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## ULSIA - Modified for Minnesota

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**John D. Healy, Jr.\***

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## I. INTRODUCTION

In the early 1990s, a panel of the American College of Real Estate Lawyers (“ACREL”) discussed the difficulties of drafting, closing, and foreclosing multi-state commercial mortgages. It was clear that state laws had to be reformed to preserve and enhance the value of commercial real estate as loan collateral. During the question period of the ACREL discussion, Norman Geis of Chicago urged that ACREL members from each state support enactment of the Uniform Land Security Interest Act (“ULSIA”).

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Minnesota's basic mortgage law dates from the nineteenth century. Though often patched, it has never had a comprehensive recodification. Lawyers and lenders from other states find it difficult to comprehend. After talking with several ACREL colleagues from Minnesota, I agreed to look at the possible benefits of the ULSIA for our state. Preliminary review indicated:

1. The ULSIA was very well thought out. Many of its concepts would improve and clarify Minnesota's mortgage law.
2. Since ULSIA deals comprehensively with its subject, enactment would be difficult.

About the same time, Daniel W. Hardy, Executive Vice President and General Counsel of the Mortgage Bankers Association of Minnesota ("MBAM"), became interested in the ULSIA through national meetings of the Mortgage Bankers Association. I was referred to the MBAM when I inquired about the ULSIA in Minnesota. The MBAM was interested in the ULSIA only for commercial and industrial real estate loans. It declined to pursue changes in the law which governs home loans or agricultural loans.

Robert Tennesen, a former Minnesota State Senator and a Commissioner on Uniform State Laws from Minnesota, caused the ULSIA to be introduced in the 1992 session of the Minnesota Legislature. That bill was the 1985 ULSIA proposed by the Commissioners on Uniform State Laws, except that loans on agricultural and homestead properties were excluded from coverage. Loans less than \$500,000 also were excluded, so that only major borrowers would be involved in the changeover.

The 1992 bill was introduced to focus discussion of mortgage law reform. It was not scheduled for committee hearings.

Late in 1992, I undertook to chair a subcommittee of the Legislative Committee of the Real Property Section of the Minnesota State Bar Association. The subcommittee was formed to study the ULSIA and to report on its feasibility for Minnesota. Subcommittee members included: Kevin J. Dunlevy, J. Kenneth Myers, William T. Norton, Jerry O. Relph, Mary E. Senkus, John R. Wheaton, and Constance L. Wilson-Steele. During three years of meetings, the subcommittee concluded that the ULSIA would significantly improve Minnesota mortgage law, and recommended several modifications to the ULSIA.

## II. MODIFICATIONS

### A. *Coverage*

The subcommittee's draft of the ULSIA retained broad exclusions for loans on one-to-four family residential property and for loans on agricultural property, as well as the \$500,000 minimum for the ULSIA. These exclusions from coverage made the "protected party" concept of the ULSIA inoperative. All protected party provisions were deleted. The subcommittee came to agree with the MBAM that there is a fundamental distinction between loans to those in personal possession of homes and farms versus loans to developers and investors who are not occupants.

### B. *Usury*

Article IV of the ULSIA addressing "usury" was deleted. In Minnesota, usury is not an issue in business loans that would be affected by the ULSIA.

### C. *Foreclosure Period*

The 1985 draft of the ULSIA allowed foreclosure sales to occur five weeks after default. The subcommittee extended that time to sixty days to conform to the cancellation period applicable to contracts for deed in Minnesota, and to allow time for the creditor's meeting.

### D. *Contracts for Deed*

The subcommittee recommended that contracts for deed not be covered by the ULSIA. Minnesota has a non-judicial, statutory cancellation procedure for contracts for deed. It provides the equivalent of strict foreclosure; title reverts immediately to the contract vendor sixty days after the notice of cancellation is served.

### E. *Creditors' Meeting*

The subcommittee adapted an alternative dispute resolution procedure from Minnesota's farm mortgage law. The secured creditor would be required to call a meeting to be held within three to four weeks after the notice of foreclosure is issued. All "interested persons," including the debtor, guarantor, other senior and junior creditors, and mechanic's lienors would be notified. Those who attend the creditors' meeting would be

required to state the source and amount of their claims and their claim of priority. The meeting would be most useful for defaulted construction loans. It may be possible to salvage the project if all concerned can be brought together promptly.

#### F. *Priority of Nonobligatory Advances*

Members of the Construction Law Section of the Minnesota State Bar Association pointed out that the 1985 ULSIA would eliminate mechanic's lienors' claims of priority over the secured creditor, to the extent of nonobligatory advances made by the secured creditor. The MBAM agreed that the lienors' priority should be retained.

#### G. *Notice to Mechanic's Lien Claimants*

Minnesota allows mechanic's lienors to file 120 days after the last labor or material is supplied. The recommended sixty-day foreclosure period would eliminate many mechanic's liens before they were even filed. After consulting with the Construction Law Section of the Minnesota State Bar Association, the subcommittee recommended that provision be made for early notice by potential lien claimants, so that they can participate in the creditors' meeting and in reinstatement.

#### H. *Reinstatement*

The 1985 ULSIA did not allow reinstatement of a defaulted loan after acceleration. The subcommittee recommended that reinstatement be allowed during the first forty-five days of the sixty-day foreclosure period.

#### I. *Receivers*

Minnesota allows the creditor a court-appointed receiver as a matter of right. The subcommittee recommended that this remedy not be disturbed.

#### J. *Effective Date*

The subcommittee recommended that the ULSIA become effective on January 1 of the second year following enactment. The delay would allow time for technical corrections during the intervening legislative session, and for continuing legal education, revision of loan documents, and orderly negotiation of loan commitments.

### III. MAJOR CHANGE FOR MINNESOTA—ABOLISH REDEMPTION

Minnesota allows a period of redemption after foreclosure sale. For most commercial loans, the redemption period is six months. Although the receiver remedy enables a secured creditor to promptly curtail “milking” of an income property, the lengthy redemption period is a problem. Ownership and long-term management decisions are kept in suspense for a minimum of eight months after foreclosure is commenced. This delay can be devastating to construction contractors, apartment residents, and shopping center and office building tenants and their employees.

### IV. PROCEDURE & RESOLUTION

State Senator David Knutson, the primary legislative sponsor of the ULSIA, sought broad support for comprehensive mortgage law reform prior to conducting legislative committee hearings. While the recommended sixty-day foreclosure period approximates the six weeks published notice now required for a nonjudicial foreclosure by advertisement in Minnesota, abolition of the six-month redemption period would extinguish the debtor’s last hope in two months instead of eight.

The subcommittee recommended a sixty-day foreclosure period in the belief that sixty days would be enough time for the creditor to conduct a sale at a price that would approach market value. The foreclosure statute should provide positive incentives for a new party to purchase the troubled property and end the involvement of the creditor and debtor. The new purchaser will be able to make improvements, write leases, and make other management decisions on a long-term basis. Neither receivers nor creditors intending to resell can take the long-term approach.

At a public meeting held to discuss the ULSIA, considerable doubt was expressed whether prospective purchasers could complete their due diligence in sixty days. There also was a doubt whether many prospects would even begin due diligence without control of the property through an option or a contingent purchase agreement.

If a near-market sale to a new party is not feasible in sixty days, or if the process of getting a defaulted property back into commerce will not even begin until the creditor has complete control of the property, it may be better for Minnesota to adopt a shorter foreclosure period. Must the debtor’s interest be completely eliminated before marketing to third parties can begin?

The MBAM has requested that hearings not be held in the 1996 Minnesota Legislative Session and that those involved in the real estate industry consult further to develop a fair and efficient time frame for the foreclosure process.