

MORTGAGE WORKOUTS: DEEDS IN ESCROW

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Editors= Synopsis: In this Article, the author undertakes a comprehensive analysis of transactions involving deeds in escrow. The Article begins by discussing the general disfavored status of deeds in escrow that accompany a party=s original acquisition of property, and hence resemble a mortgage arrangement. Turning to a deed-in-escrow transaction that arises in the context of a loan workout, the Article examines potential challenges to the escrow transaction based on theories of clogging and equitable mortgage. The Article then sets out conditions in which a deed-in-escrow transaction is likely to withstand attack. Last, the Article notes a variety of bankruptcy issues that can impact a deed-in-escrow transaction. The Article concludes that deeds in escrow can be effective as a bargained-for workout of a defaulted mortgage but warns that such transactions must be carefully drafted with close attention being paid to applicable law. The Article includes a sample escrow agreement in the appendix.

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I. INTRODUCTION

A mortgage lender, when approached by a delinquent borrower to structure a workout of a troubled loan, may seek to obtain a deed in escrow in consideration for its agreement to forbear from exercising its legal remedies (including foreclosure and assignment of rents) and to protect its interests if a subsequent default occurs under the workout documents. This provides a benefit to both parties: the borrower obtains Abreathing room@ to weather (hopefully) an economic downturn, avoid or postpone adverse tax consequences (and perhaps personal liability for the debt), avoid the embarrassment and publicity of a foreclosure proceeding, and improve the property so that it is more attractive to potential tenants; the mortgage lender avoids the time and expense of a (potentially contested) foreclosure proceeding or bankruptcy filing and having to record a loss on its books.¹ Although courts, as a matter of public policy, will not permit a deed to be placed into escrow in connection with the original mortgage transaction, they are much more lenient with respect to a deed placed in escrow as part of a subsequent negotiated and bargained-for resolution of a defaulted loan, especially when the consideration is actual and valid and the parties are sophisticated businesspeople represented by experienced counsel.² These types of arrangements are also useful (and not uncommon) in connection with mortgagor bankruptcies when the plan of reorganization provides for the placing of a deed from the borrower-debtor to the lender in escrow. Courts of equity, however, will closely scrutinize these types of transactions because the deed in escrow will cut off the mortgagor=s right of redemption when a subsequent default or other triggering event occurs. This Article will examine the legal risks that mortgage lenders must confront when contemplating and structuring deed-in-escrow transactions and will suggest strategies to minimize these risks.

¹ A deed in lieu of foreclosure has been described as Aa transaction in which a borrower, *after default*, conveys to its lender by *absolute* deed title to real property pledged as security for the indebtedness. The consideration for this conveyance consists of relieving the borrower of all *in personam* liability for the loan.@ *Morrow Dev. Corp. v. Gordon Mgmt., Inc.*, 875 P.2d 411, 413 n.3 (Okla. 1994).

² The documentation usually provides that the deed will be delivered out of escrow to the mortgagee in the event of a future default under the loan workout documents or upon the occurrence of some other specified event. The deed commonly is placed in escrow with a third party, such as a title insurance company.

II. DEED IN ESCROW IN CONNECTION WITH ORIGINAL MORTGAGE

Courts generally hold that when a mortgagor places a deed in escrow in connection with the initial mortgage transaction, with instructions to release the deed to the mortgagee immediately in the event of a future default, the deed is void and unenforceable. These types of arrangements are deemed unenforceable under general equitable and public policy principles and will not be countenanced by the courts. (Lenders rarely even attempt to obtain a deed, or place a deed in escrow, in connection with the original mortgage loan.)

For example, in a case decided by the Illinois appellate court, *First Illinois National Bank v. Hans*,³ the defendants executed an assignment of their interest as contract-for-deed purchasers for a parcel of land as security for a mortgage loan. The assignment provided that if a default occurred the defendants would execute to the assignee a Quit Claim Deed for the [property], which shall stand as a deed in lieu of foreclosure.⁴ The court declared this provision null and void, holding that the transaction created an equitable mortgage that the mortgagee must foreclose. The court reaffirmed the principle that parties cannot, by an express stipulation in the mortgage, transform the instrument into an outright conveyance upon default. Doing so, the court held, would operate to deprive the mortgagor of her redemptive rights.

In *Basile v. Erhal Holding Corp.*,⁵ the mortgagor gave the mortgagee both a mortgage and a deed in lieu of foreclosure. The mortgagee agreed not to record the deed unless the mortgagor defaulted. The mortgagor subsequently defaulted and demanded a right of redemption. The New York appellate court held that the deed was not intended as an absolute conveyance but was a mortgage because it provided further security for the loan. The court therefore granted redemption rights to the mortgagor.⁶

Similarly, in a case decided by the Colorado Supreme Court, *Larson v. Hinds*,⁷ the parties placed a deed to the property in escrow as part of the original loan transaction with the deed to be delivered immediately to the

³ 493 N.E. 2d 1171 (Ill. App. Ct. 1986).

⁴ *Id.* at 1172.

⁵ 538 N.Y.S.2d 831 (N.Y. App. Div. 1989).

⁶ See also *Leona Bank v. Kouri*, 772 N.Y.S.2d 251, 254B55 (N.Y. App. Div. 2004) (A holder of a deed given as security must proceed in the same manner as any other mortgagee by foreclosure and sale to extinguish the mortgagor's interest.)

⁷ 394 P.2d 129 (Colo. 1964).

mortgagee in the event of a subsequent loan default by the mortgagor. The court stated that the agreement A[came] as close to a formal security transaction as could have been accomplished without the execution of a mortgage or deed of trust.⁸ The court held that the agreement constituted a security transaction as a matter of law because it deprived the mortgagor of any right to redeem the property, and therefore was in violation of the public policy of the State of Colorado.⁹

⁸ *Id.* at 132.

⁹ *See id.* *See also* *Guam Hakubotan, Inc. v. Farusawa Inv. Corp.*, 947 F.2d 398, 401 (9th Cir. 1991) (A[A] mortgagor is not permitted to alienate his right of redemption at the time he enters into a mortgage agreement.); *Pollak v. Milsap*, 122 So. 16, 20B22 (Ala. 1928) (holding that transaction involving loan of money secured by deed is enforceable as mortgage); *Hamud v. Hawthorne*, 338 P.2d 387, 390 (Cal. 1959) (ruling that deed in escrow was unenforceable because it was entered into at time of original loan); *MacArthur v. N. Palm Beach Utilities, Inc.*, 202 So. 2d 181, 188 (Fla. 1967) (AA mortgagor cannot, by any agreement made contemporaneously with or as a part of the mortgage transaction, bind himself not to assert his right or equity of redemption. . . .); *Lewis Broadcasting Corp. v. Phoenix Broadcasting Partners*, 502 S.E.2d 254, 256 (Ga. Ct. App. 1998) (holding that an option to purchase collateral for a fixed price upon default, which was entered into as part of original secured loan, was impermissible clog on borrower=s right of redemption); *Panagouleas Interiors v. Silent Partner Group, Inc.*, No. 18864, 2002 Ohio App. LEXIS 1305, at *24B25 (Ohio App. Mar. 22, 2002) (AOhio law is consistent with the accepted rule that >a mortgagor=s equity of redemption cannot be clogged[,] and that he cannot, as part of the original mortgage transaction, cut off or surrender his right to redeem.=@ (quoting *Humble Oil & Ref. Co. v. Doerr*, 303 A.2d 898, 905 (N.J. Ch. 1973)); *Lincoln Mortgage Investors v. Cook*, 659 P.2d 925, 927 (Okla. 1982) (ASimply stated, the [clogging] doctrine voids any provision in an original mortgage agreement limiting or modifying the right of redemption by payment of the full mortgage debt after default for any reason.); *Kartheiser v. Hawkins*, 645 P.2d 967, 968 (Nev. 1982) (holding that in quiet-title action by third party who took title to encumbered property, quitclaim deeds given by mortgagor to mortgagee at time of delivery of deeds of trust were merely further security for mortgage loan and did not surrender grantor=s equity in properties); *Dawson v. Perry*, 30 Va. Cir. 372 (Va. Cir. Ct. 1993) (ruling that when recorded deed in lieu of foreclosure was part of original mortgage transaction, deed was not obtained for separate and adequate consideration and prevented mortgagor from exercising equity of redemption, thus violating clogging prohibition); *Marple v. Wyo. Prod. Credit Ass=n*, 750 P.2d 1315, 1320 (Wyo. 1988) (holding that deed held in escrow that was to be conveyed upon default was in fact a mortgage and could not terminate mortgagor=s right of redemption). *But see* *Gormas v. Permanent Sav. & Loan Ass=n*, No. CA84-03-035, 1984 WL 3444, at *2 (Ohio Ct. App. Oct. 15, 1984) (holding that a deed in escrow entered into at the time of the original mortgage transaction, to be delivered to the mortgagee upon a subsequent default in lieu of foreclosure, did not impermissibly extinguish the mortgagor=s right of redemption because the agreement did not Aspecifically waive the right of equity of redemption or [the right to] a sale for two-thirds [as required under Ohio foreclosure law] of the fair market value@).

III. CLOGGING ISSUES

Clogging issues may arise when the mortgagor agrees to give a deed in lieu of foreclosure to the mortgagee in the future if certain events occur. The clogging doctrine invalidates two types of mortgage provisions. First, no provision may prevent the mortgagor from redeeming and retaining ownership of the mortgaged property by paying the indebtedness in full prior to entry of a valid foreclosure decree. Second, no provision may grant the mortgagee a collateral advantage.¹⁰ A clog is a provision in the mortgage itself, or in a document related to or given along with the mortgage, or in some other document, which purportedly denies the mortgagor the right to redeem the property from the mortgage if a subsequent default occurs.¹¹ (The clog may be in the form of an option to purchase, a deed, a contract of sale, a lease with option, a shared-appreciation or other equity-participation provision or agreement, etc.¹²)

A deed in lieu of foreclosure cuts off the right of redemption prior to

¹⁰ John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279, 280 (1998). See also *West v. Reed*, 55 Ill. 242, 244 (1870):

It is settled beyond controversy, that contracts between mortgagor and mortgagee, for the purchase or extinguishment of the equity of redemption, are regarded with jealousy by courts of equity, and will be set aside if the mortgagee has, in any way, availed himself of his position to obtain an advantage over the mortgagor.

See also *Humble Oil & Co.*, 303 A.2d at 906 (A[T]he [clogging] doctrine is universally applied, both in the United States and England.); *Lincoln Mortgage Investors*, 659 P.2d at 927 (A[T]he [clogging] doctrine voids any provision in an original mortgage agreement limiting or modifying the right of redemption by payment of the full mortgage debt after default for any reason.). The *Restatement* reaffirms the general prohibition against clogging the borrower's equity of redemption:

Under [the clogging] rule, no agreement contained in the mortgage, or contemporaneous with it, could cut off a delinquent mortgagor's equity of redemption without resort to foreclosure by the mortgagee. Thus the equity courts refused to enforce attempts by a mortgagee, at the inception of the mortgage transaction, to have the mortgagor waive the right to insist on foreclosure in the event of a default.

RESTATEMENT (THIRD) OF PROP.: MORTGAGES ' 3.1 cmt. a (1997). The Introduction to the *Restatement* refers to the mortgagor's equity of redemption as "the basic and historic right of a debtor to redeem the mortgage obligation after its due date, and ultimately to insist on foreclosure as the means of terminating the mortgagor's interest in the mortgaged real estate." *Id.* ch. 3, introductory note. See also 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW ' 3.1 (4th ed. 2002).

¹¹ See Murray, *supra* note 10, at 322.

¹² See *Lewis Broadcasting Corp.*, 502 S.E. 2d at 256 (ruling that option to purchase, given to mortgagee at same time as mortgage, was impermissible clog and unenforceable).

foreclosure, and the mortgagor may claim that the transaction constitutes an impermissible clog of his right of redemption. But because a deed in lieu of foreclosure (or a deed in escrow) is subsequent to the original mortgage and it is a voluntary conveyance for independent and valuable consideration, it serves the socially useful purpose of allowing the mortgagor to avoid a time-consuming, costly, and public foreclosure (and possibly avoid personal liability on the debt). Therefore, an arm's-length, fully documented deed-in-lieu or deed-in-escrow transaction should survive a clogging challenge. Courts of equity, however, will closely scrutinize these types of transactions because the borrower's right of redemption will be cut off by delivery of the deed.¹³

IV. DEED IN ESCROW AS EQUITABLE MORTGAGE

Another legal issue faced by mortgage lenders in connection with deeds in lieu of foreclosure and deeds in escrow is the possibility that the transaction will be characterized by a court as an equitable mortgage. An equitable mortgage is a document that is not labeled a mortgage by the parties (it is often in the form of a deed) but in actuality secures a debt or other obligation.¹⁴ A clog, on the other hand (as noted above), is a provision in the mortgage itself, or in a related document, which eliminates the mortgagor's right to redeem the property from the mortgage upon a subsequent default.¹⁵

A deed in escrow, given as part of a loan workout, is more likely to be challenged as a clog on the equity of redemption than as an equitable mortgage because it deprives the mortgagor of the ability to redeem if the mortgagor defaults under the workout documents. A deed in escrow challenged as an equitable mortgage is more relevant and more likely to succeed with respect to a mortgagor's argument that a deed in lieu of foreclosure should not be enforced. For example, in *Guam Hakubotan, Inc. v. Furusawa Investment Corp.*,¹⁶ the Ninth Circuit rejected the borrower's

¹³ See RESTATEMENT (THIRD) OF PROP.: MORTGAGES ' 3.1 cmt. f:

The deed in lieu transaction clearly serves the public interest. It not only avoids the expense and delay of a foreclosure proceeding, but also reduces the pressure on scarce judicial resources. While the deed in lieu does not violate the anticlogging doctrine and is normally to be encouraged, it is closely scrutinized to ensure it is free from fraud or oppression on the part of the mortgagee and is supported by adequate consideration.

¹⁴ See *id.* ' 3.1, 3.2.

¹⁵ See Murray, *supra* note 10, at 321B22.

¹⁶ 947 F.2d at 402 (To interpret the transaction as a simple continuation of the mortgage would be to eliminate incentives for creditors to grant loan extensions sought by

argument that a deed in escrow was an equitable mortgage, reasoning that the borrower's characterization of the transaction as an equitable mortgage was inconsistent with the logic and reality of the parties' relationship because the deed was already secured by a mortgage on the property.

Some courts, however, have characterized an executory deed (or similar arrangement) as a continuing security device or an equitable mortgage, which must be foreclosed in order to enforce the provisions of the agreement. In *McGuigan v. Millar*,¹⁷ for instance, the California appellate court held that the evidence clearly indicated the intention of the parties to treat an option to purchase certain lots, representing an extension of a previous debt owed by the optionee defendant to the plaintiff, as a disguised security device, which was designed to create an impermissible waiver of the optionee's right of redemption of a mortgage loan. Courts will not permit a mortgagee to evade the requirement of foreclosing a mortgage and deprive a mortgagor of redemptive rights by subterfuge, such as by taking a deed to the property and granting the mortgagor the right to repurchase the property upon payment in full of the debt.¹⁸

Most cases that find the existence of an equitable mortgage involve situations when a deed alone, absent a separate mortgage, is given to another party, and the grantee gives the grantor the right to occupy the property and the right or option to repurchase the property upon payment in full of the debt. But the general presumption is that a deed that is absolute on its face and that conveys the entire interest of the grantor is not

debtors and instead create an incentive for creditors simply to initiate foreclosure.

¹⁷ 4 P.2d 607, 609 (Cal. Ct. App. 1931) (The trial court found as a fact that the appellant agreed to give to the respondent an extension of time within which to pay his debt, and that in consideration therefor, the respondent gave to the appellant additional security in the form of a deed . . .).

¹⁸ See, e.g., *Peugh v. Davis*, 96 U.S. 332 (1877); *Provident Trust Co. v. Metro. Cas. Ins. Co.*, 152 F.2d 875 (3d Cir. 1945); *Davis v. Stone*, 236 F. Supp. 553 (D.D.C. 1964); *Smith v. Player*, 601 So. 2d 946 (Ala. 1992); *Harbel Oil Co. v. Steele*, 318 P.2d 359 (Ariz. 1957); *Davis v. Davis* 890 S.W. 2d 280 (Ark. Ct. App. 1995); *Weil v. Colo. Prod. Credit Ass'n*, 494 P.2d 134, 137 (Colo. Ct. App. 1971); *Cohn v. Bridgeport Plumbing Supply Co.*, 115 A. 328 (Conn. 1921); *King v. King*, 74 N.E. 89 (Ill. 1905); *Felbinger & Co. v. Traiforos*, 394 N.E. 2d 1283 (Ill. App. Ct. 1979); *Holden Land & Live Stock Co. v. Interstate Trading Co.*, 123 P. 733 (Kan. 1912); *Swanbeck v. Sheaves*, No. L-85-237, 1986 WL 2957 (Ohio Ct. App. Mar. 7, 1986); RESTATEMENT (THIRD) OF PROP.: MORTGAGES ' 3.2, reporter's note, at 121, and cases cited therein; 55 AM. JUR. 2D *Mortgages* ' 1220 (1971); 28 AM. JUR. 2D *Escrow* ' 10 (1966); 4 AMERICAN LAW OF PROPERTY ' 16.5 (A. Casner ed., 1952); W.W. Allen, Annotation, *Deed from Mortgagor or Privy to Mortgage Holder as Extinguishing Equity of Redemption*, 129 A.L.R. 1435 (1940).

a mortgage or other security device.¹⁹ Several states have enacted statutes specifically addressing whether a deed given by a mortgagor to a mortgagee may constitute a continuing security device. In Minnesota, for example, there is a statutory presumption that a deed in lieu of foreclosure, if absolute in form, is not given as further or new security for the debt.²⁰ An Illinois statute states that A[e]very deed conveying real estate, which shall appear to have been intended only as a security [device] in the nature of a mortgage, though it be an absolute conveyance in terms, shall be considered as a mortgage.²¹ Other statutes provide that no defeasance to any deed of real property that is absolute on its face shall be effective to convert the document to a mortgage with respect to third parties unless the grantor's defeasance right is in writing and is recorded in the mortgage records.²²

Section 3.2(a) of the *Restatement* provides that parol evidence is admissible to establish that a deed absolute on its face was in fact intended as security for an obligation and should be deemed a mortgage.²³ Section

¹⁹ See, e.g., *Dye v. U.S. Farm Servs. Agency (In re Dye)*, 360 F.3d 744, 749 (7th Cir. 2004), *reh=g en banc denied*, 2004 U.S. App. LEXIS 10500 (7th Cir. May 24, 2004) (holding that transfer was not equitable mortgage when general warranty deed from borrower was voluntary and conveyed entire interest in property, borrower was released from personal liability, and deed did not include any language regarding redemption).

²⁰ MINN. STAT. ANN. ' 559.18 (West 2000). See also GA. CODE ANN. ' 44-14-32 (2002) (prohibiting use of parol evidence to show that deed absolute on its face is a mortgage, unless there has been fraud in the procurement); MISS. CODE ANN. ' 89-1-47 (1999), (same). But see, e.g., ARIZ. REV. STAT. ANN. ' 33-702(A) (2000) (expressly permitting a party to prove by parol evidence, if necessary, that a deed absolute on its face was in fact a mortgage); CAL. CIV. CODE ' 2924 (West 1993) (same); IDAHO CODE ANN. ' 45-905 (2003) (same).

²¹ 765 ILL. COMP. STAT. ANN. 905/5 (West 1996). See also MD. CODE ANN., REAL PROP. ' 7-101 (Lexis Nexis 1997) (providing that a deed absolute in terms shall be considered a mortgage when it appears, by any other writing, to be intended merely as additional security for a debt or performance of an obligation); N.Y. REAL PROP. LAW ' 320 (McKinney 1989) (providing that any deed conveying real property, which appears by any other written instrument to be intended only as a security, must be considered a mortgage even though it appears by its terms to be an absolute conveyance); OKLA. STAT. ANN. tit. 46, ' 1 (West 1996) (stating that every instrument purporting to be an absolute conveyance of real estate but intended as security for the payment of money is deemed a mortgage and must be recorded and foreclosed as such); UTAH CODE ANN. ' 78-40-8 (2002) (providing that a mortgage of real property, whatever its actual terms, is not deemed a conveyance for the purpose of enabling the owner to avoid the commencement of a foreclosure proceeding to recover possession of the property).

²² See, e.g., CAL. CIV. CODE ' 2950 (West 1993); ME. REV. STAT. ANN. tit. 33 ' 202 (1999); 21 PA. STAT. ANN. ' 951 (West 2001); WYO. STAT. ANN. ' 34-1-127 (2005).

²³ RESTATEMENT (THIRD) OF PROP.: MORTGAGES ' 3.2(a).

3.2(b) provides that the intention of the parties to create a security device must be proved by clear and convincing evidence.²⁴ The section further provides that the parties' intention may be shown by the following:

- (1) statements of the parties;
- (2) the presence of a substantial disparity between the value received by the grantor and the fair market value of the real estate at the time of conveyance;
- (3) the fact that the grantor retained possession of the real estate;
- (4) the fact that the grantor continued to pay real estate taxes;
- (5) the fact that grantor made post-conveyance improvements to the real estate; and
- (6) the nature of the parties and their relationship both prior to and after the conveyance.²⁵

Section 3.2(c) of the *Restatement* provides that when, in addition to the deed, a separate writing exists that indicates that a financing transaction was intended, parol evidence is admissible to establish that the writings, taken together, constitute a single security transaction.²⁶

V. DEED IN ESCROW IN CONNECTION WITH LOAN WORKOUT

As noted above, courts generally hold that a mortgagor may not be compelled to give or agree to give a deed to the mortgagee or place a deed in escrow as part of the original mortgage transaction. Despite these holdings, in recent years several courts have held that a deed that the parties place in escrow does not constitute an impermissible clog if the deed is delivered in connection with a subsequent workout of a delinquent loan and as part of the mortgagee's agreement not to foreclose or to exercise other contractual or legal remedies. This is especially true if certain positive factors are present: a sophisticated commercial borrower; lack of disparity in bargaining power and negotiating strength; representation of the borrower by knowledgeable counsel; an acknowledged loan default; actual and meaningful consideration for the deed in escrow (such as forbearance from foreclosure and other lender remedies, release of personal liability, or both); and little or no equity in the mortgaged property. There are valid policy considerations that are furthered by deed-in-escrow transactions as part of a loan workout and that should be encouraged by the courts, including out-of-court settlements of disputed matters and avoidance of the time and expense (and publicity) of protracted and contested foreclosure

²⁴ *Id.* ' 3.2(b).

²⁵ *Id.*

²⁶ *Id.* ' 3.2(c).

and bankruptcy proceedings. But the courts rightfully remain highly protective of borrowers when most or all of these factors are not present.²⁷

A good example of a case with all of the positive factors for upholding a deed-in-escrow transaction is *Ringling Brothers Joint Venture v. Huntington National Bank*.²⁸ In this case, the Florida appellate court held that a deed placed in escrow in connection with a mortgage loan workout was enforceable under state law and was not a clog on the equity of redemption. The deed in escrow was given to avoid foreclosure, and the court determined that the mortgagor received valuable new consideration to relinquish its right of redemption. The court also found that the mortgagee had not taken unfair advantage of the mortgagor. The court relied on the following relevant factors in upholding the validity of the transaction:

- § The transaction involved commercial real estate, not residential property.
- § Counsel represented each party.
- § The mortgagor received separate and valuable consideration (in the form of new loan proceeds and revised loan documents covering the original loan plus the amount owing under two prior mortgages) from the mortgagee.
- § The mortgagor acknowledged that it was not able to pay the mortgage indebtedness and had made no attempt to do so.
- § It appeared from the trial court record that there was no equity in the property (i.e., the outstanding loan balance exceeded the fair market value of the property).
- § The agreement between the parties was reached during a pending action by the first mortgage holder to foreclose its mortgage on the

²⁷ It is not uncommon for state foreclosure laws to provide that, with respect to certain types of real estate transactions (usually excluding residential), a mortgagor may agree to waive the right of redemption. For example, in Illinois, the Illinois Mortgage Foreclosure Act expressly provides that, except with respect to loans on residential and agricultural real estate, a mortgagor may waive the right of redemption at any time, including at the inception of the loan. 735 ILL. COMP. STAT. ANN. 5/15-1601 (West 2003). Furthermore,

[a]fter commencement of a foreclosure proceeding . . . a mortgagor of residential real estate or other mortgagor who is otherwise so prohibited may waive the mortgagor's rights of reinstatement and redemption, or either of them, if (i) the mortgagor expressly consents in writing to the entry of a judgment without such right of reinstatement or redemption, (ii) such written consent is filed with the clerk of the court, and (iii) the mortgagee consents and agrees to waive any and all rights to a deficiency judgment.

Id. 5/15-1601(c).

²⁸ 595 So. 2d 180 (Fla. Dist. Ct. App. 1992).

property.²⁹

Similarly, in *Oakland Hills v. Lueders Drain District*,³⁰ the Michigan appellate court held that a mortgagor's waiver of its right to equitable redemption made as part of the same contract as the mortgage was invalid when no separate consideration was given for waiver of the right and the waiver occurred prior to any event of default under the loan. But the court stated in dicta that the arrangement would not violate the clogging doctrine and would be valid and enforceable if entered into by the parties in good faith after a subsequent default, for good consideration, as part of a contract separate and distinct from the original mortgage agreement.³¹ In an earlier decision, *Russo v. Wolbers*,³² the Michigan appellate court held that a

²⁹ See *id.* at 181B82. *Guam Hakubotan*, 947 F.2d at 401 (AWhile a mortgagor can sell the mortgaged property to the mortgagee pursuant to a subsequent agreement, California courts carefully scrutinize transactions to ensure that a purported sale is not simply a scheme to deprive a debtor in difficult financial straits of his right of redemption.); *Humble Oil*, 303 A.2d at 908 (A[A]lthough a mortgagor can at a later date, after the original mortgage transaction, surrender his equity of redemption to the mortgagee and enter into an option or agreement to sell, it must be a fair bargain for an independent and adequate consideration.); *Hausman v. Dayton*, 653 N.E.2d 1190, 1195 (Ohio 1995) (A[A] mortgagor may waive the right of redemption after the mortgage agreement is entered into, provided the agreement is equitable and supported by adequate consideration.); see also *Shaw v. Walbridge*, 33 Ohio St. 1, 5B6 (1877) (citations omitted):

It is true that at the time the mortgage is made no agreement can be made to deprive the mortgagee of his right to redeem. But it is equally true that he may subsequently part with this right, and the rule on the subject may be thus stated: Courts will scrutinize such a transaction, and will not allow the mortgagee to take any advantage; he will not be allowed to use his position as creditor to oppress, or drive an unconscionable bargain. But when such sale is a fair one, under all the circumstances, it will be sustained.

But see RESTATEMENT (THIRD) OF PROP: MORTGAGES ' 3.1 cmt. illus. 13B15 (stating that while deed-in-lieu transactions are valid, executory deed-in-lieu transactions that waive borrower's equity of redemption as result of future default are not); *Id.* ' 3.1 reporter's note, at 114 (stating that an executory deed-in-lieu transaction represents a close question under the clogging principle).

³⁰ 537 N.W.2d 258 (Mich. Ct. App. 1995).

³¹ *Id.* at 264.

³² 323 N.W.2d 385, 389 (Mich. Ct. App. 1982). See also *Kubczak v. Chem. Bank & Trust Co.*, 575 N.W.2d 745, 748 (Mich. 1998) (citation omitted):

It has been the definite and continuous policy of this State to save to mortgagors the possession and benefits of the mortgaged premises, as against the mortgagees, until expiration of the period of redemption. Thus, a mortgagee can obtain possession, but only for consideration and pursuant to an explicit agreement.

See also *Gillam v. Michigan Mortg. Inv. Corp.*, 194 N.W. 981, 982 (Mich. 1925) (holding that commercial debtor could release its equity of redemption as part of loan workout

mortgagor may, after the original mortgage transaction, sell or convey her equity of redemption to a mortgagee by a separate, distinct contract entered into for valid consideration, but A[t]he exchange must be fair, frank, honest, and without fraud, misconduct, undue influence, oppression or unconscionable advantage of the poverty, distress or fears of the mortgagor.³³

agreement when Ait was not unconscionable; it was fairly made without fraud or duress; [and] it is supported by a reasonably adequate consideration@); *Panagouleas Interiors*, 2002 Ohio App. LEXIS at *22 (A[A] mortgagor may convey equity of redemption to a mortgagee in a contract executed subsequent to the mortgage.@). *But see* *Batty v. Snook*, 5 Mich. 231, 238B39 (1858):

[T]he mortgagor may release the equity of redemption to the mortgagee for a good and valuable consideration, when done voluntarily, and there is no fraud, and no undue influence brought to bear upon him for that purpose by the creditor . . . it can not be done by a co[n]temporaneous or subsequent executory contract, by which the equity of redemption is to be forfeited if the mortgage debt is not paid on the day stated in such contract.

³³ *Russo*, 323 N.W.2d at 390. In *Wright v. First National Bank of Monroe*, 297 N.W. 505, 510 (Mich. 1941), the Michigan Supreme Court enforced a deed in escrow in connection with a workout of the mortgage loan, finding that the transaction was a voluntary settlement between the parties . . . a sale by the plaintiffs of their equity of redemption to the mortgagee, the consideration being the forbearance to foreclose and the acceptance of the property in full satisfaction of the mortgage debt.@ The court also found that the mortgagors' cause of action was barred by laches and that they failed to show they were able and ready to pay the outstanding debt. In *Verity v. Metropolis Land Co.*, 288 N.Y.S. 625 (N.Y. App. Div. 1936), *aff=d*, 10 N.E.2d 582 (N.Y. 1937), the New York appellate court upheld an arrangement in which the mortgagor agreed, in consideration of an extension of a mortgage loan and release of the mortgagor's personal liability, to deliver a deed in lieu of foreclosure to the mortgagee in the event of a subsequent default. The mortgagee had instituted an action to set aside its waiver of personal liability and unwind the transaction, but the court gave effect to the agreement because it benefited the mortgagor, despite the effect on the mortgagor's equity of redemption. *See* *Guam Hakubotan*, 947 F.2d at 402 (ruling that deed delivered to mortgagee as part of loan extension agreement, to be recorded upon a subsequent default by mortgagor, was not an equitable mortgage); *Meyerson v. Werner*, 683 F.2d 723, 727 (2d Cir. 1982) (enforcing an executory deed in escrow because a court had previously decreed that agreement, which was part of court-ordered settlement, was to be binding on the parties and A[i]n this unusual situation the court's approval of the specific intention of the parties incorporated in its order provided adequate judicial protection of the debtor against overreaching@); *Bradbury v. Davenport*, 52 P. 301 (Cal. 1898) (upholding executory deed transaction conveying mortgagor's equity of redemption subsequent to original loan); *Deming v. Smith*, 66 P.2d 454, 456B58 (Cal. Ct. App. 1937) (holding that executory deed transaction was not an equitable mortgage when mortgagors were granted an extension of time to pay debt); *See also* *Baldwin v. Am. Trading Co.*, 243 P. 710, 712 (Cal. Ct. App. 1925) (A[A] mortgagor debtor, at any time after execution of the mortgage, may, by a separate and distinct transaction, sell or release his

In *Rothschild Reserve International, Inc. v. Silver*,³⁴ the Florida appellate court held that a conditional deed given as part of a settlement of a foreclosure action was not a mortgage within the meaning of a Florida statute dealing with equitable mortgages. The applicable Florida statute provides that conveyances securing the payment of money are deemed to be mortgages subject to foreclosure.³⁵ The borrower was hardly a sympathetic individual. After the court entered a summary judgment in favor of the lender in the foreclosure proceeding against the borrower, the parties entered into a settlement agreement of the foreclosure action.³⁶ The settlement agreement provided that the borrower would pay all unpaid interest and principal owing on January 30, 2001, all interest due before that date, and the lender's attorneys' fees. (The court noted that the borrower entered into this agreement through counsel.³⁷) Pursuant to the agreement, the borrower signed a warranty deed to be held in escrow by the lender's counsel, which would be returned to the borrower if and when he satisfied the terms of the settlement agreement. The borrower did not make any of the required payments under the settlement agreement and then attempted to delay payment of the amounts he owed by filing for bankruptcy. The lender was able to obtain a lift of the automatic bankruptcy

equity of redemption to the mortgagee.); *First Illinois Nat'l Bank*, 493 N.E.2d at 1172 (stating, in dicta, that separate agreement to execute quitclaim deed for property to lender, entered into after future default to avoid foreclosure expenses, may be enforceable in Illinois under certain circumstances); 4 POWELL ON REAL PROPERTY ' 37.44(1) (Michael A. Wolf ed., 2000):

The parties cannot promise in the original note and mortgage documents to resolve a default in this manner [by placing a deed in escrow]. Any such provision would be an unacceptable clog on the mortgagor's equity of redemption. After default occurs, however, the parties are permitted to resolve their relationship by means of a deed in lieu of foreclosure.

See also R.T.K., Annotation, *Deed Placed in Escrow to Grantee upon Failure to Pay Debt Due Him as a Mortgage*, 65 A.L.R. 120 (1930).

³⁴ 830 So. 2d 224 (Fla. Dist. Ct. App. 2002).

³⁵ See FLA. STAT. ' 697.01(1) (2000):

All conveyances, obligations conditioned or defeasible, bills of sale or other instruments of writing conveying or selling property, either real or personal, for the purpose or with the intention of securing the payment of money, whether such instrument be from the debtor to the creditor or from the debtor to some third person in trust for the creditor, shall be deemed and held mortgages, and shall be subject to the same rules of foreclosure and to the same regulations, restraints and forms as are prescribed in relation to mortgages.

³⁶ See *Rothschild Reserve*, 830 So. 2d at 225.

³⁷ *Id.*

stay and recorded the deed. The state court then ratified the deed and entered a writ of repossession (the borrower had agreed in the settlement agreement to a court order evicting him from the mortgaged property within ten days after the lender recorded the deed). The borrower subsequently appealed and argued that the deed he gave as part of the settlement was a mortgage under the Florida equitable-mortgage statute and that his equity of redemption should be protected because the property was worth more than the amount owed to the lender. The court rejected this argument, viewing it as nothing more than another delaying tactic by the borrower (and hardly a compelling argument for equitable intervention by the court). The court noted that the borrower did not deny that he owed the amounts he had agreed to pay nor did he allege that he was Acoerced@ into executing the settlement agreement or that he was disadvantaged by it. Neither did he allege that the lender had engaged in any inequitable conduct in connection with either the foreclosure or the voluntary settlement of the foreclosure proceeding.³⁸

The lender obviously thought it was doing the borrower a favor by not pursuing the foreclosure but instead entering into a (very reasonable) settlement agreement; the borrower and his counsel must have thought so also or they would not have agreed to place the deed in escrow. The appellate court sagely observed that A[i]f agreements to settle foreclosure actions are deemed mortgages under the statute, no foreclosure action could ever be settled.@³⁹

VI. EFFECT OF DEED IN ESCROW ON SUBORDINATE LIENHOLDERS

A mortgage lender=s placing of a deed in escrow in connection with a mortgage-loan workout arrangement can have a significant impact on subordinate lienholders (including lenders whose liens arise after the deed is placed in escrow). Mortgage lenders must be aware of the effect of such a transaction upon other lienholders and draft their workout documents (including the deed in escrow) accordingly. In general, a mortgage lender should be wary of seeking to obtain a deed in escrow unless the lender has ascertained the existence of any subordinate lienholders (through a current title search) and has obtained the consent of any such lienholders to the transaction. Proper notice to any subordinate lienholders of the deed-in-escrow transaction is crucial, as courts will often seek to protect the

³⁸ *Id.* at 225B26.

³⁹ *Id.* at 226.

³⁹ *Id.* at 226.

redemption rights of subordinate lienholders as well as the borrower.

The Illinois appellate court in *Klein v. DeVries*,⁴⁰ which involved a highly unusual fact situation, highlighted the issue of notice. The court held that upon delivery to the first mortgagee of a quitclaim deed, which had been placed in escrow as part of the mortgagor's Chapter 11 reorganization plan, a subordinate mortgagee with knowledge of the arrangement had no right to cure the mortgagor's default or redeem the property. In this case, the lender, Metropolitan Life Insurance Company (Metropolitan), held a first mortgage on Mr. DeVries's property. In 1986, DeVries filed for bankruptcy. Pursuant to the confirmed reorganization plan, which was recorded with the county recorder of deeds in 1987, DeVries delivered a quitclaim deed to the property to Metropolitan's attorney. The reorganization plan provided that upon any future default by DeVries under the mortgage loan or the plan, Metropolitan was to give notice thereof to DeVries and to any junior lienholders, as well as to all other creditors and parties in interest. The plan also provided that the parties so noticed (but not DeVries) would then have the opportunity either to cure the default or to obtain Metropolitan's position as first mortgage holder by making certain payments to Metropolitan.⁴¹ If none of the noticed parties elected these options, the deed was immediately to be delivered to Metropolitan and title would pass free and clear of liens and encumbrances, unpaid real estate taxes, and mechanics' liens excepted.⁴²

In 1989, DeVries executed and delivered to the plaintiff a note secured by three mortgages on the property already secured by Metropolitan's first mortgage. These mortgages were recorded with the county recorder of deeds on March 27, 1989. DeVries subsequently defaulted on the Metropolitan mortgage, and Metropolitan sent the required default notices to DeVries and other creditors, but not to the plaintiff. On December 7, 1989, Metropolitan recorded the escrowed quitclaim deed. Metropolitan then sold the property to an entity that in turn subdivided it and sold it in various parcels to other parties. In September 1997, the plaintiff filed a complaint for foreclosure and requested a declaratory judgment seeking to have his mortgages declared valid and to foreclose on the mortgages he held on the property. The trial court denied the plaintiff's requests for relief.⁴³

The appellate court, in affirming the holding of the trial court, first

⁴⁰ 722 N.E.2d 784 (Ill. App. Ct. 1999).

⁴¹ *Id.* at 786.

⁴² *Id.*

⁴³ *Id.*

noted that A[i]n general, a mortgagee can have no greater rights than his mortgagor.⁴⁴ The court then turned to the issue of what rights DeVries had when he entered into the mortgages with the plaintiff. The plaintiff argued that at the date of execution of the subordinate mortgages DeVries still had equitable and legal title to the property, and because no default had yet occurred under the first mortgage (as modified by the bankruptcy plan), he was entitled to cure the default and redeem the property. The appellate court disagreed, finding that DeVries=s interest in the property had been irrevocably Aaltered@Chis agreement with Metropolitan that he had no right to cure any future default under the first mortgage converted his fee simple estate in the property to a fee simple defeasible.⁴⁵ The court ruled that this was the only estate that DeVries could convey to the plaintiff and that Awhen DeVries defaulted under the Metropolitan mortgage, both DeVries=[s] and the plaintiff=s estate in the property ended.@⁴⁶ The appellate court refused to consider the issue of the lack of notice to the plaintiff as required by DeVries=s reorganization plan, ruling that because it had concluded that the plaintiff had no right to cure DeVries=s default under the Metropolitan loan A[the court] need not address plaintiff=s argument that he should have been notified of the default.@⁴⁷

⁴⁴ *Id.* at 787 (citation omitted).

⁴⁵ The court described a fee simple defeasibleCwithout citing any authorityC as Aan estate that may last forever but that may end upon the occurrence of a specified event.@ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.* at 788. In *Marple*, 750 P.2d at 1319B20, the court found that, as in *Klein*, the executory deed documents provided notice to a subsequent mortgagee so that the vendors of the property had a first priority mortgage lien. The court held, however, that the act of obtaining a release from the escrow and recording the quitclaim deed could terminate neither the mortgagor=s right of redemption, nor the security interests and rights of redemption of junior landholders. In another case involving the rights of a subordinate lienholder, *In re O.P.M. Leasing Services, Inc.*, 46 B.R. 661 (Bankr. S.D.N.Y. 1985), the bankruptcy court held that although, under New York law, legal title to property placed in escrow remains with the grantor until occurrence of the condition specified in the escrow agreement, the grantee has an equitable interest in the property, and that a judgment lien creditor with notice of the escrow agreement is subject to the equity interest of the grantee. Similarly, in *Alden State Bank v. Borton*, No. 262160, 2005 Mich. App. LEXIS 2859 (Nov. 17, 2005), the mortgage lender on a condominium project obtained a deed in escrow in connection with a loan workout with the borrower. During the period of the escrow, but before delivery of the deed as a result of the borrower=s subsequent default, a purchaser of one of the units filed a lis pendens against the property and obtained a judgment against the borrower subsequent to delivery of the deed. In a quiet-title action by the lender, the court ruled that, because the plaintiffs were not parties to the escrow agreement, the lender had no duty to them to preserve their investment and was not required to release its mortgages on the property. The

VII. BANKRUPTCY CONCERNS

A. Deed in Escrow as Executory Contract

Title insurance companies are often asked to hold the deed in escrow and issue title insurance for the transaction. If provided, title insurance coverage will be available and the title policy issued, only after the deed comes out of escrow. At the time the deed is delivered into escrow, no delivery of the deed has occurred and a bankruptcy may be filed subsequently by or against the mortgagor (unless the deed-in-lieu transaction is part of an approved bankruptcy plan). In such a case, the bankruptcy court may determine that the property remains part of the debtor's estate because the escrow arrangement constitutes an executory contract.⁴⁸ State courts also generally hold that a deed to property held in escrow does not convey title until delivery has occurred. For example, in *Hartman v. Wood*,⁴⁹ the South Dakota Supreme Court found that, in general, title to property under a deed deposited into escrow transfers when the escrowee delivers the deed or when the conditions placed upon its delivery have been met. But the court held that the assignee of a purchaser under a contract for deed was not entitled to a new warranty deed from the vendor when the vendor had previously deposited a warranty deed into escrow for delivery to the purchaser upon payment of the purchase price because the deed related back to the time of its original deposit in order to validate the conveyance to the purchaser.⁵⁰

court also held that the lender was protected from the rights of Amere judgment creditors@ such as the plaintiffs because the deed in escrow expressly stated that no merger would occur. *Id.* at *7B9.

⁴⁸ See, e.g., *Mizuna, Ltd. v. Crossland Fed. Sav. Bank*, 90 F.3d 650, 659 (2d Cir. 1996) (APlacing the deed in escrow indicates that the grantor does not intend to transfer ownership until the occurrence of some condition. The deed is >delivered out of escrow= when the condition is satisfied, because the grantor then intends to transfer ownership.@); *Dickerson v. Cent. Fla. Radiation Oncology Group*, 225 B.R. 241, 244 (M.D. Fla. 1998) (holding that, under Florida law, Alegal title to property placed in an escrow account remains with the grantor until the occurrence of the condition specified in the escrow agreement.@); *Miguel v. Beizeski*, No. 90 C 6054, 1993 U.S. Dist. LEXIS 15731, at *11 (N.D. Ill. 1993) (AWhen the conveyance is contingent on the occurrence of some event, title is not conveyed when the deed is delivered into escrow.@); *Hooker Atlanta Corp. v. Hocker (In re Hooker Inc.)*, 155 B.R. 333, 339 (Bankr. S.D.N.Y. 1993) (AIn most jurisdictions, such as New York, legal title to property placed in escrow remains with the grantor until the occurrence of the condition specified in the escrow agreement.@); *In re Sky Group Int=l, Inc.*, 108 B.R. 86, 92 (Bankr. W.D. Pa. 1989):

Debtor did *not* relinquish its legal or equitable interest in the property merely by virtue of it=s [sic] executing the Deed and depositing it with the escrow agent [I]t retains title thereto until performance of the condition or the happening of the

event upon which delivery is to be made by the escrow agent.

See, e.g., In re Scanlan, 80 B.R. 131, 134 (Bankr. S.D. Iowa 1987) (holding that delivery of deed to escrow agent, when obligations of other party have not been fulfilled, does not constitute full performance by debtor, and deed may be rejected as executory contract and the property ordered reconveyed to debtor); *Albrecht v. Brais*, 754 N.E.2d 396, 398B99 (Ill. App. Ct. 2001) (stating that deposit of deed into escrow with instructions to deliver it to grantee upon grantor's death was not binding trust and did not constitute actual delivery, and could be revoked before by informal act of grantor without notice to escrowee). *But see, e.g., Horton v. Rehbein (In re Rehbein)*, 60 B.R. 436, 441 (B.A.P. 9th Cir. 1986) (ruling that when deed has been placed in escrow and neither party has any material further obligations to perform, contract is not executory and may not be rejected); *In re ANR Advance Transp. Co.*, 247 B.R. 771, 774B76 (Bankr. E.D. Wis. 2000) (holding that purported escrow account established by lessor and lessee was true escrow, which was not included in property of estate or protected by automatic stay upon subsequent commencement of bankruptcy proceeding by debtor-lessee; court held that while debtor's rights in property are determined by state law, question of whether such interest is Aproperty of the estate@ is determined by federal law); *In re Seabrook Island Ocean Club, Inc.*, 118 B.R. 410, 412 (Bankr. D.S.C. 1990) (holding that Congress intended for the definition of Aexecutory contract@ under section 365 of the Bankruptcy Code Ato apply to contracts where significant unperformed obligations remain on both sides@); *Leefers v. Anderson (In re Leefers)*, 101 B.R. 24, 28 (Bankr. C.D. Ill. 1989) (holding that although it was clear that purchaser's nonpayment of remaining installments due under contract for deed was material breach of contract, case was remanded for determination whether by delivering deed in escrow sellers had fully performed their obligations; court found that issue of whether debtor's contract is executory, and thus subject to rejection, is question of federal law); *In re Murtishi*, 55 B.R. 564, 567 (Bankr. N.D. Ill. 1985) (AInitially, a court faced with a motion to reject an executory contract pursuant to section 365(a) should focus on the situation where both the debtor and the other party to the contract have significant obligations to perform under the contract at the time the petition is filed.@); David B. Young, *Unwarranted Lien Protection: The Misuse of Section 365(j) of the Bankruptcy Code for the Benefit of Holders of Options and Preemptive Rights*, 24 Sw. U.L. REV. 273, 284B88 (1995) (summarizing case law regarding meaning of Aexecutory contract@ for purposes of Bankruptcy Code).

⁴⁹ 436 N.W.2d 854, 856 (S.D. 1989).

⁵⁰ *See also Miguel*, 1993 U.S. Dist. LEXIS 15731, at *11 (AWhen the conveyance is contingent on the occurrence of some event, title is not conveyed when the deed is delivered into escrow.@); *LaSalle Nat'l Bank v. Kissane*, 516 N.E.2d 790, 792B93 (Ill. App. Ct. 1987) (ruling that when deed is deposited with escrowee, unauthorized delivery before escrow conditions have been complied with conveys no title); *Wilson v. Moore*, 504 N.E.2d 1383, 1388 (Ill. App. Ct. 1987); *Fairbury Fed. Sav. & Loan Ass'n v. Bank of Ill. in Normal*, 462 N.E.2d 6, 8B9 (Ill. App. Ct. 1984) (AMere delivery of a deed into escrow does not convey title when the conveyance is contingent upon the occurrence of an event which entitles the grantee to possession of the deed.@); *McMahon v. Dorsey*, 91 N.W.2d 893, 895 (Mich. 1958) (stating that fact of delivery must be judged in context of words, acts and circumstances surrounding transaction); *Havens v. Schoen*, 310 N.W.2d 870, 871B72 (Mich. Ct. App. 1981) (ruling that burden of proving delivery of deed by preponderance of evidence remains with party relying on deed even though deed was recorded); R.T. Kimbrough,

B. Deed in Escrow as Violation of Automatic Stay or as Fraudulent Conveyance/Preferential Transfer

The mortgagor, as debtor in possession, or a trustee appointed for the bankruptcy estate, may also argue that the automatic stay, which arises by operation of law under section 362(a) of the Bankruptcy Code (Code), applies as of the filing date of the bankruptcy petition and prohibits the delivery of the deed and any other escrowed documents.⁵¹ Even if the escrowed documents have been delivered out of escrow to the mortgagee prior to the mortgagor's bankruptcy, the mortgagor or the bankruptcy trustee may seek to avoid the transfer as a fraudulent conveyance, a preference, or an unperfected lien subject to the Astrong arm@ powers of the trustee under section 544 of the Code.⁵²

The bankruptcy court must first determine if the escrowed property is part of the mortgagor-debtor=s estate. Section 541 of the Code defines property of the estate to include all legal or equitable interests of the debtor in property as of the commencement of the bankruptcy case.⁵³ To determine the debtor=s interest in the escrowed property or account, the bankruptcy court must look to state law.⁵⁴ The issue of when an actual transfer of the escrowed property has occurred under section 101(54) of the Code is also a matter of state law. Section 101(54) defines Atransfer@ as Aevery mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the

Annotation, *Relation Back of Title or Interest Embraced in Escrow Instrument Upon Final Delivery or Performance of Condition*, 117 A.L.R. 69, 83 (1938); 28 AM. JUR. 2d *Escrow* ' 29 (1966).

⁵¹ See *Stockschlaeder & McDonald, Esqs. v. Kittay (In re Stockbridge Funding Corp.)*, 145 B.R. 797, 812 (Bankr. S.D.N.Y. 1992), *aff=d in part and vacated in part*, 158 B.R. 914 (S.D.N.Y. 1993) (holding that release of escrowed assignments prior to occurrence of stipulated conditions violated bankruptcy automatic stay).

⁵² See 11 U.S.C. ' 544 (2000). Section 544 vests a bankruptcy trustee with the rights of a hypothetical lien creditor whose lien was perfected at the time of the filing of the bankruptcy petition. If another creditor who claims a lien against the applicable property has not properly perfected its lien as of the date of the filing of the bankruptcy petition, the trustee or the debtor in possession can avoid that creditor=s lien and that creditor then becomes merely a general creditor of the estate.

⁵³ See *id.* ' 541(a)(1).

⁵⁴ See *Nobleman v. Am. Sav. Bank*, 508 U.S. 324, 329 (1993); *Butner v. United States*, 440 U.S. 48, 55 (1979); *In re Lee Road Partners, Ltd.*, 155 B.R. 55, 61 (Bankr. E.D.N.Y. 1993).

debtor=s equity of redemption.⁵⁵ The courts differ as to whether title to the escrowed property transfers at the inception of the escrow⁵⁶ or only when the condition of the escrow is met.⁵⁷ Some courts further hold that upon fulfillment of the escrow condition, the vesting of legal title relates back to the creation of the escrow when equitable considerations mandate such a result.⁵⁸

For purposes of determining the preference limitation period (ninety days, or one year in the case of a transfer to an insider under section 547 of the Code) or the fraudulent conveyance limitation period (one year under section 548 of the Code)⁵⁹ for bringing an avoidance action (which are

⁵⁵ 11 U.S.C. § 101(54) (2005).

⁵⁶ See, e.g., *In re Newcomb*, 744 F.2d 621, 626 (8th Cir. 1984) (stating that an unavoidable transfer . . . occurred when the escrow was created); *Dickerson*, 225 B.R. at 245 (ruling that escrow account was not property of estate because condition precedent to release of escrowed funds occurred before filing of petition); *Arrow Mill Dev. Corp. v. Shoprite of Clinton (In re Arrow Mill Dev. Corp.)*, 185 B.R. 190, 198 (Bankr. D.N.J. 1995) (ruling that escrow account was property of creditor and not property of debtor=s estate); *Musso v. N.Y. State Higher Ed. Servs. Corp. (In re Royal Bus. School, Inc.)*, 157 B.R. 932, 940 (Bankr. E.D.N.Y. 1993) (A[W]hen considering preference actions, the predominant rule is that a subsequent judgment or release of escrow monies does not deprive the estate of anything of value since the debtor reserves only a contingent right to the escrowed funds.); *Cedar Rapids Meats, Inc. v. Hager (In re Cedar Rapids Meats, Inc.)*, 121 B.R. 562, 567B68 (Bankr. N.D. Iowa 1990) (stating that escrow fund was not part of debtor=s bankruptcy estate); *Forest Hills Constr. Co. v. City of Florissant*, 562 S.W.2d 322, 328 (Mo. 1978) (holding that ultimate grantee is entitled to dividends from interest earned by escrow account prior to occurrence of stipulated condition).

⁵⁷ See, e.g., *Wilson v. United Sav. of Tex. (In re Missionary Baptist Found. of Am., Inc.)*, 792 F.2d 502, 506 (5th Cir. 1986) (holding that escrow funds are property of estate); *Makoroff v. Allegheny Graphics, Inc. (In re Allegheny Label, Inc.)*, 128 B.R. 947, 952 (Bankr. W.D. Penn. 1991) (ruling that sum of money placed into escrow was part of debtor=s bankruptcy estate); *Mason v. Benjamin Banneker Plaza, Inc. (In re Mason)*, 69 B.R. 876, 883B85 (Bankr. E.D. Pa. 1987) (holding that payments into court escrow account were property of bankruptcy estate, and that transfer occurred on date of actual remittance of funds for purpose of determining existence of avoidable transfer); *Gassen v. Universal Bldg. Materials, Inc. (In re Berkley Multi-Units, Inc.)*, 69 B.R. 638, 642 (Bankr. M.D. Fla. 1987) (holding that escrow funds are property of estate); *BancOhio Nat=l Bank v. Flannery (In re Flannery)*, 51 B.R. 697, 700 (Bankr. S.D. Ohio 1985) (finding that escrow was part of estate because debtors held Aa legal or equitable interest@ in escrow).

⁵⁸ See, e.g., *Donnelly v. Robinson*, 406 S.W.2d 595, 598 (Mo. 1966) (holding that transfer of real property by life tenant and remaindermen via escrow related back to creation of escrow).

⁵⁹ The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005), was enacted into law on April 20, 2005 and applies to all bankruptcy cases filed on or after October 17, 2005 (with limited exceptions as to certain

usually significantly longer under similar state fraudulent conveyance and fraudulent transfer laws), some courts (as noted above) have held that the transaction is no longer executory and the transfer period commences when the deed is placed in escrow and not when the deed is conveyed or released out of escrow.⁶⁰ It is therefore important that the title insurance company handling the escrow arrangement and insuring title upon delivery or release of the deed ascertain that there is fair and adequate consideration for the transaction, both when the deed is placed in escrow and again when it is released and the title company is asked to provide the policy (such as extinguishment or reduction of the underlying indebtedness and waiver, or forbearance or relinquishment of the rights and remedies of the mortgagee otherwise available for nonpayment of the debt), and that the value of the property is less than the outstanding debt. Otherwise, the title insurer will be unwilling to remove the creditors' rights exclusion from the title policy insuring the mortgagee's interest in the transferred property.⁶¹

provisions). The act amended section 548(a)(1) of the Code to extend the reach back period for avoidance of fraudulent transfers from one year to two years. The amendment applies only to cases filed one year after date of enactment (which occurred on April 20, 2005). Longer reach back periods under applicable state fraudulent conveyance statutes still apply because section 548 incorporates such statutes into the bankruptcy process. Section 544(a) of the Code gives the trustee or debtor in possession the status of a hypothetical lien creditor whose lien was perfected as of the date of the filing of the bankruptcy petition. Section 544(b) enables the trustee or debtor in possession to void any transfer of an interest of the debtor in property that is avoidable under applicable state law. For example, the *Uniform Fraud Transfer Act*, in effect in approximately 40 states, contains its own statute of limitations that extinguishes any claim not brought within four years after the transfer was made or the obligation was incurred. UNIF. FRAUD TRANSFER ACT § 9(a).

⁶⁰ See *In re Rehbein*, 60 B.R. at 441; *In re Leefer*, 101 B.R. at 28; cases cited *supra* note 45. In *Alden State Bank*, 2005 Mich. App. LEXIS 2859 at *16, the plaintiffs, third party judgment creditors, argued that the transfer via a deed in escrow to the lender should be voided as a fraudulent transfer under the Michigan fraudulent transfer statute. The court rejected this argument, finding that the plaintiffs had failed to show any intent to defraud by the lender and that the conveyances were in good faith and for valid consideration. *See id.* at *17.

⁶¹ The 1992 American Land Title Association Loan Policy contains the following creditors' rights exclusion:

[The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses that arise by reason of:]

7. Any claim, which arises out of the transaction creating the interest of the mortgage insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(a) the transaction creating the interest of the insured mortgagee being

The title insurance company also will want to review and approve all the underlying documents and agreements. It will require further that the escrow agreement contain provisions absolving it from all liability except for its gross negligence and permitting it to bring an interpleader action in the event of a dispute among any of the parties to the agreement.⁶²

A sample form of a deed-in-escrow agreement is contained in the appendix to this Article.

C. Exploding and Springing Guaranties

Mortgagees may try to Abankruptcy proof@ an executory deed-in-lieu transaction by requiring indemnifications or Aexploding@ or Aspringing@ guaranties from creditworthy third parties, or by requiring the mortgagor to establish a bankruptcy-remote entity to hold title to the property. Under an exploding guaranty, the entire debtCor some agreed-upon portion thereofCis guaranteed, and the guaranty is valid, effective, and binding as of the date the transaction is closed and the guaranty is executed. An individual or entity that is a direct or beneficial owner, holder of an equity interest in the mortgagor, or both often executes this form of guaranty. The mortgagee agrees not to enforce the guaranty unless and until certain events occur, such as the following:

- § The filing of a bankruptcy petition by or against the mortgagor.
- § The assertion of lender-liability claims against the mortgagee.
- § The institution of litigation by the mortgagor seeking injunctive relief or otherwise seeking to prevent the mortgagee from exercising its remedies under the workout documentsCincluding delivery of the deed in escrowCor the underlying loan documents.
- § The contesting of a subsequent foreclosure or enforcement pro-

deemed a fraudulent conveyance or fraudulent transfer: or

(b) the subordination of the interest of the insured mortgagee as a result of application of the doctrine of equitable subordination; or

(c) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:

(i) to timely record the instrument of transfer: or

(ii) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

AMERICAN LAND TITLE ASS=N, LOAN POLICY 4 (1992), <http://www.alta.org/forms/loan.doc> (last visited May 6, 2006).

⁶² See David S. Kupetz, *The Bankruptcy Code is Part of Every Contract: Minimizing the Impact of Chapter 11 on the Non-Debtor=s Bargain*, 54 BUS. LAW. 55, 83 (1998); Thomas M. Bryne, *Escrows and Bankruptcy*, 48 BUS. LAW. 761 (1992); Patrick E. Mears, *Can Bankruptcy Trump an Escrow?*, BUS. L. TODAY, Sept.-Oct. 1996, at 40, 45.

ceeding filed by the mortgagee.

§ The violation of certain covenants in the workout and loan documents.

The guaranty terminates upon the occurrence of certain specified events, such as payment in full of the loan, the successful completion of a foreclosure sale, or delivery of the property to the lender via a deed in lieu of foreclosure or pursuant to an escrow agreement.

Under a springing guaranty, the guarantor executes a guaranty at the closing of the loan workout. However, the guarantor's obligations under the guaranty become effective only upon the happening of certain specified events in the future, similar to those that would cause the mortgagee to enforce the guarantor's obligations under an exploding guaranty. Sometimes the springing guaranty is structured to provide that, even after it becomes effective, it still may terminate upon the occurrence of certain subsequent events, such as payment in full of the outstanding loan balance.

The validity and enforceability of springing and exploding guaranties may be attacked in a bankruptcy proceeding on a number of theories (which may or may not be successful). The mortgagor, guarantor, or other creditors may claim that the springing and exploding features of these types of guaranties are unenforceable *ipso facto* clauses under sections 363(l), 365(e), and 541(c) of the Code.⁶³ These parties also could argue that such guaranties are inequitable and therefore unenforceable under section 105 of the Code.⁶⁴ It could even be argued that the mortgagee's right to proceed against the guarantor under the guaranty for a monetary judgment constitutes an unreasonable and impermissible penalty under section 506(b) of the Code.⁶⁵ Furthermore, a claim could also conceivably be made that the enforcement of such guaranties violates the automatic-stay provisions of section 362 of the Code and that a bankruptcy court should enjoin the enforcement of such a guaranty upon the filing of a bankruptcy petition by or against the mortgagor.⁶⁶

⁶³ See, e.g., *DiCello v. United States (In re Ry. Reorganization Estate, Inc.)*, 133 B.R. 578, 583 (Bankr. D. Del. 1991) (ruling that government's springing liens on certain assets of debtor railroad were unenforceable *ipso facto* clauses).

⁶⁴ 11 U.S.C. § 105 (2004) (granting the court the power to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title).

⁶⁵ *Id.* § 506(b) (providing that an oversecured creditor may recover post petition interest in addition to reasonable fees, costs, [and] charges as part of its secured claim).

⁶⁶ See, e.g., *N. Star Contracting Corp. v. McSpedon (In re N. Star Contracting Corp.)*, 125 B.R. 368, 370B71 (S.D.N.Y. 1991) (ruling that action against corporate debtor's president violated automatic stay because situation presented special circumstances).

Fortunately for lenders, section 524(e) of the Code provides that a bankruptcy discharge does not discharge the obligation of any nondebtor party. Courts generally have construed this statutory provision as prohibiting bankruptcy plans from modifying or releasing the obligations and liabilities of guarantors under third party guaranties and prohibiting bankruptcy courts from enjoining the enforcement of such guaranties.⁶⁷

D. Deed in Escrow as Part of Approved Bankruptcy Plan

If a deed is placed in escrow as part of an approved bankruptcy reorganization plan, the plan and confirmation order should include specific findings of fact and conclusions of law that the conveyance of the property constitutes an absolute transfer of the property and is not intended by the parties as an equitable mortgage. The escrow instructions should state that if a subsequent default occurs under the plan or under the loan documents (as these documents may have been revised or restated pursuant to the plan),

based on identity of interests of debtor and third party nondebtor); *Sentry Bank & Trust Co. v. Goulding Place Developers, Inc.* (*In re Goulding Place Developers, Inc.*), 99 B.R. 493, 497B98 (Bankr. N.D. Ga. 1989) (corporate debtor=s Chapter 11 filing did not constitute bad faith so as to entitle creditor to relief from automatic stay to recover under guaranty executed by an officer of debtor, when underlying note was only in technical default upon individual borrower=s Chapter 11 bankruptcy filing and filing was necessary to preserve debtor=s equity in the property).

⁶⁷ See, e.g., *Star Phoenix Mining Co. v. W. One Bank*, 147 F.3d 1145, 1147 n.2 (9th Cir. 1998) (A[U]nder Section 524(e), a bankruptcy court does not have the power to discharge the liabilities of a bankrupt=s guarantor.); *Resorts Int=l, Inc. v. Lowenschuss* (*In re Lowenschuss*), 67 F.3d 1394, 1401 (9th Cir. 1995) (AThis court has repeatedly held, without exception, that ' 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors.); *Feld v. Zale Corp.* (*In re Zale Corp.*), 62 F.3d 746, 761 (5th Cir. 1995) (ruling that permanent injunctions discharging a potential debt of a nondebtor are not allowed by Bankruptcy Code); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592, 601 (10th Cir. 1991), *modified sub nom.* *Abel v. West*, 932 F.2d 898 (10th Cir. 1991) (A[N]either the confirmation of a plan nor the creditor=s recovery (or partial satisfaction) thereunder bars litigation against third parties for the remainder of the discharged debt.@ (citations omitted)); *In re Prussia Assocs.*, 322 B.R. 572, 596 (Bankr. E.D. Pa. 2005) (ACourts have generally construed [section 524(e)] as prohibiting bankruptcy plans from modifying or releasing the obligations and liabilities of guarantors under third party guaranties and prohibiting bankruptcy courts from preventing the enforcement of such guaranties.@).

But other courts have ruled that permanent injunctions against nondebtor parties are allowable under certain circumstances, such as consensual, noncoercive permanent injunctions that are essential to a successful plan of reorganization. See, e.g., *In re Specialty Equip. Cos., Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993); *Class Five Nev. Claimants v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 658 (6th Cir. 2002); *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2d Cir. 1992); *Menard-Sanford v. Mabey* (*In re A.H. Robins, Co.*), 880 F.2d 694, 700B02 (4th Cir. 1989).

the title insurance company, as escrow agent, will release the deed and other escrowed documents and deliver them to the designated party.⁶⁸

Because the bankruptcy court specifically will have approved this type of arrangement, it should be enforced even if the mortgagor is later the subject of a second bankruptcy case based on collateral estoppel, res judicata principles, and equitable grounds. The mortgagee therefore should be entitled to relief from the automatic stay in the subsequent bankruptcy proceeding and to specific enforcement of the escrow arrangement. For example, in *In re Howe*,⁶⁹ the Fifth Circuit Court of Appeals upheld the decision of the bankruptcy court that the debtor-mortgagor was precluded, under the principle of res judicata, from filing a lender-liability claim against the mortgagee (who was the largest creditor of the bankrupt debtor-mortgagor) five years after the confirmation of the debtor-mortgagor's Chapter 11 bankruptcy reorganization plan. The plan contained a provision that if the debtor-mortgagor failed to comply with the plan, a deed in escrow to the debtor-mortgagor's property would be released to the mortgagee. Because the debtor-mortgagor had not performed under the bankruptcy plan, the bankruptcy court denied the debtor-mortgagor's motion to dismiss the Chapter 11 proceedings and granted the mortgagee's motion for release of the deed.⁷⁰ The Fifth Circuit agreed with the bankruptcy court's holding that because the plan contained a built-in provision that eliminated default if the debtor-mortgagor couldn't pay, the mortgaged property would be transferred to the mortgagee if there was no material default under the plan that would necessitate the dismissal of the Chapter 11 proceedings or prevent the delivery of the deed to the mortgagee.⁷¹

⁶⁸ For examples of various forms of deed-in-escrow documents (bankruptcy and nonbankruptcy) see Kenneth M. Jacobson, Michael L. Molinaro, & John C. Murray, *Documenting a Consensual Transfer of Real Estate*, in CONSENSUAL TRANSFERS OF DISTRESSED REAL ESTATE 129 (American Bar Association, Section of Real Property, Probate and Trust Law 1998); see also Debra Pogrud Stark, *Problems and Strategies in Enforcing Executory Deed Transactions*, in CONSENSUAL TRANSFERS OF DISTRESSED REAL ESTATE 44 (American Bar Association, Section of Real Property, Probate and Trust Law 1998).

⁶⁹ *Howe v. Vaughan*, 913 F.2d 1138 (5th Cir. 1990).

⁷⁰ *Id.* at 1140.

⁷¹ *Id.* at 1149. In *In re 203 North LaSalle Street Limited Partnership*, 190 B.R. 567 (Bankr. N.D. Ill. 1995), the debtor's proposed Chapter 11 plan provided that a deed in escrow would be delivered to the mortgagee upon the occurrence of a future default. At oral argument in this case (which the author attended), Judge Wedoff expressed his concern that, despite the plan's assurance of a consensual transfer of the property upon a subsequent default, the mortgagee could face the issue of the enforceability of this provision of the plan

If the debtor attempted to avoid enforcement of a deed in escrow by filing a subsequent bankruptcy proceeding, the mortgagee could also seek to have the bankruptcy court dismiss the subsequent case as a bad-faith filing or abstain from hearing the case in the best interests of the creditors of the estate.⁷²

in a subsequent debtor bankruptcy proceeding filed before the debtor defaulted. But Judge Wedoff's written opinion stated (in connection with his ruling that the plan was feasible under section 1129(a)(11) of the Code) that the deed-in-escrow feature is likely to be enforced in any subsequent bankruptcy proceeding. *Id.* at 594. The district court affirmed this ruling of the bankruptcy court. *Bank of America, Illinois v. 203 N. LaSalle St. P=ship*, 195 B.R. 692, 711 (N.D. Ill. 1996). In discussing the feature of the plan providing for consensual transfer of the property by the debtor, the district court noted that the possibility of negation of the voluntary conveyance by a subsequent bankruptcy was minimized in this case because one of the debtor's principals personally had agreed to pay the mortgagee \$10 million if any of the debtor's equity holders caused the debtor to file another voluntary bankruptcy petition that attempted to block enforcement of the voluntary conveyance. The district court also noted that the mortgagee had cited no case holding that a voluntary conveyance provision might not be enforceable. The district court cited an unreported decision, *In re Billy Ray Eubanks*, Civ. A. No. 89-3426, 1990 WL 128208, at *1B2, (E.D. La. Aug. 28, 1990) which ruled that a plan providing for the immediate appointment of a receiver and liquidation of the debtor's assets if any creditor was not paid in full under the plan was feasible and enforceable. The U.S. Supreme Court ultimately rejected the debtor's plan in *203 North LaSalle* on other grounds. *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P=ship*, 526 U.S. 434 (1999). The deed-in-escrow issue became moot when the debtor subsequently obtained refinancing and agreed to pay the mortgagee the current market value of the property, as established by a third party offer obtained by the mortgagee.

⁷² See, e.g., *Hayes v. Prod. Credit Ass'n of the Midlands*, No. 87-2171, 1992 U.S. App. LEXIS 3329, at *8 (10th Cir. 1992) (A[T]o protect the integrity and administration of the bankruptcy proceedings, debtors should not be permitted to simultaneously maintain two proceedings involving the same debts. To allow such a situation would encourage debtors to abuse the protections afforded by the bankruptcy law. @). But in *Metropolitan Life Insurance Co. v. Olsen (In re Olsen)*, 861 F.2d 188, 189B90 (8th Cir. 1988), the court found that the debtor's confirmed Chapter 11 reorganization plan had not been substantially consummated even though a quitclaim deed had been placed in escrow. The court ruled that because the plan was not substantially consummated and the debtor's position was adversely affected by unanticipated changes in government farm policy, it had the right to modify the plan by reducing the yearly loan payments, thereby avoiding immediate transfer of the deed from the escrow. See also *In re Cook*, 126 B.R. 575, 580 (Bankr. D.S.D. 1991), *aff=d in part and rev=d, remanded in part sub nom. United States ex rel. Farmers Home Admin. v. Cook*, 147 B.R. 513 (D.S.D. 1992) (A[F]inality of confirmation . . . does not prevent a bankruptcy court from exercising jurisdiction to review its orders where equity so requires. @); *Fed. Land Bank v. Gene Dunavant & Son Dairy (In re Gene Dunavant & Son Dairy)*, 75 B.R. 328, 333 (M.D. Tenn. 1987) (A>To identify a deposit in escrow as a >transfer of property= under the [bankruptcy] plan ignores the practical purposes of an escrow agreement and this court . . . declines to do so. @).

VIII. CONCLUSION

A deed in escrow given to the lender in connection with a bargained-for workout of a defaulted mortgage loan is both effective and practical. It can work to the benefit of both parties and should be encouraged in commercial mortgage transactions when the situation warrants. Recent case law favors the ability of a mortgagee to obtain a deed in escrow in connection with a workout of a delinquent commercial loan, at least in those instances when there is an agreement providing (among other things) that the mortgagee agrees to forbear from exercising its legal rights and remedies as a result of the mortgagor's default subsequent to the date of the original mortgage. The parties must carefully and fully document the transaction to establish valid consideration, and the agreement should acknowledge that the mortgagor has been treated fairly, understands fully the nature of the transaction, and has been represented by competent counsel of the mortgagor's choice. The parties' agreement should further state that the transaction constitutes an absolute conveyance and is not intended as a mortgage or security of any kind. (The lender also should make certain that the escrowed deed contains explicit nonmerger language to preserve its rights against subordinate lienholders and judgment creditors.) The parties' agreement should also recite, if true, that the value of the secured property is less than the outstanding indebtedness. The law in this area is still evolving and both the mortgagor's and the mortgagee's counsel should be familiar with, and draft the documentation in accordance with, applicable statutory and case law. As noted in this Article, there are additional risks to the enforceability of a deed-in-escrow transaction if the mortgagor files, or there is filed against the mortgagor, a bankruptcy proceeding subsequent to delivery of the deed into escrow but before its release. These problems generally can be avoided if the deed-in-escrow agreement is part of a carefully drafted consensual bankruptcy plan.

APPENDIX
ESCROW AGREEMENT⁷³

THIS ESCROW AGREEMENT (this AAgreement@), dated as of _____, _____, is made and entered into by and among _____, a _____ (ABorrower@), having an office at _____; _____ and _____ (each a AGuarantor@ and together, the AGuarantors@), [each] having an address of _____; _____, a _____ (ALender@), having an office at _____; _____ Title Insurance Company (AEscrow Agent@), having an office at _____; and _____ (AProperty Manager@), having an office at _____. The following recitals form the basis, and are a material part of, this Agreement:

A. Borrower, [its general partner(s)/other] and Lender entered into that certain Agreement for Transfer (the AAgreement for Transfer@), dated as of _____, _____.

B. The Guarantors entered into that certain Guarantor Agreement (the AGuarantor Agreement@), dated as of _____, _____.

C. Capitalized terms not otherwise defined herein shall have the meaning given such terms in the Agreement for Transfer.

NOW, THEREFORE, in consideration of ten dollars (\$10.00) and other good and valuable consideration, the receipt of which is hereby acknowledged, Borrower, the Guarantors, Lender and Escrow Agent hereby covenant and agree as follows:

1. Escrowed Documents. Borrower, the Guarantors[, **add any other party(ies)**] and Lender have executed and delivered into escrow with the Escrow Agent the documents identified on **Exhibit A** attached hereto (the AEscrowed Documents@).

2. Receipt by Escrow Agent. Escrow Agent acknowledges receipt of the Escrowed Documents and agrees to establish an escrow (the AEscrow@) and hold the Escrowed Documents in escrow pursuant to the provisions of this Agreement.

3. Release of Escrowed Documents on Closing Date. If all of the

⁷³ The document that follows was prepared by Cheryl A. Kelly of Thompson Coburn LLP, St. Louis, Missouri. The author expresses his appreciation to Ms. Kelly for granting permission to reprint this document.

conditions to Lender=s obligation to close under the Agreement for Transfer have been satisfied (or expressly waived in writing by Lender) and Lender delivers notice thereof to Escrow Agent, Escrow Agent shall, on the Closing Date, remove the Escrowed Documents from Escrow, date the effective date of all of the documents as of _____ (the AClosing Date@) and deliver the same as follows:

(a) The [**General/Special**] Warranty Deed shall be delivered to Lender or its designee and, upon the receipt thereof, Lender or its designee shall execute and acknowledge the same and cause the same to be recorded in the _____ of _____ real estate records;

(b) The Bill of Sale shall be delivered to Lender or its designee;

(c) Both counterparts of the Assignment of Leases shall be delivered to Lender or its designee and, upon receipt of the same, Lender or its designee, as the case may be, shall execute both counterparts thereof and deliver one of the executed counterparts to Borrower;

(d) Both counterparts of the Assignment of Intangible Property shall be delivered to Lender or its designee and, upon receipt of the same, Lender or its designee, as the case may be, shall execute both counterparts thereof and deliver one of the executed counterparts to Borrower;

(e) The Owner=s Affidavit shall be delivered to Escrow Agent or such other party as may insure Lender=s or its designee=s title to the Property;

(f) The Assignment and the [**Full Deed of**] Release shall be delivered to Lender or its designee who shall cause the same to be recorded in the _____ of _____ real estate records;

(g) The Certificate [**of General Partner/Officer/Member/Other**] shall be delivered to Lender or its designee;

(h) One counterpart of the Termination of Management Agreement shall be delivered to each of Borrower, Lender and Property Manager;

(i) Originals of each of the Notices to Tenants shall be delivered to Lender or its designee, who shall be, and hereby is, authorized to complete the name and address for the payment of rent and to deliver the same to each tenant of the Property;

(j) One counterpart of the Release Agreement shall be delivered to each of Lender, Borrower and each of the Guarantors;

(k) The Non-Foreign Certificate shall be delivered to Lender or its designee, with a copy to the Escrow Agent; and

(l) All three counterparts of the Assignment of License Agreement shall be delivered to Lender or its designee and, upon receipt of the same, Lender or its designee, as the case may be, shall execute all counterparts

thereof and deliver one of the executed counterparts to Borrower and one of the executed counterparts to _____.

On the Closing Date, Borrower and **[describe any junior lienholder(s) and/or any other parties to the documents]** shall execute and deliver, or cause to be executed and delivered, to Lender such other documents and instruments as may be required to be executed and delivered on the Closing Date under the Agreement for Transfer or as Lender may reasonably require to effect a full and complete transfer to Lender or its designee of the Borrower=s title to the Property and right to possession thereof, the leases affecting the Property and all income and revenue therefrom, furniture, fixtures and equipment and all licenses, rights and privileges associated therewith. On the Closing Date, Borrower shall pay to Lender or its designee such amounts as may be required to be paid to Lender or its designee on the Closing Date under Paragraphs _____ and _____ of the Agreement for Transfer. On the Closing Date, the Guarantors shall execute and deliver, or cause to be executed and delivered, to Lender such other documents and instruments as may be required under the Guarantor Agreement. Borrower and the Guarantors hereby authorize and empower Lender as attorney in fact of Borrower and each of the Guarantors, to complete the Escrowed Documents as described above and to execute and deliver any such further documentation as is reasonably necessary to effectuate any such transfer. The powers of attorney granted by Borrower and each of the Guarantors to Lender pursuant to this paragraph shall be durable, shall be deemed coupled with an interest and shall be irrevocable.

4. Release of Escrowed Documents in Event of Friendly Foreclosure. If Lender exercises its right to foreclose the lien created by the **[Mortgage] [Deed of Trust]** and no Event of Default has occurred under the Agreement for Transfer, then Lender shall deliver notice thereof to Escrow Agent and Escrow Agent shall, upon receipt of such notice, take the following actions with respect to the Escrowed Documents on the date of any such foreclosure sale:

- (a) The **[General/Special]** Warranty Deed shall be returned to Borrower;
- (b) The Bill of Sale shall be returned to Borrower;
- (c) Both counterparts of the Assignment of Leases shall be returned to Borrower;
- (d) Both counterparts of the Assignment of Intangible Property shall be returned to Borrower;
- (e) The Owner=s Affidavit shall be returned to Borrower;
- (f) The Assignment and the **[Full Deed of]** Release shall be

delivered to the purchaser at the foreclosure sale, and such purchaser is authorized to cause the same to be recorded in the official real estate records for the _____ of _____;

(g) The Certificate [**of General Partner/Officer/Member/Other**] shall be delivered to Lender or its designee;

(h) One counterpart of the Termination of Management Agreement shall be delivered to each of Borrower, Lender and Property Manager;

(i) Originals of each of the Notices to Tenants shall be delivered to the purchaser at the foreclosure sale, who shall be, and hereby is, authorized to complete the name and address for the payment of rent and to deliver the same to each tenant of the Property;

(j) One counterpart of the Release Agreement shall be delivered to each of Lender, Borrower and each of the Guarantors;

(k) The Non-Foreign Certificate shall be delivered to the purchaser at the foreclosure sale; and

(l) All three counterparts of the Assignment of License Agreement shall be delivered to the purchaser at the foreclosure sale and, upon receipt of the same, such purchaser shall execute all counterparts thereof and deliver one of the executed counterparts to Borrower and one of the executed counterparts to [**describe any party that must consent to the assignment**].

On the date of any such foreclosure sale, Borrower and [**describe any junior lienholder(s)**] shall execute and deliver to the purchaser at such sale such other documents and instruments as such purchaser may reasonably require to effect a full and complete transfer to the purchaser at foreclosure of the Borrower=s title to the Property and right to possession thereof, the leases affecting the Property and all income and revenue therefrom, furniture, fixtures and equipment and all licenses, rights and privileges associated therewith. In addition, Borrower shall, on the date of the foreclosure sale, pay to the purchaser at such sale those funds required to be paid under Paragraphs _____ and _____ of the Agreement for Transfer. When any such foreclosure sale is conducted, Borrower and [**describe any junior lienholder(s)**] shall execute and deliver such agreements and certifications as may be reasonably required to cause to be issued to the purchaser at foreclosure, at the expense of such purchaser, an owner=s policy of title insurance issued by Escrow Agent. Borrower and the Guarantors hereby authorize and empower Lender as attorney in fact of Borrower and each of the Guarantors, to complete the Escrowed Documents as described above and to execute and deliver any such further documentation as is reasonably necessary to effectuate any such transfer.

The powers of attorney granted by Borrower and each of the Guarantors to Lender pursuant to this paragraph shall be durable, shall be deemed coupled with an interest and shall be irrevocable.

5. Release of Escrowed Documents in Event of Breach by Borrower or any Guarantor. If Lender exercises its right to foreclose the lien created by the **[Mortgage] [Deed of Trust]** and delivers to Escrow Agent a certification signed by an officer of Lender that an Event of Default has occurred under the Agreement for Transfer, then Escrow Agent shall, upon the receipt of such notice, take the following actions with respect to the Escrowed Documents upon the date of any such foreclosure sale:

(a) The **[General/Special]** Warranty Deed shall be returned to Borrower;

(b) The Bill of Sale shall be returned to Borrower;

(c) Both counterparts of the Assignment of Leases shall be returned to Borrower;

(d) Both counterparts of the Assignment of Intangible Property shall be returned to Borrower;

(e) The Owner=s Affidavit shall be returned to Borrower;

(f) The Assignment and the **[Full Deed of]** Release shall be delivered to the purchaser at the foreclosure, who is authorized to cause the same to be recorded in the real estate records for the _____ of _____;

(g) The Certificate **[of General Partner/Officer/Other]** shall be returned to Borrower;

(h) One counterpart of the Termination of Management Agreement shall be delivered to each of Borrower, Lender and Property Manager;

(i) Originals of each of the Notices to Tenants shall be delivered to the purchaser at the foreclosure sale, who shall be, and hereby is, authorized to complete the name and address for the payment of rent and to deliver the same to each tenant of the Property;

(j) All of the counterparts of the Release Agreement shall be destroyed, shall be deemed to be undelivered and shall be null and void and of no force or effect whatsoever, and Escrow Agent shall deliver to all of the parties to this Agreement a certificate of an officer of Escrow Agent that all of said counterparts of the Release Agreement have been destroyed;

(k) The Non-Foreign Certificate shall be returned to Borrower; and

(l) All three counterparts of the Assignment of License Agreement shall be delivered to the purchaser at the foreclosure sale and, upon receipt of the same, such purchaser shall execute all counterparts thereof and deliver one of the executed counterparts to Borrower and one of the

executed counterparts to **[describe any party that must consent to the assignment]**.

Borrower shall, on the date of any such foreclosure sale, pay to the purchaser at such sale those funds required to be paid under Paragraphs _____ and _____ of the Agreement for Transfer.

6. Transfer Absolute. Each of Borrower and **[describe any junior lienholder(s)]** acknowledges and agrees that at the time the Escrowed Documents and all additional documents and actions contemplated by this Agreement are properly delivered to Lender pursuant to the provisions of Paragraph 3 of this Agreement, then (a) such delivery is intended to effect a present and absolute conveyance and unconditional transfer of the Property, the leases affecting the Property and all income and revenue therefrom, furniture, fixtures and equipment and all licenses, rights and privileges associated therewith, and are not given as security, (b) Borrower shall deliver to Lender, its nominee, designee or assignee possession and enjoyment of the Property and the other property transferred pursuant to the Escrowed Documents concurrently with the delivery to Lender of the Escrowed Documents and Lender, its nominee, designee or assignee shall thereafter have the immediate right to occupy (subject to the rights of tenants of the Property), operate, use, sell and transfer the same or any part thereof for its own account, at its sole and absolute discretion, and (c) title to the Property shall remain subject to the **[Mortgage] [Deed of Trust]** to the full extent of the Mortgage Debt, and recording of the **[General/Special]** Warranty Deed to the Property to be given by Borrower to Lender shall not result in a merger of Lender=s interest as lienholder under the **[Mortgage] [Deed of Trust]** with Lender=s interest as title holder pursuant to such **[General/Special]** Warranty Deed.

7. Foreclosure. Nothing contained in this Agreement shall preclude Lender from pursuing a non-judicial or judicial foreclosure under the **[Mortgage] [Deed of Trust]** to the extent permitted under the Agreement for Transfer or from pursuing any rights or remedies under the Loan Documents or the Guaranties if an Event of Default occurs under the Agreement for Transfer.

8. Specific Performance. The provisions of this Agreement shall be enforceable by an action for specific performance.

9. Provisions Regarding Escrow Agent.

(a) In the event that for any reason there is any dispute or uncertainty concerning any action to be taken hereunder, Escrow Agent shall have the right to take no action until it shall have received instructions in writing concurred to by Borrower and Lender or until directed by a judg-

ment or decree of a court of competent jurisdiction in the State of _____ or in a Federal court in such State, whereupon Escrow Agent shall take such action in accordance with such instructions or such order.

(b) Escrow Agent shall not be liable to the other parties hereto or to anyone else for any action taken or omitted by it, or any action suffered by it to be taken or omitted, in good faith and in the exercise of reasonable judgment, except for acts of willful misconduct or gross negligence.

(c) Except in connection with Escrow Agent's willful misconduct or gross negligence, Escrow Agent shall be indemnified and held harmless jointly and severally by the other parties hereto from and against any and all expenses or loss suffered by Escrow Agent, including reasonable attorneys' fees in connection with any action, suit or other proceeding involving any claim, which arises out of or relates to this Agreement, the services of Escrow Agent hereunder or the documents and instruments held by it hereunder. Promptly after the receipt by Escrow Agent of notice of any demand or claim or the commencement of any action, suit or proceeding, Escrow Agent shall, if a claim in respect thereof is to be made against any of the other parties hereto, notify such other parties hereto in writing; but the failure by Escrow Agent to give such notice shall not relieve any party from any liability which such party may have to Escrow Agent hereunder.

(d) From time to time on and after the date hereof, the other parties hereto shall deliver or cause to be delivered to Escrow Agent such further documents and instruments and shall do and cause to be done such further acts as Escrow Agent shall reasonably request (it being understood that Escrow Agent shall have no obligation to make any such request and the parties hereto shall have no obligation to incur any cost or expense or any additional liability with respect to any such request) to carry out more effectively the provisions and purposes of this Agreement, to evidence compliance herewith or to assure itself that it is protected in acting hereunder.

(e) Escrow Agent may resign as Escrow Agent hereunder upon giving five (5) days prior written notice to that effect to each of the parties to this Agreement. In addition, Lender may, at any time and in its sole and absolute discretion, appoint a successor to act as Escrow Agent under this Agreement. In such event, the successor Escrow Agent shall be a reputable law firm or a nationally recognized title insurance company, selected by Lender and approved by Borrower, which approval shall not be unreasonably withheld or delayed. Such party that will no longer be serving as Escrow Agent shall deliver, against receipt, to such successor Escrow

Agent, the Escrowed Documents, if any, held by such party, to be held by such successor Escrow Agent pursuant to the terms and provisions of this Agreement. If no such successor has been designated on or before the effective date of such party=s resignation, its obligations as Escrow Agent shall continue until such successor is appointed; provided, however, its sole obligation thereafter shall be to safely keep all documents and instruments then held by it and to deliver the same to the person, firm or corporation designated as its successor or until directed by a final order or judgment of a court of competent jurisdiction in the State of _____ or a Federal Court in such State, whereupon Escrow Agent shall make disposition thereof in accordance with such order or judgment. If no successor Escrow Agent is designated and qualified within **five (5)** days after Escrow Agent=s resignation is effective, such party that will no longer be serving as Escrow Agent may apply to any court of competent jurisdiction for the appointment of a successor Escrow Agent.

This paragraph is in no way intended to limit Escrow Agent=s obligation under any policy or commitment of title insurance issued for or on behalf of Lender or to limit Escrow Agent=s responsibility to act in accordance with any closing instruction letter or other instruction for the delivery of title coverage made for or on behalf of Lender.

10. Miscellaneous.

(a) No failure or delay on the part of a party to this Agreement in exercising any power or right hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power preclude any other or further exercise thereof or the exercise of any other right or power hereunder. No modification or waiver of any provision of this Agreement and no consent to any departure by any party to this Agreement therefrom shall be effective unless the same shall be in writing and signed by the party against whom such modification, waiver or consent is being sought to be enforced against, and then such waiver, modification or consent shall be effective only in the specific instance and for the purpose for which given. No notice to or demand on any party to this Agreement in any case shall, of itself, entitle such party to any other or further notice or demand in similar or other circumstances.

(b) This Agreement may only be modified, amended, changed, discharged or terminated by an agreement in writing signed by the party to be bound thereby.

(c) Each of the parties to this Agreement (and the undersigned representatives of such parties, if any) has the full power, authority and legal right to execute this Agreement and to keep and observe all of the

terms, covenants and provisions of this Agreement on such parties= respective parts to be performed or observed.

(d) Any notice, request, direction or demand given or made under this Agreement shall be in writing and shall be hand-delivered or sent by Federal Express or other reputable overnight national courier service, and shall be deemed given when received at the following addresses whether hand-delivered or sent by Federal Express or other reputable overnight national courier service:

AS TO BORROWER:

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

with a copy to:

AS TO GUARANTORS:

_____	_____
_____	_____
_____	_____
_____	_____

AS TO LENDER:

_____	_____
_____	_____
_____	_____
_____	_____

AS TO ESCROW AGENT:

_____	_____
_____	_____
_____	_____
_____	_____

AS TO PROPERTY MANAGER:

_____	_____
_____	_____
_____	_____
_____	_____

Each party to this Agreement may designate a change of address by notice given to the other parties of such change of address.

(e) If any term, covenant or provision of this Agreement shall be held to be invalid, illegal or unenforceable in any respect, this Agreement shall be construed without such term, covenant or provision.

(f) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(g) This Agreement sets forth the entire agreement and understanding of the parties hereto with respect to the specific matters agreed to herein and the parties hereto acknowledge that no oral or other agreements, understandings, representations or warranties exist with respect to this Agreement or with respect to the obligations of the parties hereto under this Agreement, except those specifically set forth in this Agreement.

(h) This Agreement may be executed in one or more counterparts by some or all of the parties hereto, each of which counterparts shall be an original and all of which together shall constitute one and the same agreement, even though all of the parties hereto may not have executed the same counterpart of this Agreement.

(i) If any party to this Agreement commences any legal action to enforce its rights or another party's obligations under this Agreement, the prevailing party in any such action shall be entitled to recover its attorneys' fees and expenses incurred in prosecuting and/or defending against any such action from the nonprevailing party.

[Remainder of page intentionally blank; signatures follow]

IN WITNESS WHEREOF, each of the parties hereto has duly executed and delivered this Escrow Agreement as of the day and year first above written.

BORROWER:
_____, a

By: _____
Print Name: _____
Title: _____

[General Partner(s)/Guarantor(s)/ -
Junior Lienholder(s)/Other(s)],
individually

PROPERTY MANAGER:

_____, a

By: _____

Print Name: _____

Title: _____

GUARANTORS:

LENDER:

_____, a

By: _____

Print Name: _____

Title: _____

[add appropriate acknowledgments as desired]

[Continuation of Signature Page for Escrow Agreement]

ESCROW AGENT:

_____, a

TITLE INSURANCE COMPANY,

_____, a

By: _____

Print Name: _____

Title: _____

EXHIBIT A TO ESCROW AGREEMENTEscrowed Documents

1. One original of a [**General/Special**] Warranty Deed executed by Borrower;
2. One original of a Bill of Sale executed by Borrower;
3. _____ original counterparts of an Assignment of Leases executed by Borrower;
4. _____ original counterparts of an Assignment of Intangible Property executed by Borrower;
5. One original of an Owner=s Affidavit executed by Borrower;
6. One original of a [**Full Deed of**] Release executed by [**junior lienholder**], and one original Assignment executed by [**junior lienholder**];
7. One original of a Certificate [**of General Partner/Officer/Member/Manager**] executed by [**General Partner/Officer/Member/Manager**];
8. _____ original counterparts of a Termination of Management Agreement executed by Borrower and Property Manager;
9. _____ (____) original Notices to Tenants signed by Borrower;
10. _____ original counterparts of a Release Agreement executed by Lender, Borrower[, **General Partner/Other**] and the Guarantors;
11. Non-Foreign Affidavit executed by Borrower; and
12. _____ original counterparts of an Assignment of License Agreement executed by Borrower and [**any party required to consent to Assignment**].