

Construction & Real Estate

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IN THIS ISSUE:

- | [Oklahoma Cracks Down on Appraisal Management Companies](#)
- | [Housing Industry May Suffer a Blow as Mortgage Banks Take It On The Chin](#)
- | [USGBC Announces New Programs](#)
- | [Case Notes](#)

OKLAHOMA CRACKS DOWN ON APPRAISAL MANAGEMENT COMPANIES By Jennifer L. Berry

Oklahoma is among a large number of states that have enacted a statutory process for registration and regulation of Appraisal Management Companies ("AMCs") in response to the recent economic crisis. Many policymakers point the finger at poor appraisals as one of the causes of the crisis, which were often times prepared for, or at the direction of, parties with a direct interest in the transaction, for example, loan originators, realtors, and builders.



In an attempt to divert the attention of policymakers elsewhere, many lenders began using AMCs for obtaining appraisals. The idea being that lenders could rely on a third-party to be objective, provide state-by-state databases and ensure the quality of the appraisals. In an effort to look attractive to lenders AMCs began to offer discounts on appraisals and promise unrealistic turnaround times, both of which led to lower quality appraisals. In some instances AMCs would hire out-of-state appraisers who, because of their lack of knowledge of the local neighborhood, produced useless appraisals that had to be redone.

In order to improve the quality of the appraisals performed in this state, and in turn the sustainability of the underlying property values, Oklahoma now requires that all AMCs register with the Oklahoma Real Estate Appraiser Board (the "Board"). The registration fee is \$1,000. In addition, AMCs must provide the Board with a contact person, evidence of good standing, and certain information about principals owning more than ten percent of the AMC. AMCs are prohibited from using or employing appraisers who have had their credentials refused, denied or revoked. All appraisers engaged by an AMC must have up-to-date credentials and be in good standing in the state. All fees charged by an AMC must be disclosed to its client, including fees paid to the appraiser.

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Crowe & Dunlevy's Construction Law Practice Group provides a comprehensive array of legal services to construction industry clients, including contractors, subcontractors, owners, developers, architects, engineers and sureties. Our attorneys have extensive experience in a wide variety of business and litigation matters covering all phases of real estate development and construction from property acquisition through project completion, including representation before both state and federal regulatory agencies and courts, and in mediation and arbitration proceedings:

Our Experience Includes:

- I property acquisition and financing
- I construction contract negotiation, drafting and administration, both within and outside of the AIA document regime
- I bid processes and disputes
- I building permits, zoning and land use
- I environmental permitting, compliance and remediation, including Brownfields development and voluntary cleanup programs for

The Oklahoma Appraisal Management Company Regulation Act (the "Act") also attempts to preserve the objectivity of appraisals by prohibiting AMCs from interfering with the appraisal process. No employee, partner or officer of an AMC is permitted to influence the development of an appraisal, whether by withholding payments or future business. AMCs are not to modify or otherwise alter a completed appraisal and must not use an appraisal submitted by an independent appraiser for another transaction.

Violations of the Act or the rules promulgated thereunder, as well as any fraudulent activity on the part of an AMC, could result in censure, suspension of registration or fines up to \$5,000.

While Oklahoma cannot insulate itself entirely from economic crises, it can create greater transparency in the operation of AMCs in order to protect its citizens and their property values.

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HOUSING INDUSTRY MAY SUFFER A BLOW AS MORTGAGE BANKS TAKE IT ON THE CHIN By Gerald L. Jackson

The long-simmering concerns in the housing industry of the potential repercussions of sloppy and sometimes nonexistent paperwork for securitized mortgages during the real estate boom years may finally be coming to fruition. A recent decision by the Massachusetts

Supreme Judicial Court in *U.S. Bank Association, Trustee v. Antonio Ibanez* (decided January 7, 2011), has cast doubt on thousands of foreclosures in Massachusetts and could indicate another problem facing the real estate industry in Oklahoma and other states trying to dig out of the market bust. The Massachusetts court struck down two foreclosures, finding that at the time the foreclosures occurred, neither bank had the power to foreclose because the assignments of the mortgages had not yet occurred.

The facts of the underlying cases are straightforward. After closing on the home loans, the mortgages involved were transferred through a series of assignments, many of which were executed "in blank," ultimately ending up pooled and securitized into mortgage backed securities. In the first case, U.S. Bank foreclosed on the Ibanez mortgage on July 5, 2007. However, it was not until more than one year later than the actual record holder of the Ibanez mortgage executed a written assignment to U.S. Bank. In the companion case, Wells Fargo foreclosed on a mortgage to Mark and Tammy LaRace on July 5, 2007. Again, over one year later, the assignment of the LaRace mortgage to Wells Fargo was actually executed.

Under non-judicial foreclosure proceedings in Massachusetts, both properties were foreclosed on and sold. Later, both U.S. Bank and Wells Fargo filed a form of quiet title action with the Massachusetts court to obtain declarations that the banks held clear title to the properties in fee simple. The lower court denied those requests and invalidated the foreclosure sales because it concluded the banks had no interest in the mortgages at the time of the notices of sale or foreclosure sales.

The unanimous Massachusetts Supreme Judicial Court relied on well-recognized and long-standing Massachusetts law in upholding the lower court's decision, holding that the statutory power to foreclose can be exercised only by the mortgagee and any effort to foreclose by a party lacking jurisdiction and authority to carry out a foreclosure is void.

The banks relied on four primary arguments to support their chain of title: 1) the mortgage securitization pooling and serving agreements ("PSAs") of the securitizations made the banks holders of the mortgages before the notices of sale and foreclosure sales; 2) the assignment in blank of mortgages by the mortgage originator evidenced the assignment and were effective; 3) as "holders" of the mortgage note, the banks had sufficient financial interest in the mortgages to allow them to foreclose; and 4) that post-sale assignments were customary in the industry.

As to the first argument, the court noted that although the promissory notes serve as financial instruments generating a potential income stream for investors in mortgage-backed securities, the mortgages securing those notes must still be treated as legal title to someone's home. After examining the securitization documents, the court concluded that the documents did not support the banks' chain of title. In the Ibanez mortgage, the court found the private placement memorandum for the securitization only provided that a trust agreement would be executed in the future and that U.S. Bank was unable to produce any schedule of loans and mortgages to the securitization, much less a schedule identifying the Ibanez mortgage. As a result, U.S. Bank could not prove that the Ibanez mortgage was one of the pooled mortgages in the securitization. Finally, U.S. Bank was unable to produce any evidence that the entity assigning the Ibanez mortgage to it

- environmentally challenged properties
- I bonding issues and mechanics' and materialmen's liens
- I construction contract disputes
- I construction failure, negligence and warranty claims
- I insurance coverage
- I professional malpractice claims

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actually held the mortgage – and thus, was able to assign it to U.S. Bank.

Similarly, Wells Fargo was unable to produce to the court a schedule from the securitization documents demonstrating that the LaRace mortgage was among the mortgages assigned to the PSA. Wells Fargo was also unable to demonstrate the entity that assigned the LaRace mortgage to it actually held the mortgage. The court concluded that the key in both cases was "that the foreclosing entity must hold the mortgage at the time of the notice and sale in order accurately to identify itself as the present holder in the notice and in order to have the authority to foreclose under the power of sale. . . ."

The court quickly dispatched the banks' remaining arguments. The court held that an assignment of a mortgage that does not name the assignee conveys nothing and, thus, the assignments of the mortgages in blank were void. Next, the court found that under Massachusetts law, the assignment of a note without a written assignment of the mortgage does not give the holder of the note the right to foreclose. Instead, the holder of the mortgage simply holds it in trust for the purchaser of the note. Finally, the court rejected the use of post-sale assignments based on custom and usage in the industry, stating that such custom and usage was misplaced because it was contrary to Massachusetts law. Although the court recognized that a "confirmatory assignment" could be valid, it "cannot confirm an assignment that was not validly made earlier or backdate an assignment being made for the first time. Where there is no prior valid assignment, a subsequent assignment by the mortgage holder to the note holder is not a confirmatory assignment because there is no earlier written assignment to confirm."

While it remains to be seen whether the reasoning of the *Ibanez* decision is adopted by other states, this decision could nonetheless cause more problems in an already struggling housing market. If the documentation problems highlighted here are wide-spread in the mortgage industry, as some fear, then chain of title issues could be yet another factor slowing down the foreclosure process and could cause a continued drag on a struggling housing industry. Banks' inability to process delinquent loans and clear out mortgages in default could further squeeze the mortgage market and prevent a robust housing market recovery. One thing is assured, however, *Ibanez* will not be the last court decision on this issue.

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USGBC ANNOUNCES NEW PROGRAMS

By Michael R. Pacewicz

Although eco-friendly or "green" construction continues to grow in popularity, currently only a small percentage of new construction consists of Leadership in Energy and Environmental Design (LEED) certified buildings. Two programs recently announced by the U.S. Green Building Council should make it easier, however, for builders and developers to obtain certification and thereby encourage more green construction. The new programs are aimed specifically at retailers and high-volume developers.

According to the USGBC, the LEED for Retail rating system grew out of a pilot program launched in 2007. A number of national retailers, including Bank of America, Best Buy, Kohl's, McDonald's, Starbucks, and Target participated in the pilot program and provided feedback.

The LEED for Retail rating systems seeks to address the distinct needs of retail spaces. Those needs include the ability to accommodate high occupancy, management of waste streams and high energy and water use, according to the USGBC. Some retailers may find that becoming LEED certified provides them with a competitive edge in attracting environmentally conscious customers.

The LEED Volume Program is intended to make the LEED certification process faster and more manageable for high-volume property developers. Such developers include large retailers, hotel and motel chains and local, state and federal governments. Banks, restaurants and convenience store chains might also benefit from the Volume Program. Essentially, any developer who constructs a large number of commercial buildings with identical or similar designs is a candidate for the program. According to the USGBC, the Volume Program's prototype-based approach enables developers to earn LEED certification faster and at a lower cost than would be possible with individual building reviews. While the program is currently limited to new construction, the USGBC plans to expand it to include existing buildings in 2011.

Although constructing buildings that qualify for LEED certification can increase costs, retailers and high-volume developers may find the USGBC's Retail and Volume programs appealing. LEED certified buildings can be cheaper to operate than non-certified buildings because certain green building concepts provide energy savings and increase the efficiency of water use. Proponents of



green building often argue that certified buildings are healthier places to work and can increase worker productivity.

Perhaps more important from the perspective of the retailer or high-volume developer, many local and state governments have either implemented or are considering implementing green building or LEED incentives. Such incentives include expedited permitting, density bonuses and tax credits. By coupling LEED tax credits with other tax incentives offered by local or state governments, retailers and developers may reap significant savings that help offset any increased costs associated with green construction.

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CASE NOTES

Diamond Sevens, L.L.C. v. Intelligent Home Automation, Inc., Oklahoma Court of Civil Appeals, October 22, 2010

This case arose out of a contract to install a home automation system in a house built for Garth Brooks and Trisha Yearwood. Diamond Sevens, L.L.C. ("Diamond Sevens"), a limited liability company in which Brooks was a principal, sued Intelligent Home Automation ("IHA") in Tulsa County District Court asserting various claims, including negligence and breach of warranty, when the automation system allegedly did not work properly. IHA filed a motion to dismiss and a motion to compel arbitration, arguing that a contract between the parties required that any lawsuits be brought in Payne County and also required that disputes be resolved through arbitration.

The district court denied both motions. The court found that the contract was between the general contractor, Larkin Company ("Larkin"), and IHA, and not between Diamond Sevens and IHA. The district court rejected IHA's argument that Larkin, by signing the contract with IHA, bound Diamond Sevens to the contract terms. The Court of Civil Appeals affirmed the district court's decision.

The appeals court first cited established Oklahoma law for the proposition that a general contractor is not a homeowner's agent when the general contractor engages subcontractors. The court then noted that IHA submitted its invoices to Larkin and payments to IHA were made by Larkin, not Diamond Sevens. Even though Brooks was actively involved in discussions with IHA about the automation system, that was not enough to change the relationship between IHA and Diamond Sevens. IHA was always a subcontractor, the appeals court found. The court stated:

The general contractor provides the link between the homeowners and subcontractors and it is normally the general contractor who has the contractual relationship with the owners. Working as a subcontractor, without more, does not bring about a contractual relationship with the homeowners, hence the need for IHA to establish the agency relationship between Larkin and Diamond in this case, something IHA failed to do.

The appeals court also rejected IHA's argument that Diamond Sevens ratified the contract, thereby becoming a party to it. IHA argued that Brooks was willfully ignorant of the contract, making him responsible for the arbitration agreement because he should have been aware of it but was not. The appeals court said that more than the usual lack of knowledge with which an ordinary homeowner operates when dealing with contractors and subcontractors is required to show that the homeowner ratified a contractor-subcontractor agreement.

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