

REAL PROPERTY SECTION OF THE MISSISSIPPI BAR NEWSLETTER MAY 2010

2009-2010 Real Property Section Officers

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SECTION ANNUAL MEETING IN DESTIN

The Real Property Section will hold its annual meeting in Destin during the Mississippi Bar Convention. The meeting will be on **Thursday, July 8, 2010**. The Real Property Section CLE Committee (Donovan McComb, Chad Russell and Jim Tohill) are currently working on this year's presentation at the Bar Convention. Michael Martz will present an hour on ethics, including some of the more recent real estate closing disasters, and Sean Milner will update the group on RESPA and Good Faith Estimate changes.

NEW LEGISLATION

Here are some new laws passed by the 2009-10 Mississippi legislature that affect real estate.

Priority of deed of trust when real property turns personal-Miss. Code § 75-2-107(3), provides that the rights of a purchaser of goods severed from the land are subject to "third party rights provided by the law relating to realty records." [SB 2419](#) amends Section 75-2-107(3) to add to the end of the quoted language the following: "including the priority of previously recorded deeds of trust under Section 89-5-5". This language is intended to make clear that if minerals or timber are severed from the land, the lien and priority of an existing deed of trust continues in the minerals or timber despite their severance. This incorporates the holding of a case of first impression on this issue decided (correctly) by the Mississippi Court of Appeals, *Feliciano Bank & Trust Co. v. Manuel & Sessions, L.L.C.*, 943 So.2d 736 (Miss. Ct. App. 2006). This amendment becomes effective on July 1, 2010.

Statute of limitations for non-negotiable notes-Under current Mississippi law, the statute of limitations on negotiable promissory notes is six years under Mississippi's version of Article 3 of the Uniform Commercial Code, which governs negotiable instruments, while the general three-year statute of limitations applies to non-negotiable promissory notes by default. One problem this difference raises is that whether a note is negotiable or not is often not always clear on the face of the note, and in fact is a matter about which attorneys can and do disagree. As recently as April 8, 2010, the Mississippi Supreme Court issued a decision on whether a note was negotiable. *Whitaker v. Limeco Corp.*, 2010 WL 1379991. [SB 2419](#) adds a new statute, to be codified as new Section 15-1-81, that provides that the statute of limitations for non-negotiable notes is extended from three years to six years. Under the new law all promissory notes will have the same six-year statute of limitations. One effect this change will have is that it will be easier to tell from the land records when a deed of trust begins to lose priority to third parties. Under Miss. Code Ann. § 89-5-19, a deed of trust begins to lose priority when the statute of limitations on the secured note runs. Since one usually cannot tell from the face of a deed of trust whether the secured note is negotiable or non-negotiable, one cannot tell whether the statute of limitations on the secured note is three years or six years, and so cannot tell when the deed of trust begins to lose priority. This new statute becomes effective on July 1, 2012.

Transfer fees unenforceable-Under [HB 886](#), a covenant in a deed that requires a transferee of residential property to pay a fee to a third party in connection with the transfer of the property is unenforceable. Exceptions exist for fees to an owners' association, an IRC § 501(c) entity or a governmental entity. This statute would prevent a developer from enforcing a requirement in residential subdivision covenants that remote transferees of property have to pay a transfer fee to the developer after the developer has sold all of his interest in the subdivision. Under the common law, such a covenant would not be enforceable because it does not "touch and concern" the land, and because it is a covenant in gross rather than a covenant appurtenant. The most recent Restatement of Servitudes, which has been cited by the Mississippi Supreme Court in other contexts, discards the "touch and concern" doctrine and the distinction between appurtenant and gross covenants, and substitutes a general requirement that a covenant be "reasonable." A transfer fee that would not be enforceable under the "touch and concern" test arguably would be enforceable under the Restatement test. This new statute becomes effective July 1, 2010.

Lands owned by state agencies-Miss. Code Ann. § 29-1-1 governs how state agencies hold title to real estate. [HB 1447](#) amends Section 29-1-1 to require all state agencies to inventory lands that are titled in the name of the agency, quitclaim any such lands to the State of Mississippi, and provide copies of the deeds to the Secretary of State. HB 1447 also authorizes the Secretary of State to accept gifts or donations of land to the state. This new statute becomes effective on July 1, 2010.

The Uniform Real Property Electronic Recording Act was introduced in both the House, H.B. 314, and the Senate, S.B. 2508. These bills would have permitted electronic filing of documents in the real property records. Both bills died in committee.

CASES

Unauthorized Deed from LLC does not convey title to BFP

Bankplus v. Kinwood Capital Group, L.L.C., United States District Court for the Southern District of Mississippi, Civil Action No. 3:08cv498 DPJ-JCS, 2009 WL 3062457 (Sept. 18, 2009). This case is an appeal to a United States District Court from an order of a bankruptcy court. George Kiniyalocts and Michael Earwood formed a Mississippi limited liability company, Kinwood Capital Group, L.L.C. (“Kinwood”). Kinwood purchased land for development. Earwood, purporting to act on behalf of Kinwood, executed a deed purporting to convey the land to Northlake Development, L.L.C., another Mississippi company of which Earwood was the sole member. Under Kinwood’s limited liability company agreement, Earwood had no authority to execute a deed on behalf of Kinwood. Northlake executed a deed of trust on the property to BankPlus. Northlake defaulted on its loans to BankPlus, and the bank commenced foreclosure of its deed of trust. Kinwood, which had filed bankruptcy, sought an injunction against the sale. The bankruptcy court determined that the deed from Kinwood to Northlake was void because Earwood was not authorized to sign the deed, and that the deed of trust from Northlake to BankPlus therefore also was void. The bankruptcy court relied in part on Miss. Code Ann. § 79-29-303(1), which provides that every member of the LLC is an agent of the LLC unless the member in fact has no authority to act for the LLC and the person with whom he is dealing has knowledge of the fact that the member has no authority; and Section 79-29-303(4), which provides that no act in contravention of a restriction on authority will bind the LLC to a person having knowledge of the restriction. The bankruptcy court reasoned that since Earwood was not authorized to execute the deed from Kinwood to Northlake, and since Northlake had knowledge of Earwood’s lack of authority since Earwood owned Northlake, the deed from Kinwood to Northlake was void. Since Northlake did not have title to the land, the deed of trust from Northlake to BankPlus was void. The bank argued that since it was a bona fide vendee for value, its deed of trust should be valid. However, this issue apparently is one of first impression, and no authority in Mississippi or any other jurisdiction could be found supporting this argument. In the absence of any authority for the bank’s position, the district court affirmed the bankruptcy court’s holding that the bank’s deed of trust was void.

Note 1: This case has been appealed by BankPlus to the Fifth Circuit. But even if it is eventually settled, it frames some basic issues under Mississippi real estate law.

Note 2: To be clear, the authorization problem was not in the loan transaction between the bank and its customer (Northlake), but in the deed into the bank’s customer from the customer’s predecessor in title (Kinwood.) So a diligent check by BankPlus of the authority of the person executing the deed of trust on behalf of its borrower (Northlake) would not have revealed the lack of authority issue.

Note 3: The problem is that the requirements for due authorization of a business entity usually are an off-record matter. Examples of limitations on due authorization are requirements that two officers sign a deed, or that the signature of an officer be attested by the secretary with the corporate seal. Another potential limitation is whether approval

of the members, stockholders or limited partners is required for the particular transaction. For LLCs these requirements are in its operating agreement; for a corporation, its bylaws; for a limited partnership, its partnership agreement; and the operating agreements, bylaws and partnership agreements are not recorded. The certificate of formation recorded in the Secretary of State's office may specify such limitations, but these days it is rare to see anything in the certificate of formation other than the bare minimum legal requirements. Moreover, the operating agreement, bylaws or partnership agreement can be amended without any notice filed in the Secretary of State's office.

Note 4: For commercial properties, when the lender or purchaser is represented by an attorney, the attorney for the lender or purchaser usually will document due authorization by requiring as a condition of closing that the borrower or seller provide an attested incumbency certificate. Forms of incumbency certificates vary, but usually have attached copies of the borrower or seller's certificate of formation; a good standing certificate; a copy of the borrower or seller's operating agreement, bylaws, or partnership agreement; a copy of the resolution authorizing the loan or sale identifying the persons authorized to act on behalf of the borrower or seller; and specimen signatures of these authorized signatories. The level of specificity usually varies depending on the amount of money involved. Extra steps are necessary when dealing with a trustee or executor.

Note 5: In the *Kinwood* case, there were no intervening BFP's between the deed into Northlake and the deed of trust to BankPlus. Suppose that Northlake had conveyed the land to BFP1, BFP1 conveyed the land to BFP2, BFP2 had conveyed the land to BFP3, and then BFP3 had executed the deed of trust to BankPlus. Would the result be any different than in the *Kinwood* case? It appears to the editor that under the rationale of *Kinwood*, since the deed into Northlake was void, all of the subsequent deeds and deeds of trust are void also, regardless of the intervening BFP's.

Note 6: A limited statutory protection for lenders and purchasers is Section 15-1-11 of the Mississippi Code, which provides a ten-year statute of limitations on actions to recover land because a deed or other instrument was not signed by the proper officer of a corporation, a corporate seal is missing, there is no proof in the record of approval by a corporate board of directors, and for certain defects in the acknowledgment. This statute applies by its terms to corporations and not to partnerships and LLCs.

Note 7: In Mississippi the Secretary of State's records regarding corporations and other business entities are usually easily accessible on the Secretary of State's website. In many states one can only get copies of corporate documents after suffering exorbitant fees and delay. The downside of having corporate documents easily accessible is that you are more likely to be second-guessed if you don't check than if corporate documents were less readily accessible.

Note 8: One common problem that the editor sees is when the members of a manager-managed LLC sign a deed or deed of trust as members and not as manager. Most operating agreements of manager-managed LLCs expressly provide that all management authority for the company is vested in the manager and that the members do not have any power to act on behalf of the company. So if the operating agreement contains this provision, is a deed or deed of trust signed by the members as members only valid? A

related issue arises when a member of a member-managed LLC signs as “manager” or even “president.” As noted above, LLC records for LLCs formed under or authorized to do business in Mississippi are usually available for review on the Secretary of State’s website. A certificate of formation of an LLC will indicate whether the LLC is member-managed or manager-managed. For example, it only takes about a minute to determine from the Secretary of State’s records that Kinwood is a member-managed LLC, that Northlake is a manager-managed LLC, and that Michael Earwood signed the certificates of formation and is the registered agent for both companies.

Note 9: Does an attorney for a lender or purchaser have any duty to its client to check the authority of the seller or borrower’s predecessor in title? Does it make a difference if the predecessor in title was related to the borrower or seller? Remember that in the *Kinwood* case, the deed from Kinwood to Northlake was void because Earwood knew that he did not have authority to sign the deed to Northlake on behalf of Kinwood, and this knowledge was imputed to Northlake. One problem with checking the authority of predecessors in title is that the necessary records are not recorded in the public records.

Note 10: Title insurance should protect a purchaser or lender from the type of risk that is the subject of the *Kinwood* case. One of the standard Covered Risks in the 2006 ALTA owner and loan policies is “A defect in the Title caused by ... failure of any person or Entity to have authorized a transfer or conveyance;”. Are there circumstances in which a title company could argue that a purchaser or lender’s lack of due diligence regarding the borrower’s authorization was a defense to a claim under a policy?

Definition of “Neighborhood” for Zoning Purposes Expands to Infinity

Edwards v. Harrison County Board of Supervisors, 22 So. 3d 268 (Miss. 2009). The Harrison County Development Commission (HCDC) executed a contract to purchase 627 acres of land in the unincorporated Saucier community, which is in the northerly part of Harrison County. The land had been zoned agricultural and light residential in 2000. The HCDC intended to use the land as an industrial park, so the agreement was subject to the land being rezoned from agricultural and light industrial to general industrial. The HCDC applied to the Harrison County Board of Supervisors to rezone the land. The HCDC argued that since Hurricane Katrina, there existed a need for industrial land north of I-10 (the interstate highway that runs east and west parallel with the coast), and that the hurricane, and consequential shift of population north of I-10, constituted change. Local citizens expressed concerns about water quality, traffic and sufficiency of utilities. The Board of Supervisors approved the rezoning in 2006. Residents of Saucier appealed to the Circuit Court of Harrison County. The Circuit Court affirmed the Board’s decision. On appeal, in an *en banc* decision written by Justice Pierce, the Mississippi Supreme Court affirmed. In order to rezone property, there must either be a mistake in the original zoning or a change in the character of the neighborhood and a public need. In regards to the question of whether HCDC had proven change in the “neighborhood”, the court relied on *Kuluz v. City of D’Iberville*, 890 So. 2d 938 (Miss. Ct. App. 2004), in which the court said that the “neighborhood” was all of the City of D’Iberville north of I-10, and *Childs v. Hancock County Board of Supervisors*, 1 So. 3d 855 (Miss. 2009), in which 1000 acres was rezoned, to hold that there was sufficient proof of “change in the neighborhood.” The

court also noted that the supervisors could consider their own familiarity with the area sought to be rezoned and the effects of Hurricane Katrina. Chief Justice Waller, joined by Justices Graves and Kitchens, argued that the “neighborhood” for purposes of zoning should be the property sought to be rezoned and its immediate surroundings, and that since the HCDC did not show any proof of change in the Saucier area, its rezoning request should have been denied.

Note 1: The “neighborhood” for zoning purposes has always been difficult to define. But this decision sets a record in Mississippi for defining the term broadly. Under the court’s definition in this case, it appears that the “neighborhood” includes all of Harrison County north of I-10, which according to the dissent is two-thirds of the county.

Note 2: In this case the applicant was an agency of Harrison County applying to Harrison County; in effect, the county is asking itself to do something. But now it appears to the editor that the supervisors are going to have a hard time denying zoning petitions from other parties on the basis of a lack of proof of change.

Note 3: The dissent noted that the change in the zoning was from the most restrictive, light residential, to the least restrictive, general industrial, which permits among other uses chemical processing plants, slaughter houses, creosote plants and poultry processing plants.

Note 4: The majority opinion seems to be trying to make a distinction between zoning in the county and zoning in a municipality, and suggesting that when the zoning is in a county rather than a municipality, a change that affects the entire county should be taken into account.

Note 5: The *Kuluz* and *Childs* cases cited by the *Edwards* court provide interesting contrasts to the *Edwards* case. In the *Childs* case, while the area being rezoned was 1000 acres, the case does not address the question of what constituted the “neighborhood.” In the *Kuluz* case, the petitioner claimed that the “neighborhood” was all of the City of D’Iberville north of I-10, and the citizen opposing the rezoning argued that the neighborhood was much smaller. The circuit court found that both sides could point to valid reasons for their definitions; the issue thus was “fairly debatable” and the city’s decision to rezone was not arbitrary and capricious.

Note 6: Another recent case that provides an interesting contrast is *Cockrell v. Panola County Board of Supervisors*, 950 So. 2d 1086 (Miss. Ct. App. 2007). In this case the board of supervisors cited the opening of a nearby business as evidence of change. The Court of Appeals noted that the business was one-half mile away from the subject property and therefore was not in the same neighborhood as the subject property. 950 So. 2d at 1094.

Note 7: Does this decision mean that the concept of “neighborhood” is so elastic as to be as meaningless a restriction as, say, “interstate commerce”? In any event, it is clear that Mississippi Supreme Court is taking a more expansive reading of what constitutes a “neighborhood.”

LIENS AGAINST REAL PROPERTY FOR FEDERAL FINES

A federal statute provides that a judgment in favor of the United States imposing a fine or ordering restitution is a lien against “all property and rights to property of the person fined as if the liability of the person fined as if the liability of the person fined were a liability for a tax assessed under the Internal Revenue Code of 1986.” [18 USC § 3613](#). The lien arises upon entry of judgment and continues for twenty years. Has anyone ever seen one of these? Under Mississippi’s version of the Federal Lien Registration Act, Miss. Code Ann. § 85-8-5, wouldn’t a notice of such a lien have to be filed in the chancery clerk’s office in order to be constructive notice to third parties.

GENERAL

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