Real Property and Financial Services Section
Hawaii State Bar Association

Newsletter

April 1993

LETTER FROM THE CHAIR

Recently, I received a call from a mainland lender asking whether Hawaii permitted the filing of prototype mortgages.

As I learned, in at least some states, a lender can record a form (i.e., prototype) mortgage, containing all of the standard terms and conditions. Then, when a loan is made, the borrower executes a much shorter document which contains only the specific information necessary to constitute a valid lien, such as the full names and addresses of the parties, the loan amount, and the legal description of the mortgaged property. The shortened document also incorporates, by reference to the recorded prototype mortgage, all of the standard terms and conditions set forth in that prototype mortgage. Presumably, if the lender and borrower agree on modifications to the standard terms and conditions, those modifications will also be set forth in the shortened version of the mortgage.

While it is common practice in Hawaii to record "short-form" leases, option agreements, and other such documents, those short forms refer to, and incorporate, the terms of unrecorded documents. Oftentimes, the purpose of those short form documents is to give notice of and create a valid lease or lien while keeping the basic terms confidential. This is compared to the practice of recording a prototype mortgage by one party and then incorporating it in a bi-party document in order to provide public notice of the full terms and conditions of the agreement between the lender and borrower.

Although there is no statutory provision either specifically permitting or prohibiting the recordation of such a prototype instrument which does not affect a particular parcel of property, the recording offices, including the Land Court system, will accept documents of somewhat similar effect, such as general powers of attorney which are not related to a specific piece of property.

Nevertheless, when the question of the acceptability of a prototype mortgage was posed to the recording offices, I was initially surprised at the rather enthusiastic response received.

The tour of the Bureau of Conveyances taken by the Board of Directors of this Section last month explained the response. It takes two full-time clerks to unstaple, microfilm, and restaple the documents received for recordation each day. (This also explains other rules of the recording offices, such as those related to stapling.) Many of these documents are standard apartment deed, apartment lease and mortgage forms. Substantial time, effort and money (not to mention trees) could be saved by the recording offices as well as those preparing, handling and executing documents, if prototype documents, statutory deed forms and the like were adopted for this State. This is a matter which those of us who practice in this area should consider pursuing.

Deborah Macer Chun
Chair, Real Property and
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NEWS FROM THE BUREAU OF CONVEYANCES

The Bureau of Conveyances announced that in the near future it will no longer routinely return recorded documents by mail. It is anticipated that new procedures for returning recorded documents will be implemented within the next two or three months.

Discussions with title companies, major lenders and other interested parties have already, or will soon take place to establish the necessary procedures for returning the recorded documents. At a meeting held April 16, representatives of various title companies were informed that the new procedures will require each title company to pick up the recorded documents that each such company delivered to the Bureau.

Major lenders, law firms and other companies that routinely deliver documents to the Bureau for recordation also must establish procedures for pick up of the recorded documents with the Bureau. Procedures for individuals recording documents and documents mailed to the Bureau from other states or countries has not yet been addressed.

Usually it requires about ten days before documents recorded in the "regular system" are ready for mailing by the Bureau of Conveyances for return to the appropriate party; documents filed in the Land Court System take about two months before being returned.

Representatives of the Bureau of Conveyances stated that a memorandum covering the procedures to be established for return of recorded documents

that previously were mailed will be distributed in the near future to interested parties. ■

SAVE THE DATES

Upcoming Real Property and Financial Services Seminars

Several real property and financial services seminars have been planned for 1993:

Code of Financial Institutions	June 18
Legislative Update	July 16
Title Insurance	August 12
Litigation Update	October 15
Land Use Issues	December 3

Prof. David Callies, a member of the Board of the Section and a nationally recognized authority on land use controls has agreed to chair the Land Use seminar at the State Bar Convention on December 3. The seminar will cover a most interesting variety of topics including Regulatory Takings after Lucas, Coastal Zones and Shoreline Permits, County Development Plans, Amendments to the State Land Use Boundaries and the 5-Year Review, and Native Hawaiian Property Rights after Pele. The annual meeting of the Section will precede the seminar.

Two dates are still available for real property seminars, although topics are still under discussion. If there any topics you would be interested in, please contact Deborah Chun or Nancy Grekin. ■

PRACTICAL POINTERS: CONDOMINIUM DEVELOPMENT

By Mitchell A. Imanaka

The development of condominium projects in Hawaii is usually, if not always, market driven. If the demand is there, the project will be built. If not, it won't. Consequently, many projects are built in phases to minimize risk to the developer and its lender in any event that a previously-anticipated market for units does not exist.

If your client is contemplating the development of a phased condominium project, it is suggested that the land underlying the proposed project be subdivided prior to undertaking any such development. Subdividing the land will help to avoid the following potential pitfalls:

- **Mechanics' lien problems.** If the land underlying a project is not subdivided prior to development, a possibility exists that work done in later phases of the project may give rise to liens which may affect units in prior phases. This is because, in Hawaii, mechanics' liens arise upon "visible commencement of operations" on the site no matter when the work is actually done. Thus, even if work is started on a later phase after initial closings in the first phase of the project, if a lien is filed as a result of that work, and absent enforceable lien waivers, such a lien may impact units in the first phase. This result may be avoided by subdividing the site prior to the commencement of work.
- **Construction financing issues.** Generally, the construction lender will want to have a security interest in real property in order to lend money to the developer to build subsequent phases. Upon the initial conveyance of a unit in the first phase, however, the construction lender will be placed in the position of having subordinated its lien to the condominium regime. If the lender then wishes to foreclose upon a developer default, the lender will find that its security merely consists of certain reserved rights, vested in the developer, to continue the construction and sale of subsequent phases of the project. Normally, conservative construction lenders will balk at continued funding of the project loan given such nebulous security. If the project land is subdivided, however, the developer will be able to pledge the land of the subsequent phase areas as security, thus avoiding the construction lender's concerns.
- **Take-out financing issues.** Both FHA, Fannie Mae and Freddie Mac require that a project be substantially complete prior to certifying a project in which mortgage loans will be purchased. Accordingly, in any phased project, if the phases are not clearly identified as separate "projects," and, at least for FHA purposes, subdivided from the remaining portions of the project, "completion of the project" will not be deemed to have occurred upon completion of a particular phase. This will result in secondary market investors such as Fannie Mae and Freddie Mac not certifying a project and buying loans in a particular project until completion of the entire project, as opposed to the completion of a particular phase of the project. Usually, closings will not occur until certification is received. Again, this result may be avoided by subdividing the project land such that particular project areas may be clearly identified as separate "projects."
- **Loss of developer control over subsequent phase areas.** Although in any phased project the developer will reserve numerous rights unto itself to continue development of the project, the effectiveness of such a reservation has not as yet been tested in Hawaii courts. Accordingly, there is some measure of risk to a developer who proceeds on the assumption that it will be able to exercise prescribed reserved rights (such as the reserved right to build subsequent phases) at the appropriate time after the conveyance of units in earlier phases of a project. If a complication occurs and claims are made by owners of apartments in earlier phases, the developer may not have the ability to continue the development of subsequent phases. If, on the other hand, the underlying land has been subdivided, the owners of apartments in a particular phase will not have an ownership interest in lands upon which the developer proposes to build subsequent phases, and any claim by an apartment owner in a prior phase should not affect the development of such subsequent phases.
- **Construction contract and bonding problems.** If the financing for a particular phased project is done on a revolving loan basis, as many are, unless the bonding company has sufficient assurances as to the strength of the developer and the likelihood that sales will occur in the project, it is unlikely that the company will issue a bond covering the construction contract unless the financing for the project covers the entire project. Revolving loan financing relies on the clos-

ings of sales in prior phases in order that there may be sufficient funds to complete the project, and does not usually provide a commitment of funds sufficient to complete all phases of the project. If construction of the entire project must be bonded, however, and inadequate financing exists, the bond may not be available, and the developer may not be able to obtain its final report. Again, if the project is subdivided, however, the construction contract may be divided according to phases and, to the extent that the developer can show that it has adequate financing for a particular phase, the contractor should be able to obtain the requisite bond.

The bottom line on phased condominium projects is that time invested in the subdivision process up front will avoid numerous and very significant problems for a project down the road. Accordingly, when in doubt, subdivide! ■

UPDATE ON THE FEDERAL FAIR DEBT COLLECTION PRACTICES ACT

By Joyce Y. Neeley
Neeley & Anderson

The Fair Debt Collection Practices Act of 1978 (15 U.S.C Sections 1692 *et seq.*) has been the subject of some recent federal court interpretations which could have a significant impact on lawyers who collect debts on behalf of their clients.

Many Lawyers Will Qualify as a Debt Collector.

A debt collector is defined under the Act as any person: 1) who is in any business the principal purpose of which is to collect debts; 2) who regularly attempts to collect, directly or indirectly, debts owed or due another; or 3) who, in the process of collecting his or her own debt, uses any name other than his or her own. [15 U.S.C. Section 1692a(6)] Effective July 9, 1986, the exemption for attorneys in the FDCPA was eliminated. Data illustrated that by 1985 more lawyers were engaged in debt collection than non-attorney collectors. Crossley v. Lieberman, 868 F.2d 566, 569 (3rd Cir. 1989). An attorney who regularly collects consumer debts is now subject to all provisions of the FDCPA. Courts have, in fact, emphasized that abuses by lawyers are more serious than other abuses:

> Abuses by attorney debt collectors are more egregious than those of lay collectors because a consumer reacts with far more duress to an attorney's improper threat of legal action than to a debt collection agency committing the same practice.

Crossley v. Lieberman, 868 F.2d 566, 570 (3rd Cir. 1989). And, it is clear that many courts have taken the position that the FDCPA now covers many lawyers in general practice, not just those who make debt collection the focus of their practice. Littles v. Lieberman, 90 B.R. 700 (E.D. Pa. 1988) (Court finds that FDCPA applies to lawyer with general practice where that practice included a minor but regular debt collection practice.); Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992), aff'g Zartman v. Shapiro & Meinhold, 811 P.2d 409 (Colo. Ct. App. 1990) (Attorneys whose collection activities are primarily limited to foreclosures are debt collectors if they otherwise fit the definition.).

Special Issues Related to Lawyers Who Are Debt Collectors.

A. Venue.

The FDCPA requires that the suit against a debtor be filed only in the district where the consumer signed the contract upon which the suit is based or where the consumer resides. Actions to enforce an interest in real property may be brought only where the property is located. Regardless of whether the state statute may permit suit in a different county, the FDCPA prohibits such action. Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992), aff'g Zartman v. Shapiro & Meinhold, 811 P.2d 409 (Colo. Ct. App. 1990).

B. Limitations on Communications With Third Persons.

Although the FDCPA contemplates the need to deal with third parties during discovery and post-judgment proceedings, it permits such contacts only when conducted "with the express permission of a court of competent jurisdiction" or "as reasonably necessary to effectuate a postjudgment judicial remedy." 15 U.S.C. Section 1692c(b). Thus, there are many instances where contact with third parties may not be appropriate without consent or express permission -- e.g. interviewing non-client witnesses for trial.

C. If a Complaint is the First Contact, the Validation Notice may be Required for Collection Purpose.

The FDCPA requires that within five days of the initial communication with a consumer regarding the collection of a debt, the attorney must send the consumer a written notice containing: 1) the amount of the debt; 2) the name of the creditor; 3) a statement that if the consumer does not dispute the validity of the debt within 30 days of receiving the notice, it will be assumed that the debt is valid; 4) a statement that if the consumer disputes the debt in writing within 30 days, a verification of the debt or a copy of the judgment will be sent to him or her; and 5) a statement that the consumer will be provided with the name and address of the original creditor if different from the current creditor if requested in writing within 30 days. 15 U.S.C. Section 1692 g(a). Also, in the initial communication and all subsequent communications with the consumer, whether written or verbal, the attorney must state that he or she is attempting to collect a debt and that all information obtained will be used for that purpose. 15 U.S.C. Section 1692 e(11). The question which remains under the Act is whether, if the complaint is the initial communication, the initial notice must still be given. Although the FTC staff through informal staff letters and staff commentary takes a somewhat equivocal position on that issue, because of the broad interpretation the FDCPA is receiving by the courts, the most conservative approach would be to give the notice.

D. Threatening to File Suit When There is No Intention To Do So.

The FDCPA prohibits threats to file suit when there is no intention to do so. In Baker v. G.C. Services Corp., 677 F.2d 775 (9th Cir. 1982), the court held that a threat to sue which is, in fact, not a *bona fide* threat, is a violation of the Act. The FDCPA prohibits threats to file suit immediately when there is no intention to do so. In Graziano v. Harrison, 763 F.Supp. 1269 (D.N.J. 1991), aff'd in part and rev'd in part on other grounds, 950

F.2d 107 (3d Cir. 1991), the court concluded that an attorney's letter which threatened filing of suit if payment was not received within 10 days violated the Act when payment was not made until three months later and no legal action had been filed. Also, the Act clearly prohibits taking action when the threatened action is beyond the authority of the person making the threat. Crossley v. Lieberman, 868 F.2d 566 (3rd Cir. 1989) (Threatening to proceed with suit within one week when the debtor had a 30 day right to cure under state law is a violation.) It is possible that a threat to take action which is not intended could also be a violation of ethical standards applicable to attorneys: "[An attorney] may not threaten more than he can reasonably do. ..." ABA Informal Decision C-734, Informal Ethics Opinions 320 (1975).

The Validation Notice.

Congress apparently viewed the validation notice as a central provision in the Act and as a consequence the courts have strictly enforced that provision. In Swanson v. Southern Oregon Credit Service, 869 F.2d 1222 (9th Cir. 1988), the court adopted the "least sophisticated debtor" standard and rejected placement of the notice in the communication which was not at least as prominent as the threats of collection. Thus, it is not compliance with the FDCPA to enclose the notice on a separate piece of paper or to place it in small print. Furthermore, because of the "least sophisticated debtor" standard, many courts have held that it is a violation of the Act to send a demand letter of less than 30 days:

> Congress designed section 1692g to provide alleged debtors with 30 days to question and respond to the initial communication of a collection agency. The form used by [the creditor] in this case invokes a shorter response period, promising harm to the debtor who waits beyond 10 days. The form thus represents an attempt 'on the part of the collection agency to evade the spirit of the notice statute and mislead the debtor into disregarding the [required debt validation] notice.'

Id. at 1225-26. Other Circuits have followed this position. See e.g. Graziano v. Harrison, 950 F.2d 107 (3d Cir. 1991); Miller v. Payco General American Credits, Inc., 943 F.2d 482 (4th Cir. 1991). See also Sakuma v. First Nat'l Credit Bureau, National Clearinghouse for Legal Services, No. 45, 756 (D. Hawaii 1989) (collection letter violated the validation rights notice requirements because a demand for a payment within seven days would be contradictory and confusing to least sophisticated consumers). But see Bailey v. TRW Receivables Management Services, Inc. National Clearinghouse For Legal Services No. 45, 769 (D. Hawaii 1990) (request for immediate payment did not contradict notice of validation rights). As the Third Circuit noted:

> There is a reasonable probability that the least sophisticated debtor, faced with a demand for payment within ten days and a threat of immediate legal action if payment is not made in that time, would be induced to overlook his statutory right to dispute the debt within thirty days. ... A notice of rights, when presented in conjunction with such a contradictory demand, is not effectively communicated to the debtor. We conclude that the statutory notice provided . . . failed to meet the terms of [the Act].

Graziano v. Harrison, 950 F.2d 107, 111 (3d Cir. 1991). Thus, it appears that any demand letter of less than 30 days could be a violation of the Act. ■

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