respective periods of ownership* other than the known conveyances to each other. Thus, A searches the grantor-grantee indexes under Quan's name as grantor for each year between 1922 and 1950. Suppose A discovers an entry showing that Quan conveyed an easement over part of Greyacre to Ellen Estrella in 1948, before Quan conveyed title to Pond.

Continuing the search, A learns that when Pond held title between 1950 and 1997, Pond's only conveyance was the deed to Owner. Finally, A examines the grantor-grantee indexes between 1997 and the present to determine whether O conveyed any interest in Greyacre to anyone. To her surprise, she discovers a mortgage recorded in 2008 by which O mortgaged Greyacre to Midtown Bank to secure repayment of a $100,000 promissory note.

[4] Step Three: Read and Evaluate Documents That Affect Title

As shown in Table 4, A has located six documents that potentially affect title to Greyacre:

(1) the 1878 deed from the United States to Ramsey (technically termed a *patent*),

(2) the 1922 deed from Ramsey to Quan,

(3) the 1948 easement from Quan to Estrella,

(4) the 1950 deed from Quan to Pond,

(5) the 1997 deed from Pond to Owner, and

(6) the 2008 mortgage from Owner to Midtown Bank.

Using information provided in the index, A will now locate these documents

in the deed books and read them thoroughly.

Does Owner own fee simple absolute in Greyacre? There is a clear chain of title from the United States to Ramsey to Quan to Pond to Owner. A will examine each deed to ensure that it conveys fee simple absolute, rather than some lesser estate or interest; that it is valid on its face; and that it properly describes Greyacre as the property being conveyed. If so, A will rightly conclude that O owns fee simple absolute in Greyacre.

Are there any liens, easements, or other encumbrances on Owner's title that may affect the value or desirability of the land? A's search has discovered two apparent encumbrances: (1) the 1948 easement to Estrella; and (2) the 2008 mortgage to Midtown Bank. In any jurisdiction—race, race-notice, or notice—Quan received title to Greyacre in 1950 subject to the 1948 easement; as successors to Quan, Pond and Owner also took title subject to this easement. A will examine the document that created the Estrella easement (presumably a deed of easement) to determine its validity, purpose, and scope. If the easement is minor in scope (e.g., for an underground water pipe that crosses through a corner of Greyacre for a few feet), it will have little or no impact on the value or desirability of the land. However, a prospective buyer like A would also take subject to the Midtown Bank mortgage, and this presents a problem. A will evaluate the validity of the mortgage. If the mortgage is valid, A will either refuse to complete the purchase or insist that the purchase price be reduced.

[C] Title Search Using Tract Index

Now suppose instead that A's jurisdiction uses a tract index. If so, her title search will be relatively easy. In a tract index, all entries are organized according to the identity of the parcel involved, regardless of the names of the parties. Thus, all conveyances involving Greyacre are listed on a particular page of the tract index. Once A locates this page, she will immediately discover the six documents that affect title to Greyacre and can then evaluate their legal significance (*see* [B][4], *supra*).

§25.06 Recorded Documents That Provide Notice

In general, a recorded document provides notice if four requirements are met:

(1) it meets the formal requirements for recording (*see* §25.04[A]),

(2) it contains no technical defects (see §25.07[A]),

(3) it is recorded in the "chain of title" (*see* §25.07[B]), and

(4) it is properly indexed (*see* §25.07[C]).[7]

In everyday life, attorneys and other professionals are usually involved in the sale, loan, and other transactions that produce recordable documents. They are able to ensure that such documents are properly prepared and recorded. Accordingly, the vast majority of recorded documents do provide notice to later purchasers.[8]

§25.07 Recorded Documents That Do Not Provide Notice

[A] Defective Document

[1] Invalid Acknowledgment

A recorded document that fails to meet the formal requirements for recording—and thus should never have been recorded in the first place—generally does not give notice.[9] For example, if the acknowledgment is defective on its face or altogether absent, the document was not entitled to recordation, and is deemed unrecorded.[10]

A problem arises when the acknowledgment appears on its face to be valid, but suffers from a hidden defect. Suppose grantor G executes a deed in the absence of any notary; grantee E later convinces notary N to provide a certificate of acknowledgment, by which N falsely states that G personally acknowledged the deed in N's presence. The certificate appears valid on its face, but is technically invalid. E then conveys title to L, a bona fide purchaser; one week later, G purports to convey title to X, a purchaser for value.

Does the recorded G-E deed give notice to X? In most states, the answer is "yes." A later purchaser like L has no reason to suspect any flaw in the acknowledgment; and the costs of investigating each acknowledgment in the chain of title would be high. In a few misguided states, however, the G-E deed is deemed unrecorded; accordingly, X is protected as a bona fide purchaser.[11] This result is contrary to the policies underlying the recording acts.

[2] Incorrect Name

Similar difficulties arise when a recorded document contains significant errors in the names of the grantor or grantee. Suppose Greenacre is owned by Denise Berry. Berry conveys Greenacre to purchaser P, but the deed erroneously lists the grantor as "Denise Derry." The recorder's office will enter the B-P deed into the grantor-grantee index under the name "Derry, Denise." What if Berry now tries to sell Greenacre to X? Even if X diligently

searches the grantor-grantee index under "Berry, Denise," he will not locate the B-P deed. The B-P deed is outside the "chain of title" (*see* [B], *infra*), and thus does not provide notice.[12] Suppose instead that the B-P deed erroneously lists the grantor as "Denise Bery." In most jurisdictions, such a deed does give notice. Why? A court would reason that both "Berry" and "Bery" begin with the same letter, and are pronounced in substantially the same way, so the minor spelling variation is unimportant. Under the doctrine of *idem sonans*, when an improperly spelled name sounds substantially like the true name, the spelling error is ignored. Thus, a title searcher must search not only under the correct name, but also under all variations that *sound like* the correct name.

Is this an excessive burden? A growing minority of states rejects the idem sonans approach.[13] For example, one leading decision held that an abstract of judgment that wrongly identified the debtor as "William Duane Elliot" and "William Duane Eliot" did not give notice to third parties that a judgment lien existed against property owned by "William Duane Elliott" (with two "t's" and two "l's").[14]

[3] Incorrect Property Description

A deed or other document that contains a materially defective property description does not give notice.[15] In general, the description must be sufficiently accurate that a title searcher could both find the recorded document and determine that it concerned the land in question.

Luthi v. Evans[16] illustrates the point. There, Owens and others assigned their interests in various oil and gas leases to International Tours, Inc., pursuant to a written assignment that was later recorded. The assignment described the property subject to seven of these leases in great detail. It concluded with a sweeping "Mother Hubbard" clause, which provided that the "Assignors ... by this instrument convey, to the Assignee all interest ... in all Oil and Gas Leases in Coffey County, Kansas, owned by them whether or not the same are specifically enumerated above."[17] In fact, Owens owned an interest in an eighth oil and gas lease located in Coffey County, which she later transferred to Burris. The Kansas Supreme Court held that Burris was a bona fide purchaser because the earlier assignment did not describe the land subject to the eighth lease with sufficient specificity.

[B] Document Outside the "Chain of Title"

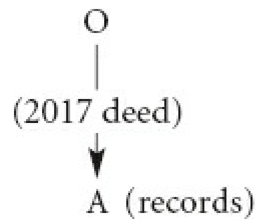
[1] The "Chain of Title" Generally

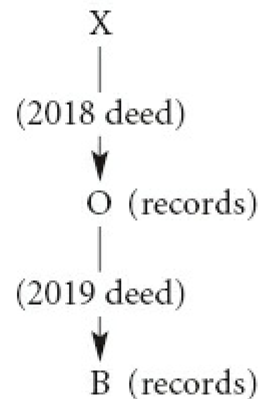
In general, recorded documents that cannot be located using the standard title search described above (*see* §25.05[B]) are deemed "outside" the *chain of title*. As such, they do not provide notice to later buyers. The four classic "chain of title" dilemmas are discussed below.

The chain of title concept is a judicially-invented limitation on the recording statutes. Consider a hypothetical "notice" statute that provides: "Every conveyance not recorded is invalid as against any subsequent purchaser in good faith and for a valuable consideration." Under the literal language of this statute, purchaser A takes priority over all later purchasers if she merely *records* her deed, even if the deed is difficult or even impossible for a later purchaser to find in the public records. Over time, courts interpreted such statutes to mean that a later purchaser was only charged with notice of documents that were recorded "in" the "chain of title" and thus could be discovered through a shorter title search. A document outside the chain of title is deemed "unrecorded."

Chain of title cases commonly focus on who should bear the notice burden—the prior purchaser or the later purchaser? The rationale of the typical case turns on which one is best situated to ensure that notice is received. Should the law require the prior purchaser to make sure that his or her deed is recorded in the chain of title, so that it can be easily located? Or should the later purchaser be required to conduct a more extensive search? In other words, where should the law draw the line between (a) protecting stability of ownership and (b) encouraging socially-beneficial transfers? The chain of title cases reflect a clear bias toward facilitating the transfer of land title to new owners.

Table 5: Prior Document Recorded Too Early



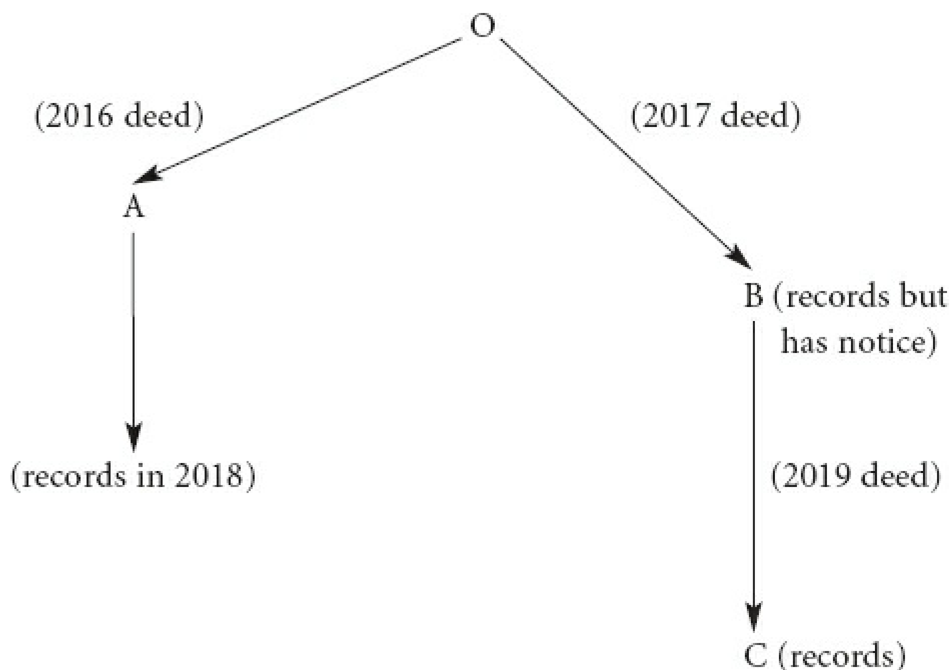


[2] Prior Document Recorded Too Early

Suppose X owns title to Greenacre. O, who has no legal rights in Greenacre, conveys title to A in 2017; A records the O-A deed. In 2018, X conveys title to O, who records the X-O deed. In 2019, O conveys title to B; B records. Is B charged with constructive notice of the O-A deed?

Most modern courts hold that a document recorded before the grantor obtained title—like the O-A deed—is not in the chain of title.[18] Why? The contrary rule would impose a difficult burden on title searchers and contribute to title uncertainty. A title searcher could locate the O-A deed only by searching the grantor-grantee index under O's name for every year of O's life before 2019. If O was born in 1969, for example, the title searcher would be required to search the index over a 50-year period, a heavy burden. On the other hand, the first grantee (here, A) can avoid the problem with minimal burden simply by rerecording the deed after his grantor (here O) receives title. Thus, under the majority approach, a title searcher need only search the index during the period *after* the grantor obtained title, here only the years 2018 and 2019. Therefore, B is not charged with notice of the O-A deed. Of course, this rule is inapplicable in a jurisdiction that uses a tract index. There the O-A deed would be indexed under "Greenacre" and thus could easily be found.

Table 6: Prior Document Recorded Too Late



[3] Prior Document Recorded Too Late

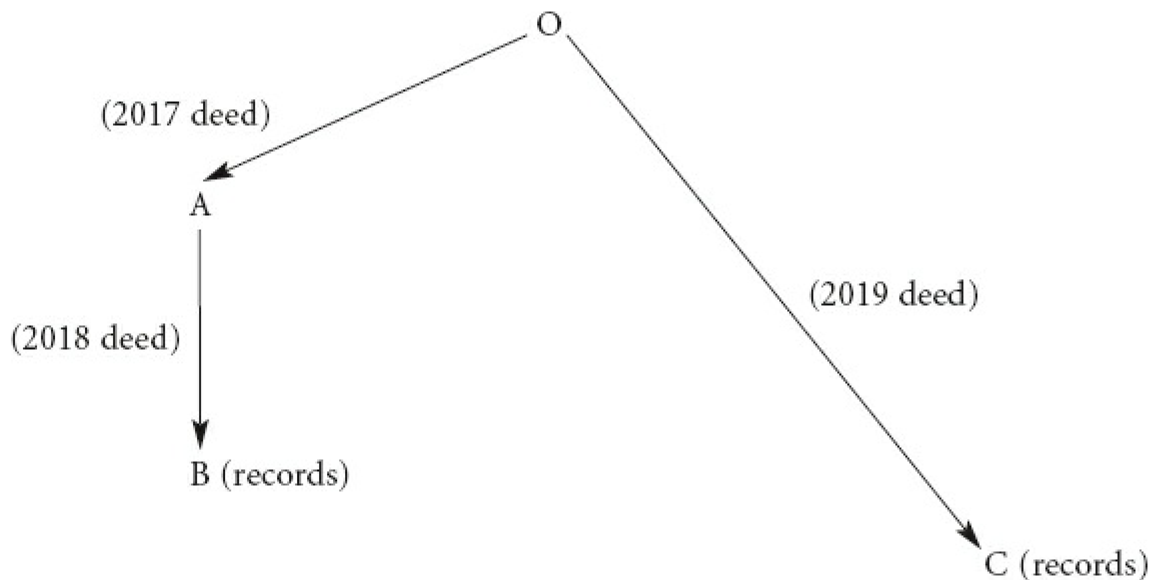
Suppose O acquires title to Greenacre in 2015. O conveys title to A in 2016, but A fails to record. In 2017, O conveys title to B, who immediately records; assume B has actual notice of the O-A deed and, accordingly, is not a bona fide purchaser. A records the O-A deed in 2018; in 2019, B conveys to C and C immediately records. Is C charged with notice of the prior O-A deed?

This "too late" scenario presents essentially the same issue as the "too early" scenario. Most courts resolve both in the same manner and for the same reason. In general, a prior deed recorded *after* the grantor conveyed title to a subsequent purchaser—like the O-A deed here—is not in the chain of title and does not give notice.[19] C is charged with notice of conveyances from O that were recorded *during* O's ownership and *before* O's recorded transfer to B. Here, C would have to search under O's name only from 2015 to 2017 and would not be charged with notice of the O-A deed.

The rationale for the majority rule is the burden of searching title. A title searcher could locate the O-A deed only by searching the grantor-grantee index under O's name for every year after O received title. This presents only a minor burden in the example above; the searcher need only examine the

index for two more years: 2018 and 2019. Yet in many cases the burden will be heavy. For example, suppose O acquired title in 1924, conveyed to A in 1925 (who failed to record), and then conveyed to B in 1926 (who recorded). Under the majority rule, a buyer like C in 2019 need only search the index under O's name for three years (1924 to 1926). Without this rule, C would be required to search title under O's name for 93 additional years (1926–2019). Again, use of a tract index would avoid this dilemma.

Table 7: Prior Deed from Grantor Outside Chain of Title



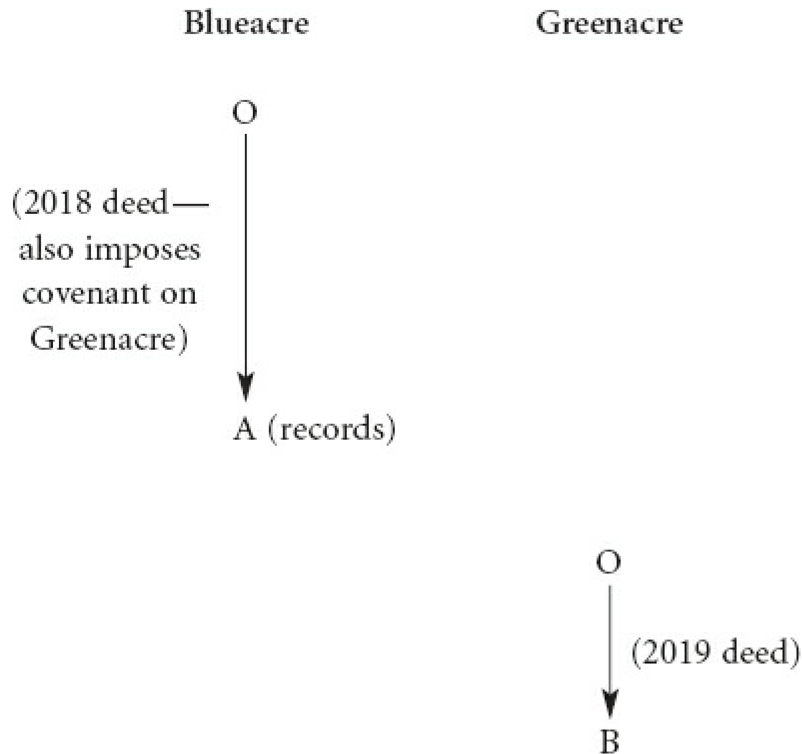
[4] Prior Deed from Grantor Outside Chain of Title

Suppose O owns Greenacre. In 2017, O conveys title to A, but A fails to record. In 2018, A conveys title to B, who immediately records. Finally, O conveys title to C in 2019 and C records. Is C charged with constructive notice of the prior A-B deed?

A prior conveyance from a grantor who is outside of the recorded chain of title—commonly called a *wild deed*—does not give constructive notice.[20] Even with the most thorough search, a later purchaser such as C could never discover the A-B deed in the grantor-grantee index. By definition, the A-B deed would be indexed under the name of the grantor, here A. But C, who is ignorant of A's existence, could only search the index under O's name. In theory, C could locate the A-B deed by reviewing each and every document ever recorded in the county land records. But this would impose an

extraordinary burden on title searchers. In contrast, the search would be simple in a jurisdiction that utilizes a tract index.

Table 8: Deeds from Common Grantor of Multiple Lots



[5] Deeds from Common Grantor of Multiple Lots

Suppose O acquires title to two adjacent properties, Blueacre and Greenacre, in 2017. In 2018, O conveys Blueacre to A and—by the same deed—covenants that Greenacre will only be used for growing crops. A records the O-A deed, but the responsible official in the recorder's office indexes the deed only using a property description of Blueacre. In 2019, O conveys Greenacre to B, without disclosing the restrictive covenant. Is B charged with constructive notice of the covenant in the O-A deed?

This dilemma arises most frequently in the subdivision context, where the subdivider uses one deed to perform two functions: conveying title to a lot and imposing CC&Rs or an easement on the subdivider's retained land. A later purchaser may be charged with inquiry notice if there is visible evidence of the interest; for example, a road provides notice that an easement may exist (*see* §24.06[D][2]). In the above hypothetical, the fact that crops are growing on Greenacre probably would not put B on notice of the

restrictive covenant, unless farming is highly unusual in the area (e.g., if Greenacre is in New York City).

States are evenly divided on whether a later purchaser is charged with constructive notice in this situation. Courts that find notice typically stress that the earlier deed can be discovered simply by examining every conveyance made by the grantor while he or she owned the property at issue.[21] Here, B could locate the restrictive covenant in the O-A deed by reading every deed from O that was recorded between 2017 and 2019, regardless of the property description used in the index. Another consideration is whether a state statute mandates the recorder's office to enter property descriptions in the index; without such a statute, some courts conclude that a title searcher cannot rely on any property description data that the recorder voluntarily chooses to include in the index.[22]

Conversely, courts that find no notice usually emphasize the burden of searching title.[23] Suppose that O in the above example is an active real estate developer who has subdivided and sold thousands of residential lots. B might be required to examine thousands of deeds before discovering the covenant.

[C] Improperly Indexed Document

Suppose O conveys Greenacre to A. A duly records her deed, but a clerk in the recorder's office neglects to enter it in the index. Two years later, C conducts a careful title search and reasonably concludes that O owns Greenacre. O now conveys title to C. Is C charged with notice of the O-A deed?

In many states, a non-indexed document gives notice.[24] Under this approach, C cannot qualify for bona fide purchaser status and, accordingly, A owns Greenacre. The same result follows if a document is indexed erroneously (e.g., using an incorrect grantor name or property description). The rationale underlying this approach is straightforward; the first-in-time buyer has done everything necessary to provide notice and should not be penalized by an unforeseeable clerical error. Yet this rule leads to an absurd result: later buyers like C are charged with knowledge of documents that they cannot find. Arguably, this approach both discourages transactions and increases costs for all parties.[25]

Conversely, in a number of states (including California and New York), an

improperly indexed document is treated as unrecorded.[26] Under this approach, C is a bona fide purchaser and hence owns Greenacre without the covenant. Legal scholars generally endorse this view, reasoning that the first-in-time buyer is in the best position to avoid the problem. A could easily check to ensure that the O-A deed is properly indexed.[27] On the other hand, C has no reason to know that the O-A deed ever existed. C could discover the deed only by examining every document recorded in the county while O held title, an extraordinarily burdensome search.

§25.08 Effect of Marketable Title Acts

The traditional title search through the grantor-grantee index is often costly and time-consuming. And it may uncover dated or "stale" interests that—while unlikely to present a title problem—must nonetheless be investigated at substantial expense.

Broad *marketable title acts* enacted in many states address these concerns.[28] In a nutshell, if an owner has a clear record chain of title back to a *root of title* (that is, a deed or similar document that created or transferred title) for a specified period (commonly 20 to 40 years) then title is free from all rights or interests that were recorded before the root of title.[29]

Suppose O acquires title to Blueacre, a vacant lot, in 1950. In 1952, O enters into a written agreement with his neighbor N, whereby O covenants that any building constructed on Blueacre will not exceed one story in height; the covenant is immediately recorded. In 1955, O conveys Blueacre to A, who records; and in 1991 A conveys title to B, who records. C now plans to purchase Blueacre from B. Assume that there is no recorded reference to the covenant after 1952. If the jurisdiction has a broad marketable title act, will C take title subject to the covenant? No. The 1955 O-A deed is deemed a root of title, because it transferred title more than 40 years before the present. Thus, C is *only* subject to interests that appear in the record *after* the 1955 deed. There is no later mention of the covenant and, accordingly, C's title will not be affected by it.[30]

The marketable title acts are certainly an overdue reform of an antiquated system. In theory at least, a title searcher need only conduct a limited search—back to a root of title—thereby minimizing expense and delay. However, these acts contain so many exceptions that an extended search is usually still required. The exceptions always include interests held by the federal government and normally extend to such items as utility easements, mineral interests, and water rights. On balance, most commentators conclude that these acts have fallen far short of their laudable objectives.

Limited marketable title acts—typically directed toward one type of interest—are in force in many states. A typical statute concerns "ancient" mortgages, mineral rights,[31] or reversionary future interests (*see* §13.05).[32]

§25.09 Technology and the Future of the Recording System

There is a clear trend toward computerization of public land title records.[33] In many recorder's offices, copies of newly-recorded documents are stored electronically and information about these filings is entered into a computerized index, usually a grantor-grantee index. Yet even these pioneers have made little effort to computerize previously-recorded documents. And the majority of recorder's offices still utilize the traditional system of paper records. Why? The costs of shifting to a computerized system are immense, while there is little public demand for modernization.[34]

However, the Uniform Real Property Electronic Recording Act has accelerated this trend.[35] Most states have already adopted the Act, which gives each local recorder's office the option to accept electronic documents, in addition to paper documents. Thus, it may soon "be possible for electronic recording systems to accept electronic documents 24 hours per day and seven days per week despite the fact that no one is in the office to process the document at the time."[36]

The recording system of the future will center around a computerized tract index. Each tract of land will be assigned a unique identifying number, akin to the modern assessor's parcel number used for property taxation.[37] All recorded documents will be stored electronically, based on the tract identification number. If X, a prospective buyer, wants to search title to Greyacre, the process will be quick, simple, and inexpensive. X will enter Greyacre's identification number into a computerized data base, and immediately retrieve copies of all recorded documents that affect title to the land.[38]

The traditional chain of title rules will wither away in this new environment. These rules developed as judicially-crafted exceptions to the recording acts due to the search burden created by the paper record system. But the reason for these rules will disappear once the wild deed and similar items can readily be discovered through a computerized tract index.[39]

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1. *See generally* Charles Szypszak, *Real Estate Records, the Captive Public, and Opportunities for*

the Public Good, 43 Gonz. L. Rev. 5 (2007); Taylor Mattis, *Recording Acts: Anachronistic Reliance*, 25 Real Prop., Prob. & Trust J. 17 (1990).

2. *See, e.g.*, Luthi v. Evans, 576 P.2d 1064 (Kan. 1978); Messersmith v. Smith, 60 N.W.2d 276 (N.D. 1953).

3. *See, e.g.*, Island Venture Assocs. v. New Jersey Dep't of Envtl. Protection, 846 A.2d 1228 (N.J. 2004) (lot buyer not bound by use restrictions outside chain of title). Yet even if a title search reveals no adverse interest, a buyer may still be subject to various prior unrecorded interests that arise as a matter of law (e.g., dower rights or title based on adverse possession).

4. *See, e.g.*, Luthi v. Evans, 576 P.2d 1064 (Kan. 1978) (searcher could not discover assignment of lease in index due to inadequate property description).

5. A handful of jurisdictions utilize a registration system, under which government does determine the state of title. *See* §26.05.

6. A might also search the grantor-grantee index to determine if the United States conveyed title to anyone other than Ramsey before 1878, but we will assume that A begins by searching under Ramsey's name.

7. *See also* Mountain States Tel. & Tel. Co. v. Kelton, 285 P.2d 168 (Ariz. 1955) (building contractor working on land had no duty to search title, and thus was not on constructive notice of recorded easement that referred to underground cable).

8. In most jurisdictions, a later purchaser is also charged with constructive notice of certain records *outside* of the recorder's office, such as probate files, bankruptcy files, and tax records. A complete title search will include an examination of such records.

9. *See, e.g.*, Leasing Enter., Inc. v. Livingston, 363 S.E.2d 410 (S.C. Ct. App. 1987). However, some jurisdictions have adopted “curative acts,” which retroactively cure minor defects in recorded documents—such as a defective acknowledgment or seal—after a period of years.

10. *See, e.g.*, Hatcher v. Hall, 292 S.W.2d 619 (Mo. Ct. App. 1956) (obvious defects on face of supposed acknowledgment). *But see In re* Barnacle, 623 A.2d 445 (R.I. 1993) (recorded mortgage was defective because it was signed by only one of two mortgagors, but still provided constructive notice).

11. *See, e.g.*, Messersmith v. Smith, 60 N.W.2d 276 (N.D. 1953).

12. *See* Ball v. Vogtner, 362 So. 2d 894 (Ala. 1978) (recorded certificate that listed debtor as “Mary Morgan” did not give constructive notice of judgment lien to later purchasers from “Mary Collins”).

13. *See, e.g.*, Nat'l Packaging Corp. v. Belmont, 547 N.E.2d 373, 375–76 (Ohio Ct. App. 1988) (“We are not a frontier society of pioneers with little education or an absence of precedent and system.... In modern society we cannot overlook matters of form by continuing to indulge in the outmoded premises of our societal infancy. To impose rigidly the doctrine ... would tax all land abstractors beyond reasonable limits and require them to be poets, phonetic linguists, or multilingual specialists.”).

14. Orr v. Byers, 244 Cal. Rptr. 13 (Ct. App. 1988).

15. *See, e.g.*, Bowlin v. Keifer, 440 S.W.2d 232 (Ark. 1969) (no property description in document).

16. 576 P.2d 1064 (Kan. 1978).

17. *Id*. at 1066.

18. *See, e.g.*, Sabo v. Horvath, 559 P.2d 1038 (Alaska 1976); Ryczkowski v. Chelsea Title & Guar. Co., 449 P.2d 261 (Nev. 1969); Palamarg Realty Co. v. Rehac, 404 A.2d 21 (N.J. 1979). *But see* Nally v. Bank of New York, 820 N.E.2d 644 (Ind. 2005) (“a mortgage recorded before a deed to the mortgagor is recorded but after the deed is dated and delivered is within the mortgagor's chain of title”).

19. *See, e.g.*, Palamarg Realty Co. v. Rehac, 404 A.2d 21 (N.J. 1979). *But see* Woods v. Garnett, 16 So. 390 (Miss. 1894) (following minority view).

20. *See, e.g.*, Board of Education v. Hughes, 136 N.W. 1095 (Minn. 1912). Similarly, a purchaser whose chain of title is based on a wild deed cannot qualify as a bona fide purchaser; by definition, he is on notice that his grantor did not have record title to the property. Salt Lake County v. Metro West

Ready Mix, Inc., 89 P.3d 155 (Utah 2004).

21. *See, e.g.*, Guillette v. Daly Dry Wall, Inc., 325 N.E.2d 572 (Mass. 1975).

22. *See, e.g.*, *id*.

23. *See, e.g.*, Witter v. Taggart, 577 N.E.2d 338 (N.Y. 1991). *See also* Genovese Drug Stores, Inc. v. Conn. Packing Co., Inc., 732 F.2d 286 (2d Cir. 1984) (subsequent lessee not charged with notice).

24. *See, e.g.*, Haner v. Bruce, 499 A.2d 792 (Vt. 1985). *Cf*. Skelton v. Martin, 673 So. 2d 877, 879 (Fla. Ct. App. 1996) (where written records maintained by county recorder's office showed delinquent taxes, but county's computerized system did not, later buyer who checked only computer system was not bona fide purchaser as to tax lien; "[T]here is no present statutory right to accurate government information on the Internet. At this point in history, such computerized data is not a form of notice constitutionally guaranteed ... by the Fourteenth Amendment to the United States Constitution."); MidCountry Bank v. Krueger, 782 N.W.2d 238 (Minn. 2010) (mortgage entered into index without complete property description was "imperfectly indexed," but provided constructive notice).

25. *See* Howard Savings Bank v. Brunson, 582 A.2d 1305, 1309 (N.J. Sup. Ct. Ch. Div. 1990) (under this approach, "lengthy title searches would cost more and would cause unreasonably long closings; potential purchasers, mortgagors and lenders would hesitate to be involved in commercial transactions where they could not be confident that a reasonable search of the record would reveal prior interests or where they feared being held liable for a clerk's misindexing error; and the cost of title insurance would increase").

26. *See, e.g.*, Mortensen v. Lingo, 99 F. Supp. 585 (D. Alaska 1951).

27. *See, e.g.*, Howard Savings Bank v. Brunson, 582 A.2d 1305, 1309 (N.J. Sup. Ct. Ch. Div. 1990) ("[P]lacing the burden on the [first in time party] to ensure that the requisite notice has been given is not out of step with the equitable maxim that where a loss must be borne by one of two innocent parties, equity will impose the loss on the party whose first act would have prevented the loss.").

28. *See generally* Walter E. Barnett, *Marketable Title Acts—Panacea or Pandemonium?*, 53 Cornell L. Rev. 45 (1967).

29. *See* H & F Land, Inc. v. Panama City-Bay County Airport & Indus. Dist., 736 So. 2d 1167 (Fla. 1999); Marshall v. Hollywood, Inc., 236 So. 2d 114 (Fla. 1970); Heifner v. Bradford, 446 N.E.2d 440 (Ohio 1983).

30. How could N have avoided this result? In such a jurisdiction, all who claim interests in land must periodically record a notice of claim or similar document (e.g., every 40 years). For example, if N had recorded such a notice in 1992, his covenant would survive.

31. *See, e.g.*, Short v. Texaco, Inc., 406 N.E.2d 625 (Ind. 1980).

32. *See, e.g.*, Presbytery of Southeast Iowa v. Harris, 226 N.W.2d 232 (Iowa 1975).

33. *See generally* John L. McCormack, *Torrens and Recording: Land Title Assurance in the Computer Age*, 18 Wm. Mitchell L. Rev. 61 (1992).

34. Ironically, privately-owned title insurance companies already utilize computerized land record systems. Thus, in one case involving work performed by a title insurance company, the court noted that "[t]he evidence in this case is interesting because it demonstrates a serious variance between the statutory method for the maintenance of public records and the electronic means by which most private and public records are now retrieved. Technology has clearly jumped ahead of the traditional methods of public record-keeping." Skelton v. Martin, 673 So. 2d 877, 879 (Fla. Dist. Ct. App. 1996).

35. For a discussion of electronic recording, see Jessica Kopplin Kranz, Note, *Expedition E-Recording, First Stop URPERA: How Universal E-Recording under URPERA Could Revolutionize Real Estate Recording in the United States and Why It Should*, 13 Minn. J.L. Sci. & Tech. 383 (2012).

36. Unif. Real Prop. Elec. Recording Act §3, Legislative Note.

37. *See* Paul E. Bayse, *A Uniform Land Parcel Identifier—Its Potential for All Our Land Records*, 22 Am. U. L. Rev. 251 (1973).

38. *See* John G. Sprankling et al., Global Issues in Property Law 116–19 (2006) (discussing system

in England and Wales, where electronic title records for most properties are already available to the public via the internet).

39. *See* Emily Bayer-Pacht, Note, *The Computerization of Land Records: How Advances in Recording Systems Affect the Rationale behind Some Existing Chain of Title Doctrine*, 32 Cardozo L. Rev. 337 (2010).

Chapter 26

Methods of Title Assurance

§26.01 Title Assurance in Context

Although it is common to discuss the purchase of "land," in reality the buyer is purchasing something quite different: title to land.[1] Title is a set of intangible, legally enforceable rights relating to a specific parcel of land. While a layperson might think that S "owns" Blackacre, technically S merely owns an estate in Blackacre (*see* Chapter 9). Thus, if B contracts to purchase "Blackacre" from S for $400,000, B is actually purchasing title to Blackacre. If S's title is defective, B may ultimately receive nothing in exchange for her $400,000 purchase price. B is protected, of course, if she discovers a title defect *before* close of escrow; the express contract provisions concerning title (or alternatively, the implied covenant of marketable title) will presumably allow her to rescind the contract or use other remedies (*see* §20.06[B]). But how can B protect herself against a title defect that is discovered *after* the close of escrow?

Three different methods of title assurance are widely used in the United States:

(1) covenants of title in deeds;

(2) title opinions and abstracts; and

(3) title insurance.

Perhaps surprisingly, none of these methods offers absolute and complete protection of the buyer's title. Because each has its own weaknesses and limitations, title assurance methods are frequently combined in a single transaction. In the above purchase, for example, B might obtain both covenants of title from the seller and title insurance from a nationally recognized company, thereby minimizing the risk of later title defects. A fourth method of title assurance—registration of title—flourishes in a few regions.

An effective system of title assurance is crucial to the marketability of land. If potential buyers like B cannot obtain reasonable protection against unknown title defects, they will be much less willing to purchase real property. On the other hand, the transaction costs of providing perfect title security to all buyers would be immense. The American system is essentially

a compromise that provides adequate title assurance for the vast majority of buyers at a socially acceptable cost.

§26.02 Covenants of Title

[A] What Are Title Covenants?

S conveys title to Greenacre to B, in return for the payment of $500,000. One day later, B discovers that S never owned any right, title, or interest in the property and—accordingly—neither does B. What are B's rights?

A deed usually contains express promises by the grantor about the state of title to the land being conveyed. These promises are known as *covenants of title* or *title covenants*. If one of these covenants is breached, the grantee (and sometimes his successors) may recover damages from the grantor. Here, depending on the language of the deed, B may be able to sue S for breach of the covenants of seisin and right to convey.

Title covenants originated in medieval England as a primitive method of title assurance. A prospective buyer could not readily search title before purchasing land in that era because England lacked an effective land record system. A buyer was forced to rely on the honesty and integrity of the seller. It became customary for the grantor to promise or covenant to the grantee that his title was good by including express language in the deed. If title failed, the grantee could sue the grantor for damages.

Although title covenants are still used routinely, their importance as a source of title protection has waned in recent decades, particularly in commercial transactions. Other methods of title assurance—notably title insurance—offer better security to the modern buyer.

[B] Scope of Title Covenants

[1] The Six Title Covenants

American law has traditionally recognized six covenants of title:

(1) covenant of seisin,

(2) covenant of right to convey,

(3) covenant against encumbrances,

(4) covenant of warranty,

(5) covenant of quiet enjoyment, and

(6) covenant of further assurances.

A deed may contain all, some, or none of these covenants; and parties may invent new and different covenants. But these six listed covenants are customarily included in most deeds.

The first three covenants above are known as *present covenants*. They are breached, if at all, at the instant the deed is delivered to the grantee. Accordingly, the statute of limitations for breach of a present covenant begins running when the deed is delivered.

The final three covenants are called *future covenants*. As the phrase suggests, they are concerned with future acts or omissions. A future covenant is breached, if at all, only when the grantee is actually or constructively evicted by someone holding superior title or suffers other damage. Thus, the statute of limitations for breach of a future covenant commences in the future, when the breach occurs.

[2] Discussion of Individual Covenants

[a] Covenant of Seisin

The *covenant of seisin* warrants that the grantor is the owner of the estate described in the deed. The covenant covers both the type of estate (e.g., fee simple absolute) and the quantity of land (e.g., 100 acres) being conveyed. Suppose O purports to convey fee simple absolute in Greenacre to B, using a general warranty deed. The covenant of seisin is breached, for example, if O owns a mere life estate in Greenacre, because O does not own the type of estate he attempted to convey. The covenant is similarly breached if O only owns fee simple absolute in the north half of Greenacre, because he does not own all of the land described in the deed.

What if O in fact owns fee simple absolute in all of Greenacre, but his title is encumbered by a mortgage in favor of M? This is not a breach of the covenant of seisin; O indeed owns fee simple absolute, the type of estate warranted. M's mortgage is merely an encumbrance on this title, and thus a breach of the covenant against encumbrances (*see* [c], *infra*).

As a general rule, even a buyer who purchases with full knowledge of a title defect can recover damages for breach of the covenant of seisin. Suppose B is aware that title to Greenacre is uncertain because O and T both

claim to be the sole owner. If O conveys his estate to B pursuant to a general warranty deed and the court later recognizes T's title, O is liable to B.

The covenant of seisin—as one of the three present covenants—guarantees the state of title only at the time of the conveyance. Thus, the covenant is breached—if at all—at the instant the conveyance is made and the statute of limitations begins running immediately. An illustrative decision is *Brown v. Lober*,[2] where the grantors purported to convey title to an 80-acre tract without exceptions, yet did not own two-thirds of the mineral rights. The grantors escaped liability for this clear breach of the covenant of seisin only because the grantees—apparently unaware of the title defect—failed to sue before the statute of limitations expired.

[b] Covenant of Right to Convey

The *covenant of right to convey* warrants that the grantor has the legal right to transfer title.[3] Thus, this covenant overlaps substantially with the covenant of seisin. If F, having no right, title, or interest in Greenacre, purports to convey a life estate in Greenacre to G, F has breached both covenants. The covenant of right to convey is independently important only in a few situations. T, the trustee of a trust who attempts to convey title to trust property in violation of the trust, for example, owns the estate described in the deed but lacks the legal authority to convey title. Similarly, R might own fee simple absolute in a particular parcel, but lack the right to convey due to an express restraint on alienation in his chain of title. Like the covenant of seisin, the covenant of right to convey is a present covenant that is breached—if at all—at the time of conveyance.

[c] Covenant against Encumbrances

[i] Nature of Covenant

The *covenant against encumbrances* warrants that there are no encumbrances on the land conveyed. What is an encumbrance? In this context, an encumbrance generally means a right or interest held by a third party—other than a present freehold estate or future interest therein—that reduces the value or restricts the use of the land. The typical encumbrance is a mortgage, easement, restrictive covenant, lease, tax lien, judgment lien, mechanic's lien, water right, or other interest in land of lesser legal status than a freehold estate.

Suppose O owns fee simple absolute in Greenacre; the land is burdened by an easement in favor of P, which allows a hidden, underground water pipe to cross Greenacre. O executes a general warranty deed conveying his estate in Greenacre to B. This conveyance does not breach the covenants of seisin or right to convey, because O owns this estate and has the right to convey it. But because P's easement is an encumbrance, the covenant against encumbrances is violated at the time of conveyance.

The scope of this covenant is controversial in two situations. Does the violation of a zoning ordinance, housing code, or other land use regulation constitute an encumbrance? And does the covenant extend to encumbrances that are obvious and visible on the land?

[ii] Ordinances and Regulations

Real property in the United States is widely subject to zoning ordinances, housing codes, and other land use regulations. All jurisdictions agree that the *existence* of such ordinances and regulations is not an encumbrance.[4] Assume, for example, that O conveys Greenacre, a vacant lot, to B pursuant to a general warranty deed. B later discovers that a local ordinance bars the building of a two-story structure on the land, and that a private covenant imposes the same restriction. Neither the ordinance nor the covenant has been violated, because the lot is vacant. The mere existence of the one-story ordinance is not a breach of the covenant against encumbrances. But the existence of the private covenant, which has the same effect, is considered a breach.

Suppose instead that there is a four-story office building on Greenacre that already violates the ordinance when B acquires title. Does the *violation* of such an ordinance breach the covenant against encumbrances? Some courts find a breach in this situation, based on the risk of litigation or similar proceedings to compel compliance.[5] Conversely, other courts conclude that such a violation does not breach the covenant against encumbrances because it merely creates a potential cause of action, not a present lien or other interest in land.[6] These courts reason that holding the seller liable for a latent violation of a land use ordinance, which could not be discovered by a title search or physical inspection of the premises, would be fundamentally unfair.

[iii] Obvious and Visible Encumbrances

Suppose O's property Greenacre is burdened with an obvious and visible defect that affects the physical condition of the land: a railroad track crosses the property. If O now sells his estate in Greenacre to B, is the covenant against encumbrances breached? The case law on the question is split into two approaches.[7] One view holds that permanent and readily visible improvements such as power lines, roads, and railroad tracks clearly indicate to any buyer that the land is subject to an easement. Accordingly, the buyer has presumably discounted the purchase price and cannot reasonably expect that the covenant against encumbrances will cover the defect.[8] But a number of courts still follow the traditional rule, insisting that the covenant extends to all encumbrances unless its language indicates otherwise.[9]

[d] Covenant of Warranty

Technically, the *covenant of warranty* is not a promise that the grantor has good title to convey. Rather, it is the grantor's promise to defend the grantee's title against other claimants; the grantor agrees to defend and indemnify the grantee who suffers an eviction or similar interference with possession of the land by a person who has superior or “paramount” title. This covenant covers both complete loss of title and the presence of an encumbrance on title. But —unlike the present covenants—it is breached only when someone holding superior title actually or constructively evicts the grantee from the land.[10] In addition to compensatory damages, the grantor is also usually liable for the attorney's fees expended by the grantee in unsuccessfully defending against the superior title claim. For all practical purposes, the covenant of warranty is identical to the covenant of quiet enjoyment.

Suppose O conveys Blueacre, a 40-acre forest tract, to A in 2017; A immediately records his deed, but allows Blueacre to remain in pristine condition. In 2019, O conveys Blueacre to B under a general warranty deed. B, who failed to search title in advance, is ignorant of A's interest, and immediately takes possession of Blueacre by building a cabin there. B now learns about O's deed to A. All states will recognize A as the true owner of Blueacre on these facts.

What must happen before B can assert a claim against O for breach of the covenant of warranty? A might actually evict B, for example, by using self-help to forcibly remove B from the land. But this scenario is unlikely to occur. A would probably first demand that B vacate Blueacre. Or A might

simply sue B to recover possession. If B vacates Blueacre in response to A's demand or lawsuit—and A is indeed the true owner—most courts would view this as a constructive eviction that breaches the warranty.[11]

On the other hand, what if A never takes any action that threatens to interfere with B's possession? Here the covenant has not yet been breached, and thus suit by B is premature. *Brown v. Lober*[12] exemplifies the point. There, the grantors purported to convey fee simple absolute in 80 acres, but failed to convey two-thirds of the mineral rights, which were owned by another. But the mineral rights holder never challenged the grantees' title or possession. The Illinois Supreme Court observed that the mere *existence* of a paramount title was insufficient to breach the covenant of quiet enjoyment; rather, the grantees could not sue until someone holding superior title *actually interfered* with their possession (e.g., by beginning to remove minerals).

[e] Covenant of Quiet Enjoyment

The *covenant of quiet enjoyment* warrants that the grantee's possession and enjoyment of the property will not be disturbed by anyone holding superior title. The original distinction between this covenant and the covenant of warranty was slowly erased by case law and statutes. As a practical matter, this covenant is now identical to the covenant of warranty.

[f] Covenant of Further Assurances

The *covenant of further assurances* is a promise that the grantor will execute any additional documents and take any other actions that are reasonably necessary to perfect the grantee's title.

[3] Title Covenants in Standard Deed Forms

In theory, the buyer and seller are free to negotiate the nature and scope of the title covenants that will appear in the deed. Freedom of contract allows the parties to select any combination of title covenants (e.g., covenants of seisin and warranty only) or none at all. In practice, however, the parties customarily select one of three basic deed forms, each providing a different level of title assurance: the general warranty deed, the special warranty deed, and the quitclaim deed.[13]

The *general warranty deed* contains all six standard title covenants discussed above and, accordingly, provides the most title protection (*see*

§23.03[B]). In some jurisdictions it is customary to expressly list each title covenant in the text of the deed. However, in most jurisdictions, the covenants are incorporated by reference into a short form deed through the use of shorthand terms (e.g., “warrant”) usually pursuant to statutory authority.[14]

Suppose O plans to convey Redacre to A, but is aware that Redacre is encumbered by a title defect that cannot be removed—a recorded covenant that prohibits building a two-story structure on the land. O is unwilling to warrant title against this covenant. How can A obtain a general warranty deed? The answer is that parties can modify the title covenants in any deed simply by exempting known defects. Here, O's general warranty deed could expressly state that the title covenants do not apply to this particular covenant.

The *special warranty deed* contains the same six standard title covenants found in the general warranty deed, but applies them *only* to title defects caused by the acts or omissions of the grantor (*see* §23.03[C]). Again, these covenants may be either listed on the face of the deed or incorporated by reference. The title protection afforded by the special warranty deed is quite limited, simply because it does not cover the acts or omissions of other parties. For example, suppose that O, holding fee simple absolute in Redacre, first executes a $100,000 mortgage in favor of A, and then conveys title to B. B, in turn, grants C an access easement across Redacre, and then conveys title to D, using a special warranty deed. D now learns that Redacre is encumbered by (1) A's mortgage and (2) C's easement. B is liable for breach of the covenant against encumbrances because she conveyed the easement to C. Because the special warranty deed warrants only against B's own conduct, however, B is not responsible for the mortgage created by O.

Finally, the *quitclaim deed* contains no title covenants at all (*see* §23.03[D]). The grantor providing a quitclaim deed makes no warranties of any kind about the quality of his title, if any.

[C] Rights of Grantee's Successors

[1] Present Covenants

Suppose A conveys title to Redacre twice, first to B and then to C (who is not a bona fide purchaser), using a general warranty deed each time; C

immediately conveys title to D, using a mere special warranty deed. D has no warranty claim against C because C did not personally cause the title defect. Can D sue A for breach of the covenant of seisin in the A-C general warranty deed?

In a majority of states, the grantee's successor cannot sue the original grantor for breach of a present covenant, such as the covenant of seisin or covenant against encumbrances.[15] A present covenant is breached—if at all—when the deed is delivered. When the A-C deed was delivered, C immediately had a cause of action against A for breach, not a continuing covenant. The common law, fundamentally hostile to the assignment of a cause of action, refused to allow D to sue in C's place. This rule makes little sense today from a policy standpoint. Modern law allows the free assignment of causes of action. Why should the original grantor be relieved of liability merely because the grantee elects to transfer title?

A handful of states allow the successor to sue a remote grantor for breach of a present covenant. These states reason that the grantee's deed to a successor is an implied assignment of the grantee's existing cause of action against the grantor.[16]

[2] Future Covenants

On the other hand, future covenants do run with the land to the grantee's successors. Thus, the grantee's successors may sue the original grantor for breach of the covenants of quiet enjoyment, warranty, and further assurances.[17] Return to D's dilemma in the above hypothetical (*see* [1], *supra*). Suppose D takes possession of Redacre from C at close of escrow; one week later, B forcefully removes D from the land. This actual eviction is sufficient interference with D's rights to breach the covenants of quiet enjoyment and warranty in the A-C deed. Thus, D could successfully sue A for breach of these future covenants.

[D] Remedies for Breach of Covenant

The grantor is liable for compensatory damages if any title covenant is breached. The appropriate measure of damages turns on which covenant is involved. As a general rule, however, the amount of recoverable damages cannot exceed the purchase price paid by the grantee.[18] The grantee who receives property as a gift through a warranty deed, for example, cannot

recover against the donor-grantor in most states.

The measure of damages for breach of most covenants—including the covenants of seisin and right to convey—is measured by the grantee's purchase price plus interest.[19] Suppose B purchases Greenacre from S for $150,000 pursuant to a general warranty deed; a court later holds that S's title was founded upon a forged deed, nullifies B's title claim, and orders that B be ejected from the land. Here S has breached the covenants of seisin, right to convey, warranty, and quiet enjoyment, entitling B to the return of his entire $150,000 purchase price. Alternatively, if B lost title to only 10% of Greenacre—a partial breach of covenant—he would receive a pro rata refund, here $15,000.

What if B loses title to all of Greenacre when its fair market value is $200,000, either due to appreciation or B's construction of improvements? In either situation, B's damages are restricted to the purchase price, $150,000. Why? Courts traditionally defend this result by explaining that value increases are unforeseeable, and contrary to the parties' contractual intent in establishing the purchase price. This rationale rings hollow in an era of increasing land values, particularly if the land—such as a residential building lot—is obviously destined to be improved.

Encumbrances present a different problem. Assume that after B purchases Greenacre from S for $150,000, he learns it is encumbered by: (a) a mortgage securing repayment of a $10,000 promissory note; and (b) an easement for an existing underground sewer pipe. The usual measure of damages for breach of the covenant against encumbrances is the amount paid by the buyer to remove the defect; if removal is impossible, the buyer's damages are measured by the diminution in the fair market value of the property caused by the defect on the purchase date. The same standard applies to breach of the covenants of warranty and quiet enjoyment when the title defect involved is an encumbrance. Here, B will be able to eliminate the mortgage by paying the amount due on the secured note, probably now less than $10,000; he is entitled to reimbursement from S for this sum. On the other hand, it is unlikely that the holder of the sewer pipe easement will voluntarily relinquish his rights; if not, B's damages will be measured by the reduction in the value of Greenacre caused by the easement.[20]

A special limitation applies to the grantee's successor suing the original grantor for breach of future covenants. The measure of damages is limited by

the purchase price paid by the original grantee.[21] Assume S conveys Greenacre to B for $150,000 by general warranty deed, and B later conveys the property to C for $200,000 by a quitclaim deed. If C is ultimately ejected from Greenacre due to S's lack of title, his maximum recovery for breach of the covenants in the S-B deed is $150,000 plus interest.

[E] Perspectives on Title Covenants

The unfortunate grantee who encounters a title defect after the close of escrow may also discover that the title covenants in the deed—even a general warranty deed—provide only limited protection. At best, the prudent buyer should rely on title covenants only to buttress another form of title protection, such as a title insurance policy.

First, the practical value of any title covenant hinges on the solvency of the grantor. If the grantor is bankrupt, dead, or simply unfindable, the luckless grantee will recover nothing even if the grantor is clearly liable. Suppose O conveys title to Greenacre to A, who moves onto the property but fails to record his deed. O then conveys Greenacre to B—who prudently conducts a title search but carelessly assumes A is merely a lessee—for $200,000 pursuant to a general warranty deed. O later promptly loses all of his money (including B's $200,000) while gambling at Atlantic City. Although O clearly breached deed covenants, B will recover nothing.

Second, the statute of limitations may bar any action against the grantor. Like the unfortunate plaintiff in *Brown v. Lober*,[22] the grantee may learn that an action on the present covenants is time-barred and an action on the future covenants is premature.

Finally, the damages awarded to the grantee who prevails in an action against a solvent grantor may not provide full compensation, particularly if the fair market value of the land has increased substantially or the grantee has built a home or other improvements.

§26.03 Title Opinions and Abstracts

Another method of title assurance is an attorney's opinion of title based on the examination of public records. Unlike early England, the United States has established a comprehensive system of public land records (*see* Chapter 25). It is accordingly possible for an American buyer to obtain title protection above and beyond the seller's covenants of title.

The process of obtaining a title opinion is simple. Suppose B is considering the purchase of O's property Goldacre and retains attorney A to provide a title opinion. A searches the public records affecting title to Goldacre, including not only the recorded documents found in the local recorder's office, but also applicable probate files, tax assessment records, and the like. Based on his examination of these records, A issues a written opinion on the state of title to Goldacre. The opinion identifies the holder of record title to Goldacre, lists any title defects revealed by the search, and states whether title is marketable.

Alternatively, A's title opinion might be based on an abstract of title. Under this approach, A does not examine the public records himself. Rather, A requests a nonlawyer who specializes in searching title (an *abstractor)* to prepare a written summary (an *abstract)* of the title to Goldacre. In chronological order, the abstract briefly describes every deed, mortgage, judgment, and other document affecting title to Goldacre that has ever been entered into the public records. A then relies on the abstract to prepare his title opinion.

A title opinion serves two distinct functions, one before the close of escrow, and one thereafter. First, the prudent buyer will include a provision in the sales contract that conditions the obligation to purchase on the prior receipt of an acceptable title opinion or title insurance policy (*see* §20.06). Thus, if the opinion discloses unacceptable title defects, the buyer can simply refuse to proceed with the purchase.

Alternatively, if the buyer purchases the property and later discovers that the title opinion was negligently prepared, he can recover compensatory damages by suing the attorney for malpractice.[23] If the abstractor caused the problem by performing a careless search, the attorney is not liable, but the

buyer can generally sue the abstractor for negligence.[24] A problem arises, however, if the buyer did not directly employ the abstractor. Traditionally, the buyer had no claim if the abstractor was hired by another party (e.g., the seller) due to lack of privity. But modern courts usually find that the buyer's reliance on the abstract is reasonably foreseeable, and thus permit suit against the negligent abstractor even without privity.[25]

The title opinion was the dominant method of title assurance in the United States during the nineteenth century and throughout much of the twentieth century. Today, however, the importance of this method is diminishing due to the widespread use of title insurance. The title opinion is the principal method only in a handful of jurisdictions.

§26.04 Title Insurance Policies

[A] The Rise of Title Insurance

Title insurance is a uniquely American method of title protection. Invented in the late nineteenth century, it remained relatively unimportant until the post-war boom of the 1940s. Over the last 70 years, title insurance has become the dominant form of title protection in the United States. Most buyers obtain an owner's title insurance policy, instead of an attorney's opinion of title. Despite the continued trend toward title insurance, buyers still rely on title opinions in some regions, particularly in rural sections of the Midwest and South.

What accounts for the modern popularity of title insurance? One reason is that title insurance offers better protection for buyers. For example: (1) title insurance covers “off-record” defects such as forgery or incapacity, while the title opinion assesses only record title; and (2) the title insurer is strictly liable for a covered defect, while the attorney is liable only for negligence. Ethical restraints also play a role; the rules of professional ethics bar attorneys from soliciting business, while title insurance companies are free from such limits.

But most authorities attribute the rise of title insurance to a third factor: the impact of the secondary mortgage market (*see* §22.04[B]). Title insurance offers a uniform, national system for protecting title, which provides crucial protection for lenders buying mortgages in interstate commerce. Banks and other institutional lenders now routinely require that virtually all new residential mortgages be protected by title insurance, and this in turn leads buyers to obtain owner's policies protecting their own title.

[B] What Is Title Insurance?

The title insurance policy is a contract of indemnity between the issuing company (the *insurer*) and the property owner or mortgagee (the *insured*). In the policy, the insurer promises to compensate or indemnify the insured against losses caused by covered title defects. Most types of insurance policies are prospective: they provide protection against contingent events that might occur in the future (e.g., a car accident or a flood). Title insurance,

in contrast, is retrospective: it protects only against title defects that already exist at the time title is transferred, not those that may arise in the future.

[C] Two Functions of Title Insurance

[1] Title Assurance before Close of Escrow

Like the title opinion, title insurance serves two related functions. Before close of escrow, it effectively tests the quality of the seller's title. The buyer will often condition the obligation to buy on the insurer's willingness to issue an adequate title insurance policy. If such a policy is available, the buyer will complete the purchase, knowing that he is protected if title defects are ultimately discovered. On the other hand, if such a policy cannot be obtained, the buyer is excused from performing the contract. Thus, before close of escrow, the availability of title insurance serves as a substitute for the buyer's examination of title.

Suppose B executes a contract to purchase Greenacre from S, contingent on obtaining title insurance. B applies to title insurance company T for a policy. Is T willing to ensure title to Greenacre? To answer this question, T, a prudent insurer, will examine the state of title to the property. Like many title insurance companies, T may maintain a computerized *plant* of land title records that parallels the public land record system; if so, T's employees will search this data base to locate recorded documents that affect title to Greenacre. Alternatively, T might base its analysis on a search of title performed by a local attorney or a professional abstractor. Based on this title examination, T will provide B with a *preliminary report*, *title report*, or similar document stating whether it will insure title to Greenacre and, if so, on what terms and conditions. T will normally exclude from coverage any title defect that is discovered during the search process. T is, after all, entitled to determine the nature and extent of the risk it is willing to take. If T and other insurers are unwilling to provide an adequate policy (e.g., because Greenacre is actually owned by X), the contract condition fails, and B is released from any obligation to buy Greenacre.

Or, as is more likely, suppose S owns fee simple absolute in Greenacre, but that the property is subject to a recorded encumbrance (e.g., an easement for a future freeway). T is willing to insure B's title to Greenacre in general, but will not insure against this known—and troublesome—defect. Such a policy would probably not satisfy the title condition in the B-S contract.

[2] Compensation after Close of Escrow

The second function of the title insurance policy is compensation. The standard policy imposes two basic duties on a title insurance company: the duty to defend and the duty to indemnify. The duty to defend obligates the company to incur the attorney's fees and costs necessary to defend the insured's title against legal challenge, subject to the policy terms. If this defense is unsuccessful, the company is required to either cure the defect or indemnify the insured.

Where a covered title defect is discovered after close of escrow, the insured buyer is entitled to recover for any actual loss that is proximately caused by the defect. This sum is usually measured by the lesser of (a) the amount needed to remove the defect from title or (b) the extent to which the defect reduces the fair market value of the land. The insured may also be able to recover foreseeable consequential damages (e.g., lost rental income, lost profits). In no event, however, can the insured's recovery exceed the policy limit specified in the policy itself.[26]

Assume, for example, that B obtains a title insurance policy upon her purchase of Blueacre, with a policy limit of $120,000. B later learns that Blueacre is encumbered by an enforceable restrictive covenant in favor of an adjacent neighbor, N, which restricts its use to farming. If N demands $100,000 to release the covenant, but the covenant only diminishes the value of Blueacre by $80,000, B's recovery is limited to the smaller of these two sums, here $80,000. Suppose instead that the farming-only covenant reduces market value by $150,000 and N demands $200,000 to remove it; here B's recovery is only $120,000, the limit she agreed to when purchasing her policy.

[D] Scope of Title Insurance Policy

[1] Policy Provisions Generally

Most title insurers use standard policy forms developed by the American Land Title Association (“ALTA”). Insurers in a few states utilize forms that are based on ALTA policies with regional modifications. The national trend, however, is toward uniformity.

There are two basic categories of ALTA forms: the owner's policy and the lender's policy. An insured may, of course, purchase special endorsements

that expand the scope of coverage. The discussion below will focus on the terms of the standard ALTA owner's policy, the type most commonly purchased by property owners. ALTA also offers a “plain language” policy that has broader coverage and is growing in popularity. Ironically, this innovative policy creates new problems of ambiguity. Unlike the standard ALTA owner's policy—which has generated an extensive body of interpretative case law—the plain language policy has little or no judicial track record.

The standard ALTA owner's policy has five parts:

(1) the cover page (which describes the covered risks);

(2) the Exclusions from Coverage (which list standard exclusions from coverage that apply to all properties);

(3) Schedule A (which states the name of the insured, the estate being insured, the policy premium amount, the policy limit, and the description of the property);

(4) Schedule B (which lists the exceptions to coverage relevant to the particular property); and

(5) the Conditions (which impose various procedural requirements concerning the time, manner, and scope of claims).

Despite the increasing use of standard policy forms, ambiguities sometimes arise. In most jurisdictions, ambiguities are interpreted against the insurer and in favor of the insured. Thus, coverage clauses are construed expansively, while exclusionary clauses are construed narrowly.[27]

[2] Covered Risks

The standard ALTA owner's policy covers four main types of risks.[28] Assuming no exception or exclusion applies, the title insurance company will compensate the insured owner if:

(1) title to the estate is actually held by someone other than the insured owner;

(2) there is a defect, lien, or encumbrance on the insured owner's title;

(3) title to the land is unmarketable; or

(4) the insured owner has no right of access to the land.

The first covered risk—if title is held by another—is straightforward.

Suppose B obtains an ALTA owner's policy upon her purchase of Greenacre from S, showing that she holds fee simple absolute. B is entitled to compensation, for example, if fee simple absolute in all of Greenacre is actually vested in someone else (e.g., because S's title is founded upon a forged deed) or if another party holds fee simple absolute in part of Greenacre (e.g., because S conveyed away part of Greenacre by an earlier deed).

The scope of the next two covered risks is more troublesome. The policy protection against defects, liens, and encumbrances essentially safeguards the insured against any mortgage, easement,[29] restrictive covenant, lease, tax lien, assessment lien,[30] judgment lien, mechanic's lien, water right,[31] or other interest in land of lesser legal status than a freehold estate, much like the deed covenant against encumbrances (*see* §26.02[B][2][c]).[32] And the common law doctrine of marketable title (*see* §20.06[B]) largely defines the meaning of "unmarketability" in the title insurance context as well. But—as illustrated by *Lick Mill Creek Apartments v. Chicago Title Insurance Co.*[33]—determining the scope of coverage is sometimes difficult.

Lick Mill was a collision between two different legal worlds: the traditional principles governing title insurance policies and the modern rules imposing strict liability for the cleanup of hazardous substances. In brief, plaintiffs obtained ALTA title policies upon their purchase of a 30-acre industrial tract. They later learned that the land was already contaminated by hazardous substances when they bought it and, accordingly, that they were strictly liable for cleanup costs under federal law (*see* §29.08). Plaintiffs cleaned up the site and sought compensation from their title insurance companies.

Plaintiffs first argued that the presence of hazardous substances on the land rendered title unmarketable. But the court distinguished between marketable title, on the one hand, and marketable land, on the other. Here, the physical condition of the property was defective, which presumably impaired the marketability of the land; but plaintiffs' title was marketable. One can hold marketable title to valueless land.[34] Next, plaintiffs asserted that because the transfer of the land carried with it the potential legal liability for future cleanup costs, this liability constituted an "encumbrance." The court rejected this argument, finding that when plaintiffs acquired title there was merely a potential for legal liability in the future—which had not yet

crystallized into a judgment or recorded lien—not an existing property interest held by a third person. And the mere physical condition of land, the court reasoned, cannot constitute an encumbrance.[35]

The final covered risk—right of access to a public road—is strictly construed in most jurisdictions. The policy ensures only that a legal right of access exists, not that the route is usable or practical.[36]

[3] Exceptions and Exclusions

The broad coverage afforded by the standard title insurance policy is limited by both *exceptions* and *exclusions*.[37]

Exceptions are actual or potential title defects that relate to the specific property, and are usually discovered during the insurer's search of title. Suppose B, a potential buyer, asks title company T to issue a policy insuring his title to Greenacre. While examining title to Greenacre, T learns that title is already encumbered with a road easement and a restrictive covenant. T will refuse to insure against these known defects, absent unusual circumstances. Accordingly, it will list them as exceptions to coverage in both its preliminary report and the eventual title insurance policy. Even though the standard policy provides coverage against encumbrances in general, then, these specific encumbrances are not covered. On occasion, a title insurance company will provide coverage against a known potential defect, usually when the risk of loss is remote and a party is willing to indemnify it against any loss; this process is known as *insuring over* or *insuring around* a defect.

Each policy also contains standard, preprinted exclusions, which apply to all properties. These are potential title defects that the title insurance company is unwilling to cover. Typical examples include:

(1) problems created by the insured party (e.g., matters “created, suffered, assumed, or agreed to by the Insured Claimant”);

(2) defects not shown by public records affecting land title but known to the insured party;[38] and

(3) the impact of any law, ordinance, or regulation relating to the use or occupancy of the land (e.g., zoning violations, hazardous waste contamination, and building code violations).[39]

[E] Liability of Title Insurer in Negligence

Suppose B applies to title insurer T for a policy insuring her title in connection with her pending purchase of Blueacre. While searching title to Blueacre, T's employees carelessly overlook a recorded pipeline easement. T provides a preliminary report to B that does not mention the easement. B purchases Blueacre, and at close of escrow T issues a standard ALTA owner's policy to B, which similarly fails to mention the easement. T is clearly liable to B in contract under the policy. But can B instead sue T in tort for negligently searching title? Phrased more broadly, is a title insurance company obligated to conduct a reasonably diligent search of title and to disclose any reasonably discoverable defects to the buyer?[40]

The national case law is split on this controversial issue. The dispute usually hinges on the nature of the preliminary report, title report, binder, commitment or similarly titled document provided by the insurer to the buyer before close of escrow. Is it a summary of title—like an attorney's title opinion—or merely a statement of the terms on which title insurance is offered?

The reason for the dispute is simple enough to identify: tort liability is much broader than contract liability. Any action for breach of contract is limited by the express terms of the policy, including the policy limit, the exclusions, and various procedural restrictions (e.g., a requirement that claims be made within 60 to 90 days after discovery of the loss). A negligence action avoids all these obstacles, potentially allowing a plaintiff like B to recover (a) more than the policy limit, (b) even though the defect is expressly excluded from coverage, and (c) even though she reported the claim too late. Similarly, a tort action may expose the title company to liability for emotional distress and punitive damages, which are not available under a contract theory.

Courts that impose negligence liability reason that the preliminary report is essentially a summary of title.[41] It is well-settled that an attorney or abstractor is liable in tort for a negligently prepared title opinion, abstract, or other summary of title. Thus, for example, if B had obtained a title opinion from attorney A that failed to list the pipeline easement, B could sue A for negligence. These courts explain that the preliminary report serves the same function as the traditional title opinion or abstract. Indeed, most buyers appear to believe that the preliminary report is in fact a summary of the state

of title, despite express disclaimers to the contrary. Thus, permitting suit in negligence protects the good faith expectations of the ordinary buyer.[42] As the New Jersey Supreme Court explained, "[t]he underlying notion is that the insured has the reasonable expectation that the title company will search the title."[43]

On the other hand, courts rejecting tort liability stress that the relationship between the insurer and the insured is essentially contractual.[44] From this perspective, the insured reasonably expects to receive a title insurance policy that imposes express limitations on the ability to recover damages (e.g., policy limits, exclusions, time limits). To allow the insured to sue in negligence—without these agreed-upon restrictions—would exceed his reasonable expectations. Although the title company routinely conducts a title search before agreeing to insure, this search is undertaken for its own benefit—to determine if it is willing to offer coverage—not for the benefit of the potential insured. Thus, the preliminary report is merely a statement of the terms and conditions on which the insurer is willing to issue its policy, not a representation about the state of title. Courts following this view also express an economic concern: the long-term effect of negligence liability would be to increase the overall cost of title insurance to buyers in general, because title companies would raise rates to compensate for the expanded risk.

[F] Perspectives on Title Insurance

Title insurance policies offer excellent title protection, particularly when compared to deed covenants or attorney opinions of title. The main advantage is solvency: title insurance companies maintain sufficient monetary reserves to satisfy potential claims, while deed covenants and attorneys' title opinions are effectively worthless if the seller or attorney is insolvent. And title insurance covers a broader range of title defects than either the attorney's opinion or the special warranty deed.

The principal criticism of title insurance is simply that it costs too much. For example, one study found that the title insurance industry paid out less than 10% of its collected premiums to satisfy claims. In the same era, the comparable loss payout ratio for most casualty insurers was 80%. Why? Title insurers explain that a large percentage of each premium dollar is used to search and examine title, a cost not faced by other types of insurers.

A secondary criticism is that the reasonable expectations of most insured buyers differ from the literal terms of their title insurance policies. The average buyer has little or no understanding about either the basic scope of coverage or the detailed exclusions from coverage. Rather, the buyer believes in general terms that the policy will protect against any title problem. Modern courts attempt to bridge this gap by construing policy ambiguities against the insurer, a process which presumes—incorrectly in most instances—that the insured actually read the policy form before purchase. The growing popularity of the "plain language" policy may alleviate this problem over time.

§26.05 Registration of Title

After studying the notable defects in the land title recording system discussed above, a neutral observer might suggest an alternative system: empower a government agency to determine who holds title.[45] Under such a title registration system—often called the *Torrens system* after its inventor—a government agency issues a *certificate of title* that establishes land title. The certificate identifies the current title holder and lists all easements, covenants, liens, mortgages, and other encumbrances on title.[46] While quite popular in England, the Torrens system is available only in a handful of states. Ironically, virtually all states use a Torrens-like system for the registration of automobiles.

An example illustrates the mechanics of the Torrens system. Suppose B is planning to purchase Redacre from O. B can search title to Redacre simply by inspecting the current certificate of title that is on file at the responsible agency. If the certificate states that O holds fee simple absolute in Redacre, free and clear of any encumbrances, for example, B can safely proceed with the purchase.[47] B can perform this examination quickly and cheaply, without the assistance of a title insurance company, attorney, or abstractor. Once O conveys title to B, B will bring his deed to the agency so that it can issue a new certificate of title that lists B as the current owner.

What if the agency makes a mistake? Suppose, for example, that title to Redacre was actually vested in X at the time of the O-B sale, and thus the certificate of title should have identified X as the owner. In a situation like this, the certificate of title is still legally effective and, accordingly, B is the legal owner of Redacre. An indemnity fund compensates anyone whose property rights are lost through error; X's only remedy is to file a claim against this fund.

The future of the Torrens system in the United States is bleak. Scholars uniformly praise the system on efficiency grounds: it is both more accurate and less expensive than the traditional recording system. During the twentieth century, many states adopted the Torrens system as an additional method of title assurance. But the promise of the system was never realized because only a small number of owners chose to register their titles. Custom,

inertia, the initial cost of registration, and the vigorous opposition of title insurance companies undoubtedly contributed to this unhappy result. Many states accordingly abandoned the system. Although Torrens is still an available alternative in some states, it flourishes only in isolated pockets. The system is most successful in Hawaii, where about 45% of the land is registered.

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1. *See generally* Joyce D. Palomar, *Title Insurance Companies' Liability for Failure to Search Title and Disclose Record Title*, 20 Creighton L. Rev. 455 (1987); Charles B. Sheppard, *Assurances of Titles to Real Property Available in the United States: Is a Person Who Assures a Quality of Title to Real Property Liable for a Defect in the Title Caused by Conduct of the Assured?*, 79 N.D. L. Rev. 311 (2003).

2. 389 N.E.2d 1188 (Ill. 1979). *See also* Holmes Development, LLC v. Cook, 48 P.3d 895 (Utah 2002) (covenants of seisin and right to convey breached when deed in chain of title listed incorrect grantor).

3. *See* Seymour v. Evans, 608 So. 2d 1141 (Miss. 1992) (covenant not breached when seller sold lot in violation of subdivision regulations).

4. Wilcox v. Pioneer Homes, Inc., 254 S.E.2d 214 (N.C. Ct. App. 1979) (stating rule); *cf.* Lohmeyer v. Bower, 227 P.2d 102 (Kan. 1951) (noting that existence of zoning ordinance that barred construction of residence within three feet of lot line was not an encumbrance for purposes of the marketable title doctrine).

5. Wilcox v. Pioneer Homes, Inc., 254 S.E.2d 214 (N.C. Ct. App. 1979) (violation of ordinance barring construction within 15 feet of lot line held an encumbrance); *cf.* Lohmeyer v. Bower, 227 P.2d 102 (Kan. 1951) (reaching similar result for purposes of the marketable title doctrine).

6. *See, e.g.*, Frimberger v. Anzellotti, 594 A.2d 1029 (Conn. Ct. App. 1991) (filling of wetlands in violation of statute did not breach covenant); *cf.* Lick Mill Creek Apartments v. Chicago Title Ins. Co., 283 Cal. Rptr. 231 (Ct. App. 1991) (presence of hazardous substances on property in violation of federal law was not an encumbrance for purpose of title insurance). *See also* Seymour v. Evans, 608 So. 2d 1141 (Miss. 1992) (conveyance in violation of subdivision regulations did not breach covenant).

7. *See generally* Jones v. Grow Inv. & Mortgage Co., 358 P.2d 909 (Utah 1961).

8. *Cf.* Leach v. Gunnarson, 619 P.2d 263 (Or. 1980) (rule was not met on facts of case because third parties' use of spring on grantor's land was not sufficiently open and notorious).

9. Lockhart v. Phenix City Inv. Co., 488 So. 2d 1353 (Ala. 1986) (knowledge of encumbrance does not preclude action for breach); Loveland Essential Group, LLC v. Grommon Farms, Inc., 251 P.3d 1109 (Colo. App. 2010) (same); War Eagle, Inc. v. Belair, 694 S.E.2d 497 (N.C. Ct. App. 2010) (same).

10. *See, e.g.*, McCormick v. Crane, 37 A.3d 295 (Me. 2012) (covenant was not breached because owner was not evicted). *But cf.* Booker T. Washington Constr. & Design Co. v. Huntington Urban Renewal Auth., 383 S.E.2d 41 (W. Va. 1989) (covenant of warranty was breached when purchaser from grantee sued grantee for failure to deliver marketable title).

11. *Cf.* Foley v. Smith, 539 P.2d 874 (Wash. Ct. App. 1975) (judgment of specific performance in favor of third party constituted a constructive eviction of grantees).

12. 389 N.E.2d 1188 (Ill. 1979).

13. One study found that the average price for a home sold with a general warranty deed was significantly higher than the average price for a home sold with a special warranty deed. David M. Brasington & Robert F. Samara, Jr., *Deed Types, House Prices and Mortgage Interest Rates*, 36 Real Est. Econ. 587 (2008).

14. *See, e.g.*, Holmes Development, LLC v. Cook, 48 P.3d 895 (Utah 2002) (discussing Utah statute).

15. *See, e.g.*, Proffitt v. Isley, 683 S.W.2d 243 (Ark. Ct. App. 1985) (covenant against encumbrances did not run to grantees' successors).

16. *See, e.g.*, Rockafellor v. Gray, 191 N.W. 107 (Iowa 1922).

17. *See, e.g.*, St. Paul Title Ins. Corp. v. Owen, 452 So. 2d 482 (Ala. 1984) (title insurance company, as subrogee to claims of insured mortgagee, may sue remote grantor for breach of covenants of quiet enjoyment and warranty).

18. *Cf.* St. Paul Title Ins. Corp. v. Owen, 452 So. 2d 482 (Ala. 1984) (maximum recovery is purchase price paid).

19. *See, e.g.*, Hillsboro Cove, Inc. v. Archibald, 322 So. 2d 585 (Fla. Dist. Ct. App. 1975) (breach of warranty of seisin); Davis v. Smith, 5 Ga. 274 (1848) (breach of covenant of warranty).

20. *See, e.g.*, Reed v. Rustin, 134 N.W.2d 767 (Mich. 1965).

21. *See, e.g.*, Rockafellor v. Gray, 191 N.W. 107 (Iowa 1922); *see also* St. Paul Title Ins. Co. v. Owen, 452 So. 2d 482 (Ala. 1984).

22. 389 N.E.2d 1188 (Ill. 1979).

23. *But cf.* Page v. Frazier, 445 N.E.2d 148 (Mass. 1983) (mortgagee's attorney who negligently prepared title opinion owed no duty of care to mortgagors).

24. *Cf.* First Am. Title Ins. Co. v. First Title Serv. Co., 457 So. 2d 467 (Fla. 1984) (title company that relied on abstract in issuing title insurance policy could sue abstracter in negligence).

25. *See, e.g.*, Seigle v. Jasper, 867 S.W.2d 476 (Ky. Ct. App. 1993); Williams v. Polgar, 215 N.W.2d 149 (Mich. 1974).

26. The title insurance company that pays an insured's claim has a right of subrogation, that is, it may seek reimbursement from other parties liable to the insured. *See, e.g.*, Fidelity Nat'l Title Ins. Co. v. Miller, 264 Cal. Rptr. 17 (Ct. App. 1989).

27. *See generally* White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985).

28. The policy also covers six more esoteric risks, such as (1) an "enforcement action based on the exercise of a governmental police power" if a notice of the action is recorded and (2) "[a]ny taking by a governmental body that has occurred" and is binding on a bona fide purchaser for value.

29. *See, e.g.*, White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985).

30. *Cf.* Transamerica Title Ins. Co. v. Johnson, 693 P.2d 697 (Wash. 1985) (title insurance company compensated the insured buyers for loss caused by assessment liens and then sought indemnification from the seller).

31. *See, e.g.*, White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985).

32. However, the mere existence of land use regulations that restrict the use of property does not violate this covenant. *See* Somerset Savings Bank v. Chicago Title Ins. Co., 649 N.E.2d 1123 (Mass. 1995).

33. 283 Cal. Rptr. 231 (Ct. App. 1991).

34. *See also* Haw River Land & Timber Co. v. Lawyers Title Ins. Corp., 152 F.3d 275 (4th Cir. 1998) (title to timberland was marketable even though ordinance prohibited logging); Riordan v. Lawyers Title Ins. Corp., 393 F. Supp. 2d 1100 (D.N.M. 2005) (title to remote mountain land was marketable where only access was by hiking and horse trail).

35. *But see* Camp v. Commonwealth Land Title Ins. Co., 787 F.2d 1258 (8th Cir. 1986) (title held to be marketable, despite violation of restrictive covenant which resulted from construction flaw in property).

36. *See, e.g.*, Gates v. Chicago Title Ins. Co., 813 S.W.2d 10 (Mo. Ct. App. 1991) (legal right of access via route described as "goat path" suitable mainly for foot or horse travel was sufficient to preclude recovery); Riordan v. Lawyers Title Ins. Corp., 393 F. Supp. 2d 1100 (D.N.M. 2005) (right to

use public hiking and horse trail through wilderness area to reach land was sufficient access).

37. Other policy provisions known as “conditions” may also affect the scope of coverage. *See, e.g.*, Stewart Title Guar. Co. v. Lunt Land Corp., 347 S.W.2d 584 (Tex. 1961) (policy provided that upon sale of property by insured, insurance company was liable only if insured was successfully sued by buyer on deed warranties).

38. *See, e.g.*, Ryczkowski v. Chelsea Title & Guar. Co., 449 P.2d 261 (Nev. 1969) (“wild” deed of easement, outside of chain of title, was excluded from coverage because it was not shown by the public records).

39. *Cf.* Lick Mill Creek Apartments v. Chicago Title Ins. Co., 283 Cal. Rptr. 231 (Ct. App. 1991) (refusing to decide whether this provision excluded coverage for hazardous substance contamination); Haw River Land & Timber Co. v. Lawyers Title Ins. Corp., 152 F.3d 275 (4th Cir. 1998) (similar clause barred recovery).

40. *See generally* James Bruce Davis, *More Than They Bargained For: Are Title Insurance Companies Liable in Tort for Undisclosed Title Defects?*, 45 Cath. U. L. Rev. 71 (1995); Joyce D. Palomar, *Title Insurance Companies' Liability for Failure to Search Title and Disclose Record Title*, 20 Creighton L. Rev. 455 (1987).

41. *See, e.g.*, MacDonald v. Old Republic Natl. Title Ins. Co., 882 F. Supp. 2d 236, 244 (D. Mass. 2012) (noting that “a critical component of title insurance is representing to home owners that they are actually buying property without a clouded title”); Moore v. Title Ins. Co., 714 P.2d 1303 (Ariz. Ct. App. 1985).

42. *See also* Transamerica Title Ins. Co. v. Johnson, 693 P.2d 697 (Wash. 1985) (even if insurer's preliminary report is deemed an abstract, the insurer is not liable to a noninsured party who failed to rely on the negligently prepared abstract).

43. Walker Rogge, Inc. v. Chelsea Title & Guar. Co., 562 A.2d 208, 218 (N.J. 1989). *See also* U.S. Bank v. Integrity Land Title Corp., 929 N.E.2d 742 (Ind. 2010) (holding that title insurance company “had a duty ... to communicate the state of a title accurately when issuing its preliminary commitment” and could thus be sued for negligent misrepresentation).

44. *See, e.g.*, *id.*; Greenberg v. Stewart Title Guar. Co., 492 N.W.2d 147 (Wis. 1992). The *Walter Rogge* court further suggested, however, that a title company might be held liable in tort if it voluntarily assumed an independent duty to the buyer (e.g., by performing escrow work for the sales transaction). *See also* Somerset Savings Bank v. Chicago Title Ins. Co., 649 N.E.2d 1123 (Mass. 1995) (finding question of fact whether title insurer voluntarily assumed independent duty).

45. *See generally* C. Dent Bostick, *Land Title Registration: An English Solution to an American Problem*, 63 Ind. L.J. 55 (1987); Charles Szypszak, *Public Registries and Private Solutions: An Evolving American Real Estate Conveyance Regime*, 24 Whittier L. Rev. 663 (2003).

46. *See, e.g.*, United States v. Ryan, 124 F. Supp. 1 (D. Minn. 1954), *rev'd*, 253 F.2d 944 (8th Cir. 1958) (judgment creating federal tax lien was never filed with registrar of titles in accordance with state law and thus did not encumber parcel registered under Torrens system).

47. However, if a buyer like B has actual knowledge of a prior encumbrance, he will take title subject to that encumbrance even if it is not listed on the current certificate of title. *See, e.g.*, Commonwealth Elec. Co. v. MacCardell, 876 N.E.2d 405 (Mass. 2007) (recognizing rule).