ANews

President's Message

L.A. Confidential – Unmasked (No, this is not Fake News!)

Breaking news! – Critical details relating to the 2017 ACREL Annual Meeting have now been leaked. This is what we have learned from unnamed sources.

The Annual Meeting will be held at the brand new Intercontinental Hotel in downtown Los Angeles. If you have not already registered for this meeting and reserved your hotel room, you should do so soon because demand for this meeting is very strong. We have many great programs, events, and activities scheduled for Los Angeles, including:

• Gale Holland of the Los Angeles Times will join an all-star panel, led by Phil Nichols and Ira Waldman, exploring possible solutions to our nation's homeless crisis.

• Professor John Lovett and his team members will take us on a deep dive into easements. Learn how easements may change over time, including topics related to relocation by the servient estate owner and examination of how to draft easements to anticipate changing conditions and changes in infrastructure and technology

• Discover from Larry Preble and his panel how one of the world's biggest and most expensive new stadiums circumvented environmental laws and outmaneuvered NIMBY'S without significant public subsidies. Then take an exclusive behind the scenes tour of this facility, scheduled for completion in 2020. The stadium is going to be the centerpiece of a

continued on p. 2

IN THIS ISSUE

President's Message
continued from p. 1

298-acre sports and entertainment district in Inglewood, California.

• Learn from Larry Dudek and his team about the new 2017 AIA Suite of Contracts and receive practice tips for advising clients on negotiating the changes to the 2017 forms.

• Compare and contrast warehouse finance with other capital sources in a presentation by Gregg Loubier and his team members. Gain an understanding of a warehouse loan's legal structure, collateral requirements and exit strategies through the secondary markets, including in rated transactions, and the impact on the warehouse borrower's loan transaction.

• Mixed up about insuring mixed use projects? Mary Alexander's team will help clear up this confusion by outlining the layers of coverage in typical mixed use centers and discuss a realistic approach to self-insured retention limits.

• Seth Katz and his team will enlighten us on the ever changing and evolving retail marketplace as we learn to flourish in the omnichannel retail environment and address the fallout and failures of the retail evolution.

• Ken Jacobson and his team will provide their opinions on the UCC Article 9 security interest opinion as they analyze the assumptions, qualifications and diligence required to provide a UCC Article 9 security interest opinion and how the assumptions, qualifications and diligence may vary across types of collateral.

During the Business Meeting on Saturday, we will be presenting the Lane Award to Bill Dunn and Dick Goldberg in recognition of the exceptional service they each have provided to the public, the profession and the College. The Frederick Lane
continued on p. 3

Meetings Calendar

2017 Annual Meeting
October 19-22, 2017
InterContinental Hotel
Los Angeles, California

2018 Mid-Year Meeting
March 22-25, 2018
Waldorf Astoria
Orlando, Florida

2018 Annual Meeting
October 18-21, 2018
The Roosevelt Waldorf Astoria
New Orleans, Louisiana

2019 Mid-Year Meeting
March 28-31, 2019
La Quinta Resort
La Quinta, California

2019 Annual Meeting
October 17-20, 2019
Le Westin Hotel
Montreal, Canada

STAFF BOX

The ACREL Newsletter is published by the
American College of Real Estate Lawyers

One Central Plaza
11300 Rockville Pike, Suite 903
Rockville, MD 20852
Items from this publication may be reprinted with permission from the editor.

Editor
Jill H. Pace
Executive Director

continued from p. 2

Award is the highest honor the College can bestow to honor the career contributions of distinguished real estate lawyers who have selflessly served the profession, the College and their community. We hope you can join us in Los Angeles to personally congratulate Dick and Bill.

In addition to the Annual Meeting, the other most important ACREL event for the fall is our member selection process. Our Membership Development Committee, led by Pete Ezell, has been working very diligently to identify new ACREL prospects and now the Member Selection Committee, led by Jonathan Rivin, is beginning its most important work of evaluating nominations of candidates for admission to ACREL. The process of selecting exemplary new members of ACREL is dependent on existing members identifying and nominating outstanding candidates.

Karen and I very much look forward to seeing you in Los Angeles. In addition to many terrific programs, tours and activities, the Annual Meeting provides an outstanding opportunity to renew our friendships and fellowships, perhaps the most important aspect of being a member of ACREL.

We're so excited to see you in LA in the fall!

Thanks to Peter Aitelli for sharing these photos.

ACRELades

Michael Meyer is the new 2017-2018 President of the Los Angeles County Bar Association.

Thomas W. Mitchell, professor of law and co-director of the Program in Real Estate and Community Development Law, has agreed to serve as interim dean of the Texas A&M University School of Law, beginning August 1, 2017.

Gisela M. Munoz, of Miami, Florida, was recently honored locally. In July, she was awarded the Dade County Bar Association's 2017 Legal Luminaries Award in the category of Real Estate Development Transactions, which is a peer-reviewed award recognizing excellence in practice. That same week, Gisela was selected as one of only ten 2017 Top Women in Law by the Daily Business Review locally.

Send us your news for future issues!

ACREL Gatherings!

Please consider hosting an ACREL event in your city.

Fellows who have attended these gatherings have been pleased with the opportunity to connect with their ACREL colleagues.
The event can be whatever you want it to be! You can have a speaker, discuss prospective members or just have lunch or a cocktail party.
Options range from brown bags at a law firm to cocktails at a local hotel.

If you are interested in hosting a session, please contact
Jo Anne Stubblefield at jstubblefield@hspclegal.com, (404) 659-6600.

Report of the 2017 ACREL Nominating Committee

The College's 2017 Nominating Committee consisting of Kathryn C. Murphy, Chair, (MA), Kenneth M. Jacobson (IL), Beverly J. Quail (CO), Robert A. Fishman (MA), Richard C. Mallory (CA), Kevin L. Shepherd (MD) and Stephen A. Cowan (CA) submits this report to President Roger D. Winston in accordance with Article V, Section 3 of the College's Bylaws.

1. Pursuant to Article VI, Section 2(b) of the College's Bylaws, Jay A. Epstein (DC) becomes President on January 1, 2018.

2. In accordance with the provisions of Article VI, Section 2(a) of the Bylaws, the Nominating Committee nominates the following Regular Fellows for election at the Annual Meeting as officers for the indicated positions commencing January 1, 2018:

Steven A. Waters (TX)	President-Elect
Marilyn C. Maloney (TX)	Vice President
Peter Aitelli (CA)	Treasurer
Nancy R. Little (VA)	Secretary

3. Pursuant to Article V, Section 3 of the Bylaws, the Nominating Committee nominates the following Regular Fellows for election as Governors at the Annual Meeting for the indicated terms commencing January 1, 2018:[1]

Barry A. Hines (KY)	3-year term
Michael D. Hamilton (CA)	3-year term
Beth H. Mitchell (MA)	3-year term
Ann M. Waeger (NJ)	3-year term
Adam B. Weissburg (CA)	3-year term

Submitted: May 31, 2017

Kathryn Cochrane Murphy
Chair

[1] Under Article V, Section 3(a), no more than two nominees for Governor in any year shall be incumbents having served one (1) three-year term. (Barry Hines and Michael Hamilton)

Dazed and Confused: Clearing the Ethics Weeds in the Marijuana Business

by Andrea Geraghty, Meyer, Unkovic & Scott LLP, Pittsburgh, PA

Introduction

To date, 29 states and the District of Columbia, Guam and Puerto Rico have enacted statutes permitting medical marijuana.[1] Additionally, eight states and the District of Columbia have legalized marijuana for recreational use.[2] Since 1996 there has been a clear and aggressive trend toward legalization or decriminalization[3] of marijuana; however, it is still unlawful to manufacture, distribute, or dispense marijuana under the Federal Controlled Substances Act ("CSA").[4] For lawyers working with clients involved in the marijuana industry in states where some form of marijuana is permitted, this dichotomy creates a difficult intersection under the Model Rules of Professional Conduct (the "RPC"), which as adopted in many jurisdictions broadly permits lawyers to advise clients on the legal consequences of conduct but prohibits lawyers from counseling a client to engage, or assisting a client, in conduct that the lawyer knows is criminal or fraudulent.[5]

To assist the real property practitioner in this relatively new and rapidly changing area of the law, this article reviews the different approaches states have taken with respect to lawyers advising clients involved in the marijuana industry. It is indisputable that patients, physicians, sellers, growers, dispensaries, and other businesses need lawyers to help navigate this new industry. Unfortunately, these individuals and entities are not well served by ethical rules that prohibit legal counsel from providing advice.

The Controlled Substances Act

When Congress passed the CSA in 1970, it classified marijuana, alongside heroin and LSD, as a Schedule I drug, while oxycodone and methamphetamine are regulated differently as Schedule II drugs.[6] Under the CSA, Schedule I drugs are drugs that "have no approved medical use in treatment" and "a high potential for abuse." During the Obama administration, the Drug Enforcement Agency (the "DEA") was expected to reschedule marijuana.[7] In 2015, the U.S Surgeon General, Vivek Murthy, suggested that marijuana "can be helpful" for some medical conditions, which contributed to the expectation of rescheduling.[8] However, on Aug 11, 2016, the DEA rejected rescheduling, concluding that marijuana has no currently accepted medical use in treatment in the United States, and has a high potential for abuse.[9] While at the same time, the DEA indicated it would increase the amount of marijuana available for legitimate research, it remains unlawful under federal law to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, marijuana in any form.[10]

Notwithstanding the federal prohibition, the U.S. Department of Justice (the "DOJ") issued a memoranda addressing the enforcement of federal law in states that permit medical or recreational marijuana use (the "Cole Memorandum").[12] The Cole Memorandum reiterated the DOJ's commitment to enforcing the CSA consistent with Congress' determination that marijuana is a dangerous drug that serves as a significant source of revenue to large-scale criminal enterprises, gangs, and cartels.[12] In furtherance of that commitment, the Cole Memorandum instructed DOJ attorneys and law enforcement to focus on the following eight priorities in enforcing the CSA against marijuana related conduct:

1. Distribution of marijuana to minors;
2. Revenue passing to criminal enterprises, gangs and cartels;
3. Diversion of marijuana from states where it is legal;
4. Use of state-authorized marijuana activity as a cover for other illegal drugs or activity;

continued on p. 7

continued from p. 6

5. Violence and the use of firearms;
6. Driving under the influence or other adverse public health consequences;
7. Use of public lands for marijuana production; and
8. Marijuana possession or use on federal property.[13]

In those states that enacted laws to authorize the production, distribution and possession of marijuana but also established strict regulatory schemes that protect the enforcement priorities identified in the DOJ Memorandum, the Obama DOJ signaled its intent to defer to state law to address marijuana activity.[14] [15] Although the Trump administration has hinted that it may take a harder line on the use and distribution of marijuana, it has not, as of this writing, reversed the Cole Memorandum. However, in early April 2017, the current Attorney General has created a task force within the Justice Department which will evaluate marijuana policy as part of a larger review of crime reduction and public safety.

While the shifting political winds may result in more aggressive enforcement, the use and distribution of marijuana remains illegal under federal law, and as a result the Rules of Professional Conduct create an obvious ethical tension for lawyers in states where some form of marijuana is legal under state law.

Model Rule 1.2(d)

The ABA Model RPC 1.2(d), permits lawyers to advise clients on the legal consequences of conduct, but prohibits lawyers from assisting clients with conduct the attorney knows is criminal.[16] Rule 1.2(d) provides:

> "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law." [17]

As the marijuana industry grows it has become even more important for bar associations and courts in affected states to provide guidance for lawyers who are asked to advise clients on marijuana-related matters.

Approaches to the Rule 1.2 Dilemma

Those states that permit the use and distribution of marijuana in some manner have approached this issue in a number of ways, from complete prohibition to tolerance in the forms of ethics opinions, comments, and amendments to their state's version of the RPC 1.2(d) and, over time, some have altered their stances. In 2010, Connecticut and Maine counseled its attorneys to stay away from state-permitted marijuana businesses because of the concern they violated federal law.[18] In August of 2016, Ohio's Supreme Court followed suit by issuing a non-binding advisory opinion stating that Ohio lawyers could not advise medical marijuana businesses and patients under the state's conduct standards.[19] While these opinions provided a bright line rule for lawyers, they also deprived numerous clients of legal counsel. Subsequently, Connecticut, Maine, and Ohio abandoned their zero-tolerance approaches. Effective January 1, 2015, Connecticut's Superior Court judges amended Rule 1.2(d) to permit a lawyer to advise or assist a client with conduct permitted by that state's law "provided the lawyer counsels the client about the legal consequences under other applicable law."[20] Shortly thereafter, Maine's Professional Ethics Commission mirrored Connecticut's approach and amended its version of Rule 1.2(e).[21] Lastly, on September 20, 2016, Ohio's Supreme Court amended its RPC so that lawyers could counsel medical marijuana clients.[22]

A majority of the states that permit the use of marijuana in some manner have obtained guidance about working with marijuana clients from their respective Supreme Courts, Bar Associations, or Ethics Committees. Lawyers practicing in states where the

continued on p. 8

Rules of Professional Conduct have been amended are afforded the most protection. Those lawyers practicing in states that have yet to address this issue or where only non-binding opinions have been issued are still at risk of violating conduct rules. The chart below lists the actions taken by each state that permits a form of marijuana:

Conduct Rules Amended
Alaska, Colorado, Connecticut, Hawaii, Illinois, Nevada, Maine, Oregon, Ohio, Pennsylvania, and Washington.
Opinions Issued or Pending
Arizona, Arkansas, California, Delaware, Florida, Maryland, Massachusetts, Michigan, Montana, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Rhode Island, Vermont, and District of Columbia

In 2011, the State Bar of Arizona concluded that lawyers could both advise and assist clients operating under the state medical marijuana statute as long as the federal government maintained its current enforcement policy and no court concluded that the CSA preempted the Arizona medical marijuana law.[23] The State Bar of Arizona, in an ethics opinion proposed the following comment to Rule 1.2(d):

> (1) at the time the advice or assistance is provided, no court decisions have held that the provisions of the Medical Marijuana Act relating to the client's proposed course of conduct are preempted, void or otherwise invalid; (2) the attorney reasonably concludes that the client's activities or proposed activities comply with the state's requirements; and (3) the attorney advises the client regarding possible federal law implications of the proposed conduct.[24]

In reaching its conclusion, the State Bar of Arizona stressed the importance of having access to legal counsel and the role attorneys serve in assisting clients with complying with Arizona's law.[25] While an ethics opinion like that issued in Arizona may give some comfort to lawyers as they give counsel on issues related to marijuana, an amendment to the Rules of Professional Conduct is essential to provide true clarity.

The Washington Supreme Court, in November 2014, adopted comment 18 to Rule 1.2, which provides:

> At least until there is a subsequent change of federal enforcement policy, a lawyer may counsel a client regarding the validity, scope and meaning of Washington Initiative 502 (Laws of 2013, Ch. 3) and may assist a client in conduct that the lawyer reasonably believes is permitted by this statute and the other statutes, regulations, orders and other state and local provisions implementing them.

In Colorado, the state's Supreme Court adopted a similar comment to Rule 1.2(d), as follows:

> A lawyer may counsel a client regarding the validity, scope, and meaning of Colorado constitutional article XVIII, §§ 14 and 16, and may assist a client in conduct that the lawyer reasonably believes is permitted by these constitutional provisions and the statutes, regulations, orders, and other state or local provisions implementing them. In these circumstances the lawyer shall also advise the client regarding related federal law and policy.

To date, the trend towards authorizing lawyers to counsel clients has continued, however, only Alaska, Colorado, Connecticut, Hawaii, Illinois, Nevada, Maine, Oregon, Ohio, Pennsylvania, and Washington have settled this issue for their lawyers by actually amending their respective conduct rules. With the exception of Minnesota, the ethical concerns of lawyers advising clients involved the marijuana industry remain unanswered.[27]

continued on p. 9

Dazed and Confused...

continued from p. 8

Conclusion

The marijuana industry has an estimated annual worth of $5.4 billion. But the dichotomy between the CSA and state legalization has caused many lawyers to shy away from this new industry. Until the CSA is amended, each state should amend its Professional Conduct Rules so that lawyers can counsel clients without worrying about ethical violations. This is important because lawyers are in the best position to guide industry participants on how to comply with the state laws that govern the marijuana industry. ■

---

[1] State Medical Marijuana Laws, NATIONAL CONFERENCE OF STATE LEGISLATURES (August 2, 2017) http://www.ncsl.org/research/health/state-medical-marijuana-laws.aspx

[2] Melia Robinson, *It's 2017: Here's where you can legally smoke weed now,* BUSINESS INSIDER, (Jan. 8, 2017) http://www.businessinsider.com/where-can-you-legally-smoke-weed-2017-1.

[3] Decriminalization is typically understood to mean that there will be no arrest, prison time or criminal record for possession of marijuana for personal use.

[4] 21 U.S.C. §§ 841, 844.

[5] ABA MODEL RULES OF PROFESSIONAL CONDUCT 1.2(d).

[6] 21 U.S.C. § 812(b).

[7] 21 U.S.C. § 812(c); Trevor Hughes, *DEA could reclassify marijuana, allowing doctors to conduct more research*, USA TODAY (May 24, 2016), http://www.usatoday.com/story/news/2016/05/21/dea-could-reschedule-marijuana-allowing-doctors-conduct-more-research/84670716/.

[8] John Hudak & Grace Wallack, *How to reschedule marijuana, and why it's unlikely anytime soon*, BROOKINGS INSTITUTION(Feb. 13, 2015), https://www.brookings.edu/blog/fixgov/2015/02/13/how-to-reschedule-marijuana-and-why-its-unlikely-anytime-soon/.

[9] DEA HEADQUARTERS NEWS, https://www.dea.gov/divisions/hq/2016/hq081116.shtml (last visited Mar. 31, 2017).

[10] 21 U.S.C. § 841(b)(1)(A), (b)(1)(D).

[11] James M. Cole, *Guidance Regarding Marijuana Enforcement*, U.S. DEPARTMENT OF JUSTICE (Aug. 29, 2013), https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

[12] *Id.*

[13] *Id.*

[14] Christopher Ingraham, *What the future of marijuana legalization could look like under President Trump*, THE WASHINGTON POST (Nov. 9, 2016), https://www.washingtonpost.com/news/wonk/wp/2016/11/09/what-the-future-of-marijuana-legalization-could-look-like-under-president-trump/.

[15] *See supra* note 10; *see also* John A. Gilbert, Jr. & Larry K. Houck, *GAO Recommends Better Monitoring of Federal Marijuana Enforcement Priorities; DOJ and DEA Officials Report on Marijuana Enforcement*, http://www.fdalawblog.net/fda_law_blog_hyman_phelps/2016/02/gao-recommends-better-monitoring-of-federal-marijuana-enforcement-priorities-doj-and-dea-officials-r.html (last visited Mar. 31, 2017).

[16] *See supra* note 4.

[17] *Id*.

[18] Maine Board of Overseers of the Bar Opinion 199 (2010); Connecticut Bar Association Professional Ethics Commission Informal Opinion 2013-02 (2013).

[19] OHIO ETHICS OPINION 2016-6, http://www.supremecourt.ohio.gov/Boards/BOC/Advisory_Opinions/2016/Op_16-006.pdf (last visited Mar. 31, 2017).

[20] Jay Stapleton, Judges Vote To Allow Lawyers To Represent Medical Marijuana Growers, Connecticut Law Tribune, http://www.ctlawtribune.com/id=1202661028491?keywords=Jay+stapleton&publication=Connecticut (last visited Mar. 31, 2017).

[21] Maine Board of Overseers of the Bar Opinion 214 (2016), http://www.mebaroverseers.org/attorney_services/opinion.html?id=683190 (last visited Mar. 31, 2017).

[22] AMENDMENTS TO THE OHIO RULES OF PROFESSIONAL CONDUCT, http://www.supremecourtofohio.gov/ruleamendments/documents/Medical%20Marijuana%20Amendment%20(FINAL).pdf (last visited Mar. 31, 2017).

[23] State Bar of Arizona, Formal Opinion 11-01 (2011), http://www.azbar.org/Ethics/EthicsOpinions/ViewEthicsOpinion?id=710 (last visited Mar. 31, 2017).

[24] *Id*.

[25] *Id*.

[26] WASH. RULES OF PROFL CONDUCT RULE 1.2(d) cmt. 18, http://www.courts.wa.gov/court_rules/?fa=court_rules.rulesPDF&groupName=ga&setName=RPC&pdf=1 (last visited Mar. 31, 2017).

[27] MINN. STAT. ANN. § 152.32(2)(i)(2014) (Minnesota passed a law that protects attorneys from ethical violations stemming from counseling marijuana clients).

In Memoriam

Robert Thompson, CA

We will miss Bob and extend our condolences to his family and friends.

Got Programs?

If you'd like to volunteer, or communicate ideas for Plenary Sessions, Roundtables, or Internal Webinars, contact programideas@acrel.org

GET YOUR GEEK ON! TECH WIZARDS WANTED

ACREL's Tech Wizards provide assistance to ACREL Fellows and committees working with ACRELShares! We have a group of dedicated Tech Wizards, but can always use more help.

If you can send an e-mail, open and save a file in Word, or electronically file a pleading in federal court, you are Tech Wizard material.

If you are interested in finding out more about becoming a Tech Wizard, please contact Trev Peterson at tpeterson@knudsenlaw.com or call Trev at 402-475-7011.

No prior wizardry experience required.

CALL FOR VOLUNTEER EDITORS!

The Publications Committee is looking for a few good volunteers to serve as editors of the ACREL Papers. No previous experience or training necessary (beyond knowing how to read and write)!

Our editors typically will edit two to four articles each year, prior to our two meetings. The job of the editors is to lend an extra "eye" to an author's work, and to make any suggestions that could enhance the paper's appeal. The time involved is relatively little, but one of the rewards of being an editor is learning more about topics that may help you in your profession or that otherwise appeal to you. It's also a great way to become acquainted with authors who are Fellows who you may not have met.

If you're interested, or have questions, please contact **Deb Macer Chun**, our Publications Committee's Chair, at dchun@chunkerr.com, or **Angela Christy**, our Publications Committee's Vice Chair, at angela.christy@FaegreBD.com They'd be delighted to tell you more and answer any questions you might have – and, they can sign you up, right on the spot!

House First, Ask Questions Later

by David H. Jones,[1] Troutman Sanders, LLP, Charlotte, NC

An unshaven panhandler asking for a dollar "so I can buy a sandwich -- mister, I ain't had nothing to eat since Wednesday"; that stooped woman, who looks old in spite of her actual age, wrapped in a blanket on a steamy day, pushing a shopping cart full of mis-matched shoes, broken radios, a lamp shade, and unidentifiable bric-a-brac, mumbling to herself. These are images that often come to mind when we hear the word "homeless". As we rush by on the way into our office or favorite coffee shop or to a client meeting, we avert our eyes as they reach out a hand for some change or as they try to speak. The problem always seems to be getting worse.

The image of the homeless, conjured above, is inaccurate, of course. The perception of the problem worsening is also wrong. It is getting better and much of the improvement is likely due to change in approach that has been supported by federal law.

The October 2017 ACREL meeting in Los Angeles will open with a session which looks at the issue of homelessness in our cities and how cities in general, and how Los Angeles in particular, are addressing it. This article will provide a brief overview of who the homeless are and how a number of communities have, with federal support, changed how they support their homeless population.

Who are the homeless? They include the hungry panhandler and the mumbling woman. They also include families, veterans and teenagers. Each year, in January, homeless service organizations conduct a point-in-time count of the homeless. The 2016 Annual Homeless Assessment Report ("2016 AHAR") provided to Congress, reported that the count in January of 2016 was 549,928 people. Sixty-eight percent of them were in shelters, transitional housing or other safe havens and the rest were in unsheltered locations. That is a lot of people, but it has steadily fallen from 2007 (the count for January of 2007 was 647,258 according to the 2016 AHAR). Certainly, some of this decrease results from an improving economy, but we should note that even during the height of the recession, according to the 2016 AHAR, the count fell from 647,258 (2007) to 630,227 (2009).

Scholars, government agencies, and homeless advocates classify the homeless into a variety of categories. One set of classifications concerns the duration and frequency of homelessness. The "transitional" homeless experience a single or only a few episodes of homelessness before finding stable housing again. The "episodic" homeless are in and out of homelessness on a more frequent basis. The "chronically" homeless live permanently in shelters or on the streets. This group has a high incidence of mental health problems and substance abuse issues and is the source of our stereotypes. According to the 2016 AHAR, they also account for *less than 20%* of the homeless population.

Other categorizations focus on homeless groups: individuals; families; veterans; unaccompanied children and youth. Perhaps the most heartbreaking numbers are that 36.5% of homeless people are homeless families (206,286 people in all) and another 6.5% (36,907) are unaccompanied children and youth.

Prior to the last decade or so, finding housing solutions for the homeless was based on them being "Housing Ready". This meant that they stayed in shelters or transitional housing, or on the streets until whatever circumstance triggered their homelessness (job loss, addiction, mental illness) had been addressed to an extent that convinced the applicable government office or social service agency that the homeless person or family was now able to maintain housing on his or their own.

Unsatisfied with the effectiveness of "Housing Ready" approaches certain localities and charitable

[1] The author would like to thank Jarred Ramo, a student at George Washington University School of Law for his assistance in researching this topic.

continued on p. 12

organizations began experimenting with "Housing First" models. A "Housing First" approach is the inverse of "Housing Ready" in that the first step is to provide housing and then start working on the issues that led to homelessness by providing the appropriate supportive services.

Early during the Obama administration, the federal government embraced the "Housing First" model. The American Recovery and Reinvestment Act of 2009 (ARRA) launched a number of temporary relief programs including a commitment of $1.5 billion to the Homelessness Prevention and Rapid Re-housing Program (HPRP). The funds were awarded to cities, counties, states, and territories using a formula based on other HUD homelessness grants programs. The main types of programs eligible for HPRP funding included: (1) financial assistance; (2) housing relocation and stabilization services; and (3) data collection and evaluation. There are no HPRP funds currently remaining as the program ended nationwide in September of 2012.

The HPRP and the grants it provided were catalysts to expand rapid re-housing programs. Rapid re-housing programs are the essence of a "Housing First" approach. Homeless persons and families are placed into apartments or houses (rather than in shelters or transitional housing) as soon as possible and then supportive services are delivered to them that are targeted to getting the person or family into a position where he or they independently can procure and pay for housing. These programs are most effective when a person's or family's obstacle to housing is financial (job loss, uninsured medical bills and the like) or if the mental health or addiction issue is more minor and can likely be addressed through out-patient therapies and treatments.

The components of a rapid re-housing program vary with the locality and lead agency but here are some general commonalities:

1. A lead agency (governmental or non-profit) that screens individuals and families and recruits landlords who agree to participate in renting units to these individuals.

2. A lease agreement where the lead agency is either the nominal tenant or a guarantor and under which the lead agency, using HUD funds, local government grants, or private donations, either pays the rent on the unit or supplements the actual tenant's ability to pay rent (note that some homeless are employed at some level and it is not uncommon in these programs to require these individuals to pay up to 30% of their income toward the rent). The agency may also provide funds for utility deposits and other move-in costs.

3. A commitment by the formerly homeless person to work on the issues that led to homelessness (treatment, job training, continuing education, etc.).

4. Social service delivery by the appropriate agency, with trained case workers to help with and monitor the progress toward that commitment.

5. A cadre of volunteers who help in tangible ways (moving-in; purchasing furniture; tutoring the children; helping with budgeting and the like).

Despite the conclusion of the HPRP program, there is still funding for homelessness assistance provided by the McKinney–Vento Homeless Assistance Grants program ("McKinney-Vento"). McKinney-Vento was passed by Congress in 1987 as a major federal legislative response to homelessness. The Homeless Emergency Assistance and Rapid Transition to Housing Act (the "HEARTH" Act) of 2009 amended and reauthorized McKinney-Vento with several substantial changes including a consolidation of HUD's competitive grant programs.

The FY 2017 Budget provides HUD with $48.9 billion in gross discretionary funding and $11.3 billion in new mandatory spending over the next decade with an emphasis on increasing homeless assistance. HUD's discretionary spending favors a Housing First approach, providing people experiencing homelessness with immediate permanent housing

continued on p. 13

House First...

continued from p. 12

in lieu of a Housing Ready approach. The Budget provides $112 million in discretionary spending for rapid re-housing programs.

HUD currently has two Homeless Assistance Grants programs: the Emergency Solutions Grant (ESG) block grant program and the Continuum of Care (CoC) program. "The CoC program funds proven interventions like cost-effective permanent supportive housing for chronically homeless people. The ESG block grant funds emergency shelter and adds a new focus on the cost-efficient interventions of homelessness prevention and rapid re-housing." (FY 2016 Appropriations: HUD Homeless Assistance Grants, http://www.endhomelessness.org/library/entry/fy-2015-appropriations-hud-homelss-assistance-grants).

The Emergency Solutions Grants Program provides funding to

1. engage homeless individuals and families living on the street,

2. improve the number and quality of emergency shelters for homeless individuals and families,

3. help operate these shelters,

4. provide essential services to shelter residents,

5. rapidly re-house homeless individuals and families, and

6. prevent families and individuals from becoming homeless (HUD's Targeted Homeless Programs Fact Sheet).

The purpose of the Continuum of Care Program provides is to

1. promote community-wide commitment to the goal of ending homelessness,

2. provide funding for efforts by nonprofit providers, States, and local governments to re-house homeless individuals and families rapidly while minimizing the trauma and dislocation caused to homeless individuals, families, and communities as a consequence of homelessness,

3. promote access to and effective use of mainstream programs by homeless individuals and families, and

4. optimize self-sufficiency among individuals and families experiencing homelessness (HUD's Targeted Homeless Program Fact Sheet).

As one can see, re-housing homeless individuals rapidly is a stated goal of both programs.

A companion approach to rapid re-housing and an important Housing First solution is to provide permanent supportive housing. Permanent supportive housing recognizes that some homeless individuals and families can manage independent housing, but not completely on their own; they will need longer term, perhaps permanent, support. The number of permanent supportive housing units now surpasses the number of shelter beds and transitional housing units in the United States. According to the 2016 AHAR in 2007 there were 188,636 permanent supportive housing units in the country, 211,451 shelter beds and 211,205 transitional housing beds/units (think of transitional housing as something like a private apartment or a single room occupancy project but with a very short term and often targeted to a narrow sub-group of the homeless). By 2015 permanent supportive housing grew 69.2% to 319,212 units, shelter beds increased 25.1% to 264,440, but transitional housing bed/units fell 23.4% to 161,827.

It is heartening to note that the numbers of people who are homeless have declined. People in rapid re-housing programs and permanent support housing are no longer counted as being "homeless". These programs are widely perceived as effective. That said, the number of people in shelters and on the streets is still high and we are only a mild recession

continued on p. 14

continued from p. 13

away from seeing the number spike. According to the 2016 AHAR, in 2015, over 6,400,000 people in the US were poor and paying more than 50% of their income on housing costs (30% is considered "affordable"). Job losses among this group would certainly push many into homelessness.

How does this touch us as lawyers? One of the by-products of rapid re-housing and permanent support housing is that they often involve the private market. Shelters and transitional housing are normally provided and owned by governmental agencies or non-profits. Units providing rapid re-housing or permanent support housing are, on the other hand, often owned by private landlords. We may represent landlords who are approached to participate in these programs. We can represent them by helping them analyze and deal fairly with the issues that they perceive as relating to these tenants. Issues such as:

1. Who pays the rent? Is the occupant paying any or is it all coming from the local lead agency? What are the financial underwriting concerns? Even if the lead agency is responsible for it all, does it have sufficient funding to pay the rent for everyone it is trying to assist, including your client's tenant?

2. If the security deposit is paid by the lead agency or by a volunteer support group, is that a sufficient disincentive for the occupant to care for the unit?

3. Who signs the lease? Who bears the legal obligations for compliance? If it is the occupant, should the lead agency sign a guaranty?

4. How does the landlord deal with background requirements? Many of these tenants will have criminal records or a history of addiction. Many landlords have policies against leasing to people with criminal records or a history of addiction (side note: An over broad prohibition on leasing to people with a criminal record may be a Fair Housing Act violation according to guidance issued by HUD in 2016[2] and a history of addiction is considered a disability under the Fair Housing Act and cannot be the basis for refusing to lease to an individual, (although current illegal drug activity is not so protected).

5. Are police visits more likely because of these occupants, some of whom may have mental health concerns, and how does that impact the other tenants in the complex or in leasing vacant units?

These are real world practical concerns and some landlords may not be willing to accept these perceived risks. It is not our job, as counsel to landlords, to act as their conscience and to nudge them to participate in these programs. However, for clients who are considering participation, to fill vacant units, out of a desire to be supportive, or with a combination of both motives, we should be willing to overcome any reflexive "parading of the horribles" and work to help understand the target population and how risks may be mitigated. For example, while denying a unit to someone with a criminal past or a history of addiction may be a Fair Housing Act violation, the lead agency may have a screening protocol or other safe guards in place that reduces risk. Thoughtful questions addressed to the lead agency may narrow the issues, and a thoughtfully prepared addendum to the landlord's form lease and lease guaranty, which addresses these concerns and others and negotiated with the lead agency, may go a long way in reducing the landlord's risks and providing the units needed to house more of the homelessness. Our experience as real estate lawyers complemented by our commitment as ACREL members to giving back, can help us help our clients and our communities. ■

[2] This Guidance was discussed in an Article posted on the ACREL website (under "Latest News" on the homepage) on June 15, 2017, "Criminals Need Not Apply" by Steven H. Mezer.

Cost Overruns and Risk Allocation between Sponsors and Investors

by Clay Howell[1] and Mack Heller[2]

Introduction

Consider a typical joint venture for the development of real estate between an investor (the "Investor") and a sponsor (the "Sponsor"). Both the Sponsor and the Investor have spent months investigating the property, planning for the development and operation of the property, pouring over draft after draft of the project budget, and negotiating a JV agreement to adequately protect each party from both the front-end and back-end risks of the project. The Sponsor and the Investor have established their relative equity contributions. A loan has been secured to fund the anticipated project costs in excess of the equity, and a parent or affiliate of the Sponsor has provided both a cost overrun guaranty to Investor and the JV and a completion guaranty to the lender. After breaking ground on the project, an unforeseen and expensive problem arises, as is apt to happen when much of the risk is hidden under the soil. If the cost of this unforeseen problem exceeds the amount of the cost overrun guaranty to the Investor, who is required to shoulder the cost? Below we will briefly discuss some of the dynamics affecting the negotiation related to this particular risk. We will then look at a more specific example and discuss possible approaches. As will be discussed, while there is no one-size-fits-all approach, the parties should undertake a thoughtful consideration of the allocation of development risk.

Background

JV members take various steps to mitigate the risk of cost overruns. Each member will conduct due diligence on the various aspects of the project. Both the Investor and the Sponsor will scrupulously review the title, survey, physical and environmental condition of the property, the experience and performance history of the other member and any third parties required for completion of the project, and the agreements creating the JV's rights and enforcement mechanisms vis-à-vis these third parties. Typically, the responsibility for this type of due diligence falls disproportionately to the Sponsor, as the Sponsor often has extensive development experience and familiarity with both political and administrative environment in which the project is to be built. The Sponsor is typically compensated for this expertise and its control of the diligence and construction process through development fees and a "promote," a disproportionate split of operating and sales proceeds after some fixed return to the Investor.

In exchange for fees and the promote, the Sponsor typically takes on increased risk. The Sponsor is often expected to bear most, if not all, of development-related overrun risk, with no ability to recover the cost overruns that are required to be funded by the Sponsor.[3] Most, but not all, Sponsor-provided cost overrun guaranties have exclusions for costs associated with the payment of interest, taxes and lease-up risks, under the theory that the Investor is primarily looking to the Sponsor's development expertise and is not looking for the Sponsor to guarantee the market performance of the asset. In addition, the Sponsor's cost overrun liability to the Investor typically excludes costs associated with negotiated force majeure events. Finally, the Sponsor often negotiates a cap on its cost overrun exposure. Often, however, the parties do not contemplate or understand, or both, the interplay between the cost overrun guaranty given to the Investor and the completion guaranty given to the construction lender.

[1] Clay Howell is a member in the real estate group of Eversheds Sutherland (US) LLP and focuses on real estate equity investments and complex urban development.
[2] Mack Heller is an associate in the real estate group of Eversheds Sutherland (US) LLP.
[3] Cost overrun payments are typically not given capital contribution treatment, although some distribution provisions will permit the Sponsor to recover at least some amount of funded cost overruns after the Investor has received a return of and a return on the Investor's capital. See Appendix A for an example distribution waterfall.

continued on p. 16

continued from p. 15

Example

Suppose an investor and sponsor form a joint venture (the "JV") to develop a $100 million project. Of the development budget, $40 million will be contributed as equity (the "Committed Equity"), to be funded 90/10 by the Investor and the Sponsor, respectively. Under the JV Agreement, the Sponsor is not permitted to call capital for amounts in excess of the Committed Equity unless Investor first consents. Under the JV Agreement, a parent of the Sponsor (the "Guarantor") has provided a cost overrun guaranty to the JV and the Investor, with the Guarantor's obligation capped at $2 million. The JV has separately entered into a construction loan to fund the remaining $60 million in the development budget, and the Guarantor has guaranteed completion of the project to the lender.

Once construction begins, the Sponsor discovers an environmental problem, and the remediation costs are estimated to produce a $3 million cost overrun. Assuming that the cost overrun is one that is covered by the Guarantor's cost overrun guaranty to the Investor,[4] the Sponsor and Guarantor are jointly and severally liable to the Investor and the Company to fund $2 million of the $3 million cost overrun. Under the construction loan agreement and the related completion guaranty, the Company and the Guarantor are required to fund the $3 million as a balancing deposit.

In the example above, as among the Sponsor, the Investor and the Guarantor, who is obligated to fund the remaining $1 million balance of the $3 million overrun?

Funding Alternatives

While there is no definitive solution, and investors and sponsors may vary in their levels of risk tolerance, some alternatives for funding the overrun gap are as follows:

1. Make the Sponsor and Guarantor liable for funding the entire $1 million overrun gap without any ability to recover the $1 million in the distribution waterfall. In the above example, this result *would render meaningless* the Sponsor's negotiated $2 million cap in its cost overrun guaranty.

2. Obligate the Investor and the Sponsor to each contribute capital based on respective capital interests (90/10 in our example). While this option may seem "fair", the Investor typically wants certainty as to its committed capital and has fiduciary duties to its investors (whether fund investors or a separate account investor). For this reason, this option may be unacceptable to the Investor.

3. Obligate the Investor and the Sponsor to each contribute capital 50/50 or some other, more Investor-friendly percentage based on capital interests. While this option is more palatable to the Investor than option 2, this option still fails to cap the Investor's obligation. In the options described in 2 or 3, another variation is to obligate the Investor to contribute up to another capped amount (e.g., the Investor may be obligated to contribute for these types of funding shortfalls for an additional $2 million).

4. Give the Sponsor the right to call for additional capital for the $1 million shortfall, but make the contribution "optional." In this scenario, each member would be permitted to fund on behalf of the other if the other did not contribute capital, with the contributing member receiving a priority return of its capital at a default rate of return (e.g., an 18% return). While this scenario potentially puts the Sponsor at risk for having to come up with additional capital, the Sponsor knows that its capital will come out first if it has to fund on behalf of the Investor. Conversely, the

4 We note that unforeseen environmental issues are often categorized as force majeure items, the risk of which is shared between the Sponsor and the Investor.

continued on p. 17

Investor's capital commitment is still capped in this scenario, but there are serious financial ramifications if the Investor does not fund its share.

There are many different permutations of the proposed solutions above, limited only by the creativity of the parties and their lawyers.

Conclusion

There is no universal approach as to which party funds overruns where there is a funding gap, and the nature of the relationship, and the relative leverage, between the Investor and the Sponsor plays a significant role in determining what allocation may be the best fit for any given JV. Too often parties either fail to consider this issue (many times unknowingly) or punt the negotiation to a later date (i.e. the date when the problem arises). With the added pressures of the completion guaranty and the accumulation of interest reserve advances looming in the background, the ultimate allocation of costs may vary greatly from what the parties would have agreed to if they had discussed this risk at the outset of the deal. Disputes at this stage may also delay the progress of the project, which may ultimately impact the financial success of the parties. As any seasoned real estate professional knows, despite the most meticulous diligence, the one thing that can be expected in the development of any project is the unexpected. As such, prudent investors and sponsors should take the opportunity at the outset of a JV negotiation to thoughtfully consider and discuss what should happen in the event of a funding gap during development. No matter the ultimate approach adopted by the parties, the inclusion of provisions to address this gap will minimize both the surprise and the delay brought on by unwelcome and unexpected events.

[4] We note that unforeseen environmental issues are often categorized as force majeure items, the risk of which is shared between the Sponsor and the Investor.

continued on p. 18

continued from p. 17

APPENDIX A

Section 8.2 Distributions of Net Cash Flow and Capital Proceeds. All Net Cash Flow and all Capital Proceeds shall be distributed in the following order of priority:

(a) *first,* 100% to the Members *pro rata*, in accordance with their respective Capital Sharing Ratios until each of the Members shall have received (in the aggregate under this *Section 8.2(a))* an Internal Rate of Return on its Capital Contributions (including the return of its Capital Contributions) equal to 10%;

For informational purposes only, but without implication that Cost Overrun Payments constitute Capital Contributions, the Members recognize that, as expressly provided in and subject to Section 6.4, Cost Overrun Payments [not to **exceed** $_________] are reimbursable to the **[SPONSOR]** from Net Cash Flow and Capital Proceeds which would otherwise be distributable to the Members after application of subsection (a), but before application of subsections (b) through (d) below.

(b) *Second*, (1) 75% to the Members *pro rata*, in accordance with their respective Capital Sharing Ratios, and (2) 25% to the **[SPONSOR]**, until each of the Members shall have received (in the aggregate under *Section 8.2(a)* and this *Section 8.2(b))* an Internal Rate of Return on its Capital Contributions (including the return of its Capital Contributions) equal to 15%;

(c) *Third*, (1) 70% to the Members *pro rata*, in accordance with their respective Capital Sharing Ratios, and (2) 30% to the **[SPONSOR]**, until each of the Members shall have received (in the aggregate under *Section 8.2(a), Section 8.2(b)* and this *Section 8.2(c))* an Internal Rate of Return on its Capital Contributions (including the return of its Capital Contributions) equal to 20%;

(d) *Thereafter*, (1) 60% to the Members *pro rata*, in accordance with their respective Capital Sharing Ratios, and (2) 40% to the **[SPONSOR]**.

All distributions to the **[SPONSOR]** under *Sections 8.2(b)(2), 8.2(c)(2)* and *Section 8.2(d)(2)* shall be referred to collectively, as the ***"Promote"***.

Freedom of Contract or Liberty to Lie? A Brief Survey Regarding the Enforcement of Non-Reliance Clauses

by Manuel Farach, McGlinchey Stafford, PLLC, Ft. Lauderdale, Florida

Non-reliance clauses occupy a special place in the world of contracts: provisions that require parties to put all their cards on the table and state whether they are relying on representations outside of the contract. This article discusses all disclaimer clauses generally, the use of non-reliance clauses in selected jurisdictions across the country, and concludes by analyzing the public policy arguments in favor of and against non-reliance clauses.

I. Disclaimer Clauses Generally and Non-Reliance Clauses Specifically

Disclaimer clauses generally fall into three categories: "integration" or "merger" clauses, "waiver" clauses, and "non-reliance" (also called "anti-reliance" or "no-reliance) clauses. Integration clauses state that all oral representations or statements not expressed in the contract "merge into" and do not survive the execution of the contract.[1] "Waiver clauses" release any fraud or wrongdoing that occurred before execution of the contract.[2] Non-reliance clauses are agreements that the parties are not relying on any statements not set forth in the contract. While the differences between the three types of disclaimer clauses seem subtle, the effects are not.

A merger or integration clause, when used without other disclaimer clauses, can suffer from enforcement issues because courts are reluctant to allow a technical contractual device to eliminate fraud claims.[3] A contractual waiver of fraud clause faces even more scrutiny as critics argue these clauses immunize fraudulent conduct. One court even stated:

> But the contractual freedom to immunize a seller from liability for a false contractual statement of fact ends there. The public policy against fraud is a strong and venerable one that is largely founded on the societal consensus that lying is wrong. Not only that, it is difficult to identify an economically-sound rationale for permitting a seller to deny the remedy of rescission to a buyer when the seller is proven to have induced the contract's formation or closing by lying about a contractually-represented fact.[4]

Conversely, non-reliance clauses approach extra-contractual statements and representations from the perspective of the contract and provide a much better method of memorializing and enforcing the parties' true agreement.[5] These clauses appear to have originated in the securities industry,[6] but have now made their way into other contractual instruments. Not surprisingly, different states have different views on these clauses.

II. The Approach of Different Jurisdictions

A. New York

New York declines to enforce a "general, boilerplate disclaimer of a party's representations [to] defeat fraud,"[7] but permits non-reliance clauses that "track[] the substance" of the alleged misrepresentation.[8] The reason for the difference? A party cannot reasonably rely on extra-contractual statements when it states in the contract itself that it did not rely on such statements. An older real estate case demonstrates the type of language that properly disclaims reliance in contracts subject to New York law:

> The Seller has not made and does not make any representations as to the . . . expenses, operation or any other matter or thing affecting or related to the aforesaid premises,

continued on p. 20

> except as herein specifically set forth, and the Purchaser hereby expressly acknowledges that no such representations have been made . . . . It is understood and agreed that . . . this contract . . . is entered into after full investigation, neither party relying upon any statement or representation, not embodied in this contract, made by the other.[9]

B. Delaware

Unsurprisingly, business-friendly Delaware is more supportive of non-reliance clauses than many other jurisdictions. But even in Delaware, non-reliance clauses were initially greeted with skepticism. The Delaware courts' view of these clauses has, however, undergone somewhat of an evolution to reach the current state of enforcement. Specifically, Delaware's public policy favors enforcement of contract clauses,[10] but some of the same concerns raised in other states first gave some Delaware courts a moment's pause.

For example, the court in *Anvil Holding Corp. v. Iron Acquisition Co.*[11] found that an agreement that stated that neither party was "'making any other express or implied representation or warranty with respect to the Company' and that the Purchase Agreement constitutes the entire agreement of the parties" did not preclude a buyer's fraud claim because these statements did not sufficiently repudiate reliance on extra-contractual statements. Likewise, earlier Delaware case law held that a clause that does not limit preserved claims to intra-contractual representations contained in the contract itself is insufficient.[12] These decisions and others led some to believe that Delaware courts needed to see proverbial "magic language" in contracts to enforce disclaimer clauses.

The decision in *Prairie Capital*,[13] however, dispelled that notion by finding the following language in a contract's "Exclusive Representations Clause" sufficient to disclaim fraud claims:

> The Buyer acknowledges that it has conducted to its satisfaction an independent investigation of the financial condition, operations, assets, liabilities and properties of the Double E Companies. In making its determination to proceed with the Transaction, the Buyer has relied on (a) the results of its own independent investigation and (b) the representations and warranties of the Double E Parties expressly and specifically set forth in this Agreement, including the Schedules. SUCH REPRESENTATIONS AND WARRANTIES BY THE DOUBLE E PARTIES CONSTITUTE THE SOLE AND EXCLUSIVE REPRESENTATIONS AND WARRANTIES OF THE DOUBLE E PARTIES TO THE BUYER IN CONNECTION WITH THE TRANSACTION, AND THE BUYER UNDERSTANDS, ACKNOWLEDGES, AND AGREES THAT ALL OTHER REPRESENTATIONS AND WARRANTIES OF ANY KIND OR NATURE EXPRESS OR IMPLIED (INCLUDING, BUT NOT LIMITED TO, ANY RELATING TO THE FUTURE OR HISTORICAL FINANCIAL CONDITION, RESULTS OF OPERATIONS, ASSETS OR LIABILITIES OR PROSPECTS OF DOUBLE E AND THE SUBSIDIARIES) ARE SPECIFICALLY DISCLAIMED BY THE DOUBLE E PARTIES.[14] (emphasis in original)

This non-reliance clause was supported with what the court termed a standard integration clause, which read as follows:

> This Agreement ... set[s] forth the entire understanding of the Parties with respect to the Transaction, supersede[s] all prior discussions, understandings, agreements and representations and shall not be modified or affected by any offer, proposal, statement or representation, oral or written, made by or for any Party in connection with the negotiation of the terms hereof.[15]

continued on p. 21

The fact that the Buyer made a specific, positive statement of non-reliance ("I relied only on . . ." as opposed to "I have not relied on . . .") combined with an integration clause was sufficient to disclaim fraud in the eyes of the court. No "magic language" was necessary; it was clear from the contract and the court's explanation of the totality of the circumstances that the parties intended to disclaim reliance on extra-contractual statements. Or in the words of the court, "[i]f a party represents that it only relied on particular information, then that statement establishes the universe of information on which that party relied. Delaware law does not require magic words. In this case, the Exclusive Representations Clause and the Integration Clause combine to mean that the Buyer did not rely on other information. They add up to a clear anti-reliance clause."[16]

C. South Carolina

At the other end of the spectrum lies South Carolina, where the South Carolina Supreme Court decided *Slack v. James*[17], and held the following clause did not bar tort claims such as fraud and negligent representation:

> 21. ENTIRE AGREEMENT. This written instrument expresses the entire agreement, and all promises, covenants, and warranties between the Buyer and Seller. It can only be changed by a subsequent written instrument (Addendum) signed by both parties. Both Buyer and Seller hereby acknowledge that they have not received or relied upon any statements or representations by either Broker or their agents which are not expressly stipulated herein.[18]

The dispute in *Slack* arose because the purchasers' closing attorney found a four-inch sewer easement running across a portion of the property after the Slacks entered into the sales contract.[19] The purchasers alleged that seller's real estate broker represented that no easements existed on the property. The purchasers did not condition the purchase on there being no easements or include an inspection period with a unilateral right to terminate based on any discoveries (related to title or otherwise) that were not acceptable to purchasers.

The *Slack* decision turns on whether a motion to dismiss was properly granted (the court held it was not), but the opinion discusses differing views on non-reliance clauses. A majority of the court felt the buyers reasonably relied on the misrepresentation of the seller's sales agent because the "speedy nature of residential real estate contracts today, it is not feasible to expect a buyer to be able to research the title of the property they are buying before entering into a contract"[20] and because "the alleged misrepresentation by Sellers' agent may have induced Buyers to refrain from discovering the true facts regarding whether there were any easements on the property before entering into a contract."[21]

The majority also stated the contract section was not enforceable as a non-reliance clause because it failed to be set out clearly in a separate section of the sales contract (it was included in a provision whose heading "ENTIRE AGREEMENT" suggested it was a merger clause) and because it lacked the specificity necessary to preclude the tort theories of negligent misrepresentation and fraud.[22] Citing *Whelan v. Abell*,[23] the majority said an opposite finding "would leave swindlers free to extinguish their victims' remedies simply by sticking in a bit of boilerplate."[24] The Court concluded that the quoted section of the sales contract was a merger clause but not a non-reliance clause. The dissent, however, pointed out the clause clearly contained non-reliance language and the purchasers "effectively waived the right to argue reliance when they signed the sales contract" that included the non-reliance language, and therefore could not satisfy each element of fraud and negligent misrepresentation.[25]

D. Florida

Florida courts, however, seem inclined to enforce non-reliance clauses based upon the principles of freedom to contract. In fact, *Billington v. Ginn-LA Pine Island, Ltd., LLLP*[26] was a real estate dispute

continued on p. 22

similar to the one in *Slack v. James* involving two separate but similar contracts for two lots. The facts of the case are that Ian Billington initially purchased a $1.35 million residential lot in Lake County, Florida. Although unclear from the opinion whether the clause was contained in the sales contract or a related brokerage contract, the transaction documents contained the following clauses:

> 14. BROKER AGENCY DISCLOSURE; COMMISSIONS; DISCLAIMER OF REPRESENTATIONS.
> ....
> NOTE: BEFORE BUYER SIGNS THE CONTRACT, BUYER SHOULD READ IT CAREFULLY AND IS FREE TO CONSULT AN ATTORNEY OF BUYER'S CHOICE.
> ....
> c. Buyer understands and acknowledges that the salespersons representing Seller in connection with this transaction do not have authority to make any statements, promises or representations in conflict with or in addition to the information contained in this Contract and the Community Documents, and Seller and Broker hereby specifically disclaim any responsibility for any such statements, promises or representations. By execution of this Contract, Buyer acknowledges that Buyer has not relied upon such statements, promises or representations, if any, and waives any rights or claims arising from any such statements, promises or representations.
> ....
> ANY CURRENT OR PRIOR UNDERSTANDINGS, STATEMENTS, REPRESENTATIONS, AND AGREEMENTS, ORAL OR WRITTEN, INCLUDING, BUT NOT LIMITED TO, RENDERINGS OR REPRESENTATIONS CONTAINED IN BROCHURES, ADVERTISING OR SALES MATERIALS AND ORAL STATEMENTS OF SALES REPRESENTATIVES, IF NOT SPECIFICALLY EXPRESSED IN THIS CONTRACT OR IN THE COMMUNITY DOCUMENTS, ARE VOID AND HAVE NO EFFECT. BUYER ACKNOWLEDGES AND AGREES THAT BUYER HAS NOT RELIED ON ANY SUCH ITEMS. (emphasis in original)

Mr. Billington later bought a second lot in the same subdivision for $1.64 million, but filed suit for misrepresentation when he learned others paid less for their lots and that he could not build private boat docks on the lots.[28] The trial court dismissed the fraudulent inducement count in Mr. Billington's Fifth Amended Complaint because the contracts attached to the complaint contained the disclaimer clauses listed above which negated his claims of reliance on the alleged misrepresentations.[29]

The apellate court surveyed non-reliance clauses throughout the country and concluded the apparent majority rule is enforcement of non-reliance clauses,[30] and affirmed the trial court's ruling by holding the non-reliance clauses negated Mr. Billington's claims of reliance.[31] The Billington court then held that "an express waiver of the right to maintain a fraud claim is all that is required to avoid liability for fraud,"[32] eloquently stating:

> Accordingly, we hold that the "non-reliance" clauses in this case negate a claim for fraud in the inducement because Appellant cannot recant his contractual promises that he did not rely upon extrinsic representations. We also conclude, pursuant to [the Florida Supreme Court's decision in] *Oceanic Villas*, that an express waiver of the right to base a claim on pre-contract representations renders the contract "incontestable ... on account of fraud." We emphasize that the disclaimer clauses here are as clear and conspicuous as they are comprehensive. If these clauses are insufficient to render a claim for fraud "incontestable" within the contemplation of the *Oceanic Villas* court, then no disclaimer can possibly accomplish that objective—an objective that is both reasonable and essential

continued on p. 23

continued from p. 22

> in our complex and litigious society. Written contracts are intended to head-off disputes. Public policy strongly favors the enforcement of contracts.[33]

III. An Argument for Freedom of Contract

Enforcing non-reliance clauses presents a compelling argument for freedom of contract. Non-reliance clauses accomplish the primary function of contracts: to force parties to carry out the promises they made in a contract as those promises are set forth in the contract.

Whether because of a "channeling function" or a "moral function," non-reliance clauses force each party to tell the other party what deal points they are relying upon when entering into the contract. Not only does this lead to a more fair allocation of risk and pricing (i.e., each party knows exactly what it is selling or buying), disclaimer clauses also avoid the renegotiation and litigation that arise from undisclosed subjective beliefs. While doing so subtly, Delaware, Florida and other similar jurisdictions focus on what is fair for both parties - not just the allegedly defrauded party- and conclude that proper allocation of societal resources is best served by having the parties clearly express their deal and perform their deal as stated in the written signed contract.

This is not to say that non-reliance clauses are without detractors; some have even called these provisions "liberty to lie" clauses.[34] But arguments against non-reliance clauses miss on several points. First, such an approach places all inferences in favor of the allegedly defrauded party and relieves that party from the contractual obligations it agreed to. Second, such an argument already presumes the party claiming fraud is right[35] and that the alleged tortfeasor is wrong. Third, these arguments create an evidentiary Catch-22 where the alleged tortfeasor is forced to look into the subjective mind of the allegedly defrauded party, ascertain their contractually unstated beliefs and intentions, and perform the contract in accordance with these hidden desires. And perhaps most important of all, these arguments encourage contract breaches instead of promoting the societally beneficial goal of adherence to one's promises because a party unhappy with the contract they entered into has an escape clause by merely alleging fraud in the inducement for failure of the alleged tortfeasor to satisfy that party's undisclosed, subjective contractual goals.

Non-reliance clauses, on the other hand, force parties to trust but verify. Admittedly, non-reliance clauses are not perfect; one can always find extreme situations where a non-reliance clause can be used to swindle another party. Condoning such activity is certainly not in the best interest of society, but employing some of the protections found in different jurisdictions can greatly reduce the risk of contractual oppression.[36] Worse yet, not enforcing non-reliance clauses is less desirable as it allows parties to avoid their contractual obligations and use the courts to renegotiate contracts — outcomes that disserve society even more. On balance, non-reliance clauses are useful mechanisms for achieving what society needs most from contracts: channeling to make sure that all parties are on the same page and certainty of risk and outcome.

IV. Conclusion

Non-reliance clauses promote positive social norms by reinforcing well-accepted contractual principles of keeping one's promises and openly disclosing contractual goals while discouraging frivolous litigation and claims. Likewise, the alleged risks of non-reliance clauses appear overstated and can be greatly reduced - if not entirely eliminated - by conditioning their use together with safeguards found in other states such as creating exclusions for application of the principle when one party has superior knowledge of contractual conditions which another party cannot ascertain with reasonable diligence.[37] The use of specific, detailed non-reliance clauses should be greatly expanded so that parties may be free to contract without fear of being unjustifiably accused of fraud. ■

continued on p. 24

continued from p. 23

[1] *Mejia v. Jurich*, 781 So. 2d 1175, 1178 (Fla. 3d DCA 2001).
[2] *Texas Standard Oil & Gas, L.P. v. Frankel Offshore Energy, Inc*., 394 S.W.3d 753,768 (Tex.App.2012).
[3] *Northwest Bank & Trust Co. v. First Illinois National Bank*, 354 F.3d 721, 725-26 (8th Cir. 2003) (merger clause will not preclude a fraud claim even if the parties are sophisticated).
[4] *Abry Partners*, 891 A.2d at 1035 – 36.
[5] Obtaining a party's signature by fraud, i.e., the party signing did not recognize or consent to signing the document that was actually signed, is a form of alleged fraud that is outside the scope of this article.
[6] Note, Big Boy Letters: Trading On Inside Information, 94 Cornell L. Rev. 133, 140 (2008). Author Edwin D. Eshmoilit argues non-reliance clauses, often termed "Big Boy Letters" for the view that parties to sophisticated securities agreements were "big boys" and could take care of themselves, emerged in response to a United States Supreme Court case regarding the misappropriation theory of insider trading: "This liability carve-out in *[United States v.] O'Hagan* [,521 U.S. 642 (1997)] subsequently gave birth to the idea of big boy letters-agreements that allow a party to trade on material, nonpublic information without having to disclose any such information." Id.
[7] *JM Vidal, Inc. v. Texdis USA, Inc.,* 764 F. Supp. 2d 599, 623 (S.D.N.Y. 2011).
[8] *Harbinger Capital Partners Master Fund I, Ltd. v. Wachovia Capital Markets, LLC*, 27 Misc. 3d 1236(A) at *5, 910 N.Y.S.2d 762 (Sup. Ct. May 10, 2010).
[9] *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 320 (1959). New York has an exception for "peculiar knowledge" where a party would face extraordinarily high costs or great difficulty in ascertaining the truth or falsity of statements. See, e.g., *Schooley v. Mannion*, 659 N.Y.S.2d 374, 375 (1997) (insulation within the structure was "not easily verified without destructive testing"). But the exception is subject to an exception if the party has the means to ascertain the truth using ordinary intelligence. See *ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.,* 25 N.Y.3d 1043, 1044 (2015).
[10] *RAA Mgmt., LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 118-19 (Del. 2012).
[11] *Anvil Holding Corp. v. Iron Acquisition Co*., 2013 WL 2249655, at *8 (Del. Ch. May 17, 2013).
[12] *Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126,141 (Del. Ch. 2009).
[13] *Prairie Capital III, L.P. v. Double E Holding Corp.* 132 A.3d 35 (Del. Ch. November 24, 2015).
[14] Prairie Capital III, L.P., 132 A.3d at 51.
[15] Id.
[16] Id.
[17] *Slack v. James,* 364 S.C. 609 (2005).
[18] *Slack*, 364 S.C. at 612.
[19] Id.
[20] Id. at 615.
[21] Id.
[22] Id. at 618.
[23] *Abel*, 48 F.3d 1247, 1258 (D.C. Cir. 1995).
[24] Id at 619.
[25] Id. at 620.
[26] *Billington*, 192 So. 3d 77 (Fla. 5th DCA 2016).
[27] *Billington*, 192 So. 3d at 79.
[28] Id.
[29] Id.
[30] Id.
[31] Id. at 79-80.
[32] Id. at 85.
[33] Id. at 84. The decision goes on to certify conflict with *Lower Fees, Inc. v. Bankrate, Inc*., 74 So.3d 517 (Fla. 4th DCA 2011), "to the extent that the disclaimer language there did not contain a waiver," and to list six questions of great public importance. Unfortunately, the intermediate appeal was not taken to the Florida Supreme Court and was eventually settled.
[34] Zeitlin, Andrew M and Baker, Alison P., At Liberty to Lie? The Viability of Fraud Claims after Disclaiming Reliance, American Bar Association Section of Litigation (April 23, 2013).
[35] This article obviously concerns itself with broader aspects of a fraudulent inducement claims as opposed to the judicial inferences of truthfulness of allegations at the motion to dismiss stage or the outcomes of evidentiary conclusions at trial. Those two topics are beyond the scope of this article.
[36] Some states require the combination of merger/integration clauses with non-reliance clauses, specific detailing of the representations relied upon, or require affirmative as opposed to negative "I have not relied on . . ." statements. Moreover, some states limit use of non-disclaimer clauses when one party has all the relevant information and the other party does not have the means to obtain the information.
[37]- An obvious example that comes to mind is superior knowledge of structural building components that could not be discovered through reasonable inspections.