

MORTGAGE WORKOUTS: DEEDS IN ESCROW

By John C. Murray

© 2009. All rights reserved.

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 “breathing room” to (hopefully) weather 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; and 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 where the consideration is actual and valid and the parties are sophisticated businesspeople represented by experienced counsel.² These types of arrangements are also

¹ A deed in lieu of foreclosure has been described as “a 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 Management, 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

useful (and not uncommon) in connection with mortgagor bankruptcies, where the plan of reorganization provides for the placing of a deed from the borrower-debtor to the lender in escrow. But courts of equity will closely scrutinize these types of transactions because the mortgagor's right of redemption will be cut off by the deed in escrow 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 suggest strategies to minimize these risks.

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 -- or at least sophisticated commercial 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

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.

³ 143 Ill. App. 3d 1033 (2nd Dist. 1986).

⁴ *Id.* at 1035.

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 his or 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 was 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 immediately delivered to the mortgagee in the event of a subsequent loan default by the mortgagor. The court stated that the agreement “comes as close to a formal security transaction as

⁵ 538 N.Y.S.2d 831 (N.Y. App. Div. 2nd Dep’t 1989), *appeal denied*, 75 N.Y. 2d 701 (1989).

⁶ See also *Leona Bank v. Kouri*, 772 N.Y.S.2d 251, 254-55 (N.Y. App. Div. 1st Dept. 2004) (“The 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”); *Greene v. East Coast Marketing, Inc. (In re Greene)*, 2007 WL 1309047 (Bankr. E.D. Va., May 3, 2007), at *5 (“Courts generally hold that when a mortgagor executes a deed in lieu of foreclosure as part of the initial mortgage transaction with instructions that the mortgagee can record the instrument immediately in the event of a future default, the deed is void and unenforceable. . . [S]uch arrangements have been deemed unenforceable under general equitable and public policy principles”); *Port Denison Marine, Inc. v. Denison Marine, Inc. (In re Denison Marine, Inc.)*, 1993 WL 72908 (Bankr. S.D. Fla., Feb. 10 1993), at *5 (“the entire transaction in the instant case consisting of the Contract of Purchase and Sale, the Agreement For Deed and Escrow Agreement was intended merely as security to the Plaintiffs in obtaining clear title to the “Port Parcel.” It was in the nature of a mortgage which, upon default by the Debtor, required foreclosure”).

⁷ 155 Colo. 282 (1964).

could have been accomplished without the execution of a mortgage or deed of trust.” 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 was therefore in violation of the public policy of the State of Colorado.⁸

⁸ *Id.* at 287. *See also 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, 1993 WL 946058 (Va. Cir. Ct.) (not reported in S.E.2d), at *3-4 (ruling that where 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. Wyoming 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); *Pollak v. Milsap*, 122 So. 16, 20-22 (Ala. 1928) (holding that transaction involving loan of money secured by deed is enforceable as mortgage); *Hamud v. Hawthorne*, 52 Cal.2d 78, 83 (1959) (ruling that deed in escrow was unenforceable because it was entered into at time of original loan); *MacArthur v. North Palm Beach Utilities, Inc.*, 292 So.2d 181, 188 (Fla. 1967) (“[a] mortgagor cannot by any agreement made contemporaneously with or as part of the mortgage transaction, bind himself not to assert his right or equity of redemption”); *Panagouleas Interiors v. Silent Partner Group, Inc.*, 2002 Ohio 1304, 2002 Ohio App. LEXIS 1305 (Ohio App. March 22, 2002), at *24-25 (“Ohio 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”); *Guam Hakubotan, Inc. v. Furusawa Inv. Corp.*, 947 F.2d 398, 401 (9th Cir. 1991), *cert. denied*, 112 U.S. 996 (1992) (“a mortgagor is not permitted to alienate his right of redemption at the time he enters into a mortgage agreement”); *Lewis Broadcasting Corp. v. Phoenix Broadcasting Partners*, 232 Ga. App. 94, 96 (1998) (“simply stated, the [clogging] doctrine voids any provision in an original mortgage agreement limiting or modifying the right of redemption by payment in full of the mortgage debt for any reason”); *Lincoln Mortg. Investors v. Cook*, 659 P.2d 925, 927 (Okla. 1982) (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). *Cf. Goemas v. Permanent Sav. & Loan Ass’n*, 1984 WL 3444 (Ohio Ct. App. 1984) (not reported in N.E.2d), at *2 (holding that a deed in escrow entered into at the time of original mortgage transaction, to be delivered to the mortgagee upon a subsequent default in lieu of foreclosure, did not impermissibly extinguish the

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.”⁹ A clog is a provision in the mortgage itself, or in a document related to or given along with

mortgagor’s right of redemption because the agreement did not “specifically waive the right of redemption or the right to a sale for two-thirds [as required under Ohio foreclosure law] of the fair market value”).

⁹ See John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279, 280, 287-88 (1998) [hereinafter “Murray”]; Murray, *Mortgage Workouts: Deeds in Escrow*, 41 REAL PROP. PROB. & TR. J. 185, 189 (2006). See also *West v. Reed*, 55 Ill. 242, 244 (1870) (“It is settled beyond controversy, that contracts between a 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.”); *Humble Oil & Refining Co. v. Doerr*, 303 A.2d 898, 906 (N.J. Super. Ct. Ch. Div. 1973) (“the [clogging] doctrine is universally applied, both in the United States and England”); *Lincoln Mortgage Investors v. Cook*, *supra* note 8, 659 P.2d at 927 (“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”). Chapter 3 of the RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES, § 3.1 cmt. a (1996) [hereinafter 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.” *Id.* § 3.1. See also 1 GRANT S. NELSON & DALE A. WHITMAN, REAL EST. AND FIN. L. § 3.1 (3d ed. 1993). The Introduction to Chapter 3 (Mortgagor’s Equity of Redemption and Mortgage Substitutes) of 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.* Introduction.

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.¹⁰ (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.)¹¹

A deed in lieu of foreclosure cuts off the right of redemption prior to foreclosure, and the mortgagor may claim that the transaction constitutes an impermissible clog of its right of redemption. But because a deed in lieu of foreclosure (or a deed in escrow) is subsequent to the original mortgage, and because 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), an arms-length, fully documented deed-in-lieu or deed-in-escrow transaction should survive a clogging challenge. But courts of equity will closely scrutinize these types of transactions because the borrower's right of redemption will be cut off by delivery of the deed.¹²

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

¹⁰ See *Id.* at 322.

¹¹ See *Lewis Broadcasting Corp. v. Phoenix Broadcasting Partners*, note 8 *supra*, 232 Ga. App. at 96 (option to purchase, given to mortgagee at same time as mortgage, was impermissible clog and unenforceable).

¹² See RESTATEMENT, *supra* note 9, § 3.1, ("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.").

isn't labeled a mortgage by the parties (it is often in the form of a "deed"), but in actuality secures a debt or other obligation.¹³ 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.¹⁴

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. The equitable-mortgage argument 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.*,¹⁵ the Ninth Circuit rejected the borrower's 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.¹⁶

But some courts 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. For example, In *McGuigan v. Millar*,¹⁷ the California appellate court held that the evidence clearly indicated the intention of the parties to treat an "option to

¹³ See RESTATEMENT §§ 3.1 and 3.2.

¹⁴ See Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. at 322.

¹⁵ *Supra* note 8, at 402.

¹⁶ *Id.* According to the court, "To interpret the transaction as a simple continuation of the mortgage would be to eliminate incentives for creditors to grant loan extensions sought by debtors and instead create an incentive for creditors simply to initiate foreclosure." *Id.*

¹⁷ 117 Cal. App. 739 (1931). The court stated that, "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." *Id.* at 744.

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 the mortgagor of its right of redemption, by subterfuge; for example, 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

In *Weil v. Colorado Livestock*,¹⁹ the lender, in an agreement dated March 4, 1969, extended the maturity date of the loan (which was in default) to October 15, 1969. As consideration for the extension, “and in order to avoid the expense of foreclosure of the real property mortgaged to [the lender],”²⁰ the borrower executed and delivered to the lender two warranty deeds covering the real property. The agreement then provided that the deeds would be held by the lender without recording on the condition that the borrower repay his past and current indebtedness before October 15, 1969, and that if such repayment did not occur by that date, then the lender would record the deeds “and they shall constitute absolute conveyances.”²¹ The Colorado appellate court noted that after execution of the agreement, “[the lender] loaned additional

¹⁸ See, e.g., *Davis v. Davis*, 890 S.W. 2d 280 (Ark. Ct. App. 1995); *Smith v. Player*, 601 So. 2d 946 (Ala. 1992); *Swanbeck v. Sheaves*, 1986 WL 2957 (Ohio App. Dist. 1986); *Davis v. Stone*, 236 F.Supp. 553 (D.D.C. 1964); *Cohn v. Bridgeport Plumbing Supply Co., Inc.*, 115 A. 328 (Conn. 1921); *Peugh v. Davis*, 96 U.S. 332 (1877); *Provident Trust Co. v. Metropolitan Casualty Ins. Co.*, 152 F. 2d 875 (3d Cir. 1945), *cert. denied*, 327 U.S.789 (1946); *Harbel Oil Co. v. Steele*, *King v. King*, 74 N.E. 89 (Ill. 1905); *Holden Land & Live Stock Co. v. Interstate Trading Co.*, 123 P. 733 (Kan. 1912); *Felbinger and Co. v. Traiforos*, 76 Ill.App.3d725, 394 N.E. 2d 1283 (1st Dist. 1979); 4 AMERICAN LAW OF PROPERTY § 16.5 (A. Casner ed. 1952); 55 AM. JUR. 2D MORTGAGES § 1220 (1971); 28 AM. JUR. 2D ESCROW § 10 (1966); Annot., *Deed from Mortgagor or Privy to Mortgage Holder as Extinguishing Equity of Redemption*, 129 A.L.R. 1435 (1940); RESTATEMENT, § 3.2, reporter’s note, at 121, and cases cited therein.

¹⁹ 30 Colo. App. 301 (1971).

²⁰ *Id.* at 303.

²¹ *Id.*

sums to [the borrower] and took additional promissory notes, which were not repaid.”²² The lender therefore recorded the deeds at the end of October, 1969. But the appellate court overruled the decision of the trial court that had held in favor of the lender, and ruled that even though warranty deeds had been given to the lender, they were not “absolute and unconditional transfers” and that the March 4, 1969 agreement “is a security agreement in the fullest sense,” since the borrower was left in possession holding equitable title, and the March 4, 1969 agreement extended the existing loan and set forth the terms of future loans. Therefore, the court found, the borrower was entitled to require that the deeds be foreclosed as mortgages, and was entitled to a sale by foreclosure and a redemption period under the applicable Colorado statute.²³

Most cases that find the existence of an equitable mortgage involve the situation where a deed alone, that is really a "disguised mortgage," is given to another party, i.e., the party takes a deed to the property but 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 conveys the entire interest of the grantor is not a mortgage or other security device.²⁴ Several states have

²² *Id.* at 304.

²³ According to the Colorado appellate court, “By the force of this statute [C.R.S. 1963, 118-6-17], the subject deeds have the legal effect of mortgages and must be foreclosed as such.” *Id.* The current version of this statute, C.R.S.A. § 38-35-117 (Mortgages, not a conveyance – lien theory), states as follows:

Mortgages, trust deeds, or other instruments intended to secure the payment of an obligation affecting title to or an interest in real property shall not be deemed a conveyance, regardless of its terms, so as to enable the owner of the obligation secured to recover possession of real property without foreclosure and sale, but the same shall be deemed a lien.

See also Stephen W. Seifert, 9 COLO. PRAC., *Creditors’ Remedies – Debtors’ Relief* § 2.13 (2008) (“A foreclosure under these conditions [as occurred in the *Weil* case] would not be through the public trustee system, but rather would be a judicial foreclosure”).

²⁴ *See, e.g., Dye v. United States, Farm Services Agency, Inc. (In re Dye)*, 360 F.3d 744, 749 (7th Cir. Ind. 2004), *reh’g, en banc, denied* 2004 U.S. App. LEXIS 10500 (7th Cir. May 24, 2004) (transfer was not equitable mortgage where

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.²⁵ An Illinois statute states that “[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.”²⁶

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). *Cf. Bernstein v. New Beginnings Trustee, LLC*, 988 So. 2d 90, 95-96 (Fla. App. 4 Dist., 2008S) (court recharacterized alleged sale-leaseback transaction as equitable mortgage, notwithstanding express language in agreement to contrary; court found that “all indicia of ownership” remained with plaintiffs and that plaintiffs’ interest could be terminated only through foreclosure action).

²⁵ MINN. STAT. ANN. § 559.18. *See also* GA. CODE ANN. § 44-14-32 (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 (same). Some states have enacted statutes that expressly permit a party to prove by parol evidence if necessary that a deed absolute on its face was in fact a mortgage. *See* ARIZ. REV. STAT. ANN. § 33-702(A); CAL. CIV. CODE § 2924; IDAHO CODE § 45-905. With respect to the law in Indiana in this area, *see Brenneman Mechanical & Elec. v. First Nat’l Bank of Logansport*, 495 N.E.2d 233, 238-39 (Ind. Ct. App. 1986) (stating that “[i]t is well settled in Indiana that a deed, absolute and unconditional on its face, may be nothing more than a mortgage or security device when executed to secure an existing debt”; the court also stated that whether “a deed, absolute and unconditional on its face,” is actually “nothing more than a mortgage or security device . . . executed to secure an existing debt,” is a matter that turns on the parties’ intent; “the law gives effect to the intention of the parties rather than being controlled by the form or names of the instrument”); *Singer v. Burcham*, 140 Ind. App. 378, 384 (1966) (“An absolute conveyance, *without any other consideration than that assumed*, coupled with an agreement to reconvey, will be regarded as a mortgage” (emphasis added)); *Ticor Title Ins. Co. of California v. FFCA/IIP 1988 Property Co.*, 898 F. Supp. 633, 640 (N.D. Ind., 1995) (“if [the plaintiff’s] recharacterization claim was to succeed under Indiana law, [the plaintiff] would have had to establish that both [the plaintiff] and the defendants intended their transaction to create a security interest rather than a grant of title”).

²⁶ 765 ILCS 905/5. *See also* MD. CODE ANN. REAL PROP. § 7-101 (providing that a deed absolute in terms shall be considered a mortgage where it appears, by any other writing, to be intended merely as additional security for a debt or

Other states 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.²⁷

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

- The statements of the parties.
- The existence of a substantial disparity between the value received by the grantor and the actual value of the real property at the time of conveyance.
- The fact that the grantor retained possession of the real property.
- The fact that the grantor continued to pay real estate taxes.
- The fact that the grantor made improvements to the real estate subsequent to the conveyance.

performance of an obligation); N.Y. REAL PROP. LAW § 320 (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); 46 OKLA. ST. ANN. TIT. 46, § 1 (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. § 70-40-8 (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).

²⁷ See, e.g., CAL. CIV. CODE. § 2950; PA. STAT. ANN. TIT. 21, § 951; ME. REV. STAT. TIT. § 202; WYO. STAT. ANN. § 34-1-127.

- The nature of the parties to the transaction and their relationship both prior to and after the conveyance.

Section 3.2(c) of the RESTATEMENT provides that where, 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.

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, such as: 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 and/or release of personal liability); and little or no equity in the mortgaged property. There are certainly 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 of out-of-court settlements of disputed matters and avoidance of the time and expense (and publicity) of protracted and contested foreclosure and bankruptcy proceedings. But the courts (rightfully) remain highly protective of borrowers where most or all of these factors are not present.²⁸

²⁸ 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

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*.²⁹ 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 listed the following relevant factors in upholding the validity of the transaction:

- The transaction involved commercial real estate rather than residential property
- All parties were represented by counsel.
- 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) was given to the mortgagor.
- 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).

respect to loans on residential and agricultural real estate, a mortgagor may waive its right of redemption at any time, including at the inception of the loan. 735 ILCS 5/15-1601. Furthermore, after 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. 735 ILCS 5/15-1601(c).

²⁹ 595 So.2d 180 (Fla. Dist. Ct. App. 1992), *review denied*, 601 So.2d 553 (Fla. 1992).

- The agreement between the parties was reached during a pending action by the first mortgage holder to foreclose its mortgage on the property.³⁰

Similarly, in *Oakland Hills v. Lueders Drain District*,³¹ 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, where 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

³⁰ *Id.* at 182. See also *Shaw v. Walbridge*, 33 Ohio 1, 5-6 (1877) (stating that “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 his 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 where such sale is a fair one, under all the circumstances, it will be upheld” (citations omitted)); *Guam Hakubotan, Inc. v. Furusawa Inv. Corp.*, *supra* note 8, 947 F.2d at 401 (“While 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 & Refining Co. v. Doerr*, 303 A.2d 898, 908 (N.J. Super. Ct. Ch. Div.1973) (“[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*, 73 Ohio St. 3d 671, 677 (1995) (“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”); *In re Greene*, *supra* note 6, 2007 WL 1309047, at *5 (“courts are more inclined to uphold deeds in lieu of foreclosure in the context of a workout”). *But see* RESTATEMENT § 3.1 cmt. F, illus. 13-15 (1997) (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”).

³¹ 212 Mich. App. 284 (1995).

agreement. In an earlier decision, *Russo v. Wolbers*,³² the Michigan appellate court held that the mortgagor may, after the original mortgage transaction, sell or convey his or her equity of redemption to the mortgagee by a separate and distinct contract entered into for good faith and for valid consideration, but “the 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

³² 116 Mich. App. 327, 336 (1982). See also *Kubczak v. Chemical Bank & Trust Co.*, 456 Mich. 653, 660-61 (1998) (“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 [citation omitted], and pursuant to an explicit agreement”); *Gillam v. Michigan Mortg. Inv. Corp.*, 224 Mich. 405, 410 (1923) (holding that commercial debtor could release its equity of redemption as part of loan workout agreement where “it was not unconscionable; it was fairly made without fraud or duress; [and] it is supported by a reasonably adequate consideration”); *Panagouleas Interiors*, *supra* note 8, 2002 Ohio App. LEXIS at *22 (“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, 238-39, 1858 WL 2318 at *5 (1858) (stating that although “the 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 contemporaneous 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”); *Weil v. Colorado Livestock*, *supra* note 19, 30 Colo. App. at 304-05 (holding that escrowed deeds to mortgaged property taken by lender in connection with separate agreement executed by borrower and lender after default by borrower, whereby maturity date of loan was extended, “was, in law, a security transaction” that required deeds to be foreclosed as mortgages with full right of redemption by borrower, even though borrower had entered into agreement and executed subject deeds only after being fully advised of his legal rights and without notifying lender that he considered deeds to be mere mortgages).

³³ *Id.*, at 338. In *Wright v. First National Bank of Monroe*, 297 Mich. 315 (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.” *Id.* at 327. 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*, 274 N.Y. 624 (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 also *Baldwin v. American Trading Co.*, 76 Cal. App. 80, 87 (1925) ("[A] mortgagor debtor, at any time after execution of the mortgage, may, by a separate and distinct transaction, sell or release his equity of redemption to the mortgagee"); *Guam Hakubotan, Inc. v. Furusawa Inv. Corp.*, *supra* note 8, 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 (2nd 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 "in 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"); *First Illinois National Bank v. Hans*, *supra* note 3, 143 Ill. App. 3d at 1034 (stating, in *dicta*, that separate agreement to execute quit claim deed for property to lender, entered into after future default to avoid foreclosure expenses, may be enforceable in Illinois under certain circumstances); *Bradbury v. Davenport*, 120 Cal. 152, 153 (1898) (upholding executory deed transaction conveying mortgagor's equity of redemption subsequent to original loan); *Deming v. Smith*, 19 Cal. App. 2d 683, 687-689, (1937) (holding that executory deed transaction was not an equitable mortgage where mortgagors were granted an extension of time to pay debt); 4 POWELL ON REAL PROPERTY (1997), 37-305, sec. 37.44(1) ("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"); Annot., *Deed Placed in Escrow to Grantee upon Failure to Pay Debt Due Him as a Mortgage*, 65 A.L.R. 120 (1930).

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 New York 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. The settlement agreement provided that the borrower would pay all principal and unpaid interest owing on January 30, 2001, all interest due before that date, and the lender's attorney fees. (The court noted that the borrower entered into this agreement "through counsel.")³⁶ Pursuant to the agreement, the borrower signed a warranty deed to be held in escrow by the lender's counsel, which deed 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 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 this 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 at no time did the borrower deny he owed the amounts he agreed to pay or allege that he was "coerced" into executing the settlement agreement or that he was disadvantaged by it. Nor did he allege that the lender had engaged in any inequitable conduct in

³⁴ 830 So. 2d 224 (Fla. Dist. Ct., App., 4th Dist., 2002).

³⁵ Section 697.01(1), Florida Statutes (2000) states that:

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 *Rothschild Reserved Int'l v. Silver*, *supra* note 34, at 225.

connection with either the foreclosure or the voluntary settlement of the foreclosure proceeding.

The lender obviously thought it was doing the borrower a favor by not pursuing the foreclosure and entering into (a very reasonable) settlement agreement, and the borrower and his counsel obviously thought so also or they would not have agreed to place the deed in escrow. The appellate court sagely observed that, "[I]f agreements to settle foreclosure actions are deemed mortgages under the statute, no foreclosure action would ever be settled."³⁷

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 existence of any subordinate lienholder(s) has been ascertained (through a current title search) and the consent of any such lienholder(s) to the transaction is obtained. Proper notice to the subordinate lienholder(s) of the deed-in-escrow transaction is crucial, as courts will often seek to protect the redemption rights of subordinate lienholders as well the borrower.

The issue of notice was highlighted in an Illinois Appellate Court decision, *Klein v. DeVries*,³⁸ which involved a highly unusual fact situation. 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' 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

³⁷ *Id.* at 226.

³⁸ 309 Ill. App. 3d 271 (Ill. App. 2nd Dist. 1999), *appeal denied*, 188 Ill. 2d 565 (2000).

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 to either cure the default or “obtain Metropolitan’s position as first mortgage holder by making certain payments to Metropolitan.” 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.”

In 1989, DeVries executed and delivered to the plaintiff (Klein) a note secured by three mortgages on the property 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.

The appellate court, in affirming the holding of the trial court, first noted that “[i]n general, a mortgagee can have no greater rights than his mortgagor.”³⁹ 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’ interest in the property had been irrevocably “altered,” i.e., his 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.⁴⁰ The court ruled that this was the only estate that DeVries could convey to the plaintiff, and “when DeVries

³⁹ *Id.* at 273.

⁴⁰ The court described a “fee simple defeasible” – without citing any authority - as “an estate that may last forever but that may end upon the occurrence of a specified event.” *Id.*

defaulted under the Metropolitan mortgage, both DeVries' and the plaintiff's estate in the property ended."⁴¹ The appellate court refused to consider the issue of the lack of notice to the plaintiff as required by DeVries' reorganization plan, ruling that because it had concluded that the plaintiff had no right to cure DeVries' default under the Metropolitan loan, "we need not address plaintiff's argument that he should have been notified of the default."⁴²

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.⁴³ State courts also generally hold

⁴¹ *Id.*

⁴² *Id.* In *Marple v. Wyoming Production Credit Association*, *supra* note 8, 750 P.2d at 1319-20, the court found that, as in *Klein v. DeVries*, the executory deed documents provided notice to a subsequent mortgagee so that the vendors of the property had a first priority mortgage lien. But the court held 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 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*, 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. The court, in a quiet-title action by the lender, ruled that because the plaintiffs were not parties to the escrow agreement the lender had no duty to them to preserve their investment and were not required to release their mortgages on the property; the court also held that because the deed expressly stated that no merger would occur, the lender was protected from the rights of "mere judgment creditors" such as the plaintiffs.

⁴³ *See, e.g., In re Scanlan*, 80 B.R. 131, 134 (Bankr. S.D. Iowa 1989) (holding that delivery of deed to escrow agent, when obligations of other party have not been

that a deed to property held in escrow does not convey title until delivery has occurred. For example, in *Hartman v. Wood*,⁴⁴ the South Dakota Supreme Court found that, in general, title to property under a deed deposited into escrow transfers when the escrowee delivers the

fulfilled, does not constitute full performance by debtor and deed may be rejected as executory contract and the property ordered reconveyed to debtor); *Mizuna, Ltd. v. Crossland Fed. Sav. Bank*, 90 F.3d 650, 659 (2nd Cir. 1996) (“Placing 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”); *Albrecht v. Brais*, 324 Ill. App. 3d 188, 191 (Ill. App. Ct. 3d Dist. 2001) (deposit of deed into escrow with instructions to deliver it to grantee upon grantor’s death was not binding on trust and did not constitute actual delivery, and could be revoked before delivery by informal act of grantor without notice to escrowee); *Miguel v. Beizeski*, 1993 U.S. Dist. LEXIS 15731 (D. Ill. 1993), at *11 (“When the conveyance is contingent on the occurrence of some event, title is not conveyed when the deed is delivered into escrow”); *In re Sky Group International, 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 its executing the Deed and depositing it with the escrow agent . . . it 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”); *Dickerson v. Central Fla. Radiation Oncology Group*, 225 B.R. 241, 244 (M.D. Fla. 1998) (holding that, under Florida law, “legal title to property placed in an escrow account remains with the grantor until the occurrence of the condition specified in the escrow agreement”); *Hooker Atlanta Corp. v. Hocker*, 155 B.R. 332, 339 (Bankr. S.D.N.Y. 1993) (“In 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”). *But see In re Rehbein*, 60 B.R. 436, 441 (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 Leafers*, 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 ANR Advance Transportation Co., Inc.*, 247 B.R. 771, 774-76 (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 “property of the estate” is determined by federal law); *In re Seabrook Island Ocean Club, Inc.*, 101 B.R. 410, 412 (Bankr. D.S.C. 1990) (holding that Congress intended the definition of “executory contract” under § 365 of the Bankruptcy Code “to apply to contracts where significant unperformed obligations remain on both sides”); *In re Murtishi*, 55 B.R. 564, 567 (Bankr. N.D. Ill. 1985) (“Initially, 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 S.W. L. REV. 273, 284-88 (1995) (summarizing case law regarding meaning of “executory contract” for purposes of Bankruptcy Code).

⁴⁴ 436 N.W.2d 854, 856 (S.D. 1989).

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.⁴⁵

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 § 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.⁴⁶ 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 “strong arm” powers of the trustee under § 544 of the Code.⁴⁷

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

⁴⁵ See also *LaSalle Nat’l Bank v. Kissane*, 163 Ill. App. 3d 534, 539-40, (1st Dist. 1987) (ruling that when deed is deposited with escrowee, unauthorized delivery before escrow conditions have been complied with conveys no title); *Fairbury Federal Sav. & Loan Ass’n v. Bank of Illinois in Normal*, 122 Ill. App. 3d 808, 811-12 (1984) (“Mere 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”); *Wilson v. Moore*, 153 Ill. App. 3d 15, 22 (1987) (same); *Miguel v. Belzeski*, *supra* note 43, 70 F.3d 1274 (Table) at *4-5 (“When the conveyance is contingent on the occurrence of some event, title is not conveyed when the deed is delivered into escrow”); *Havens v. Schoen*, 108 Mich. App. 758, 761-62 (1981) (burden of proving delivery of deed by preponderance of evidence remains with party relying on deed even though deed was recorded); *McMahon v. Dorsey*, 353 Mich. 623, 626 (1958) (fact of delivery must be judged in context of words, acts and circumstances surrounding transaction); Annot., *Escrow – Passing of Title – Relation Back*, 117 A.L.R. 69, 83 (1938); 28 AM. JUR. ESCROW § 29 (1966).

⁴⁶ See *In re Stocksclaeder & McDonald, Esqs. v. Kittay (In re Stockbridge Funding Corp.)*, 145 B.R. 797, 811 (Bankr. S.D.N.Y. 1992) (holding that release of escrowed assignments prior to occurrence of stipulated conditions violated bankruptcy automatic stay).

⁴⁷ See 11 U.S.C. § 544. 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.

of the debtor in property as of the commencement of the bankruptcy case. In order to determine the debtor's interest in the escrowed property (or account), the bankruptcy court must look to state law.⁴⁸ The issue of when an actual transfer of the escrowed property has occurred, under § 101(54) of the Code, is also a matter of state law. Section 101(54) defines "transfer" as "every 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 debtor's equity of redemption."⁴⁹ The courts differ as to whether title to the escrowed property is transferred at the inception of the escrow⁵⁰ or only when the condition of the escrow is met.⁵¹ 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.⁵²

⁴⁸ See *Butner v. United States*, 440 U.S. 48, 55 (1979); *In re Lee Road Partners, Ltd.*, 155 B.R. 55 (Bankr. E.D.N.Y. 1993); *Nobleman v. Am. Sav. Bank*, 508 U.S. 324, 328 (1993).

⁴⁹ 11 U.S.C. § 101(54).

⁵⁰ See, e.g., *In re Newcomb*, 744 F.2d 621, 626 (8th Cir. 1984) (holding that an "unavoidable . . . transfer occurred when the escrow was created"); *Forest Hills Construction Co. v. City of Florissant*, 562 S.W.2d 322, 325 (Mo. 1978) (ultimate grantee entitled to dividends from interest earned by escrow account prior to occurrence of stipulated condition); *Musso v. New York State Higher Education Services Corp. (In re Royal Business School, Inc.)*, 157 B.R. 932, 940 (Bankr. E.D.N.Y. 1993) ("when 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"); *Arrow Mill Development Corp. v. Shoprite of Clinton (In re Arrow Mill Development Corp.)*, 185 B.R. 190, 198 (Bankr. D.N.J. 1995) (escrow account was property of creditor and not property of debtor's estate); *Cedar Rapids Meats, Inc. v. Hager (In re Cedar Rapids Meats, Inc.)*, 121 B.R. 562, 567-68 (Bankr. N.D. Iowa 1990) (escrow fund was not part of debtor's bankruptcy estate); *Dickerson v. Central Florida Radiation Oncology Group*, 225 B.R. 241, 245 (M.D. Fla. 1998) (escrow account was not property of estate because condition precedent to release of escrowed funds occurred before filing of petition).

⁵¹ See, e.g., *Wilson v. United Sav. Bank of Texas (In re Missionary Baptist Foundation of America, Inc.)*, 792 F.2d 502, 506 (5th Cir. 1986) (holding that escrow funds are property of estate); *Gassen v. Universal Building Materials, Inc. (In re Berkley Multi-Units, Inc.)*, 69 B.R. 638, 642 (Bankr. M.D. Fla. 1987) (same); *In re Flannery*, 51 B.R. 697, 700 (Bankr. S.D. Ohio 1985) (finding that escrow was part of estate because debtors held "a legal or equitable interest" in escrow); *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, 883 (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).

⁵² See, e.g., *Donnelly v. Robinson*, 406 S.W.2d 595, 598 (Mo. 1966) (transfer of real property by life tenant and remaindermen via escrow related back to creation of escrow).

For purposes of determining the preference limitation period (ninety days, or, in the case of a transfer to an insider, one year, under § 547 of the Code) or the fraudulent conveyance limitation period (two years under § 548 of the Code)⁵³ for bringing an avoidance action (which are usually significant 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.⁵⁴ It is therefore important that the title insurance company handling the escrow arrangement and insuring title upon delivery or release of the deed ascertain, both when the deed is placed in escrow and again when it is released and the title company is asked to provide the policy, that there is fair and adequate consideration for the transaction (such as extinguishment or reduction of the underlying indebtedness and waiver, forbearance or relinquishment of the rights and remedies of the mortgagee otherwise available for non-payment 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.⁵⁵

⁵³ The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("Act"), 2005 (P.L. 109-8, 119 Stat. 23), 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 provisions). The Act amended § 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 § 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 Fraudulent 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. UFTA section 9(a).

⁵⁴ See *In re Rehbein*, *supra* note 43, 60 B.R. at 441; *In re Leefers*, *supra* note 43, and cases cited in *supra* note 43. In *Alden State Bank v. Borton*, *supra* note 42, 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.

⁵⁵ The 2006 American Land Title Association ("ALTA") 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:]

The title insurance company also will want to review and approve all the underlying documents and agreements. It will further require 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.⁵⁶

Sample forms of deed-in escrow agreements are attached hereto as **Appendix A** and **Appendix B** to this Article.

C. Exploding and Springing Guaranties.

Mortgagees may try to “bankruptcy proof” an executory deed-in-lieu transaction by requiring indemnifications or “exploding” or “springing” 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 debt (or some agreed-upon portion thereof) is 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 and/or holder of an equity interest in the mortgagor often executes this form of guaranty. The mortgagee agrees not to enforce the guaranty unless and until certain events occur, such as the following:

-
6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors’ rights laws, that the transaction creating the lien of the Insured Mortgage, is:
 - (a) a fraudulent conveyance or fraudulent transfer; or
 - (b) a preferential transfer for any reason not stated in Covered Risk 13(b) of this policy.

Covered Risk 13 of the 2006 ALTA Loan Policy states as follows:

13. Avoidance in whole or in part, or a court order providing an alternative remedy, based on the voidability of the lien of the Insured Mortgage, under federal bankruptcy, state insolvency or similar creditors’ rights laws because:
 - (a) of a fraudulent or preferential transfer of title to or an interest in the Land occurring prior to the transaction creating the lien of the Insured Mortgage; or
 - (b) the Insured Mortgage constitutes a preferential transfer by reason of the failure of the Insured Mortgage:
 - (I) to be timely recorded in the Public Records, or
 - (ii) to impart notice of its existence to a purchaser for value or a judgment or lien creditor.

⁵⁶ See Patrick E. Mears, *Can Bankruptcy Trump an Escrow?*, 6-Oct BUS. L. TODAY 40 (1996); Thomas A. Bryne, *Escrows and Bankruptcy*, 48 BUS. LAW. 761 (1992); 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).

- 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 documents (including delivery of the deed in escrow) or the underlying loan documents.
 - The contesting of a subsequent foreclosure or enforcement proceeding 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.⁵⁷ These parties also could argue that such guaranties are inequitable and therefore unenforceable under § 105 of the Code.⁵⁸ 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 § 506(b) of the Code⁵⁹ A claim could also conceivably be made that the enforcement of such

⁵⁷ See, e.g., *DiCello v. United States (In re Railway Reorganization Estate, Inc.)*, 133 B.R. 578, 582 (Bankr. D. Del. 1991) (Government's "springing liens" on certain assets of debtor railroad were unenforceable *ipso facto* clauses).

⁵⁸ 11 U.S.C. § 105. This provision of the Code grants the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

⁵⁹ 11 U.S.C. § 506(b). This provision of the Code provides that an oversecured creditor may recover post-petition interest in addition to "reasonable fees, costs, and charges" as part of its secured claim.

guaranties violates the automatic-stay provisions of § 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.⁶⁰

Fortunately for lenders, § 524(e) of the Code provides that a bankruptcy discharge does not discharge the obligation of any non-debtor party.⁶¹ 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 guarantees.⁶²

⁶⁰ See, e.g., *North Star Contracting Corp. v. McSpedan*, 125 B.R. 368, 370-71 (S.D.N.Y. 1991) (ruling that action against corporate debtor's president violated automatic stay because situation presented "special circumstances," based on identity of interests of debtor and third-party non-debtor). Cf. *Sentry Bank and Trust Co. v. Goulding Place Developers, Inc. (In re Goulding Place Developers, Inc.)*, 99 B.R. 493, 497-98 (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, where 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).

⁶¹ 11 U.S.C. § 524 (e) states, in pertinent part, that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt. See 2007 COLLIER PAMPHLET EDITION PART I BANKRUPTCY CODE, *Selected Case Comment, Section 524(e) – Liability of Other Entity or Property*, p. 546 (stating that "The bankruptcy court does not have the authority to release the liability of nondebtors, and a plan which contains such a provision may not be confirmed") and cases cited therein.

⁶² See, e.g., *Star Phoenix Mining Co. v. West One Bank*, 147 F.3d 1145, 1147 (9th Cir. 1998) ("under § 524(e), a bankruptcy court does not have the power to discharge the liabilities of a bankrupt's guarantor"); *In re Western 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) ("neither 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"); *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995) ("This court has repeatedly held, without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors"); *Field v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 760 (5th Cir. 1995) (permanent injunctions discharging a potential debt of a non-debtor are not allowed by Bankruptcy Code); *In re Western Real Estate Fund, Inc. In re Prussia Assocs.*, 322 B.R. 572, 596 (Bankr. D. Pa. 2005) ("Courts have generally construed this statutory provision [§ 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 guarantees"). But other courts have ruled that permanent injunctions against non-debtor parties are allowable under certain circumstances, such as consensual, non-coercive 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 Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002), *cert. denied* 537 U.S. 816 (2002); *In re Drexel Burnham Lambert Group, Inc.*, 960

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 same may have been revised or restated pursuant to the plan), the title insurance company, as escrow agent, will release the deed and other escrowed documents and deliver them to the designated party.⁶³

Because the bankruptcy court will have specifically 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 should, therefore, 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*,⁶⁴ 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. The Fifth Circuit agreed with the bankruptcy court's holding that because the plan contained "built-in provisions that eliminate default" – i.e., if the debtor-mortgagor couldn't pay, the mortgaged property would be transferred to the mortgagee - there was no material default under the plan that would necessitate the dismissal of the Chapter 11

F.2d 285, 293 (2nd Cir. 1992); *Menard-Sanford v. Mabey (In re A.H. Robins, Co.)*, 880 F.2d 694, 700-702 (4th Cir. 1989).

⁶³ For examples of various forms of deed-in-escrow documents (bankruptcy and non-bankruptcy), see Kenneth M. Jacobson, Michael L. Molinaro, and John C. Murray, *Documenting a Consensual Transfer of Real Estate*, CONSENSUAL TRANSFERS OF DISTRESSED REAL ESTATE, American Bar Association, Section of Real Property, Probate and Trust Law (1998), at 129 *et seq.* See also Debra Pogrud Stark, *Problems and Strategies in Enforcing Executory Deed Transactions*, CONSENSUAL TRANSFERS OF DISTRESSED REAL ESTATE, American Bar Association, Section of Real Property, Probate and Trust Law (1998), at 44 *et seq.*

⁶⁴ 913 F. 2d 1138 (5th Cir. 1990).

proceedings or prevent the delivery of the deed to the mortgagee.⁶⁵

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.⁶⁶

⁶⁵ *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 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 § 1129(a)(11) of the Code) that the deed-in-escrow feature "is likely to be enforced in a subsequent bankruptcy proceeding." *Id.* at 594. The District Court affirmed this ruling of the bankruptcy court. *Bank of America, Illinois v. 203 North LaSalle Street Partnership*, 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*, 1990 WL 128208 (E.D. La. Aug. 28, 1990) at *1-2, which had 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 America Nat'l Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 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.

⁶⁶ See, e.g., *Hayes v. Prod. Credit Ass'n of the Midlands*, 955 F.2d 49, 1992 U.S. App. LEXIS 3329 (10th Cir. 1992) (unpublished opinion) at *8 ("to 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 Ins. Co. v. Olsen (In re Olsen)*, 861 F.2d 188, 189-90 (8th Cir. 1988), the court found that the debtor's confirmed Chapter 11 reorganization plan had not been substantially consummated even though a quit claim 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 (Bankr. D.S.D. 1991), *aff'd* See also *In re Cook*, 126 B.R. 575 (Bankr. D.S.D. 1991), *aff'd in part and rev'd in part, remanded by, in part*, 147 B.R. 513 (D.S.D. 1992) ("finality of confirmation . . . does not prevent a bankruptcy court from exercising jurisdiction to

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 where 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 where there is a documented 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 its 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 non-merger language, to preserve its rights against subordinate lienholders and judgment creditors.) The parties' agreement should also recite that (if true) 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.

review its orders where equity so requires"); *Federal Land Bank of Louisville v. Gene Dunavant and Son Dairy (In re Gene Dunavant and Son Dairy)*, 75 B.R. 328, 333 (D.M.D. Tenn. 1987) (“[t]o 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”).

APPENDIX A

ESCROW AGREEMENT*

THIS ESCROW AGREEMENT (this "Agreement"), dated as of _____, _____, is made and entered into by and among _____, a _____ ("Borrower"), having an office at _____; _____; and _____ (each a "Guarantor" and together, the "Guarantors"), [each] having an address of _____; _____, a _____ ("Lender"), having an office at _____; _____ Title Insurance Company ("Escrow Agent"), having an office at _____ and _____ ("Property 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 "Agreement for Transfer"), dated as of _____, _____.

B. The Guarantors entered into that certain Guarantor Agreement (the "Guarantor 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 "Escrowed Documents").

* 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.

2. Receipt by Escrow Agent. Escrow Agent acknowledges receipt of the Escrowed Documents and agrees to establish an escrow (the “Escrow”) 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 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 “Closing 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 the 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

(1) 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 be 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

(1) 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

(1) 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 judgment 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:

TITLE INSURANCE
COMPANY, a

By: _____
Print Name: _____
Title: _____

EXHIBIT A TO ESCROW AGREEMENT

Escrowed 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]**.

APPENDIX B

DEED IN ESCROW AGREEMENT

THIS DEED IN ESCROW AGREEMENT (“Agreement”) is made as of _____, _____ by _____ and _____ among: _____, not personally but solely as Trustee pursuant to Trust Agreement dated _____, _____ and known as Trust No. _____ (the “Trust”), _____, an Illinois limited partnership (the “Beneficiary”); herein, the Trust and the Beneficiary are sometimes collectively referred to as the “Owner”, _____, one of two general partners, _____, one of two general partners (herein collectively referred to as the “General Partners”), _____, a _____ corporation (hereinafter referred to as “Lender”); and _____ (hereinafter referred to as “Escrow Agent”).

RECITALS:

A. WHEREAS, Lender and Owner have heretofore entered into that certain Amendment to Loan Documents, Security Agreement and Agreement Concerning Mortgage Loan, dated as of even date herewith (herein, such instrument, as the same may hereafter be amended, modified or restated from time to time, together with any and all substitutions and replacements thereof, is called the “Amendment”);

B. WHEREAS, Lender, the Owner and General Partners desire to enter into this Agreement in furtherance of certain undertakings set out in the Amendment;

C. WHEREAS, capitalized terms used herein but not defined herein shall have the meaning set forth in the Amendment.

AGREEMENT

NOW, THEREFORE, in consideration of the premises and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged by each party hereto, Owner, General Partners, Lender and Escrow Agent hereby covenant and agree as follows:

1. Affirmation of Recitals. The recitals set forth above are true and correct and are incorporated herein by reference.

2. Appointment of Escrow Agent. Lender, Owner and the General Partners hereby appoint the Escrow Agent to serve as escrow agent

hereunder for the purposes, and on subject to the conditions set forth herein; and, the Escrow Agent accepts such appointment.

3. Transfer Documents. Concurrently with the execution of this Agreement, Owner and Lender have delivered to and deposited with Escrow Agent, to be held by it in escrow hereunder pursuant to the provisions hereof, the fully executed documents and instruments identified on Exhibit A attached hereto (collectively, the “Transfer Documents”). Escrow Agent acknowledges receipt of the Transfer Documents and agrees to hold them in the escrow and to deal with them as provided in this Agreement.

4. Delivery of Transfer Documents to Lender. Within one (1) Business day after Escrow Agent’s receipt of a written notice from Lender certifying that a Monetary Default or a Non-Monetary Default has occurred under the Loan Documents (a “Transfer Direction”), Escrow Agent shall deliver the Transfer Documents to Lender or Lender’s designee identified as such in such Transfer Direction, at the delivery address set out in such Transfer Direction, by Federal Express or other reputable national overnight courier service. Not earlier than two business days after, or later than four business days after its delivery of the Transfer Documents to Lender or Lender’s designee, Escrow Agent shall notify Owner that it has made such delivery to Lender or its designee.

Upon receipt of notice of the delivery to Lender of the Transfer Documents, Owner shall immediately deliver possession of the real and personal property described in such Transfer Documents to Lender. At the time of delivery of possession to Lender, Owner shall cooperate with Lender to insure the orderly transfer of such property.

5. Completion of Transfer Documents. Upon receipt of the Transfer Documents by Lender or its designee, such recipient or its attorneys may complete the Transfer Documents in such manner as such person may consider necessary or appropriate to effect a complete and lawful conveyance and transfer to Lender (or its designee) of the Mortgaged Premises (defined for purposes hereof as defined in the Mortgage) pursuant to and as contemplated by the provisions of the Amendment. Owner and General Partners agree to cooperate fully with Lender, now and at all times in the future, to effect a prompt, complete and lawful conveyance and transfer to Lender or its designee of the Mortgaged Premises pursuant to and as contemplated by the provisions of the Amendment, and promptly to take all actions reasonably required by Lender (it being agreed that Owner and General Partners shall have no obligation to incur any cost or expense or any additional liability with respect to any such request) to effect any such conveyance and transfer, including (without limitation) supplying information regarding the Mortgaged Premises, completing and executing such further documentation as Lender may reasonably consider necessary or appropriate

promptly to effect any such conveyance and transfer (it being agreed that Owner and General Partners shall have no obligation to incur any cost or expense or any additional liability in connection therewith). The authorization and power of attorney granted to Lender pursuant to this paragraph shall be deemed coupled with an interest and shall be irrevocable.

6. Reconveyance. In the event that for any reason, following the delivery of the Transfer Documents to Lender and the recording or filing of the same in the public records as appropriate, and the bringing down of title to the property described therein, if Lender is not satisfied with the status of title to any of such property, Lender may quitclaim, in whole or in part, any such property back to Owner, in which event Owner shall be re-vested with title to all such property so reconveyed with the same force and effect as though such property has remained the property of Owner and had never been transferred to Lender.

7. Absolute Conveyance; No Merger. It is understood and agreed by Owner and Lender that any delivery of the Transfer Documents to Lender from the escrow pursuant to the terms hereof will constitute an absolute conveyance of all of Owner's rights, title and interest in and to the property described in the Transfer Documents so delivered and is not intended as a mortgage, trust conveyance or security of any kind. Notwithstanding any delivery of the Transfer Documents to Lender from the escrow, the Loan Documents shall remain in full force and effect, now and hereafter, and the interest of Lender in the property conveyed by the Transfer Documents shall not merge with the interests of Lender in such property under the Loan Documents. The acceptance by Lender of the Transfer Documents shall not prejudice, limit, restrict or effect Lender's claim of priority under the Loan Documents over any other liens, claims, or encumbrances of any kind whatsoever. It is the express intention of Owner and Lender that Lender's interest in the property conveyed by the Transfer Documents shall not merge with the interest or rights of Lender under the Loan Documents, but will be and remain at all times separate and distinct, and Lender may thereafter sell or otherwise transfer the property conveyed to it pursuant to the Transfer Documents free and clear of all rights of Owner. It is further understood and agreed that following the delivery of the Transfer Documents to Lender, Lender shall have no obligation to account to Owner for the amount, if any, by which the value of the property transferred to Lender pursuant such Transfer Documents exceeds the amount of indebtedness secured by liens on such property.

8. Termination of Escrow. Escrow Agent shall terminate the escrow and deliver the Transfer Documents to Owner if Escrow Agent receives a written notification signed by all (and not less than all) of Lender, Owner and General Partners directing that the escrow be terminated and that the Transfer Documents be so delivered.

9. Certain Provisions Regarding Escrow Agent. (a) Escrow Agent shall have no duties or responsibilities other than those expressly set forth herein. Escrow Agent shall have no duty to enforce any obligation of any other person to make any delivery or to enforce any obligation of any other person to perform any other act. Escrow Agent shall have no liability to the other parties hereto or to anyone else by reason of any failure on the part of any other party hereto or any maker, guarantor, endorser or other signatory of any document or any other person to perform such other person's obligations under any such document. Except for amendments to this Agreement made as hereinafter provided, and except for joint instructions given to Escrow Agent by Owner, General Partners and Lender relating to the Transfer Documents, Escrow Agent shall not be obligated to recognize any agreement between any or all of the persons referred to herein, notwithstanding that references thereto may be made herein and whether or not it has knowledge thereof.

(b) In its capacity as escrow agent, Escrow Agent shall not be responsible for the genuineness or validity of any security, instrument, document or item deposited with it and shall have no responsibility other than to faithfully follow the instructions contained herein, and shall not be responsible for the validity or enforceability of any security interest of any party, and it shall be fully protected in acting in accordance with any written instrument given to it hereunder by any of the parties hereto and reasonably believed by Escrow Agent to have been signed by the proper person. Escrow Agent may assume that any person purporting to give any notice hereunder has been duly authorized to do so. In the event that for any reason there is any dispute, or Escrow Agent in good faith is uncertain, 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 signed by all of (and not less than all of) Owner, General Partners and Lender or until directed by a judgment or decree of a court of competent jurisdiction in the State of Illinois or in a federal court in such State, whereupon Escrow Agent shall take such action in accordance with such instructions or such order.

(c) It is understood and agreed that the duties of Escrow Agent under this Agreement are purely custodial and ministerial in nature. 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. Escrow Agent may rely conclusively, and shall be protected in acting, upon (i) any written opinion or advice of its legal counsel or (ii) any written certificate, instrument, notice, report or other document (not only as to its due execution and the validity and effectiveness of its provisions, but also as to the trust and acceptability of any information therein contained) that is reasonably believed by Escrow Agent to be genuine and to be signed or presented by the proper person or persons.

Except as set forth in Paragraph 4 or Paragraph 8 of this Agreement, Escrow Agent shall not be bound by any notice or demand, or by any purported waiver, modification, termination or rescission of this Agreement or any of the terms hereof, unless evidenced by a final judgment or decree of a court of competent jurisdiction in the State of Illinois or a federal court in such State, or in a writing delivered to Escrow Agent signed by the proper party or parties and, if the duties or rights of Escrow Agent are affected, unless it shall give its prior written consent thereto.

(d) Escrow Agent shall have the right to assume, in the absence of written notice to the contrary from the proper person or persons, that a fact or an event by reason of which an action would or might be taken by Escrow Agent does not exist or has not occurred, without incurring liability to the other parties hereto or to anyone else for any action taken or omitted, or any action suffered by it to be taken or omitted, in good faith and in the exercise of reasonable judgment, in reliance upon such assumption.

(e) Except for, or in connection with, Escrow Agent's willful misconduct or gross negligence, Escrow Agent shall be indemnified and held harmless jointly 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; but as among the parties hereto other than Escrow Agent, if any of them shall be primarily responsible for the bringing, assertion, prosecution or maintenance of any such action, suit, proceeding or claim, such party shall reimburse and indemnify all such other parties for any amounts such other parties may be required to pay or reimburse to Escrow Agent pursuant to this paragraph. Promptly after Escrow Agent's receipt of notice of any demand or claim or the commencement of any action, suit or proceeding as to which Escrow Agent may desire to assert a claim against any of the other parties hereto, Escrow Agent shall notify such other parties hereto in writing, and its failure to give such notice shall relieve any party not receiving such notice from liability to Escrow Agent hereunder with respect thereto.

(f) 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 may 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.

(g) Escrow Agent may resign as Escrow Agent hereunder at any time upon giving not less than thirty days' prior written notice to that effect to each of the other parties to this Agreement. In such event, Lender may designate and appoint, by written notice of designation delivered to Owner, General Partners, and the resigning Escrow Agent, any nationally recognized title insurance company or trust company to serve as the successor Escrow Agent hereunder. Upon such designation by Lender, (i) the resigning Escrow Agent shall deliver to such successor Escrow Agent, against receipt, all Transfer Documents and other documents and instruments (if any) it then holds in the escrow, to be held by such successor and (ii) such successor Escrow Agent shall sign a counterpart of this Agreement and thereafter shall be deemed the Escrow Agent hereunder for all purposes. If Lender fails so to designate such a successor Escrow Agent, or if any person so designated declines to serve as Escrow Agent hereunder, the obligations as Escrow Agent hereunder of the person seeking to resign from that capacity shall continue until such successor is appointed; provided, however, that its sole obligation thereafter shall be to safely hold all documents and instruments then held by it in the escrow and to deliver the same to the person designated as its successor or until directed by a final order or judgment of a court of competent jurisdiction in the State of Illinois or a federal court in such State, whereupon the resigning Escrow Agent shall make disposition thereof in accordance with such order or judgment. If no successor Escrow Agent is designated and qualified within five days after Escrow Agent's resignation was intended to be effective, such resigning Escrow Agent may apply to any court of competent jurisdiction for the appointment of a successor Escrow Agent.

10. Miscellaneous Provisions. (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 and 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 sought to be enforced, and then such waiver, modification or consent shall be effective only in the specific instance and for the express 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) Any notice, request, direction or demand given or made under this Agreement shall be in writing, shall be sent to the parties at their respective addresses set forth below and shall be delivered personally, by Federal Express or other reputable overnight national courier service, by electronic telefax transmission, or by certified U.S. Mail, return receipt requested, and shall be deemed given upon the earlier to occur of (i) actual

receipt, (ii) the second business day after being deposited in the U.S. mail, (iii) the next business day after being deposited in federal express or another reputable overnight courier or (iv) the date sent, if sent by electronic telefax transmission:

If to Owner or General Partners, to:

Facsimile: () _____
Telephone: () _____

If to _____:

Facsimile: () _____
Telephone: () _____

If to Escrow Agent:

Facsimile: () _____
Telephone: () _____

Each party to this Agreement may designate a different address within the 48 contiguous United States of America as its address for receipt of notices hereunder, by notice given to all other parties not less than ten (10) days prior to the date such change of address is to become effective.

(c) If any term, covenant or provision of this Agreement is held to be invalid, illegal or unenforceable in any respect, this Agreement shall be construed without such term, covenant or provision and the remainder of this Agreement shall be enforced, it being the parties' intention that this Agreement be enforced to the fullest extent permitted by applicable law.

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

(e) 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.

(f) THE PARTIES TO THIS AGREEMENT HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVE ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, SUIT OR COUNTERCLAIM ARISING IN CONNECTION WITH, OUT OF OR OTHERWISE RELATING TO THIS AGREEMENT.

(g) This Agreement has been executed, delivered and accepted by all parties hereto in the State of Illinois. This Agreement is, and shall be deemed to be, a contract entered into under and pursuant to the laws of the State of Illinois and shall in all respects be governed, construed, applied and enforced in accordance with the laws of the State of Illinois. No defense given or allowed by the laws of any other state or country shall be interposed in any action or proceeding hereon unless such defense is also given or allowed by the laws of the State of Illinois.

(h) The parties hereto agree to submit to personal jurisdiction in the State of Illinois in any action or proceeding arising out of this Agreement and, in furtherance of such agreement, the parties hereto hereby agree the consent that without limited other methods of obtaining jurisdiction, personal jurisdiction over any of the parties hereto in any such action or proceeding may be obtained within or without jurisdiction of any court located in the State of Illinois and that any process or notice of motion or other application to any such court in connection with any such action or proceeding may be served upon the parties hereto by registered or certified mail or by personal service at the last known address of the parties hereto, whether such parties be within or without the jurisdiction of any such court.

(i) 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 a single agreement. This Agreement may be executed in any number of duplicate originals and each such duplicate original shall be deemed to constitute but one and the same instrument.

IN WITNESS WHEREOF, Owner, General Partners, Lender and Escrow Agent have duly executed this Agreement as of the day and year first above written.

LENDER

By: _____
Print Name: _____
Title: _____

TRUST

_____,
not personally but as Trustee under Trust Agreement
dated _____, _____ and known as
Trust No. _____

By: _____
Print Name: _____
Title: _____

BENEFICIARY

_____,
an Illinois limited partnership

By: _____
_____, one of two general partners

By: _____
_____, one of two general partners

ESCROW AGENT

By: _____
Print Name: _____
Title: _____

EXHIBIT A
Transfer Documents