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# ESSAYS

## LAND TITLE ISSUES FOR COUNTRIES IN TRANSITION: THE AMERICAN EXPERIENCE

HUGH A. BRODKEY\*

### INTRODUCTION

Title insurance provides a mechanism for evaluating and shifting many risks related to the ownership of real property and arising from the application of the title records and conveyancing systems. Investors in the United States are accustomed to using title insurance in any transaction involving the acquisition of real property rights, either directly or as a security for the investment. It is only natural, therefore, that American investors investigating foreign real estate markets want to obtain a similar product. Since title insurance is a uniquely American phenomenon with very limited use in Canada, Mexico and England, the investor is faced with the problem of understanding and weighing the risks of foreign conveyancing systems. In countries with long-standing viable real estate markets, established real estate laws and conveyancing practices and a body of professional conveyancers produced manageable systems for determining the ownership of real property, identifying competing claims and identifying and allocating risks. These systems are frequently quite different from those in the United States, a source of concern to the U.S. investor. Most importantly, however, investors in those countries may be comfortable with a greater degree of risk than U.S. investors.

The U.S. investor is faced with an even more difficult situation when dealing with real property located in what can be called Countries in Transition — those countries undergoing major political, social and economic change. The legacy of the Nazi and Communist regimes in Central and Eastern Europe, the recent social and political change in South Africa and the current efforts in China to expand its participation in the global economy have all raised serious questions for outside investors. Not unexpectedly, U.S. investors wonder whether title insurance companies can

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\* Vice President and Associate General Counsel Chicago Title Insurance Company ©. The following comment is based on a presentation made by the author to introduce the Second Robert Kratovil Program in Real Estate Law at The John Marshall Law School on September 21, 1995, entitled *Challenges to American Investors in Real Estate in China, South Africa and Eastern Europe*.

issue title insurance in each of these foreign countries. The answer requires that the title insurer analyze the title and conveyancing system in place or being developed in the particular country. It is interesting to note that in each country the author investigated, the same four major areas of risk seem to exist.

The first major risk is that various private parties may have rights arising from land being taken from them in a clearly, or arguably, illegal way. The second major risk involves the uncertainty of defining the nature of private property rights in countries developing new laws. The third risk U.S. investors face is the uncertainty of the extent to which foreign governments will tolerate or encourage real property investment by foreign entities under current and future laws. Lastly, U.S. investors cannot be sure of the degree of certainty given to real property ownership under existing and planned foreign record and conveyancing systems.

How should a country in transition resolve these areas of risk and uncertainty? U.S. investors frequently assume that the American real property system is free from the four areas of risk described above. Foreign governments frequently ask consultants whether aspects of the U.S. real property system could be beneficially imported into their system. Actually, throughout its history, the United States has dealt with all of these risk areas and continues to do so. Not only is it unclear whether American solutions would be useful to other foreign countries, but it is not even certain whether the solutions worked satisfactorily for us.

#### I. THE RIGHTS OF PRIVATE OWNERS DISPLACED BY THE GOVERNMENT: NATIVE AMERICAN LAND CLAIMS

The approach of the English colonies in dealing with the Native Americans was consistent with the English tradition of treating indigenous peoples as sovereign nations.<sup>1</sup> The acquisition of real property took the form of purchases and treaties. Early in U.S. jurisprudence, the Supreme Court enunciated the concept of Aboriginal Title.<sup>2</sup> In essence, the mere fact that native peoples were using the property before the Europeans arrived gave those people rights in the property. The Aboriginal Title was good against all parties except the federal government. Many cases dealt with the issue of how the federal government could alter, or permit alteration, of native property rights.<sup>3</sup> During some peri-

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1. *E.g.*, James Warren Springer, *American Indians and the Law of Real Property in Colonial New England*, 30 AM. J. LEGAL HIST. 25, 32 (1986).

2. *Johnson v. M'Intosh*, 21 U.S. (8 Wheat.) 543, 586 (1823). *See also* *Cherokee Nation v. Georgia*, 30 U.S. (5 Pet.) 1, 17 (1831) (stating that the relationship between Indians' land and the United States resembled that of a "ward to his guardian").

3. *See, e.g.*, Tim Vollman, *A Survey of Eastern Indian Land Claims: 1970-1979*,

ods, the government acted through the executive branch and in other periods through the legislative branch.<sup>4</sup> While the number of transactions between the government and the native tribes has steadily declined, over the last twenty-five years numerous significant lawsuits have tested the propriety of past transactions.<sup>5</sup> While some of these disputes are based upon the fairness and equity of the original transaction, others are based on a technical foundation, such as whether Congress properly approved a treaty between a state and a tribe.<sup>6</sup>

It is important to note that the social and economic issues raised by these disputes have parallels today in countries undergoing change. How does the legal system deal with the competing claims of prior owners (or of the descendants of prior owners) who were improperly deprived of property rights 50, 100 or 150 years ago when the property has been occupied by other totally innocent parties for a similar amount of time? Should the land be returned? Should compensation be paid by the government? Should compensation be paid by the current occupants?<sup>7</sup>

Has the United States resolved these issues? Even today, private parties must frequently structure their development of forest lands and resort areas to accommodate Native American hunting and fishing claims. The issue of gambling casinos on Indian reservations continues to raise questions concerning the overlapping jurisdiction of federal, state and tribal law.<sup>8</sup> The courts and the legislature still have much to explore.

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31 ME. L. REV. 5, 7 (1979) (discussing both the federal grant of rights to Indians and the Indian Nonintercourse Act); see also John Eduard Barry, Comment, *Oneida Indian Nation v. County of Oneida: Tribal Rights of Action and the Indian Trade and Intercourse Act*, 84 COLUM. L. REV. 1852, 1853 (1984). Federal law governs tribal land rights with the United States holding the underlying fee to most reservation lands. *Id.* Therefore, a tribe's "possessory interest cannot be alienated without federal approval." *Id.*

4. See 5a RICHARD R. POWELL & PATRICK J. ROHAN, *POWELL ON REAL PROPERTY* §§ 67.01-67.04 (1995) (explaining the distinctions between aboriginal title, recognized title and executive order title).

5. See, e.g., *Nichols v. Rysavy*, 809 F.2d 1317 (8th Cir.), *cert. denied*, 484 U.S. 848 (1987).

6. See *Oneida Indian Nation v. County of Oneida, N.Y.*, 414 U.S. 661, 676 (1974) (finding that treaties determine the nature and extent of Indian's rights); see also *County of Oneida, N.Y. v. Oneida Indian Nation*, 470 U.S. 226, 231 (1985) (requiring the U.S. Supreme Court to determine the validity of a treaty between New York and the Oneida tribe).

7. See Paul Brodeur, *Annals of Law: Restitution*, THE NEW YORKER, Oct. 11, 1982, at 76-155 (vividly describing the legal and political implications of settling successful claims of the Passamaquoddy and Penobscot tribes of Maine).

8. E.g., *Seminole Tribe v. Florida*, 11 F.3d 1016 (11th Cir. 1994), *aff'd*, 116 S. Ct. 1114 (1996); *New Mexico v. Johnson*, 904 P.2d 11 (N.M. 1995).

## II. THE DEFINITION OF PRIVATE PROPERTY RIGHTS

There is a general belief that the English colonists enjoyed an advantage in the area of property rights because they brought England's well-established land laws with them to the New World.<sup>9</sup> After the American Revolution, states frequently incorporated the entire body of English law directly into the fundamental law of the state.<sup>10</sup> Over the years, court decisions and specific state legislation have modified these laws, but we are still creatures of the Common Law property forms.

Ironically, from time to time these forms have proven to be obstacles rather than aids to real property investment. For example, a popular commercial financing structure in recent years is the "convertible mortgage" in which the dollar investment of the investor is secured by both a mortgage on the real estate and an option to buy the real estate. This structure gives the lender great flexibility in deciding how long and in what form to continue the investment. The convertible mortgage serves the needs of sophisticated real estate developers and financial companies. However, it created great apprehension on the part of property lawyers since it seems to violate the Common Law rule prohibiting the "clogging of the mortgagor's equity of redemption."<sup>11</sup> The classical English rule was that the lender was not allowed to impose any impediments on the right of the borrower to pay the debt and fully remove the lender's rights in the land as created by the mortgage. Consequently, English courts in earlier times would not enforce an option given to the lender in connection with a mortgage.<sup>12</sup>

Would contemporary American courts also come to this conclusion? There was real concern that they might and a flurry of articles attempted to distinguish modern transactions.<sup>13</sup>

It is also interesting to note that while U.S. law has adopted the common law distinctions between real and personal property, modern commercial transactions, such as the use of Real Estate Investment Trusts, test these concepts to the limit. When tax laws or banking laws discriminate between real and personal property,

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9. The reader should note, however, that the Spanish and French colonies brought a better understanding of Community Property concepts to America.

10. *E.g.*, 1 PA. CONS. STAT. ANN. § 1503 (1975); VA. CODE ANN. § 1-11 (Michie 1950).

11. Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure — An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 856 n.36 (1985).

12. Laurence G. Prebel & David W. Cartwright, *Convertible and Shared Appreciation Loans: Unclogging the Equity of Redemption*, 20 REAL EST. PROB. & TR. J. 821, 824 (1985).

13. *See id.* at 823 n.1.

we are faced with the somewhat strained situation of a bank refusing to make mortgage loans secured by real property, but not hesitating to buy all of the shares of a corporation owning the controlling partnership interest in a partnership which owns real estate.<sup>14</sup>

By importing the whole panoply of English Common Law estates into our law, our colonial ancestors gave U.S. property lawyers great flexibility for crafting new forms of real estate ownership and investment. Even before the passage of enabling legislation, American property developers and financiers had created ownership structures similar to condominiums. Similarly, since estates in land could be separated from ownership of buildings, sale-leaseback financing could be made increasingly elaborate. On the other hand, many former Communist countries have not yet decided on the extent to which private ownership of land will be permitted. In these countries the emphasis has been, and continues to be, solely on the recognition of rights to *use* the land and on various ownership rights in the buildings and improvements. Will they, too, ultimately utilize sale-leaseback techniques?

It could be said, then, that while the United States seemed to benefit by importing an entire body of real property law at the outset, the countries whose law is now in transition may still have an advantage in being able to craft a unique body of law which is more attuned to the current commercial needs of the country.

### III. FOREIGN INVESTMENT IN REAL PROPERTY

The English colonies followed the common law doctrine that a non-citizen could own land with a title which was good against everyone except the sovereign.<sup>15</sup> Through a procedure of "office found," the sovereign could seize the property without compensation. At the same time, the non-citizen did not have "heritable blood" so that the property belonging to the non-citizen could not be inherited by a non-citizen.<sup>16</sup> To promote immigration, the colonies encouraged foreign settlers to become British citizens so that they could actually own land. The success of this policy became a major political issue and, in fact, the colonists complained in the Declaration of Independence of King George III's inaction in gran-

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14. For a description of the structure and limitations of the REIT, a creature of the tax laws, see S. Michael Giliberto, *An Overview of Real Estate Investment Trusts*, THE GUARANTOR (Chicago Title Insurance Co.), Spring 1993, at 6.

15. *Fairfax's Devises v. Hunter's Lessee*, 11 U.S. (7 Cranch) 603, 607 (1813); James A. Frechter, *Alien Landownership in the United States: A Matter of State Control*, 14 BROOK. J. INT'L L. 147, 150 (1988).

16. Frechter, *supra* note 15, at 150; 2 WILLIAM BLACKSTONE, COMMENTARIES \*249.

ting British citizenship to many U.S. immigrants.<sup>17</sup> Ironically, after the Revolution, it was the British loyalists who were the aliens and the colonies confiscated their property and turned it over to the new government.<sup>18</sup>

After the Revolution, most of the states enacted laws concerning foreign ownership of land but many distinctions were drawn. Some treated aliens as citizens.<sup>19</sup> Others distinguished between resident and non-resident aliens.<sup>20</sup> Others sought to reward citizens of those countries which had helped the colonies in the Revolution.<sup>21</sup> Since that time, the attitude of the states toward foreign investment seems to have gone in waves. During most of the nineteenth century, statutes were sympathetic to foreign occupancy and ownership of land. During the depression of the 1880s, however, as the Populist movement swept through the farm communities, the blame for farm foreclosures and tenant evictions was placed on big corporations and foreign owners. The large cattle ranches owned by absentee English and European investors were an easy target for many state laws which subsequently restricted or limited the ownership of such land by aliens.<sup>22</sup> In the 1920s and 1930s, some restrictions were imposed as a result of prejudice against Oriental immigrants and settlers. The laws in California and other western states purported to restrict even resident aliens "not eligible to citizenship" (*i.e.*, Orientals) from owning real property.<sup>23</sup> While the courts continued to uphold the power of the states to restrict land ownership by non-resident aliens, resident aliens were held to have constitutional protection.<sup>24</sup> The 1970s and 1980s saw a large number of real property investments by sources in the Middle East, Japan, Germany and

17. THE DECLARATION OF INDEPENDENCE para. 9 (U.S. 1776).

18. See C. ALBERT WHITE, A HISTORY OF THE RECTANGULAR SURVEY SYSTEM 17 (1985).

19. *E.g.*, COLO. REV. STAT. §§ 15-11-111, 15-11-112 (1973); MASS. GEN. LAWS ANN. ch. 184, § 1 (West 1987); OHIO REV. CODE ANN. § 2105.6 (Baldwin 1994); TENN. CODE ANN. §§ 66-2-101, 66-2-102 (1995); TEX. PROB. CODE ANN. § 41(c) (West 1980); TEX. PROP. CODE ANN. § 5.005 (West 1984).

20. *E.g.*, MISS. CONST. art. IV, § 1; OKLA. CONST. art. XXII, § 1; MISS. CODE ANN. § 89-1-23 (1972); WIS. STAT. ANN. § 710.02 (West 1981).

21. Prior to 1985, Connecticut granted the right to "hold, inherit or transmit real estate" to "any alien resident in the United States, and any citizen of France . . ." CONN. GEN. STAT. §§ 47-57 (1978).

22. From 1880 to 1900, eight states which had granted aliens the same treatment as citizens adopted restrictions (Colorado, Illinois, Kansas, Minnesota, Nebraska and Wisconsin). Charles H. Sullivan, *Alien Land Laws*, 36 TEMP. L.Q. 15, 31 n.68 (1962).

23. For a discussion of these statutes, see generally *Takahashi v. Fish & Game Comm'n*, 334 U.S. 410 (1948); *Oyama v. California*, 332 U.S. 633 (1948); *Namba v. McCourt*, 204 P.2d 569 (Ore. 1949).

24. *Oyama*, 332 U.S. at 633.

other parts of the world. Some communities welcomed the investment<sup>25</sup> and others resisted it.<sup>26</sup> The current anti-immigrant pressures in states like California and in Congress create doubt as to exactly what the future position of many of the states will be concerning foreign ownership of U.S. land.

For countries where private ownership of land is a new or recently restored concept, it is hardly surprising that the threat of foreign intrusion into the physical and economic control of land looms large.

#### IV. SECURITY OF THE TITLE SYSTEM

The American recording system is virtually unique. The early colonial system of recording the conveyances of land parcels was not part of the English tradition,<sup>27</sup> but it served the purpose of preventing disputes and set the stage for some of today's recording statutes.<sup>28</sup> The basic pattern involved the land owner depositing a copy of the deed acknowledged by some public official in a central place available to the public. This differed from a title registration system requiring a formal government approval to the transaction.

In the United States, the recording system was expanded significantly following the American Revolution. The treaty with England gave the United States land extending from the colonies

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25. South Carolina is an earlier example of legislative flexibility. The South Carolina Constitution requires the General Assembly to enact laws limiting the number of acres any alien may own within the state. S.C. CONST. art. III, § 35. For many years, legislation established a limit of 500 acres. In 1956, apparently to encourage a specific commercial development, this limit was raised to 500,000 acres. S.C. CODE ANN. §57-103 (Law. Co-op. 1952) (amended 1956).

26. The Oklahoma Constitution prohibits aliens who are not residents of Oklahoma from acquiring or owning land. OKLA. CONST. art. XXII, § 1. In 1979 the Oklahoma Attorney General took the position that the constitutional restriction applied to corporations as well as individuals and attempted to declare an escheat of valuable office buildings belonging to a Canadian corporation. The state supreme court agreed with this interpretation, but held that the particular corporation had become "domesticated" through being licensed to do business and was no longer an alien. State *ex rel.* Cartwright v. Hillcrest Investment, Ltd., 630 P.2d 1253, 1257 (Okla. 1981).

27. Indeed, the English crown had tried since the time of Henry VIII to require a central recording or "enrollment" of land transfers (to prevent the avoidance of transfer taxes). Statute of Enrollments, 27 Hen. 8, ch. 16 (1536). The efforts were a failure due to the ingenuity of Common Law lawyers who devised conveyancing structures such as Deeds of Lease and Release which were not technically deeds of "bargain and sale" and were not subject to "enrollment" under the statute.

28. R.G. Patton compares the 1640 law of the General Court of Massachusetts Bay Colony to the modern recording statutes of Massachusetts. R.G. Patton, *Priorities, Recording and Registration*, in 4 AMERICAN LAW OF PROPERTY § 17.4 (A. James Kasner ed., 1952).



West to the Mississippi River — an asset of very great value.<sup>29</sup> The federal government had two immediate needs for the land: the proceeds from the sale of this land was needed to pay war debts and the land itself was needed to compensate many of the soldiers and officers who had been paid during their service with scrip and land warrants. The mechanics of dealing with these vast areas of only partly-explored land further encouraged the use of widely spread local offices (frequently on a county level) for the maintenance of land documents.

Commencing with the Government Survey of 1785, surveyors divided areas into square townships of six miles by six miles (and then further subdivided them into thirty-six mile-square sections). Records of the initial property sales were maintained in a few land offices, but after that point, further transactions were documented by depositing copies of the subsequent deeds, mortgages and other documents in more local offices.<sup>30</sup> The recording laws which supported these offices established a secure way of determining the ownership of a particular piece of property. In a two-step process, it was necessary to search the records office for all of the documents affecting the particular piece of property and then to examine each document to evaluate its legal effect. In some parts of the country a lawyer accomplished both steps. In other parts of the country an abstractor did the search while the lawyer wrote an opinion of title. In this system, some risks still existed including errors committed by the abstractor or lawyer, "hidden risks" such as forgery or other matters which did not appear from the records, and errors on the part of the Recorder. If such a risk resulted in economic loss, it could be difficult to determine which party, if any, was responsible and how to recover damages from such a party. It was this set of risks and problems which led to the development of title insurance.<sup>31</sup> Since that time, title insur-

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29. Treaty of 1793, Sept. 3, 1783, U.S.-Great Britain, 48 C.T.S. 487.

30. Many countries facing the "privatization" of land held by the government are concerned about two issues: 1) whether wealthy interests should be allowed to amass large land holdings or whether sales should be controlled to assure widespread ownership by ordinary citizens; and 2) how the government can assure it is not parting with too much land.

The Land Ordinance of 1785, "An Ordinance For Ascertaining The Mode of Disposing of Lands in the Western Territory" (passed by Congress on May 20, 1785), addressed both these issues. After dividing the area into six mile square townships and one mile square sections, the townships were sold alternately as entire tracts and as individual sections. This hindered the amassing of continuous tracts. In addition, the government retained four sections, plus "Section 16" for school purposes, from each township sale.

31. The case which inspired title insurance was *Watson v. Muirhead*, 57 Pa. 161 (1868). In this case, the professional conveyancer knew of recorded judgments which appeared to affect the title but ignored them after consulting with an attorney. *Id.* at 164. The conveyancer was held not to be negligent and, therefore, not

ance has been expanded to provide coverage for many other types of risks and the provision of many other services related to real property transactions.

Most other countries have some form of title registration system involving the use of cadastres and title registries maintained by government officials.<sup>32</sup> By their nature, these systems provide varying degrees of protection to the real property investor. In some countries undergoing change, such as South Africa, such a system is well maintained and reliable,<sup>33</sup> while in other countries the prior records have been destroyed, neglected or are otherwise deficient. The establishment of reliable land records and conveyancing procedures is critical to the future economic development of many countries.<sup>34</sup> The U.S. system of document recording and title insurance has proven itself to be effective for a country with *its* history and *its* tradition of land development. Indeed, with few exceptions, American experiments with "Torrens"-style title registration systems have been discarded.<sup>35</sup>

#### CONCLUSION

Like the American colonies, many countries are in a position to create a property ownership system and a title system "from scratch." There are many models from which to choose. None are risk free. Time will tell whether the choices made allocate risk in a manner which simultaneously fulfills the needs of the citizens and is sufficiently attractive to foreign investors.

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liable to the purchaser who relied on his work and suffered a loss. *Id.* at 172.

32. For an excellent historical review and analysis of the relationship between cadastral (map-oriented) records and title registration systems, see generally GERHARD LARSSON, *LAND REGISTRATIONS AND CADASTRAL SYSTEMS* (1991).

33. See generally F.G.T. Radloff, *Land Registration and Land Reform in South Africa*, 29 *J. MARSHALL L. REV.* 809 (1996).

34. *A Matter of Title*, *THE ECONOMIST*, Dec. 9, 1995, at 47.

35. See generally BLAIR C. SHICK & IRVING H. PLOTKIN, *TORRENS IN THE U.S.: A LEGAL AND ECONOMIC HISTORY AND ANALYSIS OF AMERICAN LAND-REGISTRATION SYSTEMS* (1978).

