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May 4, 2007

The Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21401-1991

Re: Senate Bill 396 and House Bill 463

Dear Governor O'Malley:

We have reviewed and hereby approve Senate Bill 396 and House Bill 463, identical bills entitled "Ground Rents - Remedies for Nonpayment of Ground Rent." In the course of our review, we have considered whether the bills violate the Contract Clause of the United States Constitution, the Due Process Clauses of the Maryland and United States Constitutions, the guarantee of access to courts in the Maryland Constitution, or constitute an unconstitutional taking, and we have concluded that the bills are constitutional.

Senate Bill 396 and House Bill 463 amend Real Property Article § 8-402.2 which provides procedures for the remedy of ejectment for nonpayment of rent, to exclude residential leases from this provision, leaving the remedy of ejectment only for commercial leases and those for multifamily uses with four or more dwellings.[1] Section 8-402.3, which provides additional procedures for ejectment for nonpayment of rent, is

[1] The ground rent bills consistently draw a line between smaller residential uses and multifamily uses with four or more dwellings. In this letter, we have used the term "residential property" to refer to the former.

repealed.[2] The bills also specify that the action for possession in Real Property Article § 14-108.1 does not apply to an action for nonpayment of ground rent under a ground lease on residential property, and repeal a provision limiting the ability of a ground lease holder to receive reimbursement for additional costs and expenses related to the collection of back rent in a suit or action to recover back rent. The bills add a new Real Property Article § 8-402.3, applicable to ground rents on residential property, which provides for the establishment of a lien for past due rent on the property subject to the ground rent. The lien that is created has priority from the date that the ground lease was created. The bills further provide that the lien may be foreclosed in the same manner as a mortgage or deed of trust that contains neither a power of sale nor a consent to decree if the lien is not satisfied.[3] If the lien is foreclosed, the ground lease holder of a redeemable ground rent is to be paid the amount of the lien, including rent that has come due since it was established, and the redemption amount calculated under Real Property Article § 8-110(b)(2). In the case of an irredeemable ground rent, the ground lease holder is to receive the amount of the lien, including the rent that has come due since it was established, and the purchaser of the property takes the property subject to the ground rent. The bills also provide for the satisfaction of the lien in cases where the lienholder cannot be found.

These bills, and others related to ground rent, have been introduced in response to articles in the Baltimore Sun in December of 2006.[4] Those articles reflect that ejectment

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[2] The bills use the term "ground lease holder" for the holder of the reversionary interest, and "leasehold tenant" for the holder of the leasehold interest.

[3] Compare the procedures set out in Maryland Rule 14-204 with respect to foreclosure and sale under a power of sale or an assent to decree, with those in Maryland Rule 14-205 relating to foreclosure where the lien instrument or statutory lien contains neither a power of sale nor a consent to a decree.

[4] *See On shaky ground; An archaic law is being used to turn Baltimoreans out of their homes,* Baltimore Sun (December 10, 2006); *The new lords of the land: A small number of investors who own many Baltimore ground rents often sue delinquent payers, obtaining their houses or substantial fees,* Baltimore Sun (December 11, 2006); *Demands for Reform: Even as critics call for loosening ground rent's grip on Baltimore, new ones are being created*, Baltimore Sun (December12, 2006); *Family faces loss of home over suit*, Baltimore Sun (December 15, 2006); *Clerk of Court reviews suits on ground rent*,

actions over ground rents were increasing at a high rate, and that people were losing their homes over small amounts of past due rent. The articles also reflect that by the time the homeowner gets notice of the suit, costs have risen to the point where many homeowners cannot afford to pay them to keep their home. In one case, a suit over $24 in ground rent ended up being settled for $18,000. Research of court records show that fewer than 2% of homeowners win their cases once sued, and that a high number do not attempt a defense. The articles also revealed that it was not always possible to find the ground lease holders in order to pay the rent, and that notice of ejectment actions often did not reach the leasehold tenants.

In the ground rent lease, as used in Maryland, the owner of the land in fee simple typically leases it for the period of 99 years, with a covenant for renewal from time to time forever upon payment of a small renewal fine, upon the condition that the lessee will pay a certain rent and that if the payment is in default the lessor may reenter and terminate the lease. *Kolker v. Biggs,* 203 Md. 137, 141 (1953). The lessee also covenants to pay all taxes on the property. *Id.* The annual rent reserved has traditionally been small, usually an amount which, if capitalized at a reasonable rate of interest, represented what was conceived to be the value of the land. *Heritage Realty, Inc. v. City of Baltimore*, 252 Md. 1, 3 (1969). Since the rent was categorized as a rent *service*, the remedy of distraint was available to the lessor. *Id.* The lessor also had a right to re-enter in the event that the rent was six months in arrears. *Id.*

The leasehold interest in the property is considered personalty, and is governed by the law that directs administration of the personal estate. *Myers v. Silljacks*, 58 Md. 319, 330 (1882). But it "so far partakes of the realty that the title can only pass by deed executed with all the solemnities which are prescribed by law for the sale and conveyance of real estate." *Bratt v. Bratt*, 21 Md. 578, 583 (1864). It has also been said that "in practical effect" the leasehold is "real property subject to payment of the ground rent and all taxes on the land and improvements." *Kolker v. Biggs,* 203 Md. 137, 141 (1953); *Moran v. Hammersla*, 188 Md. 378, 381 (1947), *see also City of Baltimore v. Latrobe*, 101 Md. 621, 640 (1905) (The leaseholder ... is the substantial owner of the property). Moreover, the leasehold tenant has the authority to "take down and build up, alter, remodel and reconstruct" the improvements on the property "at his own pleasure" so long as he does not render the reversioner's rent insecure. *Crowe v. Wilson*, 65 Md. 479, 484

Baltimore Sun (December 19, 2006); *Ground rent case settled – for $18,000*, Baltimore Sun (December 21, 2006).

(1886). In short, the absolute management and control of the property is in the leasehold tenant so long as the rent is paid. *Beehler v. Ijams*, 72 Md. 193 (1890); *Crowe v. Wilson*, 65 Md. 479, 481-482 (1886).

The interest in the reversion is deemed an interest in real property. *Myers v. Silljacks*, 58 Md. 319, 330 (1882); *Coombs v. Jordan*, 3 Bland 284 (1831). And it is treated as real property in probate. *Culbreth v. Smith*, 69 Md. 450, 454 (1888); 15 *Opinions of the Attorney General* 242 (1930). The nature of the interest in the reversion is not the same as that of an ordinary owner in fee simple. *Mayor and City Council of Baltimore v. Canton Company*, 63 Md. 218, 236 (1885). Instead, interest in the land is but a form of money investment, analogous to that secured by a mortgage. *Id*. at 237. *See also Heritage Realty Inc. v. City of Baltimore*, 252 Md. 1, 8 (1969) (The reversion is in effect a mortgage without a due date). "All that the owner of the ground rent is concerned about is that his rent is secure, and in the great majority of leases made years ago in Baltimore, it is secure whether the property is improved or not, as they were made when the value of the ground was much less than it is now." *City of Baltimore v. Latrobe*, 101 Md. 621, 640 (1905). The owner of the reversion has no cause of action against one who damages any improvement to the land unless the damage imperils his security. *Whiting-Middleton Construction Company v. Preston*, 121 Md. 210, 216 (1913). He or she cannot consent to installation of telephone poles on the property, *Maryland Telephone Company v. Ruth*, 106 Md. 644, 657 (1907), or to petition for the paving of the street, *Holland v. Mayor and City Council*, 11 Md. 186 (1857). He or she may not build on or improve the property, *Beehler v. Ijams*, 72 Md. 193, 195 (1890), and in most cases, cannot sue the leasehold tenant for waste, *Crowe v. Wilson*, 65 Md. 479, 481 (1886).

There can be no question that Senate Bill 396 and House Bill 463 have retroactive effect, in that they reach ground leases entered into in advance of their effective date.[5] In *Dua v. Comcast*, 370 Md. 604, 623 (2002), the Court of Appeals held that the Constitution of Maryland, specifically Declaration of Rights Article 19, guaranteeing access to courts, and 24, guaranteeing Due Process and Article III § 40 of the Constitution, which prohibits taking without just compensation "prohibits legislation

[5] In fact, in light of the passage of Chapter 1 of 2006, (Senate Bill 106), which prohibits the creation of new ground rents, these bills are likely to apply only to contracts entered into prior to their effective date.

which retroactively abrogates vested rights."[6] However, the Court has also recognized that a person has no vested right in a particular remedy. *Baltimore & O. R. Co. v. Maughlin*, 153 Md. 367, 376 (1927); *Wilson v. Simon*, 91 Md. 1, 6 (1900). Thus, "the Legislature may retroactively abrogate a remedy for the enforcement of a property or contract right when an alternative remedy is open to the plaintiff." *Dua v. Comcast*, 370 Md. 604, 638 (2002).

There is no question that ejectment is a remedy rather than a property right. 9 M.L.E. *Ejectment* § 1.[7] It is consistently referred to as such in cases in which it is discussed. *Porter v. Schaffer*, 126 Md.App. 237, 273 (1998); *Fett v. Sligo Hills Development Corp*., 226 Md. 190, 196 (1961); *Glorius v. Watkins*, 203 Md. 546, 549 (1954); *Lansburgh v. Donaldson*, 108 Md. 689, 691 (1908); *Carswell v. Swindell*, 102 Md. 636, 639 (1906); *Myers v. Silljacks*, 58 Md. 319, 331 (1882); *Lannay's Lessee v. Wilson*, 30 Md. 536, 546 (1869); *Fenwick v. Floyd's Lessee*, 1 H. & G. 172, 173, 1827 WL 753 (1827). Thus, the Maryland Constitution does not prevent the General Assembly from abrogating the remedy of ejectment for nonpayment of rent on residential ground rents, and providing the remedy of a lien and foreclosure in its place.

It is also established that the alteration of remedies does not violate the Contract

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[6] In contrast, Due Process analysis under the federal Constitution requires only that the retroactive application of the legislation independently meet the rational basis test, that is, that it be rationally related to the accomplishment of a legitimate State purpose. *Usery v. Turner Elkhorn Mining Company*, 428 U.S. 1, 15-17 (1976). In light of the problems identified in the Baltimore Sun articles, there can be no question that replacement of the remedy of ejectment with creation of a lien and the possibility of foreclosure is rationally related to the State's interest in protecting its citizens from the loss of their homes and all equity therein for debts as small as $24. Significantly more far-reaching changes in remedy have been held not to violate federal Due Process requirements. *See Duke Power v. Carolina Environmental Study Group*, 438 U.S. 59 (1978); *New York Cent. R. Co. v. White*, 243 U.S. 188 (1917).

[7] It has been argued that Senate Bill 396 and House Bill 463 work a taking because they destroy the right of re-entry. However, the substitution of the remedy of creation of a lien and the possibility of foreclosure, protects the interests that protected by the right of re-entry in the context of nonpayment of rent. In other contexts, such as failure to renew the ground rent, and equitable waste, *see Crowe v. Wilson,* 65 Md. 479 (1886) the right of re-entry survives, and can be enforced using the remedy of ejectment.

Clause of the United States Constitution, unless it "so affects that remedy as substantially to impair and lessen the value of the contract." *Pittsburg Steel Company v. Baltimore Equitable Society*, 113 Md. 77, 80 (1910), *affirmed* 226 U.S. 455 (1913); *Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 315 (1843). "[T]he new remedy may be deemed less convenient than the old one, and may in some degree render the recovery of debts more tardy and difficult, yet it will not follow that the law is unconstitutional." *Wilson v. Simon*, 91 Md. 1, (1900), *citing Bronson v. Kinzie*, 42 U.S. (1 How.) 311, 316 (1843). This is true whether the remedy is expressly included in the lease, *Wilson v. Simon*, 91 Md. 1, 6 (1900); *Van Rensselaer v. Snyder*, 13 N.Y. 299, 1855 WL 6888 (N.Y. 1855), or included under the general rule that remedies existing at the time of the formation of the contract become part of the contract. *Pittsburg Steel Company v. Baltimore Equitable Society*, 113 Md. 77, 80 (1910), *affirmed* 226 U.S. 455 (1913). This is because "[n]ot only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order." *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 435 (1934); *Gelfert v. National City Bank of New York*, 313 U.S. 221, 231 (1941), *see also*, *Van Rensselaer v. Snyder*, 13 N.Y. 299, 1855 WL 6888 (N.Y. 1855) ("[T]he parties to the grant must be presumed to have contracted in reference to the power and right of the legislature to modify or annul that remedy in common with others."). Furthermore, not even the inclusion of specific remedies in the contract can "bind the hands of the State" and prevent its abolition. *Wilson v. Simon*, 91 Md. 1, 6 (1900).

While Senate Bill 396 and House Bill 463 eliminate the ability to bring an action of ejectment for nonpayment of rent on a ground lease of residential property, they protect the interest protected by that remedy by providing for the establishment of a lien, and permitting foreclosure of the lien on complaint of the ground lease holder. The substituted remedy involves additional steps, and requires better notice to the holder of the leasehold interest. Thus, it is arguably less convenient, and may make the recovery of debts more tardy and difficult. But it does not impair the contract. Moreover, while the remedy eliminates the windfall profits that can be made by ejectment in the current market for real property, it permits the ground lease holder to recover the full amount of the rent, the security of which the right to re-enter is intended to protect. as well as the redemption value of the ground lease in the case of redeemable ground rents. A ground lease holder is constitutionally entitled to no more than payment in full. *Gelfert v. National City Bank of New York*, 313 U.S. 221, 233-234 (1941); *Honeyman v. Jacobs*, 306 U.S. 539, 544 (1939); *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124, 130 (1937). In fact, it has been held that "state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily

constitute a substantial impairment" requiring Contract Clause scrutiny. *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 411 (1983). Since Senate Bill 396 and House Bill 463 do no more than restrict ground lease holders to the gains they could reasonably expect from their contracts - that is, the past due rent, costs, and redemption where appropriate - it does not substantially impair the contract.

Even if the alteration of remedy in Senate Bill 396 and House Bill 463 were found to substantially impair the contract between the parties, modern Contract Clause jurisprudence makes clear that the constitution prohibition on the impairment of contract is not absolute. Instead, "its prohibition must be accommodated to the inherent police power of the State 'to safeguard the vital interests of its people.'" *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 410 (1983), *citing Home Building & Loan Assoc. v. Blaisdell*, 290 U.S. 398, 434 (1934). Thus, a substantial impairment is not automatically invalid, but must be justified by a showing of "a significant and legitimate public purpose ... such as the remedying of a broad and general social or economic problem." *Allied Structural Steel v. Spannaus*, 438 U.S. 234, 247, 249 (1978). "One legitimate state interest is the elimination of unforeseen windfall profits." *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 412 (1983) *citing United States Trust Co. v. New Jersey*, 431 U.S. 1, 22 (1977). Once such a public purpose is identified, the next inquiry is whether the adjustment of "the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 412 (1983).

In this case, the State not only has the public purpose of the elimination of unforeseen windfall profits recognized in *Energy Reserves* and *United States Trust*,[8] but also the protection of leasehold tenants from the loss of their homes for minor debts, which is similar to the interests recognized in cases like *Blaisdell* and *Gelfert*. Moreover, the approach chosen, which preserves all of the reasonable expectations of the ground lease holder, is clearly one that meets the test stated in *Energy Reserves* and other modern

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[8] Property values vary over time, and certainly will vary over the life of a lease that is, at least theoretically, perpetual. While windfall profits are currently the rule, rather than the exception, there have been times when the fair market value of reversionary interests were lower than the redemption amount. *Heritage Realty, Inc. v. City of Baltimore*, 252 Md. 1, 5 (1969). Thus, it is not unfair to refer to these profits as "unforeseen."

contract clause cases. And the approach taken is especially appropriate with respect to long term leases, as the State would otherwise be foreclosed from taking any meaningful action to deal with the problem.

Finally, Senate Bill 396 and House Bill 463 amend two sections that are also amended by Senate Bill 755 and House Bill 458, identical bills entitled "Ground Rents - Property Owned by Baltimore City - Reimbursement for Expenses - Notices." Specifically, Senate Bill 755 and House Bill 458 amend Real Property Article § 8-111.1 to add, as a lead-in to subsection (c), "Except as provided under subsection (d) of this section, in." However, Senate Bill 396 and House Bill 463 repeal subsection (c) altogether, making the lead-in language unnecessary. Similarly, Senate Bill 755 and House Bill 458 amend Real Property § 8-402.3 to provide that the section does not apply to a ground rent on property owned by the City of Baltimore that is abandoned or distressed property, while Senate Bill 396 and House Bill 463 repeal Real Property § 8-402.3 and enact an entirely new section with that number thus making the application provision unnecessary. It is our view that the language in Senate Bill 755 and House Bill 458 that amends provisions of law that are repealed by Senate Bill 396 and House Bill 463 should properly be repealed along with those sections. As a result, we recommend that Senate Bill 755 and House Bill 458 be signed before Senate Bill 396 and House Bill 463.

Very truly yours,

/s/

Douglas F. Gansler
Attorney General

DFG/KMR/kmr
cc: Joseph Bryce
Secretary of State
Karl Aro
The Honorable Lisa A. Gladden
The Honorable Samuel I. "Sandy" Rosenberg