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Message from the Section Chair

Little did I think many years ago when I first joined the Section's Title and Transfer Committee, and listened to one Bernard Rifkin reciting (often without a note in front of him) the latest case law nuggets of the day, that I would one day be Chair of the Section. It is with great honor and a true sense of appreciation for those who have preceded me that I assume this role.

First and foremost, my thanks to the outgoing Chair, John Hall. John was always available with insight, leadership skills and a smile! One of John's main concerns was—and continues to be—the public image of the lawyer and the ongoing attempts to remove the residential real estate practice from lawyers entirely. To help on both fronts, John conceived of the idea of a video, enlisted the skills of Harold Lubell of New York City and Maureen Pilato Lamb of Rochester to "set the stage"—and the rest is history. Playing on a cable channel near you—and available to local libraries and bar associations—is the Section's production of "The Role of the Lawyer in a Residential Real Estate Transaction."

Secondly, I would like to thank the current officers of the Section: Steven Horowitz, James Grossman and Melvyn Mitzner as well as the members of the Executive Committee. These are busy practitioners who, on a regular basis, are called upon to attend meetings, prepare legislative reports, write articles and contribute to continuing legal education ("CLE") seminars, all with one goal in mind—to serve the members of the Section and the profession as a whole.

Back to my days as a junior lawyer. I started my work with the Section by doing reports on proposed legislation, attending those Title and Transfer Committee meetings where I was afraid to say a word and then getting involved with CLE. Keith Osber, a former Chair of the Section, and I were two of the panelists on a program chaired by John Blyth, also a former Chair. We hit the road with a travelling show about the dueling concerns of the permanent lender and the construction lender. I then was asked to co-chair the Financing and Liens and Land Use Committees, followed by my role as Secretary. I recite the history of my involvement

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to show those of you who may not be as active as you would like a path for more Section activity.

The following are my priorities for the upcoming year:

1. Technology and computerization will continue to dominate our concerns. We want to expand our homepage, and John Blyth has graciously agreed to serve for one year as our "Web master." As more county clerks and the Secretary of State go "on-line," we need to be prepared to take advantage of all the advances in this area.

2. We must continue to be aggressive with legislation, not only in circulating on a timely basis our comments on proposed legislation that affects real estate law, but also in taking a proactive stance in proposing new bills. I hope by the time this message appears that our efforts for foreclosure reform, led by the capable Richard Fries of New York City, will have met with success. Our Title and Transfer Committee, co-chaired by Samuel Tilton and Karl Holtzschue, has been following proposed amendments to the mortgage recording tax statute. There are continuing attempts by various special interest groups to increase the requirements for disclosure in residential real estate transactions and our Section will monitor and comment on those attempts.

3. I would like to see the members become more involved in the work of the Section and the Committees. Another goal is to increase the involvement of junior attorneys. For those of you who have been practicing a while, take a moment to introduce a junior attorney to the work of our wonderful Committees, which we highlighted during the January 1998 annual meeting. Our Real Estate Financing Committee is known throughout the country for having produced a model subordination, non-disturbance and attornment agreement and report. Our Attorney Opinion Letters Committee has produced, after much input and numerous drafts, a model opinion letter. While I know that time is at a premium for all of us, I cannot stress enough how much each attorney will benefit from involvement with the Section, particularly at the Committee level.

4. I would like to see a survey of you, the Section members, to make certain we are addressing your needs. If you are contacted in the near future to share your views, please agree to participate.

5. Finally, by all accounts mandatory CLE for all practitioners is almost here. We need to make certain that the Section participates in producing timely, quality programs that are affordable and accessible for all practitioners. Having grown up the daughter of a lawyer in rural St. Lawrence County, and being the spouse of a sole practitioner, I am very sensitive to the needs of our members with respect to the location, timing and cost of our programs.

In closing, I would like to again thank John Hall for his contributions as Chair. I look forward to a wonderful year working with all the Section members, and hope to have an opportunity to meet or talk with as many of you as possible during my tenure.

Lorraine Power Tharp

Attention Real Property Law Section Members: Watch your mailboxes

Over the next few weeks, the Section will be conducting a Member Satisfaction Survey. If you are selected to participate, please respond promptly! Your cooperation will be essential in helping us review and improve services for you, our valued members. Thank you.

New York City Watershed Agreement Provides Guidelines to Municipalities, Property Owners and Environmental Organizations

by Joel H. Sachs*
White Plains, New York

On January 21, 1997, a momentous Memorandum of Agreement ("Agreement") to protect the New York City Watershed ("Watershed") was signed by representatives of the City and State of New York, the U.S. Environmental Protection Agency, an entity known as the Coalition of Watershed Towns, various counties, towns and villages located within the Watershed and several not-for-profit organizations. The Agreement sets forth provisions to protect the Watershed, which comprises almost 2,000 square miles of land located in eight counties both east and west of the Hudson River and includes 19 reservoirs and tributaries that supply potable water to New York City and its environs.

The Agreement includes (i) a grant of $17.5 million in city and state funds to implement a land acquisition program of environmentally sensitive lands in three counties east of the Hudson River, (ii) appropriation of $1.4 billion for watershed protection and partnership programs in five counties west of the Hudson River and (iii) creation of a Watershed Protection and Partnership Council and other committees to develop long-term measures to improve and protect water quality within the Watershed.

As adopted by the New York City Department of Environmental Protection, new Watershed Regulations are the keystone of the Agreement. The regulations, effective May 1, 1997, were promulgated to prevent the contamination, degradation and pollution of the city's water supply pursuant to the 1986 Safe Drinking Water Act, 42 U.S.C. § 300(f) and § 300(j) and the 1989 Surface Water Treatment Rule, 40 C.F.R. § 141.71 (1997).

> *"The new regulations prohibit or regulate 16 types of activities within portions of the eight upstate counties where the New York City water supply originates."*

New York City is authorized to regulate activities affecting its watershed lands in upstate New York under § 1100(1) of the New York State Public Health Law which provides:

> The Commissioner of Environmental Protection of the City of New York and the Board of Water Supply of the City of New York may make such rules and regulations subject to the approval of the Department for the protection from contamination of any or all public supplies of potable waters and their sources within the state where the same constitute a part of the source of the public water supply of said city.

The new regulations prohibit or regulate 16 types of activities within portions of the eight upstate counties where the New York City water supply originates. Among the materials and activities either prohibited or regulated within the Watershed are disposal and storage of pathogenic materials, hazardous substances and wastes, radioactive materials, petroleum products, pesticides, fertilizers and winter highway maintenance materials.

The major components of the Agreement that will significantly impact real estate development within the eight watershed counties include:

(A) *Regulation of wastewater treatment plants*: Under the regulations, all new waste water treatment plans require approval of New York City. No part of any absorption field for a subsurface discharge from a plant shall be within a buffer zone of 100 feet of a watercourse or wetland or within 500 feet of a reservoir or a reservoir stem or controlled lake. Further, treatment plants with surface discharges are prohibited within three types of areas within the Watershed, namely 60-day travel time zones, coliform restricted basins and phosphorous restricted basins. Under the so-called Putnam Plan, no more than three new waste-water treatment plants can be built east of the Hudson within the next five years.

(B) *Regulation of sub-surface sewage treatment systems*: This provision includes any underground system—such as septic systems and cesspools—used for collecting, treating and disposing of sewage into the ground. All new septic systems and cesspools within the Watershed require approval of the city of New York. Further, no part of any absorption field can be located within a buffer zone of 100 feet of a watercourse or wetland or within 300 feet of a reservoir, reservoir stem or controlled lake.

(C) *Impervious surface regulations*: Surfaces within the Watershed that are resistant to penetration by moisture including pavement, concrete, asphalt and roofs are subject to the new regulations. Construction of such impervious surfaces are not allowed within the buffer zone of 100 feet from a watercourse or wetland or within 300 feet of a reservoir or reservoir stem or controlled lake. Moreover, developers must submit pollution prevention plans to the city for approval.

Participating municipalities have promised to act in good faith to implement and comply with the Agreement. In return, the city has agreed to make funds available to assist and benefit upstate municipalities in complying with the Agreement through activities such as formulating water protection plans and conducting sewage diversion feasibility studies.

"Participating municipalities have promised to act in good faith to implement and comply with the Agreement."

The new Watershed Regulations also establish a permit procedure, administered by the city Department of Environmental Protection, for applicants who wish to conduct activities regulated by the new standards. However, a landowner who believes that it would constitute a hardship to meet the new requirements may apply to the City Department of Environmental Protection for a variance under criteria similar to those needed for a zoning variance. Determinations made on permit applications are appealable to a New York City Administrative Law Judge prior to the commencement of an Article 78 proceeding by an aggrieved party.

As with most successful negotiations, none of the parties to the New York City Watershed Agreement was entirely satisfied with its contents. However, the Agreement does provide a framework for handling future land use issues within the Watershed. Unfortunately, the one significant group that was not a party to the Watershed Agreement was the real estate development community, especially those holding large tracts of undeveloped land within the Watershed. Their reaction to the Agreement and the new Watershed Regulations, including a major lawsuit, will be discussed in a future article.

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Ruling on Debt Collection Law Threatens Dispossess Practices

by Janice J. DiGennaro*
Uniondale, New York

Congress enacted the Fair Debt Collection Practices Act (FDCPA)[1] more than 20 years ago to protect debtors from fraudulent and abusive debt collection practices. Since then, it has been used to block bill collectors from engaging in a wide variety of actions, from sending inappropriate dunning letters to making threatening midnight telephone calls.

" . . . the court indicated that it was willing to penalize lawyers for their strict adherence to the letter of the New York State law relating to initiating summary non-payment proceedings."

Recently, however, the U.S. District Court for the Southern District of New York issued a decision that, for the first time, extends the reach of the FDCPA, making it a statutory precondition to bringing suit, an application that, in this writer's opinion, simply goes too far.

In *Romea v. Heiberger & Associates*,[2] the court refused to dismiss a claim that a law firm had violated the FDCPA by serving the tenant with a "three day notice" on behalf of its landlord client as a statutory precondition to commencing a summary dispossess proceeding for non-payment of rent. In essence, the court indicated that it was willing to penalize lawyers for their strict adherence to the letter of the New York State law relating to initiating summary non-payment proceedings.

The decision currently is on appeal. If it stands, it will have severe implications for real estate attorneys and their clients who are involved in dispossess cases. Indeed, with almost 300,000 such proceedings commenced in the housing courts of the City of New York each year, the practical impact of the district court's ruling will be staggering.

Three-Day Notice

The case arose after Jennifer Lynn Romea, who was renting an apartment in Manhattan for $700 per month, received a letter from the law firm representing her landlord. The letter, which was in a form familiar to New York real estate attorneys, stated:

"PLEASE TAKE NOTICE that you are hereby required to pay to 442 3rd Ave. Realty LLC landlord of the above described premises, the sum of $2,800.00 for rent of the premises 700.00/Dec 96 700.00/Nov 96 700.00/Oct 96 700.00 Sep 96

"You are required to pay within three days from the day of service of this notice, or to give up possession of the premises to the landlord. If you fail to pay or give up the premises, the landlord will commence summary proceedings against you to recover possession of the premises."

The form of the three-day notice the law firm sent to Romea complied with the statutory prerequisites to instituting summary dispossess proceedings under the New York Real Property Actions and Proceedings Law (RPAPL).[3]

Romea, however, brought an action against the law firm for violating the FDCPA—solely by virtue of having served the statutory three-day rent demand notice on her pursuant to RPAPL § 711. She claimed that the notice violated the FDCPA because it:

- failed to clearly disclose that the law firm was attempting to collect a debt and that any information obtained would be used for that purpose,
- contained threats to take actions that could not legally, or were not intended, to be taken, and
- omitted notice of the required 30-day validation period.[4]

The law firm moved to dismiss the complaint on the ground that it failed to state a claim on which relief could be granted. In particular, the firm argued that the unpaid rent that was the subject of the three-day notice was not a "debt" covered by the FDCPA because the obligation was incurred in a transaction that did not involve the extension of credit. The firm contended that because rent is paid in advance, the transaction between a landlord and tenant involves no deferral of payment or extension of credit and thus a rent arrearage does not involve "debt" collection.

Although the U.S. Court of Appeals for the Second Circuit has not determined whether an obligation must involve the deferral of payment to constitute a debt within the meaning of the FDCPA, and while other federal courts of appeals are divided on the question,[5] the district court examined the FDCPA's definition of debt[6] and found that the "plain language" of the statute covered consumer obligations such as unpaid rent, without regard to whether the underlying transactions involved extension of credit or deferral of payment.

In the court's view, that conclusion was confirmed by the FDCPA's legislative history. It noted that in enacting the FDCPA, Congress dropped proposed statutory language that would have limited the statute's application to debts arising from transactions involving extensions of credit. By refusing to include that language, Congress indicated that it did not intend to so limit the statute's application, the court found.

The law firm also asserted that the three-day notice it sent was not a "communication" to collect a debt within the meaning of the FDCPA. The district court spent little time on this argument, noting that "communication" is defined in the FDCPA as "the conveying of information regarding a debt directly or indirectly to any person through any medium."[7] The court said that in view of the fact that the notice demanded payment on pain of the commencement of eviction proceedings, there was "no colorable argument" that it did not satisfy the FDCPA's definition of "communication."

The law firm also pointed out that the staff of the Federal Trade Commission (FTC)—the federal agency charged with interpreting and enforcing the FDCPA—has concluded that notices such as the three-day notice sent to Romea should not be covered by the FDCPA. Specifically, the staff commentaries would exclude from FDCPA coverage "a notice that is required by law as a prerequisite to enforcing a contractual obligation between creditor and debtor, by judicial or nonjudicial legal process."[8] The district court recognized that the three-day notice fell within this language, but stated that it could not adopt the exclusion.[9]

The court pointed out that the staff commentaries state that they are "not binding on the Commission or the public." It also said that in light of the "unambiguous definition of communication" in the statute and the absence of any indication that Congress intended to authorize the FTC to create an exception to that definition for notices such as the three-day notice, it was compelled to conclude that the notice was covered by the FDCPA.

The law firm also contended that because the notice was required by New York law, it should be excluded from the FDCPA's scope in light of Congress' intent not to interfere with creditors' judicial remedies.[10] The court dismissed this argument as well. It simply declared that because the three-day notice is a precondition to commencing a non-payment proceeding, not part of the proceeding itself, this exception was inapplicable.

The court indicated some "discomfort" with its refusal to dismiss Romea's complaint against the law firm, recognizing that its decision would have a significant effect on New York's statutory scheme for resolving landlord-tenant rent disputes. It also conceded there was nothing to indicate that Congress intended to influence the state rules when it enacted the FDCPA. The court, however, concluded that it had no alternative and denied the law firm's motion to dismiss.

Attorney Exemption

Certainly this case would not have been filed had the original version of the FDCPA still been in effect. The law, as enacted in 1977, excluded attorneys from the definition of debt collectors.[11] In 1986, however, Congress amended the law and deleted the attorney exemption. The U.S. Supreme Court, in *Heintz v. Jenkins*, refused to find a blanket exception for all litigating attorneys, but rather directed courts to read the FDCPA's substantive provisions "plausibly" so as not to impair creditors' remedies, one of the FDCPA's stated purposes. The result reached in the *Romea* decision is an "implausible" result that, in fact, impairs landlords' remedies.

The Supreme Court also recognized in *Heintz v. Jenkins* that Congress repealed the attorney exemption without revisiting all the other sections of the FDCPA and, therefore, there was reason for some "awkwardness" in applying the statute's substantive provisions to litigating attorneys. The repeal of the exemption, however, to the extent that it leads to decisions such as the one rendered in the *Romea* case, will cause more than awkwardness.

For one thing, attorneys will no longer be permitted to regularly sign and send three-day notices to tenants. One alternative may be to have landlords sign and send these notices themselves (because the FDCPA does not apply to a creditor that collects its own debt).[12]

However, this would result in extended delays and administrative expenses as lawyers prepare the documents and send them to landlords, who will have to review and sign them and then return them to the lawyers to be served. Moreover, requiring landlords to take these additional steps would seem to provide no additional protections to tenants compared with current practice.

Another alternative would be for lawyers to provide a thirty-day notice instead of a three-day notice. Unfortunately, this will fundamentally alter the nature of summary proceedings within New York and trans-form an landlord's expeditious remedy into a time-consuming court proceeding, with particularly disastrous effects on landlords with fewer rental units.

That is because a 30-day period would essentially result in a delay of two months before non-payment proceedings could be commenced, subjecting owners to substantial financial burdens. Suppose rent is due by the first of each month, with a grace period until the tenth; a three-day rent demand usually results in service by mid-month, with litigation, if any, following shortly thereafter.

However, service of an FDCPA notice allowing for 30 days would take the parties through the middle of the following month, at a minimum. Only at that point could litigation be brought. For many owners already operating at the margin, this would be disastrous.[13]

Conclusion

The district court's ruling will affect owners of rental buildings as well as cooperatives that need to bring proceedings against delinquent shareholders for maintenance and other arrears. It unnecessarily intrudes on landlord/tenant procedure, which typically is governed by state regulation, without adding any protections for tenants.

The RPAPL already has provisions to protect tenants' rights. The RPAPL governs when a landlord's demand must be made, how it must be served, what it must contain and on whom it must be made. It requires that three-day notices accurately reflect the amount of rent due without including any improper charges; a notice will be deemed defective and the non-payment proceeding predicated thereon will be dismissed if the notice improperly includes a demand for charges in addition to the legal rent due.

From the practicing lawyer's point of view, the decision is likely to open the floodgates of litigation against attorneys engaged in landlord/tenant practice in New York. Real estate lawyers need to pay particular attention to this case and its aftermath.[14]

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Endnotes

1. 15 U.S.C. §§ 1692 et seq. (1982 & Supp. 1997).
2. 988 F.Supp. 712 (S.D.N.Y. 1997), motion to certify ruling for interlocutory appeal granted, 988 F.Supp 715 (S.D.N.Y. 1998).
3. *See 442 3rd Ave. Realty LLC v. Romea*, No. 053637/97 (N.Y. Civ. Ct., June 2, 1997); N.Y. Real Prop. Acts. Law Art 7 (McKinney 1979).
4. Generally speaking, the FDCPA requires that a debt collector's communications to a consumer debtor include warnings advising the consumer that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose. *See* 15 U.S.C. §1692(e)(11). Similarly, § 1692(g) requires a consumer to be advised in a debt collection communication that unless the consumer disputes the debt within 30 days after receipt of the notice, the debt will be assumed valid, and that if the consumer advises the debt collector, in writing, within that 30-day period that the debt is disputed, the debt collector will supply verification of the debt.
5. *Compare Zimmerman v. HBO Affiliate Group*, 834 F.2d 1163 (3d Cir. 1987) (extension of credit required) *with Bass v. Stolper, Koritzinsky, Brewster & Neider*, *S.C.*, 111 F.3d 1322 (7th Cir. 1997) (extension of credit not required).
6. The FDCPA defines "debt" as: "Any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family or household purposes, whether or not such obligation has been reduced to judgment." 15 U.S.C. §1692(a)(5).
7. 15 U.S.C. §1692(a)(11).
8. *See* Statements of General Policy or Interpretation, Staff Commentary on the Fair Debt Collections Act, 53 Fed.Reg. 50,097 et seq.
9. *See Heintz v. Jenkins*, 514 U.S. 291 (1995) (refusing to defer to FTC commentaries).
10. *See id.* at 296.
11. *See Firemen's Ins. Co. of Newark v. Cahill*, 753 F.Supp. 1137 (S.D.N.Y. 1990).
12. If lawyers are subject to the FDCPA when they send three-day notices, other agents for landlords, including a building's independent managing agent, probably also will be deemed subject to the law.
13. Although it is unlikely that a court would find that a violation of the FDCPA in an attorney-signed three-day notice was a defense to a non-payment proceeding, it is quite likely that tenants will attempt to make that argument. *See First Trust Nat'l v. Crespo*, No. CV 95-0328135S, 1996 WL 383437 (Conn. Super. Ct. June 14, 1996); *First Federal Bank v. Craco*, No. CV 950249553S, 1996 WL 176366 (Conn. Super. Ct. April 2, 1996); *cf. Kelly v. Kosuga*, 358 U.S. 516 (1959) (violation of federal antitrust laws is not a defense to an action to recover agreed price for goods sold and delivered except in the rarest of circumstances).
14. Insofar as the statute contains strict limits on statutory penalties, both on an individual case or a class action, *see* 15 U.S.C. §1692(k); the only real winner economically, by application of the FDCPA in this context, is the tenant's lawyer due to the fee-shifting provisions contained in the FDCPA. These lawyers are plainly not the intended beneficiaries of the FDCPA's remedial objectives.

***Janice D. DiGennaro, a partner in the Long Island-based law firm of Rivkin, Radler & Kremer, represents the defendant law firm in the *Romea* case discussed in this article.**

The Enforceability of Due-on-Encumbrance Clauses

by David J. Croft*

I. Introduction

A due-on-encumbrance clause is a mortgage clause giving the mortgagee the right to accelerate the loan if the mortgagor encumbers the secured property in any way.[1] Unlike due-on-sale clauses—which arose during the 1960s and 1970s owing to lenders' efforts to take advantage of rising interest rates by preventing assumption of a low-interest mortgage[2]—due-on-encumbrance clauses were developed primarily to enable mortgagees to protect their security by preventing the mortgagor from encumbering the mortgaged property.[3]

As due-on-sale clauses became more widespread, some state courts and legislatures began to restrict their enforceability. These state-law restrictions typically conditioned enforcement on a showing that there was a threat to the lender's security.[4] Congress responded to state-law restrictions by passing 12 U.S.C. § 1701j-3, part of the Garn-St. Germain Depository Institutions Act (the "Garn Act").[5] The Garn Act authorizes lenders to use and enforce due-on-sale clauses, explicitly preempting state laws to the contrary.[6] It defines a "due-on-sale clause" as a provision which permits a lender to accelerate a loan if "all or any part of the property, or an interest therein . . . is sold or transferred without the lender's prior written consent."[7] It also prohibits the enforceability of due-on-sale clauses in the residential context under certain circumstances.[8]

This article attempts to deal with two unresolved questions. First, does the Garn Act validate due-on-encumbrance clauses? Second, if the Garn Act does not apply to due-on-encumbrance clauses, are they enforceable under other law?

II. Applicability of the Garn Act to Due-on-Encumbrance Clauses

The language of the Garn Act appears to define "due-on-sale clause" broadly enough to include a due-on-encumbrance clause, but this is not clearly the case.

A. The View of the Authorities

Commentators are not in agreement as to whether the Garn Act covers due-on-encumbrance clauses. One author flatly states that, although the Garn Act "bars state interference with the enforcement of the due-on-sale clause . . . [s]tates . . . remain free to regulate due-on-encumbrance clauses."[9] Others view the Garn Act as effectively overturning judicial decisions prior to 1982, which had denied enforcement of due-on-encumbrance clauses in the nonresidential context,[10] and that "[a] due-on-sale clause . . . includes a due-on-encumbrance as well as a due-on-sale clause"[11] and thus is validated by the Garn Act.[12] Other commentators fall between the extremes, but they lean toward the view that the Garn Act validates due-on-encumbrance clauses.[13]

B. The View of the Courts (i.e., the Lack Thereof)

While commentators disagree on whether the Garn Act makes due-on-encumbrance clauses enforceable, the courts are silent. Based on Westlaw and Lexis searches of state and federal case law for "1701j-3," only 51 published cases cite that section.[14] Only one of those cases deals with the application of the Garn Act to a due-on-encumbrance clause or its functional equivalent, and in that case the court held only that 12 U.S.C. § 1701j-3(d)(1) prohibited enforcement of any due-on clause for a second mortgage on a residential property.[15] The remaining cases involved due-on-sale clauses allegedly triggered by outright sale of the property. In a few cases the clauses arguably were worded such that an encumbrance short of a sale could have triggered acceleration; however, none of the cases actually involved a transfer short of a sale. Most involved the question of the applicability of the Garn Act. When the Act was found inapplicable, usually in "window states" or with regard to transactions that took place before the Garn Act, the courts applied state law. When the Garn Act was found applicable, the due-on clauses generally were held enforceable.

Some courts have suggested that a due-on-encumbrance clause *is* a due-on-sale clause.[16]

In a pre-Garn Act case, the California Supreme Court defined a "due-on clause [as] a device . . . used to provide . . . for acceleration . . . upon the sale, alienation, or further encumbering of the real property security."[17] Under that definition, a due-on-encumbrance clause clearly would be validated by the Garn Act.

C. A Close Reading of the Statute and Regulation

Both the structure and language of the Garn Act and its regulation suggest that due-on-encumbrance clauses are valid. The structural argument is based on the exceptions to enforceability in the residential context. The Garn Act and its associated regulation explicitly make due-on-sale clauses unenforceable in nine specific situations in the context of residential loans.[18] One of these is the creation of an encumbrance subordinate to the lender's interest, which does not relate to a transfer of occupancy rights in the residential property.[19] If these nine situations are carve-outs for the residential context—and they appear to be—then the general rule outside the residential context must be that due-on-encumbrance clauses are validated by the Garn Act. Otherwise, no carve-outs would be necessary.[20] At least one court reached the same conclusion in enforcing a due-on-encumbrance clause in a commercial context (the residential carve-out was inapplicable), based on a provision with essentially the same structure as the Garn Act in a regulation that was a precursor to the Act.[21]

A plain reading of the statute and its regulation also supports the conclusion that the Garn Act applies to due-on-encumbrance clauses.

The language of 12 U.S.C. § 1701j-3(a)(1) seems unambiguous: "'due-on-sale' clause means a . . . provision which authorizes a lender to [accelerate a debt] if all or any part of the property, or an interest therein . . . is sold or transferred." The regulation promulgated pursuant to the Garn Act, 12 C.F.R. Part 591, Preemption of State Due-on-Sale Clauses, adopts the statutory definition of "due-on-sale clause."[22] Unlike the statute, it also provides a definition of "sale or transfer" as "the conveyance of real property of [sic] any right, title, or interest therein, whether legal or equitable, whether voluntary or involuntary, by outright sale, . . . or any other method of conveyance of real property interests."[23]

There is, thus, catch-all language in both the Garn Act (a due-on-sale clause includes a clause authorizing acceleration upon sale or transfer of "all *or any part* of the property, *or an interest therein*"[24]), and its regulation (a sale or transfer is "the conveyance of real property [or] . . . *any right, title, or interest therein*"[25]). If the Garn Act were only intended to validate true due-on-sale clauses that could be invoked only upon an outright sale involving transfer of title, the catch-all language would be surplusage. The fact that the drafters put the catch-all language both in the Act and the regulation suggests that the Act was intended to validate due-on clauses that may be triggered by a transfer of something less than title, i.e., an encumbrance.[26]

> *"In the 16 years since the passage of the Garn Act, only one reported state or federal case has dealt with whether the Act validates due-on-encumbrance clauses."*

At least one court has construed language only slightly broader than the definition of "sale or transfer" in C.F.R. § 591.2(b) to include an encumbrance. The mortgage document in that case provided that the mortgagee could accelerate the loan "in the event of any change in, or relinquishment of, the Mortgagor's present legal or equitable rights, title or interest in the mortgaged premises in any manner or to any extent whatsoever."[27] The court concluded that a subsequent mortgage was an event that could trigger the acceleration clause.

If granting of an easement or a second mortgage is a transfer of interest in property, then a due-on-encumbrance clause seems clearly to be included within the the broad language of the Garn Act's definition of due-on-sale clause and the even broader language of the regulation, and is thus validated by the Garn Act.

III. The Enforceability of Due-on-Encumbrance Clauses but for the Garn Act

In the 16 years since the passage of the Garn Act, only one reported state or federal case has dealt with whether the Act validates due-on-encumbrance clauses.[28] If the Garn Act does apply to due-on-encumbrance clauses, then they should be generally enforceable, aside from the statutory exceptions. The Garn Act explicitly preempts any state law.[29] However, if the Garn Act does not apply to due-on-encumbrance clauses, then reference to state law is necessary to determine their enforceability.

A. Statutory Exceptions to Enforceability

Due-on-sale clauses may not be enforced in mortgages for residential property with fewer than five dwelling units under certain circumstances,[30] including the creation of an encumbrance that does not transfer occupancy rights.[31] This prohibition thus creates areas where both due-on-sale and due-on-encumbrance clauses are *unenforceable*, irrespective of the breadth of the Garn Act.

The Garn Act also allowed states to preserve some limited restrictions on the enforcement of due-on clauses.[32]

B. Enforceability of Due-on-Encumbrance Clauses under State Law[33]

There have been only a handful of cases dealing with the enforceability of true due-on-encumbrance clauses, as opposed to due-on-sale clauses, either before or since the passage of the Garn Act in 1982.[34] However, cases dealing with the enforceability of due-on-sale clauses are relatively legion. Because due-on-encumbrance clauses are fairly similar to due-on-sale clauses, debate about the enforceability of due-on-encumbrance clauses (if the Garn Act leaves the question open at all) would reasonably include arguments from the due-on-sale clause context.

The cases on enforceability of due-on clauses may be said, generally, to fall into three categories: those that invalidate the use of the clauses on unconscionability grounds; those that invalidate them as unreasonable restraints on alienation; and those that enforce them.

1. Unconscionability and Inequitability

Courts may exercise their equitable powers to refuse to enforce a due-on clause, in certain circumstances, on general contract grounds of unconscionability or inequity.[35] Unconscionability may even be enough to overcome the Garn Act.[36] Nondisclosure of the potential effect of the due-on clause to the borrower is arguably a weak basis for a defense of unconscionability, given the nontechnical language needed to give the lender the power to accelerate.[37] An actual finding of nondisclosure or other inequitable conduct by the lender is needed to prevent a lender from exercising a due-on clause on the basis of unconscionability.[38]

2. Due-on Clauses as Restraints on Alienation

Due-on clauses are arguably restraints on alienation and thus should be unenforceable, at least if their enforcement would be unconscionable.[39]

The California courts have held that due-on-sale clauses may be unreasonable restraints on alienation,[40] and that enforcement of a due-on-encumbrance clause is an unreasonable restraint on alienation unless the lender can show that its security is endangered.[41] In *La Sala v. American Sav. and Loan Ass'n*, the California Supreme Court held that a due-on-sale clause is automatically enforceable, since the mortgagor can pay off the accelerated mortgage with the consideration received for the transfer; but a due-on-encumbrance clause is only enforceable with a showing of impairment of the lender's security, since the consideration received by the mortgagor for the encumbrance is probably not sufficient to pay off the accelerated debt. Furthermore, it may be inequitable to allow acceleration for an outright sale that does not provide the mortgagor with the cash needed to pay off the accelerated debt, such as an installment land contract[42] or other executory contract.[43]

Some courts have held that a due-on-sale clause—not specifically a due-on-encumbrance clause—may be an unlawful restraint on alienation when combined with, and exercised at the same time as, a prepayment fee provision[44] or "transfer fee" that was not provided for in the mortgage.[45] Presumably, a due-on-encumbrance clause could also, in combination with another contract provision such as a prepayment fee, constitute an unenforceable restraint on alienation under state law. In fact, New York Real Property Law § 254-a prohibits the simultaneous exercise of a due-on clause and the levying of a prepayment fee in the context of a mortgage on an owner-occupied residential property.[46]

The bulk of the authority outside California, however, is against invalidating due-on-sale clauses as unreasonable restraints of trade.[47]

3. Due-on Clauses Are Generally Valid

Even before the Garn Act, due-on clauses were generally valid.[48] The major exceptions were in states that followed the California rule and required a showing of impairment of the lender's security before allowing enforcement[49] and cases penalizing lenders for unconscionable behavior.[50] Most courts enforce due-on clauses even if the lender's motive for exercising the clause is to secure a higher interest rate.[51] However, where the mortgagee has agreed not to unreasonably withhold consent to a transfer, withholding consent for the sole reason of increasing the interest rate may not be permissible.[52]

IV. Conclusion

Due-on-encumbrance clauses should be enforceable. The language and structure of the Garn Act and the regulation promulgated thereunder strongly suggest that result, but no court has yet held either way. If the Garn Act does not apply to due-on-encumbrance clauses, then their enforceability is a matter of state law. While the state law on due-on-encumbrance clauses is sparse at best, state courts generally have found them enforceable. However, there are exceptions to enforceability where there is unconscionable or inequitable behavior by lenders or where enforcement of the clause would constitute an unreasonable restraint on alienation.

Endnotes

1. *See* Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law* 359-60 (1993); Baxter Dunaway, *The Law of Distressed Real Estate* § 11.03[6] (1998); Dennis Greenwald & Michael Asimow, California. Prac. Guide Real Prop. Trans. Ch. 6 § 397 (1997); Robert A. Thompson & Brian D. Smith, *Negotiating Loan Transactions*, PLI, Real Estate Law and Practice Course Handbook Series No. N4-4506 § 3.27 (1989).

2. *See* Nelson & Whitman, *supra* note 1, at 360; Grant S. Nelson & Dale A. Whitman, *Congressional Preemption of Mortgage Due-on-Sale Law: An Analysis of the Garn-St. Germain Act*, 35 Hastings L.J. 241, 247-48 (1983).

3. *See* Greenwald & Asimow, *supra* note 1, at Ch. 6 § 393; Dunaway, *supra* note 1, at § 11.03[6].

4. *See* discussion *infra* Part III.B.

5. The grandfathering provision of the Garn Act allowed states to defeat the preemption of state law by the Garn Act for loans made within the period starting when the state first created restrictions on the use of due-on-sale clauses and ending three years after the passage of the Garn Act. 12 U.S.C. § 1701j-3(c) (1997). Only three states (Michigan, New Mexico, and Utah) took advantage of this option with permanent legislation imposing some restrictions on the enforceability of due-on-sale clauses in these so-called "window loans." These three, along with two states that temporarily extended state law restrictions on the use of due-on clauses, are "window states." *See generally* Nelson & Whitman, *supra* note 1, at 385-95.

   New York is not a window state. *See Home Sav. Bank of Upstate New York v. Baer Properties, Ltd.*, 460 N.Y.S.2d 833 (App. Div. 1983).

6. 12 U.S.C. § 1701j-3(b)(1) (1997).

7. 12 U.S.C. § 1701j-3(a)(1) (1997).

8. *See* discussion *infra* Part III.A.

9. Christopher A. Seeger, *The Fixed-Price Preemptive Right in the Community Land Trust Lease: A Valid Response to the Housing Crisis or an Invalid Restraint on Alienation?*, 11 Cardozo L. Rev. 471, 488 n.82 (1989).

10. *See* Thompson & Smith, *supra* note 1, at § 3.27.

11. Alex M. Johnson, Jr., *Adding Another Piece to the Financing Puzzle: The Role of Real Property Secured Debt*, 24 Loy. L.A. L. Rev. 335, 341 n.46 (1991).

12. *See* Greenwald & Asimow, *supra* note 1 at Ch. 6 § 397.

13. Alan Wayte says that the language of 12 U.S.C. § 1701j-3(a)(1) is not clear, and that the regulations only *imply* that the creation of a junior lien is a transfer of an interest within the meaning of the statute. Thus "[d]ue-on-encumbrance clauses affecting commercial real estate may not be validated by the Garn Act and are possibly governed by state law." Alan Wayte, *Real Estate Financing Documentation: Coping with New Realities*, ALI-ABA Course of Study 37, 47 (1996). Nelson and Whitman do not say that due-on-encumbrance clauses are covered by the Garn Act, but they strongly imply it: "Due-on-encumbrance clauses are very common in mortgages on commercial property, but are prohibited by federal statute in loans on one-to-four-family homes." Nelson & Whitman, *supra* note 1, at 360 (citing 12 U.S.C. § 1701j-3(d)(1)). Nelson and Whitman do not mention other restrictions on the enforceability of due-on-encumbrance clauses in the aforementioned passage or elsewhere in their extensive and relatively current (1993) discussion of due-on-sale clauses.

14. This result is probably an accurate measure of the reported cases on point. It seems likely that any lender defending a due-on clause of any kind since the passage of the Garn Act would cite 12 U.S.C. § 1701j-3 as a defense, and that a court opinion dealing with the issue would cite the statute.

15 *See Dupuis v. Yorkville Fed. Sav. and Loan Ass'n*, 589 F.Supp.820 (S.D.N.Y. 1984) (12 U.S.C. § 1701j-3(d)(1) prohibits the enforcement of any due-on clause for a second mortgage on a residential property).

16. *See Wellenkamp v. Bank of Am.,* 582 P.2d 970, n.1 (Cal. Super. Ct. 1978); *Fogel v. S.S.R. Realty Assoc.*, 443 A.2d 1093 (N.J. Super. Ct. Ch. Div. 1981).

17. *Wellenkamp*, 582 P.2d at n.1.

18. 12 U.S.C. § 1701j-3(d) (1997); 12 C.F.R. § 591.5(b) (1997).

19. *See* 11 U.S.C. § 1701j-3(d)(1) (1997); 12 C.F.R. § 591.5(b)(1) (1997).

20. *See* Wayte, *supra* note 13 (making same argument).

21. *See Egbert v. Freedom Fed. Sav. and Loan Ass'n*, 440 N.E.2d 22, 27-28 (Mass. App. Ct. 1982).

22. 12 C.F.R. § 591.2(b) (1997).

23. *Id.*

24. 12 U.S.C. § 1701j-3(a)(1) (1997) (emphasis added).

25. 12 C.F.R. § 591.2(b) (1997) (emphasis added).

26. *But see* Wayte, *supra* note 13.

27. *Egbert*, *supra* note 21, at 384.

28. *See* discussion *supra* Part II.B.

29. 12 U.S.C. § 1701j-3(b)(1) (1997).

30. *See* 12 U.S.C. § 1701j-3(d) (1997).

31. *See* 12 U.S.C. § 1701j-3(d)(1) (1997).

32. *See supra* note 5.

33. This brief review of the state law is an attempt to point out only the more frequently cited cases and the major issues.

34. *See Dupuis,* 589 F.Supp. at 820; *La Sala*, 489 P.2d at 1123-24 (enforcement of a due-on-encumbrance clause is an unreasonable restraint on alienation unless the lender can show that its security is endangered); *McCausland v. Bankers Life Ins. Co. of Nebraska*, 757 P.2d 941, 943 (Wash. 1988) (mortgage contained both due-on-sale clause and due-on-encumbrance clause, but the only issue was the validity of the prepayment penalty). In *Egbert*, which involved a commercial loan, the court held that the language of the due-on clause included a second mortgage. 440 N.E.2d at 27-28. *See also supra* note 22 and accompanying text (a regulation similar to the Garn Act validated due-on-encumbrance clauses); *supra* note 28 and accompanying text (the exercise of this due-on clause agreed to by two sophisticated parties was not inequitable); *Egbert*, 440 N.E.2d at 394.

35. *See Ceravolo v. Buckner*, 444 N.Y.S.2d 861 (N.Y. Sup.Ct. 1981); *Shoreline Bank & Trust Co. v. Leninski*, 1993 WL 88345 (Conn.Super. 1993); *Continental Fed. Sav. and Loan Ass'n v. Fetter*, 564 P.2d 1013 (Okla. 1977); *Crockett v. First Fed. Sav. and Loan Ass'n of Charlotte*, 224 S.E.2d 580 (N.C. 1976); *Mutual Fed. S & L Ass'n v. Wisconsin Wire Works*, 205 N.W.2d 762 (Wis. 1973). *See generally* Eric J. Murdock, *The Due-On-Sale Controversy: Beneficial Effects of the Garn-St. Germain Depository Institution Act of 1982*, 1984 Duke L.J. 121, 127-29 (1984); Nelson & Whitman, *supra* note 1, at 396-97.

36. *See* Nelson & Whitman, *supra* note 1, at 397 (discussing *Central National Bank v. Shoup*, 501 N.E.2d 1090 (Ind. App. 1986), refusing to enforce a due-on-sale clause where the lender had inserted the clause without the mortgagor's knowledge and against his or her wishes).

37. *See* Murdock, *supra* note 35, at 128-29.

38. *See, e.g.*, *Baer,* 460 N.Y.S.2d at 833 (lender's use of due-on-sale clause inequitable when triggered by corporation's transfer of property to its president when the lender knew that president was real owner); *Nichols v. Evans*, 401 N.Y.S.2d 426, 428 (N.Y. Co. Ct. 1978) (inequitable to enforce due-on-sale clause where debtor continued to make payments, offered to reconvey the property and there was no jeopardization of security); *Continental*, 564 P.2d at 1013 (finding lender's imposition of a "transfer fee" inequitable when there was no provision for such a fee in the mortgage documents and it was not bargained for).

39. *See Crockett*, 224 S.E.2d at 580; *Nichols v. Ann Arbor Federal Savings & Loan Ass'n*, 250 N.W.2d 804, 809 (Mich. App. 1977). *See generally* Nelson & Whitman, *supra* note 1, at

363.

40. *See Wellenkamp* 582 P.2d at 976; *Tucker v. Lassen Sav. and Loan Ass'n,* 526 P.2d 1169, 1173-74 (Cal. 1974); *Coast Bank v. Minderhout*, 392 P.2d 265, 268-69 (Cal. 1964).

41. *See La Sala v. American Sav. & Loan Ass'n*, 489 P.2d 1113, 1123-24 (Cal. 1971).

42. *See Tucker*, 526 P.2d at 1173. *But see Newburgh Sav. Bank v. Grossman*, 462 N.Y.S.2d 92 (Sup. Ct. 1982) (installment contract of sale is a sale or conveyance of the premises triggering due-on-sale clause). *See also* Nelson & Whitman *supra* note 1, at 378-79.

43. *See Tan v. California Fed. Sav. and Loan Ass'n*, 189 Cal.Rptr. 775 (Cal.App. 1983).

44. *See*, *e.g.*, *Warrington 611 Assoc. v. Aetna Life Ins. Co.*, 705 F.Supp. 229, 234-35 (D.N.J. 1989); *McCausland,* 757 P.2d at 943.

45. *Continental*, 564 P.2d at 1013.

46. *See* New York Real Prop. Law § 254-a (McKinney 1997); *see also* Leon Edward Wein, *Due on Sale in New York*, 49 N.Y.S. Bar Journal, No. 3, p. 203, 204 (1977); Bruce J. Bergman, *Due on Sale in New York: Clearer with Time?,* 58 N.Y.S. Bar Journal, No. 3, p. 27, 28 (1986).

47. *See, e.g., Ceravalo*, 444 N.Y.S. at 861; *First Fed. Sav. & Loan Assoc. v. Jenkins*, 441 N.Y.S.2d 373 (N.Y. Sup.Ct. 1981); *Dunham v. Ware Sav. Bank*, 423 N.E.2d 998 (Mass. 1981); *Society for Sav. v. Bragg*, 444 A.2d 919 (Conn.Super. 1981); *Occidental Sav. and Loan Ass'n v. Venco Partnership*, 293 N.W.2d 843, 845 (Neb. 1980). Nelson & Whitman, *supra* note 1, at 364, and Murdock, *supra* note 35, at 129-33 argue that the restraint on alienation is weak. *See also* Bergman, *supra* note 46, at 29.

48. *See, e.g., Newburgh Sav. Bank v. Grossman*, 462 N.Y.S.2d 92 (Sup. Ct. 1982); *Ceravalo*, 444 N.Y.S.2d at 861; *Jenkins*, 441 N.Y.S.2d at 373; *Mutual Real Estate Inv. Trust v. Buffalo Sav. Bank*, 395 N.Y.S.2d 583 (Sup. Ct. 1977); *Stith v. Hudson City Sav. Inst.*, 313 N.Y.S.2d 804 (Sup. Ct. 1970); *Bragg*, 444 A.2d at 919; *Fogel*, 443 A.2d at 1093; *Mutual Fed. S & L Ass'n*, 205 N.W.2d at 762; *Occidental*, 293 N.W.2d at 843; Wein, *supra* note 46, at 239; Bergman, *supra* note 46, at 30.

49. *See* discussion *supra* Part III.B.1.

50. *See* discussion *supra* Part III.B.2.

51. *See, e.g., Bonady Apartments, Inc. v. Columbia Banking Fed. Sav. and Loan Ass'n*, 465 N.Y.S.2d 150, 153-54 (Sup. Ct. 1983), *aff'd in relevant part* in 472 N.Y.S.2d 221 (App.Div. 1984); *Iris v. Marine Midland Bank of Southeastern New York, N. A.*, 450 N.Y.S.2d 997 (Sup. Ct. 1982); *Ceravalo*, 444 N.Y.S.2d at 861; *Dunham*, 423 N.E.2d at 999; *Century Fed. Sav. and Loan Ass'n of Bridgeton v. Van Glahn*, 364 A.2d 558, 562 (N.J. Super. Ct. Ch. Div. 1976); *Crockett*, 224 S.E.2d at 580.

52. *See Silver v. Rochester Sav. Bank*, 424 N.Y.S.2d 945, 947-48 (App.Div. 1980); *see also Bleecker Assoc. v. Astoria Fed. Sav. and Loan Ass'n*, 544 F.Supp. 794 (S.D.N.Y. 1982).

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Disclosure Requirements for Foreign Investors in the United States

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I. Introduction

The United States has traditionally maintained an "open door" policy with respect to foreign investment in American enterprise and in real property, including agricultural land. This policy springs from the dual premise that the investment process works best in the absence of government intervention, and that foreign investment decisions should be accorded neither preferential nor discriminatory treatment.[1] This policy was reaffirmed by President Clinton on February 23, 1993, because it promotes growth, stimulates jobs and fosters competition.[2]

There have been periods of strong and vocal resentment to foreign investment, most notably during the "Cross of Gold" days of William Jennings Bryan at the end of the last century. Historically, however, Americans have remained relatively sanguine about the role of foreign money here, preferring to view the many positive contributions of foreign capital rather than dwell on any strings that may be attached to such investments.[3]

Just how open this door is to foreign investment in the United States and how sanguine the American is about that investment may be judged by the materials which follow.

II. Government Restrictions on Foreign Investment in Real Estate in the United States

A. State Restrictions on Foreign Investment

1. Generally

In some states, investment restrictions or disclosure requirements on foreigners are encountered, particularly with respect to agricultural lands. In other states, such as New York, there are generally no restrictions on foreign investments within the state. A foreigner contemplating investment in the United States is thus forced to examine the civil code of each particular state where investment is proposed.

2. Restrictions on Aliens

Some states restrict foreigners in the types of investments they may make. Some states prohibit ownership of any interest in agricultural land unless the person is a citizen of the United States (or of Canada, in some states) or a permanent resident alien of the United States.[4] In some states, there are no restrictions against foreign ownership of agricultural lands, but the foreigner may be required to register or report the ownership interest.[5] Some states prohibit ownership by a foreign corporation or limited liability company,[6] but are silent about similar ownership by a general partnership or limited partnership.

In New York, foreign investors are authorized to take, hold, transmit and dispose of real property in the same manner as native-born citizens of the state of New York, and their heirs and devisees take in the same manner as citizens.[7] The fact that title to real property was derived through a prior holder who was an alien does not affect the title.[8] Foreign governments are empowered to hold, transmit and dispose of real property for the purpose of maintaining offices and places of residence for their ambassadors and consular officers.[9]

3. Courts May Hold Money or Property for the Alien Beneficiary

In appropriate circumstances, a court may direct that the money or property due an alien beneficiary be paid into the court for the benefit of such beneficiary or other persons who may later become entitled to it.[10] An appropriate circumstance would be where the alien beneficiary would not be able to take the gift, as where the alien's totalitarian government would seize it.

4. Treatment of Alien Corporations

In New York, alien corporations are statutorily treated as foreign corporations.[11] Foreign corporations are authorized to acquire, hold and convey real property "in furtherance of corporate purposes," the same as domestic corporations.[12] The same is true with respect to New York's recently enacted Limited Liability Company Law.[13] In the case of citizens of another state of the United States, such treatment is based on the full faith and credit clause of the U.S. Constitution.[14] With alien entities, such treatment is based on principles of comity.[15] In New York, alien corporations are statutorily treated as foreign corporations.[16] Foreign corporations are authorized to acquire, hold and convey real property "in furtherance of corporate purposes," the same as domestic corporations.[17] The same is true with respect to a limited liability company formed in that state.[18]

Each state uniformly accords the same treatment to corporations and other legal entities formed outside of that state as they do to such entities formed within that state. A "foreign corporation" (or other entity) may refer either to a corporation formed in another state or to a corporation formed in another country. Between states in the United States, such treatment is based on the full faith and credit clause of the U.S. Constitution.[19] With alien entities, such treatment is based on principles of comity.[20]

5. Real Property Records

While not operating as a restriction on the ownership of real property, the public recording of documents relating to the ownership of real property and interests in real property constitutes some disclosure of the facts recorded. Such recording, however, does not as a practical matter reveal in-depth information concerning the nature of the ownership or the equity or debt involved in such ownership.

B. Federal Restrictions on Foreign Ownership of Real Property

1. Hostile or Enemy Aliens

The Trading with the Enemy Act of 1917[21] and the Alien Property Custodian Regulations and the Foreign Assets Control Regulations[22] govern the potential seizure and handling of the assets of non-nationals. They do not apply to the assets of a U.S. national, i.e., a U.S.-owned corporation. While the former applies "during the time of war," the latter requires no formal declaration of war to "block" assets. The latter regulations work to prohibit transactions with respect to designated foreign countries, currently North Korea, Cambodia, North Vietnam and South Vietnam.[23]

2. Producers of Defense Material

The U.S. Defense Department is a "lead" agency in granting clearance for the obtaining of files and documents in the federal defense contract procurement process. Foreign ownership, control or influence in the ownership of domestic plants, laboratories and offices is a key factor weighing against obtaining required facility clearance, not the place where a legal entity was formed. "Control" is determined on a case-by-case basis in order to obtain required facility clearance. If top management is comprised of foreign nationals, required personnel clearance is unlikely. Clearance for United Kingdom and Canadian nationals, however, is less restricted.[24]

3. Sensitive Industries

Ownership or control of businesses in certain "sensitive" industries is restricted by federal statute. The Communications Act of 1934, as amended,[25] closely restricts foreign operation of a radio or television station and the holding of a station license by a foreign government. Twenty percent or more control by foreigners in merged telegraph carriers is also proscribed. The Communications Satellite Act of 1962[26] disallows foreign ownership of more than 20 percent of a communications satellite corporation.[27]

The Atomic Energy Act of 1954[28] calls for license rejection on nuclear facilities in case of ownership, control or domination by aliens, foreign corporations and foreign governments. The Federal Power Act of 1935[29] restricts the granting of licenses to citizens and domestic corporations for the development, transmission and utilization of power over federally controlled land.

Section 2170 of the Exon-Florio Review process[30] provides that the president may under some circumstances suspend or prohibit a merger, acquisition or takeover, that is proposed or pending after August 23, 1988, which could result in foreign control of an entity engaged in interstate commerce in the United States. If it is determined that an investigation should be undertaken, it shall commence no later than 30 days after receipt by the president, or the president's designee, of written notification of the proposed or pending merger, acquisition or takeover. Pursuant to section 2170(a), such investigation shall be completed no later than 45 days after such determination.

Generally, however, the Exon-Florio Review process is not intended to cover real property acquisitions (except possibly where real estate is used in connection with industries having possible national security ramifications). Although parts of the Exon-Florio amendment have expired, the following provisions have not:

The president may act if it is found that foreign control might impair the national security of the United States[31] and if other provisions of federal law do not give the president adequate authority to protect the national security.[32]

The Committee on Foreign Investment in the United States has been given the permanent authority to administer the Exon-Florio provision. It consists of representatives from the Departments of Treasury, State, Defense, Commerce and Justice as well as from the Office of U.S. Trade Representative, the Council of Economic Advisors, and the Office of Management and Budget. It was created by Executive Order No. 11858 of May 7, 1975. The information or documentary material file shall be exempt from disclosure under federal freedom of information laws,[33] and the information or documentary material may not be made public except as it may be relevant to any administrative or judicial action or proceeding.[34]

The factors to be considered are (taking into account the requirements of national security) among other factors (1) domestic production needed for projected national defense requirements; (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials and other supplies and services; and (3) the control of domestic industries and commercial activities by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security.[35]

The president gives a report to Congress of his or her determination, but the action itself is taken by the president.[36] The president may refer legal actions to the attorney general,[37] but the president's actions shall not be subject to judicial review.[38]

As previously noted, real property acquisitions are not intended to be covered by section 2170. It is not clear to what extent real estate acquisitions are excluded as a part of the acquisition of ongoing, viable business or joint ventures. It is also not clear whether a foreclosure by a foreign lender which results in control by that lender of a United States business is subject to section 2170 review. Note also the interrelationship of Exon-Florio with the provisions of the disclosure requirements for foreign acquisition of corporate interests under the Williams Act (*see* II.C.2. *infra*).

The Alien Land Act of 1887[39] limits land ownership in the territories of the United States to U.S. citizens, resident aliens and aliens formally declaring intent to become citizens. Land acquired by inheritance or debt collection is to be divested within ten years.[40] Exceptions exist for cases secured by treaties or subjects of foreign countries, as provided in specific treaties,[41] and for the District of Columbia.[42] Aliens have only limited rights to public lands grazing permits.[43] Hawaii was formerly included as a territory but was removed when it became a state.[44]

Foreign leasing, ownership and use of certain natural resources is restricted, and in some cases prohibited, by federal statute. The Mining Act of 1872[45] denies to foreigners, who have not declared the intent to become citizens, rights of exploration and extraction of minerals on federal lands. Foreigners may acquire such rights, however, through a domestic corporation. Although owned by foreign shareholders, the domestic corporation is nevertheless a citizen of the United States. The Mineral Leasing Act of 1920[46] limits leasing to U.S. citizens and domestic corporations, with the latter to be foreign owned only if the foreign owner's nation reciprocates.

Under the Geothermal Steam Act of 1970,[47] only U.S. citizens and domestic corporations (no mention is made of foreign ownership of domestic corporations) may receive geothermal steam leases on federal lands.[48] Foreign owners of 10 percent or more of such corporations face disclosure rules (*see infra*).

Hydroelectric power licenses on navigable streams, under the jurisdiction of the Federal Power Commission, are limited to U.S. citizens and domestic corporations. Such corporations, however, are open to foreign investors, subject to disclosure requirements (*see infra*).

The Outer Continental Shelf Lands Act[49] governs oil, natural gas and mineral deposits leasing; by regulation, leases are limited to citizens, resident aliens, and private, public or municipal domestic corporations.[50] There is no restriction against foreign ownership of a private corporation.

The use of water from federal projects is restricted to U.S. citizens, U.S. residents and resident aliens under the Federal Reclamation Law.[51] This law affects 17 western states.

C. Collateral Controls and Requirements Affecting Ownership of Real Estate by Foreigners

Several federal statutes have an indirect effect on property ownership. The Federal Aviation Act of 1958[52] limits aircraft registration to U.S. citizens; permanent residents; and foreign corporations when they are organized and doing business under the laws of the United States or of a state, and the aircraft is based and primarily used in the United States. The Secretary of Treasury defines the meaning of "based and used primarily in the United States."[53]

Numerous other statutes and regulations concerning the banking and insurance industries are in effect. Note, in particular, the

Currency and Foreign Transactions Reporting Act of 1970 (CFTRA), sometimes called the "Bank Secrecy Act."[54] This act requires domestic financial institutions and certain other persons to report to the Secretary of the Treasury transactions involving currency or monetary instruments. Payments of currency transfer receipts in excess of $10,000 must be reported. Bank draft and wire transfers are exempt. The export or import of any monetary instrument having a value greater than $10,000 on any one occasion must also be reported. (*See also* II.C.1., *infra*.)

CFTRA regulations also require each person subject to U.S. jurisdiction,[55] or with a financial interest in or signature or other authority over a bank account, securities or other financial account in a foreign country, to report such relationship annually. Penalties for violating the act are both civil and criminal. Bank secrecy is a myth, especially in the United States. Even numbered accounts are subject to federal subpoena.[56]

1. Money Laundering and Forfeiture

Money laundering is an international business which promotes international crime. It applies to everything from the international transfer by wire of hundreds of millions of dollars in drug proceeds to the purchase of an automobile with funds robbed from a bank. Many countries during the 20th century have attempted to deal with it with varying degrees of success.

The law governing money laundering, with the correspondingly harsh penalty of forfeiture, creates many traps for the unwary. Applicable to a United States citizen wherever the activity occurs and to a non-United States citizen who engages in illegal conduct within the United States, it is not difficult to run afoul of the law if one knows of the criminal activity or, more importantly, should have known of the criminal activity. One who is willfully blind to the fact that property is criminally derived—i.e., his or her suspicions were aroused—and who refuses to investigate for fear of discovering that the property is criminally derived, makes oneself open to prosecution.

Examples of property involved in money laundering offenses include: commissions or fees paid to the launderer, bank accounts, automobiles, improvements to a farm, improvements to a building which involve not only the building but also the land on which it is located, and a trucking business.

By way of penalty for the violation of the money laundering prohibitions, 18 U.S.C. sections 981-986 provide that any property, real or personal, involved in a transaction or attempted transaction in violation of these laws will be forfeited under civil and criminal provisions. The launderer forfeits not only the profit but also the property itself.

Recent newspaper accounts report that the U.S. Treasury Department is tightening rules governing electronic transfer of money among currency exchanges, casinos, brokerage firms and banks. Banks will be required to keep records about sources and recipients of all wire transfers because they are frequently used to move cash from the United States to financial institutions overseas.

The Anti-Drug Abuse Act of 1986[57] was passed to combat the pernicious problem of "money laundering."[58] It was amended in 1988, 1990, 1992, 1994 and 1996. Money laundering in the United States is defined in three alternative ways but each of the first two ways has two sub-parts. Section 1956(a)(1) prohibits money laundering generally. Section 1956(a)(2) is similar to (a)(1) but applies to international transactions.[59] Section 1956(a)(3), added in 1988, is similar to (a)(1) but applies to government sting operations by fine-tuning the level of intent required for conviction in sting operations. Paragraphs (a)(1), (a)(2) and (a)(3) are subdivided to provide for the various types of knowledge or intent which may serve as a basis for the offense.

Subsections (a)(1)(A)(i) and (a)(2)(A)(i) apply where there is an intent to promote the carrying on of an unlawful activity. Subsections (a)(1)(B)(i), (a)(2)(B)(i) and (a)(3)(B) apply where there is an intent or knowledge of a design to conceal some information about the funds or property involved. Subsections (a)(1)(B)(ii), (a)(2)(B)(ii) and (a)(3) apply where there is an intent, or knowledge of a design, to avoid a transaction reporting requirement. In addition, subsection (a)(1) contains an intent provision not found in the other two subsections: (a)(1)(A)(ii) applies where there is an intent to violate certain Internal Revenue Code sections.

As recognized in *United States v. Jackson*,[60] subsections (a)(1)(A)(i) and (a)(1)(B)(i) are aimed at different activities: the first is the practice of plowing back proceeds of "specified unlawful activity" (SUA) to promote that activity; the second is aimed at hiding the proceeds of the activity.

The first type of money laundering is called "financial transaction" money laundering. There is an offense if a person engages in a certain type of "financial transaction" either (1) with the intent to promote a "specified unlawful activity"; or (2) with knowledge that the transaction is designed in whole or in part either (a) to conceal or disguise the nature, location, source, ownership or control of the proceeds of SUA or (b) to avoid a state or federal transaction reporting requirement. This offense is chargeable as a violation of section 1956(a)(1).

As indicated above, this subsection applies to international transactions. There is extraterritorial jurisdiction over the proscribed conduct if (1) it is conducted by a United States citizen or, in the case of a non-United States citizen, the conduct occurs in part in the United States; and (2) the transaction or series of related transactions involves funds or monetary instruments of a value exceeding $10,000.[61]

The two elements of money laundering under this subsection are (1) that the money be the proceeds of an SUA and (2) that the defendant knows that the money constitutes unlawful proceeds.[62]

The financial transaction itself need not involve a financial institution. Nor must the particular defendant have knowledge that the transaction involves the proceeds of a particular offense. It is sufficient that there exists an offense under federal, state or even foreign law. The proceeds, however, must be from a "specified unlawful activity." The list of activities is very broad and includes RICO offenses, federal and foreign felony drug offenses, and an assorted list of miscellaneous bribery, white collar, export control and espionage offenses.

The financial transaction must involve the movement of funds by wire or other means or one or more monetary instruments and there must be an effect on interstate or foreign commerce unless a financial institution is involved.

For subsection (1), intent to promote, proof is required that the proceeds from prior "specified unlawful activity" were laundered for the purpose of being used to promote subsequent "specified unlawful activity." For either subsection, it is not necessary that a particular defendant share the criminal's intent to promote further unlawful activity or to conceal the source or ownership of the unlawful proceeds, or to avoid a transaction reporting requirement. He or she simply must be aware of the criminal's design or purpose. This awareness can be proved by direct or circumstantial evidence.

This subsection is the most frequently used part for prosecuting money laundering. The term "specified unlawful activity" is not limited to narcotics offenses but rather includes most serious state and federal crimes, as well as violations of foreign law involving drug trafficking, kidnapping, robbery, extortion or fraud by or against a foreign bank.

The second type of money laundering is called "transportation" money laundering. It is the same as the first except that "transportation" is involved instead of a "financial transaction." The transportation involves the transportation of funds or a monetary instrument to or from the United States. The same intent and knowledge requirements apply. It is charged under section 1956(a)(2).

It should be noted that, with respect to subsection (A) of section 1956(a)(2) only, the monetary instrument involved does *not* have to be proceeds of criminal activity. For example, if "clean money" is transferred from the United States to a foreign country to purchase illegal drugs, this can be a violation of section 1956(a)(2). Similarly, if "clean money" is transferred into the United States from a foreign country to promote an SUA, this also can be a violation of section 1956(a)(2)(A).

Both the first and second types of money laundering have a maximum potential 20-year prison sentence and a $500,000 fine or twice the amount involved in the transaction. There is also a civil penalty of not more than the greater of $10,000 or the value of the funds involved in the transaction.[63]

The third type of money laundering is the "sting" provision. It makes it a crime to engage in a financial transaction with money represented by a law enforcement officer to be the proceeds of an SUA. This provision allows prosecution of defendants who are the subject of undercover operations. Undercover government agents pose as persons who are in possession of criminal proceeds. The agent provides the purported "dirty" money to the money launderers for purposes of laundering. Since the funds are not really but are only represented to be SUA proceeds, the launderers could not be prosecuted under the first two subsections of section 1956 and, consequently, this third section was needed in order to support a sting operation.

Section 1957 makes it an offense for anyone to engage in a monetary transaction in criminally derived property of a value greater than $10,000 that is derived from an SUA. Section 1957 differs from section 1956 in three ways: (1) The term "monetary transaction" requires that the transaction involve a monetary instrument or funds by, through or to a financial institution; section 1956 does not have this limitation. (2) Section 1957 requires that the transaction involve property or funds in excess of $10,000. (3) Section 1957 does *not* have the additional *intent* requirements (such as intent to promote an SUA or to conceal the proceeds) that section 1956 has.

There is no requirement that the transaction be designed for any particular purpose. A deposit, withdrawal, transfer or exchange is sufficient, except that the transaction must have an effect on interstate or foreign commerce. The offense carries a maximum penalty of ten years in prison and a maximum fine of $250,000 or twice the value of the transaction. There is no civil penalty provision.

In addition to the prosecuting money laundering offenses under sections 1956 and 1957, certain money laundering offenses can be charged under the provision of the Bank Secrecy Act.[64] Under section 5313, domestic financial institutions are required to file Currency Transaction Reports for transactions in currency in excess of $10,000. Under section 5316, persons are required to file reports when they transport monetary instruments in excess of $10,000 into or out of the United States. Pursuant to section 5324, it is an offense to structure a financial transaction for the purpose of evading the currency reporting requirements. A similar requirement is imposed on persons engaged in trades and businesses who receive more than $10,000 in cash in the course of that trade or business.[65]

"Knowing" can include actual knowledge, circumstantial evidence or willful blindness. Willful blindness is the hardest form of knowledge to define and represents the greatest potential threat to the unwary. While a person charged with violating section 1956 generally has the alleged intent to conceal or disguise the funds, knowledge of a design to disguise or conceal the funds is indistinguishable from the question of whether such a design or intent existed.

It is possible to have the requisite knowledge of the intent, and thus make one subject to prosecution, without having the intent one's self.[66] Section 1956 has survived constitutional challenges that it is void for vagueness.[67]

Willful blindness, the doctrine that a defendant's knowledge of a fact may be inferred from his or her willful blindness to the existence of that fact, is often sufficient to provide the requisite level of knowledge needed to support a prosecution.[68] It is hard to distinguish from "reason to know" or "reckless disregard" concepts. The evidence of the doctrine is found in the cases construing the requirement.

Some evidence of suspicious or non-standard activity used to base an allegation of willful blindness include:

- Delivery of the $101,000 cash down payment to the real estate agent in an attaché case and a shoe box with instructions to convert the cash into cashier's checks, each under the $10,000 reporting requirement.[69]
- Where the owner of a legitimate business received cash from a cocaine dealer in the amount of the dealer's supposed gross wage from the business and, in return, gave the cocaine dealer a check for the net wage, withholding income tax, social security and workers' compensation (the difference between the gross and net amounts represented payment for the laundering), the court found that the owner well knew that the moneys he received represented the proceeds of some form of unlawful activity. The business owner was held to know that the funds were drug trafficking proceeds because (1) there was evidence that the cocaine dealer had no legitimate source of income and there was nothing in the record to indicate that the owner had any basis for believing otherwise; (2) the dealer actually told the business owner that he, the dealer, sold drugs for a living; (3) years earlier the owner had been informed by the dealer that the dealer's first cash disbursement to the owner had come from selling drugs; (4) the business owner knew that the dealer was arrested on drug charges a few years later; and (5) on a later occasion, the dealer told the business owner that a second dealer sold drugs for him.[70]
- A real estate agent was held to have knowledge that the source of funds for the sale of a house to a drug dealer was illegal from (1) the buyer's lifestyle (he and his companion both drove new Porsches, he carried a cellular telephone, he flashed vast amounts of cash, and he was able to be away from his purportedly legitimate business for long stretches of time during normal working hours); (2) the buyer stated prior to the sale that he may have accepted drug money; and (3) the purchaser asked the seller to accept $60,000 under the table in cash in order to lower the official price.[71]
- Defendant's knowledge of unlawful activity, so as to be guilty of aiding and abetting money laundering, was inferred in part from the defendant's receipt of a box containing $299,895 in counted money wrapped in aluminum-foil packets from a suspected narcotics trafficker shortly after the drug trafficker made a call from a public telephone, a common method for setting up meetings among drug dealers.[72]
- Payoff of a marijuana distributor's mortgage with funds transferred from the marijuana distributor to the mortgage company in increments of less than $10,000. If the payoff had been handled through the mortgage company where the distributor worked, he would have received a commission. He eschewed the commission in favor of making payments through another mortgage company which was on the verge of bankruptcy so that evidence of the transactions would shortly disappear and the reporting requirements could be avoided.[73]

- Use of convoluted financial dealings including the use of “front men”: a cocaine dealer used “front men” to purchase $50,000 in uncut emeralds from Brazil, accompanied the “front men” to Brazil, returned from Brazil to Chicago to sell the gems, guarded the gems with a gun, negotiated the sale of the gems, claimed the gems were his property and transported the property from Chicago to the city where he lived. He also used the “front men” to invest in a charter boat business. The dealings showed an intent to conceal the nature or source of the proceeds and an intent to avoid the transaction reporting requirement.[74]
- While the money laundering statute should not be interpreted to encompass all financial transactions, a defendant preacher was held to violate that statute where he chose to place the proceeds of his drug sales not in a personal bank account, but in bank accounts ostensibly maintained by the church where he was a preacher. The defendant treated the funds as his own but removed himself from the funds by using the church secretary to present checks made out to cash, who then turned over the checks to the defendant. To violate the law, the court observed, it is not necessary that the defendant do a good job of laundering the proceeds.[75]
- For a conspiracy to violate section 1956, it is not necessary that the conspirators be in agreement as to the nature of the unlawful activity that produced the funds to be laundered (one believed the money to come from narcotics while the other believed it came from gambling) since both narcotics and gambling transactions are specified unlawful activities.[76]

In summary, willful blindness may include acceptance of a commission where the industry does not use commissions; acceptance of a commission above market rates; use of a false name to purchase; numerous and unjustified transfers to others/sham; failure to provide identification or suspicious identification; cash in large denominations; legitimate livelihood insufficient to provide lifestyle and business activities; grossly inadequate or inflated price; seller’s obligation to break or bend company rules; and business under odd circumstances, at irregular hours, in unusual locations by industry standards.

In order to avoid being accused of willful blindness, the following due diligence steps should be considered: Obtain a Dun and Bradstreet report on the other company; inquire into the source of funds for the transaction/loan; maintain a consistent checklist of due diligence items for each transaction; consider employing “money laundering counsel”—one who has a specific perspective, different from regular counsel; consider obtaining an opinion of counsel addressing money laundering activities. (But from what counsel? What guidelines are to be used? Once obtained, however, of what value is it? It is only an opinion of counsel, which represents due diligence only. It is not a guaranty of the transaction.) Affidavits from principals regarding their conduct, conversations with United States attorneys regarding current programs, and questionnaires and confidentiality agreements are useful. Be wary of tax-advantaged trusts and be wary of offshore corporations.

For a violation of the money laundering statutes, the guilty person forfeits not only the property itself (corpus)[77] but may also forfeit fungible substitute property.[78] No forfeiture of property may occur, however, if the act or omission of the owner or lienholder occurred without the knowledge of the owner or lienholder.[79]

Forfeitures include, and no property right shall exist in them:[80]

- Controlled substances; raw materials used in controlled substances; container for controlled substances or raw materials; all conveyances (transport/used-facilitate); books, records, research; moneys, negotiable instruments, securities, bearer bonds; all real property used in/traceable to; processed controlled substances; listed chemicals; drug paraphernalia; firearms.
- Actual property (corpus), not merely profit; fungible, substitute property, intermediary exception.

Upon receipt of the property, the federal government is authorized to dispose of the property—i.e., retain, sell, forward to the Treasury, donate for a public area as recreational/historical.

Forfeiture laws can be both civil and criminal. In response to widespread inconsistencies and unfairness in the use of civil forfeiture laws, the American Bar Association (ABA) is urging Congress to enact legislation to make the laws more just and equitable based on a set of principles adopted by the ABA. Under civil forfeiture, the government seizes personal property by showing that there was “probable cause” for the belief that the property was used unlawfully by anyone. The burden then shifts to the owner to prove by “a preponderance of the evidence” that his or her property was not used in a crime. It is estimated that 80 percent of all property owners who lose property to civil forfeiture have not been charged with a crime, but government officials usually keep the seized property. H.R. 1916, known as Hyde's Bill, provides that either lack of knowledge or lack of consent by a property owner is sufficient for an "innocent owner" defense if the owner took reasonable steps to prevent illegal use of the property.[81]

1. Securities Laws

Where in a general partnership management functions are ceded to one or more persons, or where there is a limited partnership, the interest in the partnership may be deemed to be a security. The issue of whether or not an interest is deemed a security depends upon whether it falls within the meaning of an "investment contract" within the scope of the securities laws. The meaning of an "investment contract" was analyzed in *Securities and Exchange Commission v. W.J. Howey Company*[82] as a transaction in which a person invests his or her money in a common enterprise and is led to expect profits from the efforts of the promoter or a third party. This somewhat Marxist analysis was tempered by later cases and the test now seems to be one of whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise—i.e., the "efforts of others" or "lack of control" requirement.[83] If the investor realizes profits from the efforts of others or does not exercise control over the enterprise, then the interest will be deemed to be a security.

In that event, the Securities Act of 1933 (registration or exemption), the Securities Exchange Act of 1934 (anti-fraud rules) or blue sky restrictions (state securities laws) such as the New York Real Estate Syndication Act, may be applicable. Pertinent parts of these statutes may require disclosure of the entire workings of the transaction, registration and the payment of filing fees.

2. Disclosure Requirements for Foreign Acquisition of Corporate Interests

The Domestic and Foreign Investment Improved Disclosure Act of 1977,[84] constituting the Williams Act amendments to the Securities Exchange Act of 1934, requires that the acquisition of a foreign beneficial interest in United States corporations in excess of 5 percent be reported to the Securities and Exchange Commission, to the issuer of such securities and to any exchange on which such class of securities is traded. The disclosure requirement also applies to any person or group making a tender offer that would result in the ownership of more than 5 percent of any class of any such securities.

3. Antitrust Laws Affecting Property Acquisitions; the Hart-Scott-Rodino Act

The Hart-Scott-Rodino Antitrust Improvements Act of 1976[85] and Regulations, Statements and Interpretations Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976[86] apply potentially to acquisitions of real estate affecting interstate commerce if the "size of person" and "size of transaction" tests are met.

The size of person test is met generally if (1) one party to the transaction has annual net sales or total assets of $100 million or more (counting all companies under unified control); and (2) the other party has annual net sales or total assets of $10 million or more (counting all companies under unified control).[87] "Control" is broadly defined and includes both direct and indirect control.[88]

The size of transaction test is met if, as a result of the acquisition, the acquiring person would hold (1) 15 percent or more of the voting securities or assets of the acquired entity, or (2) an aggregate total of the voting securities and assets of the acquired entity in excess of $15 million.[89] Special rules apply with respect to the formation of corporate joint ventures because of the definition of control.[90]

Exemptions include (1) acquisitions of realty transferred in the ordinary course of business or (2) acquisitions, in the ordinary course of business, of the voting securities of an entity whose assets consist or will consist solely of real property and assets incidental to the ownership of real property (such as cash, prepaid taxes or insurance, rental receivables and the like).[91]

Complex questions arise depending upon whether the land is raw land, whether it is income producing, and whether the use is to be changed. The Federal Trade Commission staff has taken the position that all acquisitions of office buildings and residential apartment buildings are exempt from the act,[92] but the acquisitions may nevertheless be subject to the impact of the act.

4. Tax Filing Requirements for Resident Alien Officers and Directors

A nonresident alien who acts as an officer or director of a corporation owning United States real estate is required under Internal Revenue Code sections 861, 862, and 872 (I.R.C.) to file personal tax returns if the company is a United States corporation, even if no compensation is paid. Such persons must also file if their income, even if paid abroad, is for services rendered in connection with a United States trade or business.

III. IITSA—International Investment and Trade in Services Survey Act of 1984

A. The Reporting Requirement

Originally known as the International Investment Survey Act of 1976 (IISA), as amended by the Foreign Direct Investment and International Financial Data Improvement Act of 1990,[93] IITSA requires a report to be filed with respect to every "business enterprise" subject to U.S. jurisdiction, including real estate, in which "foreign persons" have a direct or indirect pecuniary or voting interest of more than 10 percent.[94] This law reflects congressional concern regarding the amount of foreign investment in the U.S., particularly in U.S. farmland. The U.S. policy is still basically one of "hands off" (nothing is intended to restrain or deter foreign investment in the United States),[95] but here the U.S. has indicated it wants to know the magnitude of the investment.

B. What Constitutes a "Business Enterprise"?

In determining whether the requirements of a U.S. business enterprise (BE) have been met, beneficial, not record, ownership is the basis of the reporting requirements.[96] Any organization, association, branch or venture which exists for profit making or otherwise to secure economic advantage, and most owners of real estate,[97] are covered by the act. Residential real estate held for personal use (by an individual or corporation) is excluded.[98]

C. What Constitutes a "Foreign Person"?

A foreign person is a non-U.S. resident or a person subject to the jurisdiction of a country other than the United States. Individuals, corporations, partnerships, associations, estates, trusts, organizations and governments can be "foreign persons."

Other business relationships may also qualify an entity as a foreign person. An affiliate—a business enterprise located in the United States which is directly or indirectly owned or controlled more than 10 percent by a foreign person—would satisfy the foreign person requirement.[99] A U.S. entity may be a "foreign person" if it acts as an intermediary (trust or agent) for the benefit of a foreign "ultimate beneficial owner" (UBO) who is not more than 50 percent owned or controlled by another person.[100] Any "associated group" of two or more of the foregoing may be foreign persons if, by the appearance of their actions, by agreement or by an understanding, they exercise their voting privileges in a concerted manner to influence the management of a business enterprise.[101]

D. Exemptions

Under some circumstances, a business enterprise may be able to avoid the requirements of the International Investment and Trade in Services Survey Act. For example, IITSA may not apply where (1) direct or indirect ownership or control by a foreign person in the U.S. business enterprise is less than 10 percent; or (2) where acquisition cost is less than $1 million (inclusive of mortgage debt) and the acquisition does not involve more than 200 acres (if, however, the acquisition involves more than 200 acres, reporting is required even if the cost is less than $1 million); or (3) where the property is residential real estate held for personal use (not profit-making purposes) including real estate held by a corporation whose shareholder occupies the property.[102]

Note that in order to obtain the exemption, a report must nevertheless be filed. It contains only minimal information and is filed in Supplement C to Form BE-13.

E. Transactional Reporting Requirements

According to the instructions on Form BE-13, within 45 days of the event a report must be filed in connection with a foreign person's direct or indirect acquisition, establishment or purchase of a U.S. enterprise, including a business segment, operating unit or real estate (other than real estate purchased for personal use) of a business enterprise. The acquisition of a 10 percent or more voting interest in the U.S. enterprise is sufficient to trigger the reporting requirement.[103]

Form BE-13 must be filed by either (1) the U.S. business enterprise, business segment or operating unit that has been established or partially or totally acquired; or (2) the existing U.S. affiliate which established or acquired the U.S. business enterprise; and each foreign parent or other U.S. affiliate that is itself a party to the transaction.

Form BE-14 should be filed by any U.S. person who assists or intervenes[104] in the acquisition of a U.S. business enterprise by a foreign person, or who enters into a joint venture with a foreign person (Form BE-14), if that person knows of foreign involvement in the transaction or has reason to believe that the acquiring person may be a foreign person and that person does not have a reasonable basis to believe that the transaction is being reported on Form BE-13. This includes an intermediary or real estate broker but does not include an attorney acting solely in a title closing or settlement capacity. One who "assists or intervenes" is a U.S. person, including but not limited to, an intermediary, a real estate broker and a brokerage house, who assists or intervenes in the sale to, or purchase by, a foreign person or a U.S. affiliate of a foreign person, of a 10 percent or more voting interest in a U.S. business enterprise including real estate.[105]

An exemption may be possible if the cost of the acquisition or the assets of the acquired or established enterprise total $1 million or less and 200 or fewer acres of U.S. land are involved in the transaction, but an exemption claim, Form BE-13 must be filed to obtain the exemption.

Reporting of bearer share corporate ownership or ownership through a trust or other proxy is not deemed compliance with the law.[106] Disclosure of the ultimate beneficial owner is required. If a company in the foreign chain has publicly traded bearer shares, identification of the ultimate beneficial owner may stop with identification of the company whose capital stock is represented by such bearer shares.

F. Required Filing of Periodic Reports

Form BE-605 is a quarterly report of transactions and accounts of a U.S. affiliate with its foreign parent. The report is required of every U.S. business enterprise (except an unincorporated bank)[107] in which a foreign person owned a 10 percent or greater voting interest at any time during the reporting period. Items to be reported include a foreign parent's equity in the U.S. affiliate and information regarding direct payments, receipts and intercompany debt balanced between a foreign parent and its U.S affiliate.[108]

Exemption from the BE-605 filing requirement may exist for a U.S. affiliate that is indirectly foreign owned and has no direct transactions with a foreign parent at any time during the year, provided a claim for exemption for filing is or has been filed. A further exemption exists for U.S. affiliates whose total assets, annual sales or gross revenues, and annual net income (or loss), do not exceed $20 million, positive or negative. A certification to the foregoing is nevertheless required. A branch or agency of a foreign company is not required to file a BE-605.[109]

G. Annual Reporting Requirements

Form BE-15 Annual Report is the annual survey of foreign direct investment in the United States. Form BE-15 must be filed annually (e.g., by May 31, 1997, for the 1996 fiscal year) by each non-bank U.S company in which a foreign company owns or controls, directly or indirectly, more than a 10 percent voting interest. Form BE-15 must be filed either in long or short form. A long form (LF) is required if, in a given year, total assets, sales or revenues, or net income exceeds positive or negative $20 million. The short form (SF) must be filed when a non-bank affiliate is not required to file a long form and if the total assets, sales or gross operating revenues, or net income after taxes exceeds positive or negative $10 million.

H. Penalties for Failure to File

Failure to file can result in a fine of $2,500 to $24,000, injunctive relief, or both. The willful failure to file can result in a fine not to exceed $10,000, imprisonment for up to one year, or both.[110]

I. The Requirement of Confidentiality of Reported Information Against Foreign Governments

Transmission of survey information to foreign governments and disclosure under the Freedom of Information Act is prohibited.[111] Based upon the prohibition contained in section 3104(c), providing that no person can compel the submission or disclosure of any report or constituent part thereof without the consent of the person who maintained or furnished the report, several requests for information under the Freedom of Information Act have been denied.

In 1982, the American Jewish Congress was denied a Freedom of Information Act request under IISA when it sought to obtain from the Department of Treasury a copy of a document containing the most recent aggregate figures showing the amount of moneys in United States banks deposited by, and the amount of Treasury Bills owned or held by, foreign persons from three Arab countries—Saudi Arabia, Kuwait and the United Arab Emirates. The United States District Court for the District of Columbia sustained the Treasury Department's assurances to foreign countries that the confidentiality of their investments in the United States will be maintained and continued.[112]

The Foreign Affairs Subcommittee was also refused information concerning former Philippines President Marcos's United States investments.[113]

IV. AFIDA—The Agricultural Foreign Investment Disclosure Act of 1978[114]

Pursuant to AFIDA, which became effective on February 2, 1979, any foreign person who acquires or transfers an interest (other than a security interest) in U.S. agricultural land must file a report with the U.S. Secretary of Agriculture.[115]

The purpose of AFIDA is to enable the United States to collect sufficient data to determine the extent of foreign investment in U.S. agricultural land and its effect on family farms and rural communities.

According to "Foreign Ownership of U.S. Agricultural Land in

1993," in *RTD Updates: Foreign Landownership, U.S. Dept. of Agriculture Economic Research Service*, No. 1 (April 1994), foreign ownership of agricultural lands has remained constant at about 1 percent for some time. The amount of foreign ownership varies from zero in Rhode Island to approximately two-and-a-half-million acres in Maine where there is significant Canadian ownership of timberland. The British, Canadians and Germans are the largest investors.

The definition of a "foreign" person includes an individual, corporation, partnership, estate, trust, institution, association or "other" organization which is:

1. A non-U.S. citizen;
2. A non-permanent resident who is not paroled into the U.S under the Immigration and Nationality Act (e.g., a person residing in the U.S. on the basis of a treaty investor visa, treaty trader visa or visitor's visa);
3. An organization formed under foreign law or a U.S. organization whose principal place of business is outside the U.S., or
4. A U.S. organization where more than 10 percent is controlled by foreigners. If no single foreign owner or coalition of foreign owners acting together holds directly or indirectly a 10 percent or more equity interest, then the foreign persons do *not* hold "significant interest or substantial control" unless, in the aggregate, they hold a 50 percent interest.

The phrase "acquires or transfers" presumably covers purchase, gift and inheritance. Security interests and mineral interests (e.g., interest in oil and gas leases) are excluded.[116] Conversions and changes in status are reportable, including: the conversion of land from non-agricultural to agricultural,[117] a change of status from a foreign person to a U.S. person holding a reportable interest in agricultural land[118] and ownership by a foreign person of a reportable interest on February 1, 1979 (AFIDA's effective date).[119]

U.S. agricultural land includes: timberland, ranchland and cropland; idle lands if the last use within the last five years was agricultural; leaseholds longer than ten years; and easements and rights-of-way unless used for non-agricultural purposes. U.S. agricultural land does *not* include: contingent future interests, or non-contingent future interests which do not become possessory upon the termination of the present possessory estate; land less than ten acres in size from which the land products are less than $1,000 in gross sales and are produced for the personal or household use of the person holding the interest; or security interests and mineral interests (*see above*).

A triplicate report, Form FSA-153, is due within 90 days of acquisition of the land at the local (county) Farm Service Agency (FSA) office where the tract of land is located or administered (Form FSA-153). The information is submitted to the Department of Agriculture, which files annual reports of the data collected.

AFIDA reports must include specific information: (1) the identity of the foreign person; (2) the type of interest, or consideration given; (3) the date of acquisition and agricultural purpose for which the foreign person intends to use the land; (4) a legal description of the land, including acreage; and (5) the identity of the investor's "representative" who is completing the form.

The penalty for the knowing submission of a false or inaccurate report is 25 percent of the fair market value (FMV) of the interest in the land. The penalty for a late filing is one-tenth of 1 percent of the FMV of the interest in the land for each week that the violation continues, up to a maximum of 25 percent of the FMV of the land.[120]

While ownership is nominally not traceable beyond the third tier, the Secretary of Agriculture may require the reporting entity to identify any person holding that person's equity. Moreover, the information is available for public inspection, and it is available to a treaty partner under a mutual assistance treaty such as Friendship, Commerce and Navigation (FCN) treaty or under an Income Tax Treaty (e.g., Cayman Islands, Liechtenstein, the Netherlands Antilles, Panama and Switzerland).

V. FIRPTA—Foreign Investment in Real Property Tax Act of 1980[121]

A. Generally

The purpose of FIRPTA is to tax foreign investors in U.S. real property on the same basis as similarly situated U.S. real estate investors are taxed. It is not technically a disclosure statute.

Section 1445 of the Internal Revenue Code imposes a 10 percent withholding tax on amounts realized upon the disposition of U.S. real property interests (USRPI) by foreign investors.

The earlier scheme of enforcement through extensive disclosure or, alternatively, security agreements with the Internal Revenue Service, was ineffective. Workable regulations were never released and few security agreements were consummated. The responsibility now for enforcement is primarily with the *transferee, not* with the realtor nor with an intermediary. Although section 6039C creates authority for the Internal Revenue Service to require reporting at a future date, there are no disclosure or reporting requirements at present.

B. Withholding Provisions

Section 1445 sets forth specific deducting and withholding provisions for the transferor of a USRPI. Several important exceptions to the withholding provisions should be noted however.

There is an exception to the withholding provisions if the transferor provides the transferee with an affidavit stating that the transferor is a non-foreign person. A non-foreign certification, either from an individual or from an entity, should be part of every real estate transaction. It must be retained for five years after the year in which the transfer occurs. Such a certification is not used, however, for the residential exception.

The transferee of an interest in a non-publicly traded U.S. corporation receives an affidavit from the corporation that the corporation is not and has not been a U.S. real property holding corporation (USRPHC) during the applicable period. The applicable period is the shorter of (1) the period following FIRPTA's general effective date in 1980 or (2) the five-year period ending on the date of disposition of the stock or other interest. The affidavit is made under penalty of perjury. Therefore, a transferee of non-publicly traded stock in a U.S. corporation may be liable for withholding unless he or she obtains either a non-foreign affidavit or a non-USRPHC affidavit from the transferor.

Disposition of a residence where the consideration is less than $300,000 and where the transferee intends to use it as his or her principal residence is exempt—i.e., where the transferee at the time of transfer has a definite plan to reside at the property for at least 50 percent of the number of days the property is in service during each of the first two 12-month periods following the date of transfer. If the residency requirement is not met, the transferee will become liable for failure to withhold. Disposition of stock regularly traded on an established securities market is also exempt.

The transferor may obtain a qualifying statement from the Internal Revenue Service that he or she is exempt from tax, has provided adequate security for the payment of tax or has made arrangements with the Service to pay the tax.

C. Agent Liability—Internal Revenue Regulation § 1.1445-4

Agents have a duty to provide notice to transferees of false certifications or statements.[122] "Agent" is widely defined by section 1445 to include any person representing either the transferor or the transferee in negotiating or settling a transaction. Any agent failing to give the required notice will be held liable for the tax, limited to the amount of compensation he or she derives from the transaction.[123]

D. Revisions to § 6039C

The revised section 6039C, retroactive to 1980, repealed earlier reporting requirements and substituted simplified reporting requirements. Section 6039C affects only "direct" investors in USRPIs, and eliminates disclosure up the chain of ownership.

The foreign person holding a "direct investment" must disclose his or her name, address and a description of the USRPI,[124] if (1) the foreign person did not engage in trade or business during the calendar year *and* (2) the FMV of the USRPI "directly" held was greater than $50,000 during the year.[125]

"Directly" seems to apply only if the disposition would be taxable under FIRPTA—no look-through. There is no longer a need to disclose shareholders of foreign corporations. Two attribution rules do, however, apply to (1) a USRPI held by a partnership, trust or estate which is treated as owned proportionately by partners or beneficiaries and (2) a USRPI held by a spouse or by a minor child or an individual which is deemed held by the individual.[126]

E. Penalties

The Tax Reform Act of 1984 contains no special penalties for failure to file, withhold or pay the tax. Normal penalties under the Internal Revenue Code are applicable—payment of the tax which should have been withheld plus interest and penalties, both civil and criminal.

F. Use of Information—*Not* Confidential

Information is intended to be exchanged between the United States and its tax treaty partners. Such broad exchange of information provisions could have a drastic effect on the investor in the investor's home country. Absent a treaty, information may be exchanged as an accommodation to a foreign government, even though not legally authorized.

VI. TEFRA—The Tax Equity and Fiscal Responsibility Act of 1982[127]

Through I.R.C. section 6038A, any domestic corporation which is 25 percent or more foreign owned must file an annual informational return which must detail "transactions" with related parties. An activity may be a "transaction" at any of the phases of planning, arranging or consummation. An exception is made for settlement officers and clerical personnel.[128] Under section

6038C, the same is true of foreign corporations involved in a trade or business within the U.S. during the taxable year.

A corporation is 25 percent foreign owned if at least 25 percent of the total voting power of all classes of stock entitled to vote or at least 25 percent of the total value of all classes of stock of a corporation are owned at any time during a taxable year by one person (designated as a 25 percent shareholder).

A "related party is any 25 percent foreign shareholder or any person related to the reporting corporation or to a 25 percent foreign shareholder of the corporation. A "foreign person" includes any non-resident alien or foreign corporation, partnership, estate or trust.

Form 5472 identifies the party, the nature of business, the country of organization, relationships, transactions and related parties.

Failure to file results in a penalty of $10,000.[129] Failure to file after notice results in greater penalties, not to exceed an additional $30,000.[130]

While the form is confidential, it is open to inspection by or disclosure to state tax authorities. It is also available to foreign governments pursuant to relevant tax treaties.

From time to time, attempts have been made to increase the existing reporting requirements concerning foreign investment in the United States. One such attempt, last tried in 1989, was the so-called "Bryant Amendment." While it never became law, it bears mention because the political policies which prompted it may again come into fashion, particularly with future political swings in the United States executive and legislative branches and with mood swings in the traditional United States "open door" policy toward foreign investment.

The Bryant Amendment would have required the reporting of a "significant interest" and of a "controlling interest" acquired by foreign persons in U.S. properties and business enterprises. A "significant" interest meant any equity or ownership interest exceeding 5 percent of the total interest in a United States business that has, or United States real property that comprises, assets in excess of $5 million, or recent annual gross sales in the United States in excess of $10 million. A "controlling interest" meant any equity or ownership interest exceeding 25 percent of the total interest in a business enterprise with United States assets or recent annual gross sales in the United States exceeding $20 million.

The information to be disclosed included address, nationality, description of the legal structure, industry involved, date of acquisition, size of interest and price paid. Failure to comply would have resulted in fines and imprisonment harsher than those contemplated by either IITSA or AFIDA.

VII. Summary and Conclusions

It is not difficult to posit a simple fact pattern which would bring into play several disclosure statutes. Assume that a New York holding corporation owns an interest in United States agricultural land which includes an easement for ingress and egress to a vineyard. The corporation is 50-percent owned by foreign persons, and the foreign shareholder persons sell their interest in the corporation to another New York corporation.

IITSA applies because the foreigners own more than a 10 percent interest in a U.S. business enterprise. AFIDA applies because the corporation owns an access easement to the vineyard, an interest in U.S. agricultural land. FIRPTA applies to the sale because it is a sale of shares by foreign investors; the seller is foreign and the buyer becomes the agent of the U.S. government to collect the 10 percent withholding tax. TEFRA applies because the corporation is a domestic corporation with more than 25 percent owned by a foreign person. The U.S. advisor (one who aids or assists in the acquisition under IITSA, one who does not provide the required notice to the transferee under FIRPTA) will be very sensitive to the situation and to his or her liability for reporting the transaction, despite the foreigner's aversion to having any disclosure made. A few comparisons are in order.

A. Foreign Persons Who Must Disclose Ownership Interests

In addition to any state requirements, there are federal minimum threshold ownership requirements:

IITSA—10 percent of the business enterprise

AFIDA—an interest in U.S. agricultural land

FIRPTA—has no minimum or maximum ownership requirements, and

TEFRA—25 percent foreign ownership of a domestic corporation or foreign corporation involved in a U.S. trade or business.

B. Foreign Persons Defined

Foreign persons are separately defined in each statute: alien vs. non-alien; citizen vs. non-citizen; resident vs. non-resident or resident alien; permanent resident vs. non-permanent resident; organized under U.S. laws vs. organized under foreign laws; principal place of business inside the U.S. vs. principal place of business outside the U.S.; controlled by foreigners vs. non-controlled by foreigners. Obviously each statute must be examined for its own peculiar requirements:

IITSA refers to a non-resident of the United States or one subject to the jurisdiction of a country other than the United States.

AFIDA refers to a non-U.S. citizen, a nonpermanent resident, a company organized under foreign law or a U.S. organization with its principal place of business outside the United States *or* one more than 10 percent controlled by foreigners.

FIRPTA defines a foreign person by what that person *is not*: One who (1) holds a U.S. tax identification number; (2) U.S. citizen; (3) U.S. resident alien; (4) organized under a U.S. or state law; (5) estate or trust whose income is subject to U.S. income tax (watch the special distribution rules).

TEFRA refers to a non-resident alien or foreign corporation, partnership, estate or trust.

Foreign persons include direct investors and indirect investors even though there is no general requirement to go up the chain of ownership. The term would include those who control or own a foreign corporation but would not include a subsidiary of that foreign corporation which was formed under the laws of one of the states in the United States. Foreign persons include all kinds of entities: persons, partnerships, corporations, estates and trusts.

The definition of foreign persons includes attribution rules:

IITSA affiliate (a business enterprise located in one country which is directly or indirectly owned or controlled more than ten (10%) percent by a foreign person and a coalition of foreign owners, none of whom owns more than ten (10%) percent, but who together own more than fifty (50%) percent; the IITSA U.S. intermediary and associated group; and TEFRA related party (more than twenty five (25%) percent).

C. Penalties for Failure to Disclose

Several statutes contain certain levels of outright prohibitions against foreign ownership of communications, energy sources, those which might impair national interests, and U.S. territories and public lands. Although ownership of natural resources are usually not prohibited, foreign ownership is often restricted and regulated. The Hart-Scott-Rodino Act imposes antitrust considerations.

Criminal and civil penalties are imposed for violating the Bank Secrecy Act, the money laundering and forfeiture statutes, IITSA, AFIDA (fines up to 25 percent of the fair market value of the land); FIRPTA (usual Internal Revenue Code penalties, payment of the tax plus interest and penalties); and TEFRA (monetary fines).

D. Confidentiality or Use of the Information Disclosed

IITSA (business enterprise). The information disclosed *is* confidential and has withstood freedom of information demand. Intra-governmental transfers are permitted, however, and the fear exists that the information may be disclosed informally or through formal, annual reports.

AFIDA (real property). The information disclosed *is not* confidential. It is also available through treaty programs, e.g., friendship, commerce and navigation treaties; income tax treaties; and estate tax treaties.

FIRPTA (income tax). The information disclosed *is not* confidential. The information may be available through tax treaty exchanges and informal "accommodations."

TEFRA (income tax). The *form is* confidential but it is open to state tax authorities and open to foreign countries through relevant tax treaties. The lack of confidentiality of information disclosed is a deterrent to disclosure in the first place, to complete disclosure and to more widespread foreign investment in the United States.

E. Suggestions for the Promotion of Compliance with Disclosure Requirements

Know the relevant statutes and case law and require compliance. Begin with relevant state law. Understand the liability of an advisor to a foreign person if the foreign person does not comply. An "advisor" includes the manager of property, a trustee, an agent for a foreign person (FIRPTA); an attorney who advises the foreign person; and a representative who completes the form (AFIDA) or a representative (broker) who does not complete the form.

Additional suggestions include indemnification of the agent by the principal and exoneration of the agent by the principal.

F. Levels of Compliance

Although there are apparently no studies which discuss the levels of compliance with disclosure laws, some anecdotal information exists among those who regularly advise foreigners on investments in the United States. One must also be constantly on the alert for changes in the laws and for new or altered disclosure requirements buried in seemingly obscure statutes, regulations and case law.

Endnotes

1. *See* Kirby Scarborough, *The Foreign Investor in the United States: Disclosure, Taxation and Visa Laws*, 19 Int'l Law. 85 (1985).
2. *See* Jeffrey P. Bialos, *National Security Considerations in International Commercial Agreements: Foreign Investment Rules and Export Controls*, International Commercial Agreements at 637, Practising Law Institute (1994).
3. *See* Frantz & Collins, *An Overview of Foreign Investment in U.S. Real Estate, Foreign Investment in U.S. Real Estate, A Comprehensive Guide 1*, Real Prop. Prob. & Trust Law Section, American Bar Association (1990); *see also* Committee to Study Foreign Investment in the United States of the Section of Corporation, Banking and Business Law of the American Bar Association, *A Guide to Foreign Investment Under United States Law*, Law & Business 1-22 (1979).
4. *See, e.g.*, Minn. Stat. § 500.221(2). Such a person may, however, acquire such ownership by devise, inheritance or as security for indebtedness, among other things, provided it is disposed of within three years after such acquisition. *See* Minn. Stat. § 500.221(2)(1). Although permitted to own such an interest, a permanent resident alien must, however, annually register the ownership. *See* Minn. Stat. § 500.221(1a); *see also* Iowa Code § 567.3 (having similar exceptions); Mo. Rev. Stat. § 442.586; N.D. Cent. Code § 47-10.1-02. Such a statute is not unconstitutional under North Dakota law. *See Asbury Hosp. v. Cass County*, 7 N.W.2d 438 (1943); *Asbury Hosp. v. Cass County*, 16 N.W.2d 523 (1944).
5. *See, e.g.*, Ark. Code. Ann. §§ 77-2201 to 77-2211; Fla. Stat. Ann. § 607.325; Ill. Comp. Stat. Ann. ch. 5, §§ 601-608; Me. Rev. Stat. Ann. tit. 7, §§ 33-36; Mo. Ann. Stat. § 442.592; N.C. Gen Stat. §64-1.1; N.D. Cent. Code § 47-10.1-05; Ohio Rev. Code § 5301.254; Pa. Stat. Ann. tit. 68, § 45; S.D. Codified Laws §§ 47-9A-16, -17, -19; Va. Code Ann. § 3.1, -22.24.
6. Seeking to protect the family farm and to recognize the threat to the family farm by conglomerates in farming, South Dakota prohibits both a foreign and domestic corporation, except as provided, from owning, leasing, holding or otherwise controlling agricultural land to be used in the business of agriculture. *See* S.D. Codified Laws § 47-9A-1.
7. *See* N.Y. Real Prop. Law §§ 10(2), 11.
8. *See* Real Prop. Law § 15.
9. *See* Real Prop. Law § 10(3).
10. *See* N.Y. Surr. Ct. Proc. Act 2218(i)(a).
11. *See* N.Y. Bus. Corp. Law § 1304(b). In the United States, a "foreign corporation" in one state may mean a corporation formed under the laws of another state or a corporation formed under the laws of a foreign country. Similarly, a "domestic corporation" in one state may mean a corporation formed under the laws of another state or a corporation formed under the laws of a foreign country. Care must therefore be taken in determining the context of the words "foreign" and "domestic."
12. Bus. Corp. Law § 1307.
13. *See* N.Y. Ltd. Liab. Co. Law § 304.
14. *See Restatement (Second) Conflict of Laws* §§ 2, 100 (Supp. 1988).
15. *See Ruta Exportaciones Agropecuaries Limitada v. Overseas Fruit Corp.*, 400 N.Y.S.2d 538 (App. Div. 1978); *Restatement (Second) Conflict of Laws* § 98 (Supp. 1988).
16. *See* Bus. Corp. Law § 1304(b).
17. Bus. Corp. Law § 1307.
18. *See* Ltd. Liab. Co. Law § 304.
19. *See Restatement (Second) Conflict of Laws* §§ 2, 100 (Supp. 1988).
20. *See Ruta Exportaciones Agropecuaties Limitada v. Overseas Fruit Corp.*, 400 N.Y.S.2d 538 (App. Div. 1978); *Restatement (Second) Conflict of Laws* § 98 (Supp. 1988).
21. 12 U.S.C. § 95a.
22. 31 C.F.R. § 500.
23. *See* 31 C.F.R. § 500.201.
24. *See generally Industrial Security Regulation (ISR)* published by the Department of Defense for the regulations. Gruson, *Reporting Requirements for Foreign Investments in the United States,* International Commercial Agreements 707 (Practising Law Institute 1994).
25. 48 Stat. 1064, (codified in scattered sections of 47 U.S.C. §§ 151-158, 201-226, 301, 302, 302a-312, 313-333, 351-353a, 354, 354a, 355-362, 381-386, 390-392, 392a, 393, 393a, 394-399b, 401-416, 501-505, 506, 507-510, 521, 522, 531-533, 541-547, 551-559, 601, 602, 603-613, and Amendments of 1952, 1960, 1978, 1982, and 1996).
26. 47 U.S.C. §§ 701-744.
27. 47 U.S.C. § 734(d).
28. 42 U.S.C. § 2133(d).
29. 15 U.S.C. § 797(e) (as amended by Pub. L. No. 99-495 § 3(a), 100 Stat. 1243).
30. Omnibus Trade and Competitiveness Act of 1988, 50 U.S.C. §§ 2170 *et seq.*; *see also* 31 C.F.R. § 800 (giving reporting and filing requirements).
31. *See* 50 U.S.C. § 2170(b).
32. *See* 50 U.S.C. § 2170(e)(2).
33. *See* 5 U.S.C. § 552.
34. *See* 50 U.S.C. § 2170(c).
35. *See* 50 U.S.C. § 2170(f).
36. *See* 50 U.S.C. § 2170(g).
37. *See* 50 U.S.C. § 2170(d).
38. *See* 50 U.S.C. § 2170(e).
39. Act of Mar. 3, 1887, ch. 340 § 1, 24 Stat. 476 (codified at 48 U.S.C. § 1501-8 (1987)).
40. *See* 48 U.S.C. §§ 1502, 1503.
41. *See* 48 U.S.C. § 1501.
42. *See* 48 U.S.C. § 1508.
43. *See* 48 U.S.C. § 1507.
44. *See* 48 U.S.C. §§ 1509-1523.
45. 30 U.S.C. § 22.
46. 30 U.S.C. § 181.
47. 30 U.S.C. §§ 1001-1025.
48. 30 U.S.C. § 1015.
49. 43 U.S.C. §§ 1331 *et seq.*
50. 30 C.F.R. § 281.4.
51. Pub. L. 97-293, Reclamation Reform Act of 1982 and Rules and Regulations, 43 C.F.R. § 426.6(b)(1).
52. 49 U.S.C. §§ 40101-49101.
53. 49 U.S.C. § 44102; 14 C.F.R. § 47.2.
54. 31 U.S.C. §§ 5311-5322.
55. A "person subject to U.S. jurisdiction" is not defined in the statute. Presumably it means a "person," which is defined, who is subject to the laws of the United States. For example, in the money laundering context under the Bank Secrecy Act, U.S. jurisdiction refers to the extent to which U.S. law is applicable to the activities of foreign branches, foreign branches being branches of foreign domestic financial institutions. 31 U.S.C. § 5311(c)(2).
56. *See* Marshall J. Langer, *Practical International Tax Planning* 203 (European Edition 1987).
57. 18 U.S.C. §§ 1956, 1957.
58. *United States v. Herron*, 825 F.2d 50 (5th Cir. 1987).
59. 18 U.S.C. § 1956(f).
60. 935 F.2d 832 (7th Cir. 1991).
61. *See* 18 U.S.C. § 1956(f).
62. *See United States v. Brown*, 763 F. Supp. 1518 (D.C. Ariz. 1991), *aff'd on*

other grounds, 979 F.2d 1380 (9th Cir. 1991).

63. 18 U.S.C. § 1956(a)(1), (2).

64. 31 U.S.C. §§ 5311 *et seq.*

65. *See* 26 U.S.C. § 6050I.

66. *See United States v. Kaufmann*, 985 F.2d 884 (7th Cir. 1993).

67. *See United States v. Werbe*r, 787 F. Supp. 353 (S.D.N.Y. 1992).

68. *See United States v. Jewell*, 532 F.2d 697 (9th Cir. 1976) (*en banc*).

69. *See United States v. Connor*, 1991 U.S. App. LEXIS 25370 (6th Cir. 1991).

70. *See United States v. Isabel*, 945 F.2d 1193 (1st Cir. 1991).

71. *See United States v. Campbell*, 977 F.2d 854 (4th Cir. 1992).

72. *See United States v. Gallo*, 927 F.2d 815 (5th Cir. 1991).

73. *See United States v. Brown*, 944 F.2d 1377 (7th Cir. 1991).

74. *See United States v. Beddow*, 957 F.2d 1330 (6th Cir. 1992).

75. *See United States v. Jackson*, 935 F.2d 832 (7th Cir. 1991).

76. *See United States v. Stavroulakis*, 952 F.2d 686 (2d Cir. 1992).

77. *See* 18 U.S.C. §§ 981, 982.

78. *See* 18 U.S.C. § 984.

79. *See* 18 U.S.C. § 981(A)(2).

80. *See* 21 U.S.C. § 881.

81. Rhonda McMillion, *Fairness in Civil Forfeiture*, A.B.A. J., Nov. 1996, p. 102.

82. 328 U.S. 293 (1946).

83. Mark A. Sargent, *Limited Liability Company Handbook* 3-3 (1993).

84. 15 U.S.C. § 78(m).

85. 15 U.S.C. § 18(a).

86. 16 C.F.R. § 800-03.

87. *See* 15 U.S.C. § 18(a)(2).

88. 16 C.F.R. § 801.1(b).

89. *See* 15 U.S.C. § 18a(c).

90. *See* 16 C.F.R. § 801.40.

91. *See* 15 U.S.C. § 18a(c).

92. *See* David Alan Richards, *Reporting and Disclosure Requirements for the Foreign Investor in U.S. Real Estate*, 25 Real Prop. Prob. & Tr. J. 217, 240 (1990).

93. 22 U.S.C. §§ 3101-3108; 15 C.F.R. § 806.

94. 15 C.F.R. § 806.15(a)(1).

95. *See* 22 U.S.C. § 1301(c).

96. *See* 22 U.S.C. § 1302(6).

97. *See* 22 U.S.C. § 3102(6).

98. *See* 15 C.F.R. § 806.15, “Exclusions and exemptions” (a).

99. *See* 22 U.S.C. § 3102(8).

100. 15 C.F.R. § 806.15(a)(6).

101. Form BE-13, Instructions, I. Definition P., Associated Group.

102. 22 U.S.C. § 3102(3) defines a “person” to include a “partnership.” This has led to some speculation that a limited partnership is not included within the definition of a “person.” The better view is that a limited partnership is included within the definition because the definition of a “person” also includes any other organization, whether or not organized under the laws of any state.

103. 15 C.F.R. § 806.15(j)(3).

104. One who assists or intervenes: A U.S. person—including but not limited to an intermediary, a real estate broker and a brokerage house—who assists or intervenes in the sale to, or purchase by, a foreign person or a U.S. affiliate of a foreign person, of a 10 percent or more voting interest in a U.S. business enterprise including real estate. 15 C.F.R. § 806.15(j)(4).

105. 15 C.F.R. § 806.15(j)(4).

106. *See* 15 C.F.R. § 806.15(a)(6)(c).

107. Form BE-605, Transactions of a U.S. Affiliate, Except an Unincorporated Bank, With Foreign Parent, Reporting Requirements (Rev. 4-88).

108. *See id.*

109. *Id.*

110. *See* 22 U.S.C. § 3104(c).

111. 22 U.S.C. § 3104(c).

112. *See American Jewish Congress v. Department of the Treasury*, 549 F. Supp. 1270 (D.C.D.C. 1982), *aff’d*, 713 F.2d 864 (D.C. Cir. 1983).

113. Richards, *supra* note 92, at 230.

114. 7 U.S.C. §§ 3501-3508; 7 C.F.R. § 781. The state of Maine reporting requirement may be met by filing a report under AFIDA. *See* Me. Rev. Stat. Ann. tit. 7, §§ 33-36. Pennsylvania monitors compliance with agricultural land restrictions through AFIDA. *See* Pa. Stat. Ann. tit. 68, § 45.

115. 7 U.S.C. § 3501(a).

116. 7 C.F.R. § 781.3(i).

117. *See* 7 U.S.C. § 3501(d), 7 C.F.R. § 781.3(d).

118. *See* 7 C.F.R. § 781.3(c).

119. *See* 7 C.F.R. § 781.3(b)(1).

120. *See* 7 C.F.R. § 781.4.

121. I.R.C. §§ 861(A)(5), 897, 6039C, 6652(F) (1986).

122. Treas. Reg. § 1.1445-4(a).

123. Treas. Reg. § 1.1445-4(e).

124. I.R.C. § 6039C(a)(13)

125. I.R.C. § 6039C(b)(1), (2).

126. I.R.C. § 6039(C)(b)(3)(A), (B).

127. Pub. L. 97-248, 96 Stat. 325.

128. Treas. Reg. § 1.1445-4(f)(3).

129. *See* I.R.C. § 6038A(d)(1).

130. *See* I.R.C. § 6038A(d)(2).

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BERGMAN ON MORTGAGE FORECLOSURES . . .

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Publishing the Summons*

Will some grousing be entertained? Although judicial foreclosure in New York is always prone to offering frustration, one of the particularly irksome aspects is publication of the summons. Why publication exists at all, what happens when a lender is forced into this odious pursuit and what it means in the end will be the focus here.

Except in heavily litigated matters where motions, discovery or a trial are the reasons for delay (which in residential foreclosures are a minority anyway), a significant portion of the foreclosure case is consumed at the initial stage—service of process. This is one of the boring parts, but stay with us to make the point. If a borrower (or any necessary party) in the foreclosure is served with the summons and complaint by in-hand delivery to that person, the time to answer is, of course, 20 days. That is not bad. *But*, if the person is not home (or, if service is attempted at the place of business and the person is not there either), then the pleadings can be left with a person of suitable age and discretion. That, too, is fine, except that for this type of service, there must also be a mailing of the pleadings. Service is not complete until ten days after an affidavit of the delivery and the mailing is filed with the court.

As litigators know, there is yet more. When this method is used, the time to answer does not expire until *30 days* after service was completed, which, as mentioned, wasn't until 10 days after the affidavit was filed. So, 40 days is a virtual minimum time, and that doesn't account for whatever time it took to deliver the papers to the process server, however long it took the process server to go to the house or business and how many times the server had to visit before he or she found someone fitting the definition of suitable age and discretion.

The preliminaries are still not over. What if no one is ever home—which definitely can happen. Then the process server must attempt service at least three times before the fourth occasion, when the papers can be affixed to the door and then posted. This approach likewise suffers from the detainment of 30 days plus 10 days. Worse, when there are multiple defendants, one may be served on Monday—first triggering the seemingly interminable time periods—while another might not be served until Friday, with others served the week after.

Although not every case is a process-serving nightmare, the potential should be obvious. Dismayingly, this whole discussion was just an appetizer for the main course, the need to publish the summons—which leads to a proverbial catch-22. Because service by publication is so unwelcome (to be addressed in a moment), special efforts to avoid it are made. That means ever more diligent efforts to ferret out elusive defendants: seeking other or different addresses from the lender's files; employing a skip trace; "running" the social security number; inquiring of neighbors; and pursuing a forwarding address from the post office. The ironic result is that if the lender must ultimately publish after all, still more time was used up trying to avoid the delay publication imposes!

What, then, is so terrible about publication of the summons? Because setting the stage for this narrative was itself time consuming, let's shorten the verbiage here by presenting the points more tersely. Publication of the summons is unwanted because (in no particular order):

(1) It adds considerable time to the case.

(2) Counsel must prepare an order for publication, an affirmation in support and present evidence of all the efforts made to find the defendant(s) against whom publication is sought. That order must be submitted for signature, and even waiting for that could take many weeks at best.

(3) Once the order is signed—and received—publication ensues once a week for four successive weeks in *two* newspapers, thus creating still more delay.

(4) The publication order, proceeding on the theory that the party who couldn't be located might be dead, appoints a guardian *ad litem*. The guardian is entitled to a fee, and counsel must prepare a host of papers for that guardian (i.e., an answer, consent, affidavit, waiver; still more effort and expense).

(5) A part of this whole process is preparation of a supplemental summons, amended *lis pendens* and amended complaint, all because the caption of the case changes with all variety of unknown parties added. (This is called the omnibus clause.)

(6) Still another aspect is the naming of the state (and sometimes the United States of America) as a new party to the foreclosure for any estate taxes which may be due as against the missing party—not so surprising because that person might be dead!

(7) Remember those two newspapers that publish the summons for a month each? The court selects those. Counsel has nothing to say about it. But legal advertising in some papers is very expensive, sometimes $3,000 to $5,000 or *much* more.

(8) If counsel did all this work, *some* additional fee is required.

(9) And then there is the final insult. Service by publication in New York is *not* personal service. So, if the missing person was an obligor or guarantor, no deficiency judgment can be pursued against that person.

The mess is really somewhat more convoluted than we have noted here, but further emphasis should not be needed to make the point. Neither lenders/servicers nor their counsel want to encounter a need to publish the summons. Sometimes, though, it is just unavoidable.

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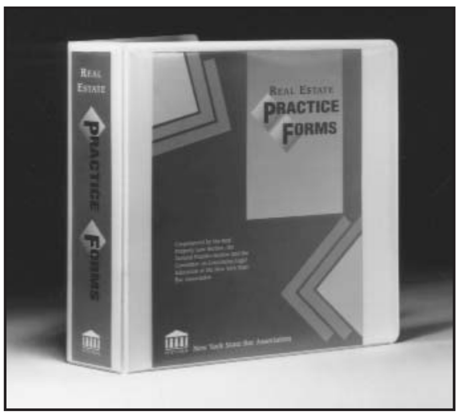

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