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of the New York State Bar Association

A Message from the Section Chair

As my family and I looked down on Paris, the reality of my task of heading the Real Property Law Section began to come into focus. Following Steve Horowitz as Section Chair would be challenging. His leadership and dedication in dealing with issues facing real estate practitioners were exemplary. As the Section continues to react and comment on issues such as multidisciplinary practice, non-lawyer participation in residential real estate transactions, residential property disclosure legislation and computerization of legal transactions, including e-signatures, I could only hope to motivate our membership to be as diligent as Steve demanded.

As our plane touched down at Orly Airport, I also felt a recently heightened sense of urgency to attempt to make a difference. The cause for this, an early July automobile accident, which my family and I had, without any reasonable explanation, walked away from without injury, made the success of this particular annual meeting especially significant to me.

Of course, the truth is that the Chair of the Section has little to do with the planning of the annual meeting. This task had been Mel Mitzner's, the Section's 1st Vice-Chair. I am pleased to report that thanks to Mel's efforts and those of Rosalyn Sachs who helped plan the special events including the dinner cruise on the Seine and a delightful evening at the Museum d'Orsay, as well as the efforts of the State Bar staff, especially Kathy Heider, Paris was a well-attended, memorable meeting. It was also gratifying to meet many members of our Section who were attending our meeting for the first time.

Many of these first-timers took the time to let me know how wonderful the meeting was, both the social events and the legal education sessions held on Friday and Saturday mornings. It remains a puzzle as to why more of our over 4,500 members do not take advantage of the opportunity to meet with other practitioners from across the state at the Section's annual event. I assure you that those who do attend the meetings establish lasting contacts, learn from uniquely qualified panels and leave with enduring memories of the chosen venue.

The program sessions in Paris, put together by Les Bliwise and John Blyth, were certainly up to the high standards of past years. The speakers covered a wide variety of topics including the different role played by attorneys in French and

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American real estate transactions, title insurance issues for Americans purchasing European properties, choices of entity and the many appearances of money laundering.

As our Section meeting concluded on Sunday, together with the other major happening in Paris, *the Tour de France*, I felt that the Section was on its way to continuing in its leadership position on behalf of New York lawyers handling the wide array of issues involving real estate. I urge all our members to seek to become involved, submit articles to this *Journal*, become active on a Section Committee or forward issues for consideration to the Executive Committee. Hopefully, together, our Section will continue to be a group of lawyers that others, both within and outside the profession, can look to as representing the significant contributions of attorneys to the community.

James S. Grossman

Recent Legislative Activity Sparks Debate of Real Property Disclosure

By Thomas Barletta and Ronald F. Kennedy

Among the many bills that have yet to be acted upon by the governor is a badly flawed measure that would require owners of residential property to make disclosures regarding the condition of their property prior to sale (Real Property Disclosure Bill, A. 1173-C). During the course of the legislative session the Real Property Section worked closely with the New York State Association of Realtors in an attempt to reach a compromise on this issue. When those efforts failed the bill was passed over the strong objection of the former (see Legislation Report No. 76, available on the NYSBA Web site at www.nysba.org/legis/99report/R-76.html).

Heralded by its sponsors as a consumer protection measure, the bill is, in fact, incapable of meeting its laudable goals. Specifically, the legislation does not adequately protect purchasers because it fails to require that any disclosures by the seller concerning the condition of the property have to be made before the purchaser is legally bound to complete the contract. It also lacks a remedy for the purchaser if the seller fails to provide the required disclosure. Sellers, on the other hand, are asked to make representations regarding the condition of their properties, not based on defects they actually know about, but based upon what a third party, presumably a court, deems they had "constructive" knowledge of.

Since passage of the measure, representatives of the Real Property Section have met with the governor's counsel to urge a veto. At that time they stressed their willingness to draft a workable bill that is fair to both sellers and purchasers. A number of other groups have joined the Section in submitting memoranda in opposition to the measure. The governor will have 10 days to act on the bill after it reaches his desk.

This article was originally published in the September/October 2000 issue of the *State Bar News*.

Thomas Barletta is Director of the state bar's Governmental Relations Department, and Ronald F. Kennedy is Associate Director of the Department.

2000 NYSBA Residential Contract of Sale: Mortgage Commitment Contingency Clause and Other Changes

By Karl B. Holtzschue

Changes Approved

On September 22, 2000, the Executive Committee of the Real Property Section of the New York State Bar Association (NYSBA) approved changes to update the Residential Contract of Sale that was jointly prepared by it and the New York State Land Title Association (NYSLTA), the Committee on Real Property Law of the Association of the Bar of the City of New York (ABCNY) and the Committee on Real Property Law of the New York County Lawyers Association (NYCLA) in 1990.[1] The other sponsors also have approved the changes.

This form is the most commonly used form for sales of residential real estate in downstate areas, particularly in New York City and Nassau and Westchester Counties. The most important change is to Paragraph 8, the Mortgage Commitment Contingency Clause. The other changes added reference to lead-based paint disclosure, deleted references to the repealed gains tax and made changes to better conform this contract with those being proposed for the downstate contracts of sale for cooperative apartments and condominiums.

The 2000 version of the NYSBA/NYSLTA/ABCNY/NYCLA form will be available in the NYSBA's Residential Real Estate Forms on HotDocs (LEXIS) and in a new Blumberg form.

Mortgage Commitment Contingency Clause

The Model Mortgage Commitment Contingency Clause (see appendix A) was drafted and unanimously approved by a Joint Committee of the NYSBA Title and Transfer Committee, the ABCNY Committee on Real Property Law and the NYCLA Committee on Real Property Law.[2]

"This form is the most commonly used form for sales of residential real estate in downstate areas, particularly in New York City and Nassau and Westchester Counties."

As a reading of the Clause shows, the fundamental approach of the prior clause has not been changed: the contract of sale is conditioned on issuance of a mortgage commitment on the stated terms, not on funding of the loan (emphasized by adding "Commitment" to the heading). The clause expressly states that the purchaser must accept a commitment conditioned on sale of the current home, payment of debt and no material adverse change in the purchaser's financial condition. This alerts the purchaser as to what is likely to happen and gives the purchaser an opportunity to negotiate to delete terms that are unacceptable. The Joint Committee's view is that these conditions are customary and thus not a change from the result under the current contract (which hides them as "customary conditions"). The Rockland County and Monroe County contracts take a similar approach. Optional application to a mortgage broker continues to be permitted.

The principal features of the Mortgage Commitment Contingency Clause are the following:

1. The clause in the Blumberg form A 125 (11/96) has been broken up into subparagraphs, in an effort to make it more readable.
2. The Commitment Date has been defined as a number (to be filled in) of days after the purchaser receives a fully executed copy of the contract, as the current NYSBA cooperative apartment form provides, to make sure delays by the seller don't reduce the usefulness of the contingency period. The seller's attorney should state his/her calculation of the Commitment Date in the letter delivering the executed contract to the purchaser's attorney. The purchaser's attorney should promptly correct or confirm that date. The purchaser should inform its lender of the scheduled date for closing in the contract and request that the expiration date of the commitment occur after the scheduled date of closing.[¶ 8(a)]
3. The rate of interest has been changed to the "prevailing" fixed or adjustable rate. [¶ 8(a)]
4. The purchaser expressly takes the risk of a commitment conditioned on sale of the purchaser's current home, payment of any outstanding debt or a material adverse change in the purchaser's financial condition, and the purchaser accepts the risk that all conditions will be met (except for approval of an appraisal), as

the Rockland County contract provides. The purchaser is alerted to cancel or get an extension if an appraisal has not been approved by the Commitment Date. It is expressly stated that the purchaser's obligations are conditioned only on issuance of a Commitment. Once a Commitment is issued, the purchaser is bound even if the loan is not funded for any reason. [¶ 8(a)]

5. The purchaser is required to apply to one lender, but may elect to apply to more than one. [¶ 8(b)(i)]

6. The purchaser must accept a commitment meeting the described terms. [¶8(b)]

7. If the lender denies the application in writing before the Commitment Date, the purchaser may cancel. [¶ 8(d)]

8. If the seller does not receive a copy of a commitment accepted by the purchaser by the Commitment Date, the seller may cancel on five business days' notice, which is effective unless the purchaser delivers a copy to the seller within ten business days, giving the purchaser time to cure if he/she can. This allows the seller not to have to wait until the scheduled closing date to see if the purchaser will be able to come up with the funds needed to close (after the purchaser insisted on conditioning its obligations under the contract on obtaining a mortgage commitment). The right of the seller to do so is found in some upstate contract forms[3] and in several reported cases.[4] [¶ 8(h)]

9. The purchaser is deemed to have been given a fully executed copy of the contract on the third business day following the date of ordinary or regular mailing, postage prepaid. [¶ 8(j)]

The principal motivation for the spelling out of the purchaser's risks and responsibilities in paragraph 8(a) was to clarify for the courts the intention of the draftsmen. Attention has previously been called to the fact that courts have sometimes mistakenly favored purchasers over sellers and allowed purchasers to cancel despite language to the contrary in mortgage contingency clauses in contracts of sale drafted by experienced practitioners.[5] The concern of the draftsmen was recently illustrated once again by *Kapur v. Stiefel*,[6] where a majority in the Appellate Division, First Department allowed a purchaser to cancel a cooperative apartment contract of sale[7] after the purchaser's mortgage commitment was canceled by the lender when the purchaser lost his job. Finding, correctly, that there was no express right in the contract that allowed the purchaser to cancel in those circumstances, the majority looked to equitable principles and held that the issue turned on whether there was bad faith on the part of the plaintiff. The dissent by Judge Saxe correctly stated the view of the contract draftsmen that under the contract of sale the risk of loss of his job after acceptance of a commitment was intended to fall on the purchaser. The Joint Committee that drafted the new clause carefully considered many alternatives, including giving the purchaser the right to cancel if the commitment was canceled for reasons other than the fault of the purchaser, but overwhelmingly voted to continue the approach of the draftsmen of the 1990 contract. The new clause goes out of its way to alert the purchaser (and the courts) to these risks. If the purchaser does not want to accept the risk, the purchaser is supposed to negotiate for modifications to the printed form.

It was clear to the draftsmen of the form that it should be reviewed in detail by both parties and their attorneys in each transaction and modified to suit their needs in the circumstances. No one clause can be fully adequate for all situations. The Notes to the Clause (see appendix B), which are intended to be consulted before each use of the Clause, clearly make this point.

"The Joint Committee that drafted the new clause carefully considered many alternatives, including giving the purchaser the right to cancel if the commitment was canceled for reasons other than the fault of the purchaser, but overwhelmingly voted to continue the approach of the draftsmen of the 1990 contract."

Other Changes to the Residential Contract of Sale

The changes to the NYSBA/NYSLTA/ABCNY/NYCLA residential contract of sale (see appendix C) other than the Model Mortgage Commitment Contingency Clause are intended to update the contract of sale and conform it to changes suggested by the cooperative apartment contract of sale revision process. The NYSBA/ABCNY Cooperative Apartment Contract of Sale Revision Subcommittee is in the final stages of approving extensive revisions to the ABCNY Cooperative Apartment Contract of Sale.[8] Changes similar to those described here for the residential contract have been proposed for the ABCNY Condominium Contract of Sale.[9]

These changes include additions to conform the personal property lists, additions to conform the escrow clauses, deletion of reference to the gains tax, addition of a FIRPTA withholding certificate, permitting fax notice with respect to closing checks, permitting attorneys to send and receive notices on behalf of their clients, and reference to a lead paint rider:

1. In ¶ 2 "Chandeliers" are added because they have often been the subject of controversy. The parties should focus specifically on them. Built-in microwave ovens, like all other built-ins, are included (so those that are not built-in are not included).

2. In ¶ 3(a), "good" is inserted before "check" to make clear that only delivery of a good check will comply with the contract.

3. In ¶ 6(a) "for Seller's account" and in ¶ 6(b) "although Escrowee is holding the Downpayment for Seller's account, for all other purposes" are deleted because the addition of ¶ 6(f) ("The party whose attorney is Escrowee shall be liable for loss of the Downpayment.") makes the point more clearly.

4. In ¶ 6(b) the presumption as to holding the escrowed downpayment in a non interest-bearing account is reversed by this change, to conform to the old and revised cooperative apartment contracts and to better reflect the norm of use of an interest-bearing account. With the new form, the draftsperson must insert "non" to provide that the downpayment is to be held in a non-interest bearing account; in most cases, it should then be placed in an IOLA account. If the user of the new form makes no change, the downpayment must be placed in an interest-bearing account.

5. In ¶ 6(b) "(with right of contribution)" is added to allow a claim for contribution by a party who feels that it should not have to pay the entire cost of any indemnification of the Escrowee.

6. In ¶ 6(b) "(by attorneys selected by Escrowee)" is added to allow the Escrowee to select the attorneys who will defend Escrowee at the parties' expense.

7. In ¶ 7(b) and ¶ 20 "reasonable prior" replaces "no less than 3 business days" because the prior requirement was felt to be too restrictive with respect to obtaining closing checks, and "reasonable prior" notice seems to better reflect actual practice.

8. In ¶ 16(d) the form expressly permits the option to the purchaser to provide a withholding certificate from the I.R.S.

9. In ¶ 25 Notice by fax is permitted only with respect to closing checks. The attorneys are also authorized (but not required) to give and receive on behalf of their clients all Notices and deliveries.

10. New ¶ 28(i) adds reference to a complete and fully executed lead-based paint disclosure, to be attached to the contract.

Endnotes

1. The form has been printed by Blumberg/Excelsior as form A125, dated 11-96. The principal changes since 1990 were made in 1996: in ¶ 8a to permit loans by mortgage bankers and credit unions and in ¶ 8d deeming application to a mortgage broker to be full compliance.
2. The Clause was unanimously approved by the Joint Committee of the NYSBA Title and Transfer Committee, the ABCNY Committee on Real Property Law and the NYCLA Real Property Committee at its March 18, 1998 meeting (and includes subsequent editorial clarifications). The author of this article was Chair of the Joint Committee. The Clause was unanimously approved by the Executive Committee of the Real Property Section of the NYSBA on May 14, 1998.
3. *See, e.g.*, Erie County Contract (1998) ¶ 10(B)(6); Monroe County Offer to Purchase (3/94) ¶ 4.
4. Holtzschue, *Mortgage Contingency Clauses: Courts Favor Purchasers*, 26 N.Y. Real Prop. L.J. 53, 58 at note 31 (Spring 1998).
5. Holtzschue, *Mortgage Contingency Clauses: Courts Favor Purchasers*, 26 N.Y. Real Prop. L.J. 53 (Spring 1998).
6. 695 N.Y.S.2d 330 (1999).
7. The residential, condominium and cooperative apartment forms are all virtually identical on this point.
8. *See* Blumberg/Excelsior form M 123 (10-89).
9. *See* Blumberg/Excelsior form M 146 (3-95).

Karl B. Holtzschue is a member of the Executive Committee of the Real Property Section, Co-Chair of the Title and Transfer Committee, author of Holtzschue on Real Estate Contracts (PLI) and Vol. 1, New York Practice Guide: Real Estate (Matthew Bender), editor of NYSBA's Residential Real Estate Forms on HotDocs (Lexis), and an Adjunct Professor at Fordham University School of Law.

Appendix A

Model Mortgage Commitment Contingency Clause for Residential Contract of Sale

(Approved by NYSBA Real Property Section 09/25/00) (Jointly prepared by NYSBA, NYSLTA, ABCNY, NYCLA) (Blumberg form A 125 dated 11-96))

8. Mortgage Commitment Contingency. (Delete paragraph if inapplicable)

(a) The obligation of Purchaser to purchase under this contract is conditioned upon issuance, on or before days after a fully executed copy of this contract is given to Purchaser or Purchaser's attorney in the manner set forth in paragraph 25 or subparagraph 8(j) (the "Commitment Date"), of a written commitment from an Institutional Lender pursuant to which such Institutional Lender agrees to make a first mortgage loan, other than a VA, FHA or other governmentally insured loan, to Purchaser, at Purchaser's sole cost and expense, of $____ for a term of at least years (or such lesser sum or shorter term as Purchaser shall be willing to accept) at the prevailing fixed or adjustable rate of interest and on other customary commitment terms (the "Commitment"). To the extent a Commitment is conditioned on the sale of Purchaser's current home, payment of any outstanding debt, no material adverse change in Purchaser's financial condition or any other customary conditions, Purchaser accepts the risk that such conditions may not be met; however, a commitment conditioned on the Institutional Lender's approval of an appraisal shall not be deemed a "Commitment" hereunder until an appraisal is approved (and if that does not occur before the Commitment Date, Purchaser may cancel under subparagraph 8(e) unless the Commitment Date is extended). Purchaser's obligations hereunder are conditioned only on issuance of a Commitment. Once a Commitment is issued, Purchaser is bound under this contract even if the lender fails or refuses to fund the loan for any reason.

(b) Purchaser shall (i) make prompt application to one or, at Purchaser's election, more than one Institutional Lender for such mortgage loan, (ii) furnish accurate and complete information regarding Purchaser and members of Purchaser's family, as required, (iii) pay all fees, points and charges required in connection with such application and loan, (iv) pursue such application with diligence, and (v) cooperate in good faith with such Institutional Lender(s) to obtain a Commitment. Purchaser shall accept a Commitment meeting the terms set forth in subparagraph 8(a) and shall comply with all requirements of such Commitment (or any other commitment accepted by Purchaser). Purchaser shall furnish Seller with a copy of the Commitment promptly after receipt thereof.

(c) (Delete this subparagraph if inapplicable) Prompt submission by Purchaser of an application to a mortgage broker registered pursuant to Article 12-D of the New York Banking Law ("Mortgage Broker") shall constitute full compliance with the terms and conditions set forth in subparagraph 8(b)(i), provided that such Mortgage Broker promptly submits such application to such Institutional Lender(s). Purchaser shall cooperate in good faith with such Mortgage Broker to obtain a Commitment from such Institutional Lender(s).

(d) If all Institutional Lenders to whom applications were made deny such applications in writing prior to the Commitment Date, Purchaser may cancel this contract by giving Notice thereof to Seller, with a copy of such denials, provided that Purchaser has complied with all its obligations under this paragraph 8.

(e) If no Commitment is issued by an Institutional Lender on or before the Commitment Date, then, unless Purchaser has accepted a written commitment from an Institutional Lender that does not conform to the terms set forth in subparagraph 8(a), Purchaser may cancel this contract by giving Notice to Seller within 5 business days after the Commitment Date, provided that such Notice includes the name and address of the Institutional Lender(s) to whom application was made and that Purchaser has complied with all its obligations under this paragraph 8.

(f) If this contract is canceled by Purchaser pursuant to subparagraphs 8(d) or (e), neither party shall thereafter have any further rights against, or obligations or liabilities to, the other by reason of this contract, except that the Downpayment shall be promptly refunded to Purchaser and except as set forth in paragraph 27.

(g) If Purchaser fails to give timely Notice of cancellation or if Purchaser accepts a written commitment from an Institutional Lender that does not conform to the terms set forth in subparagraph 8(a), then Purchaser shall be deemed to have waived Purchaser's right to cancel this contract and to receive a refund of the Downpayment by reason of the contingency contained in this paragraph 8.

(h) If Seller has not received a copy of a commitment from an Institutional Lender accepted by Purchaser by the Commitment Date, Seller may cancel this contract by giving Notice to Purchaser within 5 business days after the Commitment Date, which cancellation shall become effective unless Purchaser delivers a copy of such commitment to Seller within 10 business days after the Commitment Date. After such cancellation neither party shall have any further rights against, or obligations or liabilities to, the other by reason of this contract, except that the Downpayment shall be promptly refunded to Purchaser (provided Purchaser has complied with all its obligations under this paragraph 8) and except as set forth in paragraph 27.

(i) For purposes of this contract, the term "Institutional Lender" shall mean any bank, savings bank, private banker, trust company, savings and loan association, credit union or similar banking institution whether organized under the laws of this state, the United States or any other state; foreign banking corporation licensed by the Superintendent of Banks of New York or regulated by the Comptroller of the Currency to transact business in New York State; insurance company duly organized or licensed to do business in New York State; mortgage banker licensed pursuant to Article 12-D of the Banking Law; and any instrumentality created by the United States or any state with the power to make mortgage loans.

(j) For purposes of subparagraph 8(a), Purchaser shall be deemed to have been given a fully executed copy of this contract on the third business day following the date of ordinary or regular mailing, postage prepaid.

Appendix B

Notes on Mortgage Commitment Contingency Clause for Residential Contract of Sale

(Approved by NYSBA Real Property Section 09/25/00) (Blumberg form A 125 dated 11-96))
(Jointly prepared by NYSBA, NYSLTA, ABCNY, NYCLA)

1. WARNING: the mortgage commitment contingency clause for the Residential Contract of Sale is a bar association form that attempts to provide a mechanism that makes the rights and obligations of the parties clear in sales of residences in ordinary circumstances. It should be reviewed carefully by Seller and Purchaser and their attorneys in each and every transaction to make sure that all the provisions are appropriate for that transaction. Negotiated modifications should be made whenever necessary.

2. Under the clause, the obligation of Purchaser to purchase under the contract of sale is contingent on Purchaser's obtaining a mortgage commitment letter from an Institutional Lender within the number of days specified for the amount specified. This refers to calendar days. Seller's attorney should state his/her calculation of the Commitment Date in the letter delivering the executed contract to Purchaser's attorney, to prevent confusion later. Purchaser should promptly confirm or correct that date. In applying for a loan, Purchaser should inform its lender of the scheduled date of closing in the contract and request that the expiration date of the commitment occur after the scheduled date of closing. Purchaser must comply with deadlines and pursue the application in good faith. The commitment contingency is satisfied by issuance of a commitment in the amount specified on or before the Commitment Date, unless the commitment is conditioned on approval of an appraisal. If the commitment is conditioned on approval of an appraisal and such approval does not occur prior to the Commitment Date, Purchaser should either cancel the contract or obtain an extension of the Commitment Date. If the commitment is later withdrawn or not honored, Purchaser runs the risk of being in default under the contract of sale with Seller.

3. If there are loan terms and conditions that are required or would not be acceptable to Purchaser, such as the interest rate, term of the loan, points, fees or a condition requiring sale of the current home, those terms and conditions should be specified in a rider.

4. This clause assumes that initial review and approval of Purchaser's credit will occur before the commitment letter is issued. Purchaser should confirm with the lender that this is the case before applying for the commitment.

5. If, as has been common, the commitment letter itself is conditioned on sale of Purchaser's home or payment of any outstanding debt or no material adverse change in Purchaser's financial condition, such a commitment will satisfy the contract contingency nonetheless, and Purchaser will take the risk of fulfilling those commitment conditions, including forfeiture of the downpayment if Purchaser defaults on its obligation to close. Under New York case law, a defaulting purchaser may not recover any part of the downpayment, and Seller does not have to prove any damages. If Purchaser is not willing to take that risk, the clause must be modified accordingly.

6. Purchaser may submit an application to a registered mortgage broker instead of applying directly to an Institutional Lender.

7. This clause allows Seller to cancel if a commitment is not accepted by Purchaser by the Commitment Date, unless Purchaser timely supplies a copy of the commitment, to allow Seller the option to avoid having to wait until the scheduled date of closing to see if Purchaser will be able to close. Seller may prefer to cancel rather than to wait and settle for forfeiture of the downpayment if Purchaser defaults. Because of Seller's right to cancel, Purchaser may not waive this contingency clause. This clause means that Purchaser is subject to cancellation by Seller even if Purchaser is willing to risk that he/she will obtain the Commitment after the Commitment Date. Some Purchasers may not want to be subject to such cancellation by Seller.

8. Purchaser may want to add to paragraph 22 that Purchaser's reimbursement should include non-refundable financing and inspection expenses of Purchaser, which should be refunded by Seller if Seller willfully defaults under the contract of sale [alternative: if Seller is unable to transfer title under the contract of sale].

Joint Committee on the Mortgage Contingency Clause:

- Real Property Section of the New York State Bar Association
- Real Property Law Committee of the Association of the Bar of the City of New York
- Real Property Committee of the New York County Lawyers Association

Appendix C

Proposed Modifications to Residential Contract of Sale

(Blumberg form A 125 dated 11-96) (Jointly prepared by NYSBA, NYSLTA, ABCNY, NYCLA) [to conform to proposed new NYSBA coop contract form]

¶2: add “chandeliers” after “lighting and cooking fixtures”,add “and counters” after “kitchen cabinets”, and add “built-in microwave oven” after “oven” [new coop 1.11]

¶3(a): add “good” before “check” [new coop 2.2.1]

¶6(a): delete “for Seller’s account” in 2nd line [see ¶6(f)]

¶6(a): add “address:” in the blank space at the left margin [new coop 1.25]

¶6(a): delete “(not)(Delete if inapplicable)” and replace “an” with “a(n) ___” [reversing the presumption from the 1990 and 1996 forms!] [new coop 1.25]

¶6(b): delete “, although Escrowee is holding the Downpayment for Seller’s account, for all other purposes” [see ¶6(f)]

¶6(b): add “(with right of contribution)” after “severally” in 8th line [new coop 27.3]

¶6(b): add “(by attorneys selected by Escrowee)” after “defend” in 8th line [new coop 27.3]

¶6(f): add “(f) The party whose attorney is Escrowee shall be liable for loss of the Downpayment.” [new coop 27.2]

¶7(b): in the 5th line, replace “no less than 3 business days” with “reasonable prior” [new coop 2.2.2]

¶8: replace with Model Mortgage Commitment Contingency Clause

¶16: delete (c) [re gains tax] and renumber the remaining subparagraphs [old coop 10.4]

¶16(d): add the following at the end of the first sentence: “or a withholding certificate from the I.R.S.” and replace “certification” with “certificate” throughout (d) [new coop 25]

¶20: “in the 14th line, insert “reasonable prior” before “notice” and delete “given not less than 3 business days before Closing,” [new coop 2.2.2]

¶25: add “or (c) with respect to ¶7(b) or ¶20, sent by fax to the party’s attorney. Each notice by fax shall be deemed given when transmission is confirmed by the sender’s fax machine. A copy of each notice sent to a party shall also be sent to the party’s attorney. The attorneys for the parties are hereby authorized to give and receive on behalf of their clients all Notices and deliveries.” [new coop 17.5 and 17.7]

¶28(i): add “(i) If applicable, the complete and fully executed disclosure of information on lead-based paint and/or lead-based paint hazards is attached hereto and made a part hereof.” [new coop 30]

The Guaranty Agreement in Loan Transactions

By William P. Gardella

Guaranty agreements are frequently provided in loan transactions. While they are not at all uncommon, it is probably fair to say that in virtually every transaction the guarantor and the lender each hopes that the agreement will never need to see the light of day, much less the illumination of a courtroom. This article reviews the principles underlying guaranty agreements in loan transactions and discusses guaranty agreements that have received judicial review.

As a starting point, a guaranty can be defined as an agreement to be responsible for the obligation of another party.[1] A guaranty arrangement involves three parties: the guarantor—the party who agrees to be responsible for another's obligation, the principal debtor or primary obligor—the party whose obligation is guaranteed, and the obligee or creditor—the party who obtains the benefit of the guaranty. The extent of a guarantor's obligations will be the same as the principal's unless the guaranty agreement provides for a broader or narrower scope of liability.[2] A guaranty agreement is sometimes confused with an indemnity contract, but a guaranty can be distinguished from a contract of indemnity in that an indemnity, unlike a guaranty, does not run in favor of a creditor. An indemnity runs instead to a third person who is or will become a debtor as a result of the imposition of a contingent liability.[3]

Guaranty agreements are subject to the same rules of interpretation that apply to other contracts;[4] however, in accordance with the statute of frauds a guaranty agreement must be in writing in order to be enforced.[5] A guaranty, like other agreements, must be supported by consideration. Although the agreement normally recites the consideration supporting the guaranty, the consideration does not need to be expressed in the agreement. The consideration may be inferred from the facts.[6] For example, if the circumstances surrounding a guaranty arrangement show that the guaranty was given in exchange for a promise to advance funds to a borrower and the lender did advance the funds, courts have held that there is valid consideration to support the guaranty.[7]

"While [guaranty agreements] are not at all uncommon, it is probably fair to say that in virtually every transaction the guarantor and the lender each hopes that the agreement will never need to see the light of day, much less the illumination of a courtroom."

If the guaranty is given in consideration of loans that were already made to the principal debtor, the "past" consideration should be expressed in the guaranty agreement. The New York General Obligations Law provides that a written agreement shall not be denied effect on the grounds that the consideration is past, so long as the consideration is expressed in the written agreement, the consideration was actually provided, and the past consideration would otherwise constitute valid consideration.[8] If the prior loans are not expressed in the written agreement as the consideration supporting the guaranty, the creditor cannot rely on the General Obligations Law and therefore the prior loans as the consideration to support the guaranty agreement.[9]

A guarantor is not liable unless the principal debtor is.[10] A guarantor may, therefore, raise the defense of failure of consideration. A guarantor, though, when sued alone, may not raise an independent defense that exists in favor of the principal debtor. If a guarantor were able to do so, the principal would be deprived of the ability to assert its own defense.[11] This means, for example, that if a guarantor is sued alone, the guarantor cannot assert a defense of fraud or breach of warranty that exists in favor of the principal debtor. Those are independent causes of action that may not be raised by the guarantor unless the principal consents. If the guarantor controls the principal, it has been held that such consent is presumed.[12]

Guaranty agreements will be strictly construed. This rule of strict construction means that a court will protect a guarantor against an obligation that is not clearly included within the terms of the guaranty agreement.[13] This rule requires that the guaranty obligation may not be extended beyond the plain and explicit meaning of the agreement, but it does not mean that a guarantor is entitled to any particular "tenderness" in the interpretation of its agreement.[14]

There are various types of guaranty agreements. Although different terminology is used, in loan transactions the significant distinction in type is that between a guaranty of payment and a guaranty of collection.[15] That difference determines when the creditor may seek recovery from the guarantor. If a guaranty of a loan is a guaranty of collection, before the lender may bring an action against the guarantor, the lender must produce evidence that it made every reasonable effort to recover the amount owed on the underlying obligation from the debtor.[16] In the context of a mortgage loan transaction, the lender must foreclose and obtain a deficiency judgment (to the extent permitted by the loan documents) before the lender may proceed against a guarantor of collection.[17] If the guaranty is a guaranty of payment, the lender does not need to first take enforcement action against the debtor before proceeding against the guarantor. Once a default has arisen on the guaranteed obligation, the holder of a guaranty of payment may proceed against the guarantor without first seeking recovery from the debtor.[18]

A mortgage lender who holds a guaranty of payment will usually bring an action against the debtor and the guarantor at the same time. The guarantor is a proper party to a foreclosure action in New York since the Real Property Actions and Proceedings Law provides that "any person who is liable to the plaintiff for the payment of a debt secured by a mortgage may be made a defendant in the action."[19]

If a mortgage lender bids the full amount of the debt in the foreclosure proceeding, the lender may not subsequently bring an action against a guarantor. The lender cannot later claim that the value of the property was less than the amount of the debt. The lender's act of bidding the full amount of the debt at the foreclosure sale constitutes the complete satisfaction of the debt, and thereby relieves the guarantor of further liability on its guarantee.[20] If there is a shortfall between the amount of the debt and the value of the mortgaged property, in order to reserve rights against a guarantor, a foreclosing lender must move for a deficiency judgment at the time the lender moves for an order confirming the sale.[21]

These rules related to bidding at a foreclosure sale exist to protect borrowers and guarantors. A lender will not be permitted to seek recovery from the guarantor if the court is not able to determine the proper amount of the deficiency. The court must establish and credit the debtor with the fair and reasonable market value of the property and not merely whatever sum may have been bid at the foreclosure sale.[22]

A guaranty of a loan will usually state whether it is a guaranty of payment or a guaranty of collection. While that express acknowledgment is desirable to remove ambiguity, the agreement is not fatally defective if it does not include such a statement. When the agreement does not specify whether it is a guaranty of payment or a guaranty of collection, a court will look to the intention of the parties as reflected in the agreement. If the agreement evidences an intention to require the guarantor to pay immediately upon the occurrence of an event of default by the debtor, the court will conclude that it is a guaranty of payment. If the agreement evidences an intention that the guarantor will only be required to pay after attempts to obtain payment from the debtor have failed, a court will conclude that the guarantor is a guarantor of collection.[23]

The use of certain words in guaranty agreements has caused confusion on the issue of whether the agreement is a guaranty of payment or a guaranty of collection. To illustrate, an agreement reviewed by a court provided that the guarantor would guaranty the full, prompt and "ultimate" payment of several notes and any renewals of those notes. When the lender attempted to enforce the guaranty, the guarantor focused on the words "ultimate payment," and claimed that they evidenced an intention that the agreement was a guaranty of collection. The court acknowledged that those words caused confusion. The court held, however, that the word "ultimate" was intended to include the payment of all notes within the scope of the guaranty, including notes finally or "ultimately" given in *renewal* of the original notes. The word "ultimate," the court reasoned, was not used to limit the guaranty to loans that remained unpaid after diligent efforts to collect them had been made.[24]

A guaranty of one-half of any loss suffered by a lender as a result of mortgage loans made to a borrower which result in foreclosure and the sale of the mortgaged property was held to be a guaranty of collection. The court interpreting that agreement stated that pursuant to the terms of the agreement, a foreclosure is a condition precedent to the lender's ability to take enforcement action against the guarantor. As a result, the court concluded that it was a guaranty of collection.[25]

> *"The use of certain words in guaranty agreements has caused confusion on the issue of whether the agreement is a guaranty of payment or a guaranty of collection."*

Once a guaranty is furnished questions may arise as to whether the primary obligation that is guaranteed may be modified without affecting the guaranty. As a general rule, the underlying obligation may not be modified without the guarantor's consent. If the underlying obligation is modified without the guarantor's consent the guarantor is released.[26] Courts will not permit the debtor and creditor to substitute a new obligation in place of the original obligation without the guarantor's consent.[27]

An obligation is modified for purposes of this rule if the creditor can no longer enforce the original obligation against the principal debtor, and can only enforce the amended or substitute obligation. If the principal debtor has the right to raise the new contract as a defense to the enforcement of the original, the guarantor is released unless it consented to the modification of the original contract.[28] Conversely, if the principal debtor is not bound by the amended contract (for example, due to the absence of consideration for the amended contract), and is still bound by the original agreement, the guarantor is not released of its obligation to guaranty the original agreement.[29] The guarantor can consent to such modifications, even in advance.[30] That consent is often provided in the guaranty agreement.

When the debtor and creditor agree to extend the maturity date of the debt without the guarantor's consent, the general rule is that the guarantor is released. If, on the other hand, the creditor merely acts with leniency in enforcing the debt, the guarantor is not released. The determining factor is whether the creditor may still enforce the original obligation against the debtor. If the creditor retained the right to enforce the original obligation against the debtor in spite of the indulgence granted to the debtor, the guarantor is not released.[31] Where the creditor's indulgences are sufficient to provide the debtor with a legally enforceable defense to the original obligation, the guarantor will be released unless it consented to the modification of the original obligation.[32]

If a creditor releases the debtor, the guarantor is also released unless the guarantor consented to the release. The guarantor's consent may be obtained in advance, and it frequently is through a provision in the guaranty agreement. New York courts have consistently upheld the enforceability of such provisions in guaranty agreements.[33]

A lender in a New York case obtained guaranty agreements of the same loan from several guarantors. The borrower defaulted and the lender commenced an action against the borrower and several of the guarantors. The lender eventually released the borrower and several, but not all, of the guarantors. At the time the lender released those parties, it did not expressly reserve rights to proceed against one of the guarantors. When the lender brought an action against that guarantor, the guarantor asserted that in accordance with the terms of the New York General Obligations Law,[34] the lender's failure to reserve rights against the guarantor resulted in a complete discharge of the guarantor.[35] The lender claimed that the guarantor was not discharged because the guaranty agreement contained an explicit acknowledgment that the debtor and the guarantors could be released. The court held that although the terms of the New York General Obligations Law would appear to support the guarantor's argument, the statute does not apply where the guarantor has consented to the release of the debtor and of other guarantors. The court found such consent in the guaranty agreement.[36]

". . . New York courts have upheld broad waiver provisions in guaranty agreements."

A construction lender in another New York case held a guaranty of payment of a loan. In order to permit the long-term loan to be funded and thereby repay most of the construction loan, the construction lender marked the guaranteed note "paid" and satisfied the mortgage. The borrower still owed the construction lender approximately $40,000 because the long-term lender held that portion of its loan proceeds in escrow to secure the completion of unfinished work. The construction lender brought an action on the guaranty to recover the $40,000. The guarantor claimed that the construction lender's act of satisfying and releasing the debt and the collateral resulted in the guarantor's release. The court disagreed, pointing out that the guaranty agreement contained a provision that authorized the construction lender to release the debt and the collateral without affecting the guarantor's obligations to the lender.[37]

These cases show that New York courts uphold provisions in guaranty agreements in which the guarantor consents to the release of the borrower. Moreover, New York courts have upheld broad waiver provisions in guaranty agreements. A New York court focused on a guaranty agreement that provided that the guarantor's obligations would be unconditional and irrevocable regardless of the validity, legality or enforceability of the loan agreement. The agreement also stated that the guarantor would be liable in spite of the absence of any action by the lender to enforce the loan agreement, and any other circumstance that would otherwise constitute a legal or equitable discharge or defense of a guarantor. The court upheld the enforceability of the waiver provision, concluding that it would defeat the guarantor's claim that it was released from its obligations under the guaranty when the creditor released the debtor.[38] A guarantor's waiver of rights of setoff has also been upheld.[39]

Guarantors have claimed that they should be released in situations where the lender gave up safeguards in the loan documents to the guarantor's prejudice. This argument has been rejected by New York courts in situations where the guaranty agreement contained a waiver of defenses provision.[40] To illustrate, a guarantor agreed in the guaranty agreement, to the lender's "taking or omission of any of the actions referred to in . . . the [loan agreement]." The guarantor also agreed that "any failure, omission or delay on the part of the Bank to enforce, assert or exercise any right, power or remedy conferred on the Bank" would not release the guarantor. The court upheld the waiver contained in the guaranty. The court concluded that commercial agreements would be disrupted if lender safeguards in loan documents were transformed into shields for guarantors. The court also relied on the fact that the loan documents provided that they were solely for the benefit of the borrower and the lender and that no other person would have any rights, benefits or interest in the documents. According to the court, the guarantor and not the lender must be responsible for borrower's failure to perform.[41] Similar waiver provisions have also been used to defeat arguments by guarantors that the creditor did not act promptly in attempting to recover from the principal while it was still possible to do so,[42] but different results have been reached in transactions subject to the Uniform Commercial Code.[43]

A guarantor is entitled to rights of subrogation, the equitable principle that is intended to afford a person who pays the debt or performs the obligation of another party the opportunity to be reimbursed in full.[44] In the context of a guaranty, upon paying the debt of the principal debtor the guarantor is entitled to the assignment of all of the collateral taken and held by the creditor and an assignment of the debt.[45] Many forms of guaranty agreements either provide that the guarantor waives its rights of subrogation or that the guarantor will not exercise its subrogation rights until all amounts payable under the guaranty agreement have been paid in full.

A recent case illustrated the application of a guarantor's subrogation rights to the detriment of the lender. The lender held a first mortgage and a second mortgage on the same property. The lender also held an individual's guaranty of the payment of the first mortgage. The individual did not guaranty the second mortgage. When the borrower defaulted on the first mortgage loan, the lender called on the guarantor to pay in accordance with its obligations under the guaranty agreement. In response, the guarantor asked the lender for an assignment of the first mortgage before it paid the amount owed under the guaranty agreement. The lender refused, apparently realizing that its rights under the second mortgage would be impaired if the guarantor held the first mortgage. The trial court ruled for the lender, holding that there was no guaranty agreement since the agreement before the court stated that the individual was a primary obligor and not merely a guarantor. The trial court accepted the defendant's argument that it was a joint obligor and not a guarantor, which may have been advanced in an attempt to avoid the consequences of subrogation.

"There are limits to the enforceability of guaranty agreements even though the agreements state that they are absolute and unconditional."

An appellate court reversed. According to the appellate court, when a secondary obligor is obligated to pay the debt of another, the secondary obligor has guaranty or suretyship status.[46] The key to such status is that the secondary obligor has a duty to perform an obligation which, as between the primary obligor and the secondary obligor, ought to be performed by the primary obligor. In order to determine whether there is a surety relation, the court stated that it must look to the substance of the transaction and not the mere words of the agreement. The trial court, according to the appellate court, placed too much emphasis on the portions of the agreement that provided that the guarantor was a "primary obligor" and not a mere surety. The appellate court concluded that the document signed by the individual was a guaranty, and as a guarantor the individual was entitled to rights of subrogation. Since the court held that the individual guarantor had rights of subrogation, the guarantor was entitled to an assignment of the first mortgage. That mortgage, now held by the guarantor, could be foreclosed to extinguish the lender's rights under the second mortgage. The result may have been different, the court noted, if the case involved a single mortgage securing several obligations and if the guarantor had guaranteed only one of them.[47]

There are limits to the enforceability of guaranty agreements even though the agreements state that they are absolute and unconditional. Two potential areas of limitation are fraudulent misrepresentation claims and fraudulent conveyance claims. The standard that the guarantor must meet in order to avoid its guaranty obligation on the basis of a fraudulent misrepresentation claim is high. It has been held that unless there is clear proof that the lender was guilty of "fraudulent concealment or misrepresentation or circumstances inconsistent with a bona fide transaction," the guaranty may not be set aside.[48] Courts impose duties of awareness and inquiry on the guarantor. Therefore, to constitute fraud, mere silence on the part of the creditor must be tantamount to the affirmation of a state of affairs which does not exist and which would have the effect of deceiving or defrauding the guarantor. Furthermore, a creditor does not have a duty to disclose facts that the guarantor could have obtained.[49]

To illustrate, a guarantor asked the lender about the value of the collateral for a loan before signing a guaranty. In response to the guarantor's question, the lender disclosed that it was holding stock that the debtor provided as collateral. When the guarantor asked the lender what the value of the stock was, the lender referred the guarantor to the normal market price of the stock. The lender, however, did not inform the guarantor that the particular shares of stock it held as collateral were restricted. The lender knew that since restricted stock cannot be traded without first being registered in accordance with the securities laws, its value was actually less than the market value of unrestricted shares. Given those circumstances, the court held that the lender's conduct would relieve the guarantor of its obligations under the guaranty.[50]

The guaranty agreement in a case dealing with a similar issue listed collateral held by the lender. The lender, however, had previously released a significant portion of the collateral listed in the guaranty agreement and did not disclose that fact to the guarantor at the time the guaranty was signed. The court found that the lender was responsible for creating the false impression that the collateral described in the guaranty agreement would secure the debt, and that the lender knew the guarantor was relying on the adequacy of the listed collateral when he provided the guaranty. The facts before the court also indicated that the lender had reason to believe that the guarantor would not have executed the guaranty had it known that a significant portion of the security had been released. The court held that the lender's conduct amounted to constructive, if not actual fraud, and as a result the lender could not enforce the guaranty.[51]

In another New York case a guarantor claimed that it should be relieved of its obligations because the lender failed to disclose a material adverse change in debtor's financial condition despite the guarantor's express inquiry. According to the court, under certain circumstances a lender's conduct can result in the release of the guaranty but in the absence of a clear showing that the lender was guilty of fraudulent concealment or misrepresentation, the guaranteed obligation should not be avoided. Furthermore, the court concluded that the lender was not under a duty to disclose information that the guarantor could have obtained. A guarantor cannot, according to the court, close his eyes and fail to seek relevant information. Since the facts regarding the debtor's financial condition were not peculiarly within the lender's knowledge, the court held that the lender did not have a duty to advise the guarantor of the borrower's financial condition.[52]

A New York court has also held that the terms of the guaranty agreement itself can defeat a claim of fraud in the inducement. The guaranty agreement stated that the obligation of the guarantors was absolute and unconditional regardless of any other agreement or circumstance which might otherwise constitute a defense. In response to the guarantors' claim of fraud in the inducement, the court held that the terms of the guaranty precluded a claim that the lender fraudulently induced the guarantors to enter into the guaranty agreement by the lender's alleged oral promise to lend additional funds.[53]

Fraudulent transfers involve transferring assets or incurring liabilities with actual intent to hinder, delay or defraud,[54] or transferring assets or creating liabilities in a constructively fraudulent manner.[55] In order for a guaranty to constitute a constructive fraudulent transfer under the U.S. Bankruptcy Code three conditions must be met. First, the transfer must be made or the obligation must be incurred within one year before the date of the filing of the bankruptcy petition.[56] Secondly, the guarantor must have received less than reasonably equivalent value in exchange for the guaranty.[57] The final requirement is that one of the following conditions must be met: (i) the guarantor was insolvent at the time the obligation was incurred or the guarantor was rendered insolvent as a result; (ii) the guarantor was engaged in a business or a transaction or was about to engage in a business or transaction with an unreasonably small amount of capital; or (iii) the guarantor incurred debts or believed it would incur debts beyond its ability to repay them as they matured.[58] A six-year statute of limitations applies to New York's fraudulent conveyance statute.[59]

With respect to guaranty agreements then, a requirement for a fraudulent conveyance under the U.S. Bankruptcy Code is a finding of one of the three elements summarized in (i), (ii) and (iii) above. Those elements relate to the guarantor's financial condition. It should be unusual to find any of those elements in a situation where a lender is requesting a guaranty from a financially strong entity and even more unusual for a guarantor's financial statements to reflect anything but the contrary. Additionally, courts have held that when evaluating a guarantor's financial condition the value of its subrogation rights should be considered.[60] Subrogation rights should be valuable in the context of a guaranty of payment but those rights may not be valuable to a guarantor of collection since, by definition, the guarantor will only be required to pay after the creditor has exhausted its remedies against the principal debtor.[61] While subrogation rights may have value for purposes of accessing the guarantor's financial condition, including waivers of the guarantor's subrogation and indemnification[62] rights in guaranty agreements was suggested as a result of the *Deprizio* decision.[63] Relief from the *Deprizio* decision was provided to creditors by an amendment to the Bankruptcy Code[64] that became effective in 1994, although there have been court decisions that suggest that there may be benefits to the continued use of "Deprizio" waivers in some contexts.[65]

In addition to a finding of one of the three elements listed above related to the guarantor's financial condition, to find a fraudulent conveyance the guarantor must receive less than reasonably equivalent value for providing the guaranty. Finding reasonably equivalent value should not be difficult in situations where a partner, stockholder or other owner of an entity provides a guaranty of the entity's obligations. The owner, by providing the guaranty, is protecting or enhancing the value of its investment in the entity.[66] Every guaranty arrangement may not involve a parent-subsidiary relationship, and therefore, finding reasonably equivalent value in those situations is not always obvious. However, even if there is no parent-subsidiary relation, courts have concluded that reasonably equivalent value may exist. It has been held, for example, that a debtor may receive fair consideration even though the consideration for the property or obligation initially goes to a third party since consideration given to the third party may ultimately confer an economic benefit on the debtor.[67]

> *". . . New York courts can be expected to abide by the intention of the parties as reflected in a carefully prepared guaranty agreement."*

Having considered these principles and cases, one can conclude that New York courts can be expected to abide by the intention of the parties as reflected in a carefully prepared guaranty agreement. In the absence of highly unusual circumstances and provided a creditor does not accept a guaranty from a financially troubled guarantor, the provisions of the guaranty agreement should be upheld. While there is no "guaranty" of this result, there is a fair degree of confidence.

Endnotes

1. *See Coburn Corp. of America v. Orr, et al.*, 304 N.Y.S.2d 345, 348 (1969); *Pink v. Investors Syndicate Title and Guaranty Co.*, 285 N.Y.S. 155, 159 (1936) (A guaranty arrangement involves two different obligations, one is the principal debtor's and the other is the guarantor's. The principal "debtor is not a party to the guaranty agreement, and the guarantor is not a party to the principal['s] obligation."); *Fehr Brothers, Inc. v. Scheinman*, 509 N.Y.S.2d 304, 305-06 (1986) ("A suretyship relationship exists when one person becomes responsible for the [obligation] of another." A distinction that has been offered between a guarantor and a surety is that while a guarantor is a type or kind of a surety, a guaranty agreement differs from other forms of surety contracts in that a guaranty is a separate contract that is collateral to the contract between the obligor and obligee).
2. *See American Trading Co. Inc. v. Fish*, 42 N.Y.2d 20, 26 (1977).
3. *See General Phoenix Corp. v. Cabot*, 300 N.Y. 87, 93 (1949).
4. *Id*. at 92.
5. *See* N.Y. Gen Oblig. Law § 5-701(a)(2) (McKinney 1989); *Sun Oil Co. v. Heller*, 248 N.Y. 28, 32-33 (1928).
6. *Id*. at 31.
7. *See First American Bank of New York v. Builders Funding Corp.*, 607 N.Y.S.2d 460, 462 (1994); *see also First New York Bank for Business v. DeMarco, et al.*, 130 B.R. 650, 654 (Bankr. S.D.N.Y. 1991); *Lafayette National Bank v. Koch*, 272 N.Y.S. 322, 323 (1934).
8. N.Y. Gen. Oblig. Law § 5-1105 (McKinney 1989); *see also Teitelbaum v. Mordowitz*, 669 N.Y.S.2d 811, 811 (1998); *Hudson Valley Paper Co. v. LaBelle*, 571 N.Y.S.2d 107, 108-09 (1991);
9. *See Mazella v. Lupincahi*, 333 N.Y.S.2d 775, 777 (1972).
10. *See Pro-Specialties, Inc., v. Thomas Funding Corp.*, 812 F.2d 797, 799 (1987); *Walcutt v. Clevite Corp.*, 13 N.Y.2d 48, 55 (1963).
11. *See Cinema North Corp. v. Plaza At Latham Assoc.*, 867 F.2d 135, 139 (2d Cir. 1989); *Walcutt v. Clevite Corp.*, 13 N.Y.S.2d 834, 838 (1963).
12. *See Bloor v. Shapiro*, 32 B.R. 993, 1001 (Bankr. S.D.N.Y. 1983). *But see DeMarco* 130 B.R. at 655 (However, it has been held that the implied consent of a related principal would no longer apply when the principal debtor is in bankruptcy since any claims of the debtor would then be part of the bankrupt's estate).
13. *See generally Continental Airlines, Inc. v. Lelakis*, 943 F. Supp. 300 (1996); *People of the State of New York v. Stuyvesant Insurance Co.*, 413 N.Y.S.2d 843 (1979).
14. *Banco Portugues v. Asland, et al.*, 745 F. Supp. 962 (1990).
15. *See Consol. Steel Corp. v. Pressed Steel Car Co.*, 194 N.Y.S. 649 (1922) (A guaranty of payment is a form of an "unconditional" or "absolute" guaranty since its enforcement is not dependent on any condition other than the primary debtor's default); *Tucker Leasing Capital Corp. v. Marvin Medical Management, Inc.*, 833 F. Supp. (1993) (A guaranty of collection is a form of a "conditional" guaranty, the condition being the need to first exhaust collection remedies against the principal debtor); *see also Pennsylvania Steel Co. v. New York City Railway Co.*, 198 F. 721 (1912).
16. *See Gannett Co., Inc. v. Tesler*, 577 N.Y.S.2d 248, 248-49 (1991).
17. *See generally* N.Y. Real Prop. Acts. Law § 1371(3) (McKinney 1979); *Gonsenhauser v. Central Trust Co.*, 378 N.Y.S.2d 536 (1976).
18. *See FDIC v. Schwartz*, 432 N.Y.S.2d 899, 901 (1980); *General Phoenix Corp. v. Cabot*, 300 N.Y. 87 (1949).
19. N.Y. Real Prop. Acts. Law § 1313 (McKinney 1979).
20. *See Alaimo v. First Federal Savings and Loan Assoc. of Rochester*, 383 N.Y.S.2d 751, 753 (1976); *aff'd* 42 N.Y.2d 1030 (1977).
21. *See* N.Y. Real Prop. Acts. Law § 1371(3) (McKinney 1979).
22. *See* N.Y. Real Prop. Acts. Law § 1371(2) (providing that the amount of a deficiency is the amount of the debt plus costs, less the market value of the property as determined by the court or the sales price of the property whichever is less); *see also Columbus Realty Investment Corp. v. Gray et al.*, 658 N.Y.S.2d 685, 686 (1997); *Hudson City Savings Institution v. Drazen et al.*, 550 N.Y.S.2d 163, 164 (1990); *Merchants National Bank & Trust Co. of Syracuse v. Wagner et al.*, 402 N.Y.S.2d 936, 938 (1978); *Broward National Bank of Fort Lauderdale v. Starzec et al.*, 290 N.Y.S.2d 112, 114 (1968).
23. *See Federal Deposit Insurance Corp. v. Schwartz*, 432 N.Y.S.2d 899, 901 (1980). *See, e.g., General Phoenix Corp. v. Cabot*, 300 N.Y. 87, 92 (1949).
24. *See First National Bank of Litchfield v. Jones*, 219 N.Y. 312, 315 (1916).
25. *See Gonsenhauser v. Central Trust Co.*, 378 N.Y.S.2d 536, 538 (1976).
26. *See Jones v. Gelles*, 509 N.Y.S.2d 900, 902 (1986).
27. *See Bier Pension Plan Trust v. Estate of Schneierson*, 546 N.Y.S.2d 824, 826 (1989).
28. *See Banco Portugues Do Atlantico v. Asland, S.A.*, 745 F. Supp. 962, 969 (S.D.N.Y. 1990).
29. *See Bier*, 546 N.Y.S.2d at 826.
30. *See Banco*, 745 F. Supp. at 970.
31. *See generally First American Bank of New York v. Builders Funding Corp.*, 607 N.Y.S.2d 460, 462 (1994).
32. *See Bier*, 546 N.Y.S.2d at 826.
33. *See Inland Credit Corp. v. Weiss*, 405 N.Y.S.2d 258, 259 (1978).
34. *See* N.Y. Gen. Oblig. Law § 15-105 (McKinney 1989).
35. *See* N.Y. Gen. Oblig. Law § 15-105 (McKinney 1989) (providing that if an obligee releases an obligor without an express reservation of rights against a co-obligor,

and the obligee knows (or has reason to know) that the obligor being released did not pay the portion of its obligation to the co-obligor, the obligee's claim is deemed to be satisfied in the amount which the obligee knew (or had reason to know) that the released co-obligor was obligated to pay. If the obligee does not know (and has no reason to know) that the obligor being released did not pay its portion of the obligation to its co-obligor, the obligee's claim against the co-obligor is deemed satisfied to the extent of the lesser of: (a) the fractional share of the obligation of the obligor being released, or (b) the amount the obligor was required to pay to its co-obligor).

36. *See generally National Bank of North America v. Kory*, 404 N.Y. S.2d 626, 627 (1978).

37. *See Inland Credit Corp.*, 405 N.Y.S.2d 259; *see also*, *Indianapolis Morris Plan Corp. v. Karlen et al.*, 319 N.Y.S.2d 831, 835 (1971).

38. *See generally First New York Bank for Business v. DeMarco et al.*, 130 B.R. at 653-54.

39. *See Iselin-Jefferson Financial Co. v. Orlinsky*, 313 N.Y.S.2d 935, 936 (1970).

40. *See Compangie Financiere v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 188 F.3d 31, 34 (2d Cir. 1999); *United Orient Bank v. Lee,* 637 N.Y.S.2d 96, 96 (1996).

41. *See Banco Portugues Atlantico v. Asland*, S.A., 745 F. Supp. 962, 972 (S.D.N.Y. 1990).

42. *See FDIC v. Schwartz*, 432 N.Y.S.2d at 901.

43. *See Bank of China v. Chan*, 937 F.2d 780, 786 (1991) (With respect to UCC transactions, it has been held that the requirement of § 9-504(3) that the post-default disposition of collateral be commercially reasonable may not be waived and was not waived by an unconditional guaranty); *Marine Midland Bank v. Kristin International Ltd.*, 534 N.Y.S.2d 612, 614 (1988) (UCC § 9-501(3) provides that the rights granted to a debtor and the duties imposed on a creditor by § 9-504(3) may not be waived. It has been held that a guarantor is deemed to be a "debtor" for purposes of § 9-501(3) and therefore, a guarantor may not waive the right to have a post-default sale of the collateral conducted in a commercially reasonable manner). *But see*, *First City Div. of Chase Lincoln First Bank v. Vitale*, 510 N.Y.S.2d 766, 768 (1987).

44. *See e.g.*, *Scarsdale National Bank and Trust Co. v. United States Fidelity and Guaranty Co.*, 264 N.Y. 159, 164 (1934).

45. *See generally Inland Credit Corp.*, 405 N.Y.S.2d at 259-60; *United States Fidelity and Guaranty Co. v. Triborough Bride Authority*, 297 N.Y. 31, 36 (1947); *The National Savings Bank of Albany v. Fermac Corp.*, 271 N.Y.S. 836, 839 (1934); *The National Exchange Bank of Lansingburgh v. Silliman*, 65 N.Y. 475, 481 (1875); *Ellsworth v. Lockwood*, 42 N.Y. 89, 96 (1870).

46. *See supra* note 1 (defining suretyship).

47. *See Chemical Bank v. Meltzer*, 93 N.Y.2d 296, 304 (1999).

48. *State Bank of Albany v. McDonnell*, 337 N.Y.S.2d 697, 699 (1972).

49. *See Security National Bank of Long Island v. Compania Anonima De Seguros*, 190 N.Y.S.2d 820, 823 (1959).

50. *See Chemical Bank v. Layne*, 423 F. Supp. 869, 878 (1976).

51. *See First Citizens Bank & Trust Co. of Utica v. Sherman's Estate*, 294 N.Y.S. 131, 133 (1937).

52. *See Marine Midland Bank v. Smith*, 482 F. Supp. 1279, 1288 (1979).

53. *See Citibank v. Plapinger et al.*, 66 N.Y.2d 90, 92 (1985).

54. *See* 11 U.S.C. § 548(a)(1) (2000).

55. *Id.* at § 548(a)(2).

56. *Id.* at § 548(a).

57. *Id.* at § 548(a)(2)(A).

58. *Id.* at § 548(a)(2)(B).

59. N.Y. C.P.L.R. § 213 (McKinney 2000); *see also Orr v. Kinderhill Corp.*, 991 F.2d 31, 35 (2d Cir. 1993).

60. *See In re Ollag Construction Equip. Corp.*, 578 F.2d 904, 908 (2d Cir. 1978); *Syracuse Engineering Co., Inc. v. Haight*, 97 F.2d 573, 576 (2d Cir. 1938).

61. *See supra* notes 16-17 and accompanying text.

62. *See Assets Realization Co. v. Mercantile National Bank*, 153 N.Y.S. 156, 158 (1915) (A guarantor has implied rights of indemnification which entitle the guarantor to be reimbursed by the principal debtor for damages the guarantor suffers by making good on the guaranty); *Blanchard v. Blanchard*, 201 N.Y. 134, 139 (1911).

63. *See In re V.N. Deprizio Construction Co.*, 874 F.2d 1186 (7th Cir. 1989) (§ 547(b) of the U.S. Bankruptcy Code provides that preferential transfers may be avoided if made for the benefit of a creditor. In *Deprizio*, Deprizio Construction Company made payments to a creditor on a loan that was guaranteed by shareholders of the company. The company filed for bankruptcy. The court held that the trustee in bankruptcy could recover the payments made to the creditor within one year of the filing even though the creditor was not an insider. The court reasoned that the payments were made for the benefit of the inside guarantors (who were deemed to be creditors by virtue of their subrogation and indemnification rights) since the payments reduced the guarantors' liability to the lender under their guaranty agreements. Pursuant to Deprizio waivers, guarantors would waive their subrogation and indemnification rights, and as a result, the guarantor should not be considered to be a creditor of the debtor).

64. Subsection (c) of § 550 of the U.S. Bankruptcy Code, added in 1994, provides that if a transfer is made between 90 days and one year of the filing in bankruptcy, and if the transfer is avoided as a preferential transfer pursuant to § 547(b) of the Code, and the transfer was made for the benefit of a creditor who was an insider, the trustee in bankruptcy may not recover the property transferred from a transferee that is not an insider.

65. *See In re Williams*, 234 B.R. 801, 804-05 (Bankr. D. Or. 1999) (where the court held that the 1994 statutory "Deprizio amendment" merely prevents recovery of property from a non-insider transferee, but it does not prevent the avoidance of a security interest granted to a non-insider transferee).

66. *See Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 991 (2d Cir. 1981).

67. *See In re Augie/Restivo Baking Co.*, 87 B.R. 242, 247 (E.D.N.Y. 1988).

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"Vouching-In": The Key to the Sublessor's Defense of a Sublessee's Warranty of Habitability Counterclaim

By Edward D. Loughman, III

A sublessor is faced with a dilemma when a sublessee defends a non-payment proceeding with a counterclaim alleging a violation of the warranty of habitability. If the claim has any validity, the responsibility may ultimately lie with the landlord. If it has no validity, the tenant/sublessor needs the landlord's testimony. Procedurally, his ability to involve the landlord or managing agent in the summary proceeding is limited. Politically, suing the managing agent or the landlord may not be the wisest. Withholding rent not only has political ramifications, but can also result in eviction. Moreover, if the tenant is the owner of a co-operative apartment, it may result in cancellation of the stock and lease and foreclosure proceedings by the holder of the tenant co-op loan. Vouching-in the landlord may be the key.

"Vouching in" is the common law predecessor to modern impleader statutes.[1] Prior to the development of impleader, a defendant having a claim over against another responsible person had to defend and then, if unsuccessful, seek indemnification by suing the responsible party. Under the doctrine of vouching-in, the defendant gives the responsible party notice of the lawsuit and invites it to take over the defense. The responsible party can either choose to intervene and control the defense or be bound by the consequences. If there is a judgment adverse to the defendant and the third party has a duty to indemnify, the third party will be bound by the judgment. Unlike impleader, however, the third party is not immediately bound; a second lawsuit is needed but the third party is estopped from contesting the validity of the judgment against the defendant.

Although impleader makes the third party a party to the action obviating the need for a second action, it is not always available. Summary proceedings to evict are special proceedings so impleader is not available without court order.[2] Moreover, not only does the motion add time to the process but so does the impleader if leave is given. To a cooperative shareholder needing the rent to pay maintenance and the co-op loan, the delay could be fatal.

"Politically, suing the managing agent or the landlord may not be the wisest."

Especially if the co-op or managing agent has been trying to address the problem that is giving rise to the subtenant's claim of violation of the warranty of habitability, the tenant/sublessor may be reluctant to make the landlord an adversary by impleading it. Not only may this impede the cooperative's desire to resolve the problem quickly but it may come back to haunt the tenant when he or she later needs the approval of the co-op board to sell or sub-lease the apartment.[3]

Unfortunately, what may work for the subtenant may not work for the tenant. Typically, tenants faced with warranty of habitability issues withhold rent. Indeed, that is likely the subtenant's rationale in our scenario. The co-operative tenant, however, does so at his or her peril. Not only does the co-operative tenant face cancellation of the leasehold and cancellation of his or her stock,[4] but faces the threat of foreclosure as well. Most lenders to the purchasers of co-op apartments require some sort of recognition agreement in which the co-op is obligated to give the lender notice when the borrower fails to pay maintenance. Not only is this failure a default under most notes and security agreements, but because the co-op's claim for maintenance has priority over the lender's lien,[5] the default is taken very seriously. Accordingly, this tack should not be taken without consideration of the consequences.

Finally, defending the counterclaim and then going after the landlord is dangerous. Not only does it mean litigating the warranty of habitability issue twice, but the results are not guaranteed to be identical. Absent vouching in or impleader, the landlord is not bound by the prior finding and is entitled to contest it. Even if the subtenant cooperates and testifies in the second action, his zeal may be lessened by his successful judgment against the tenant. The landlord's side is now likely to be vigorously defended. Indeed, the subtenant's earlier success may well have been helped by the landlord's less than eager assistance as witness. If vouched-in however, the landlord's lack of cooperation will preclude it from challenging the subtenant's claims later.

There is no formalized procedure to effect vouching-in, only that the defendant give the responsible parties notice of the proceeding and the opportunity to take over the defense.[6] Even though the notice could be oral,[7] written notice is well advised. Notice should be accompanied by a copy of the counterclaim,[8] detailing the status of the proceeding. Although in most warranty of habitability situations the landlord is likely to have already been contacted by the tenant or subtenant, when a warranty of habitability claim is expected, it is advisable to memorialize the notice even before the summary proceeding is commenced. Not only should affidavits of service of the notice be prepared but personal delivery or certified mail, return receipt requested is suggested.

If the landlord accepts the offer to take over the defense, the tenant must allow the landlord to control the litigation of the counterclaim (or intervene). Failure to allow the landlord control can undo the process and the landlord will not be bound by the first adjudication.[9] If the landlord takes control it is bound by the judgment and would be liable to the tenant/sublessor for any judgment or offset in favor of the subtenant.

> *"Vouching-in protects the sublessor from inconsistent judgments and encourages cooperation from the landlord."*

If the landlord does not accept the offer, the landlord is estopped from challenging the resulting judgment. Although the tenant must still sue the landlord, the only issue is whether the landlord is bound to indemnify the tenant. The warranty of habitability is implied in every lease and cannot be waived.[10] If the premises were uninhabitable by the subtenant, they would be uninhabitable by the tenant. Even though there is caselaw to the effect that an out-of-possession tenant/sublessor can not raise the warranty of habitability as a defense to a non-payment proceeding,[11] that does not preclude a claim of implied indemnity by the tenant/sublessor against the landlord. Although the warranty exists between sublessor and subtenant, the primary duty is by the landlord. Having discharged the duty owed by the landlord, the tenant/sublessor is entitled to indemnity from the landlord.[12] Thus, unless the inhabitability was caused by what the tenant did, rather than what the landlord did (or did not do) the second action may well be resolved by summary judgment.

Conclusion

Vouching-in protects the sublessor from inconsistent judgments and encourages cooperation from the landlord. If the landlord fails to cooperate in the defense of the sublessee's counterclaim for violation of the warranty of habitability, it does so at its peril because any victory by the sublessee binds the landlord.

Endnotes

1. *See generally* David D. Siegel, New York Practice § 168 (3d ed. 1999); J. Wicks & M. Zweig, *Impleader Practice in New York: Does It Really Discourage Piecemeal Litigation*, 71 N.Y. S.B.J. 44 (1999); *see also George Cohen Agency Inc. v Donald S. Perman Agency Inc.*, 51 N.Y.2d 358, 362 (1980) (despite the adoption of the impleader statutes, the "vouching in" doctrine survives). *See, e.g.*, *Hartford Accident Indemnity Co. v. First National Bank & Trust Co. of Hudson*, 281 N.Y. 162 (1939).
2. *See* N.Y. C.P.L.R. § 401 (McKinney 1990). *See generally Gorman v. Gorma*n, 355 N.Y.S.2d 902 (1974) (impleader does not appear to be favored); *Rothbaum v. Ebel*, 354 N.Y.S.2d 545 (1974) (impleader was allowed to bring in the Department of Social Services when it was involved in the landlord tenant dispute); *Sessa v. Blakney*, 336 N.Y.S. 149 (1972); *Blackman v. Walker*, 316 N.Y.S.2d 930 (1970).
3. *See generally Smolinsky v. 46 Rampasture Owners Corp*, 646 N.Y.S.2d 110 (1996) (denying consent because of prior litigation improper); *Chemical Bank v. 635 Park Avenue Corp*, 588 N.Y.S.2d 257 (1992) (requiring discontinuation of litigation as a condition to consent improper). The Board's rationale for denial or delay is not always obvious.
4. Although many, if not all, proprietary leases allow the co-op to cancel the stock and lease for non-payment and then bring a holdover proceeding, this use of the conditional limitation to avoid non-payment defenses such as the warranty of habitability is disfavored. *See generally McMillan v. Park Towers Owners Corporation*, 640 N.Y.S.2d 144 (1996); *Saada v. Master Apartments Inc.*, 579 N.Y.S.2d 536 (1991). The co-op could still bring a non-payment proceeding to cancel the lease and then conduct a sale of the stock and lease. An out-of-possession tenant's resort to the warranty of habitability defense is suspect, *see, e.g.*, *Halkedis v. Two East End Avenue Apartment Corp.*, 555 N.Y.S.2d 54 (1990), *appeal dismissed*, 76 N.Y.2d 711 (1990); *25 W. 13th Street Corp. v Gerevitz*, 488 N.Y.S.2d 597 (1985); probably rendering the tenant/sublessor no choice but to pay maintenance to avoid eviction.
5. *See generally ALH Properties Ten, Inc. v. 306-100th Street Owners*, 86 N.Y. 2d 643 (1995); *In re Nadelson (Citibank)*, N.Y.L.J., Feb. 4, 1994, at 22; *Swartwood v. 222 East 57th Street*, N.Y.L.J., Jan. 31, 1991, at 27.
6. *See Hartford Accident & Indemnity Co. v. First Nat'l Bank & Trust Co. of Hudson*, 281 N.Y.2d 162, 168-69 (1939); 30 Carmody-Wait 2d, New York Practice § 168 (1996).
7. *See generallly Urbach v. City of New York*, 259 N.Y.S.2d 975 (1965); *Bouleris v Cherry-Burrell Corporatio*n, 256 N.Y.S.2d 537 (1964).
8. *See Urbach*, 259 N.Y.S.2d at 975 (failure to enclose pleading may preclude claim of offer to assume defense).
9. *See L.B. Kaye & Associates, Ltd. v. Libou*, 527 N.Y.S.2d 216 (1988).
10. N.Y. Real Prop. Law § 235-b (McKinney 1989 & Supp. 2000).
11. *See generally Helkedis v. Two East End Apartment Corp.*, 555 N.Y.S.2d 54 (1990) *appeal denied*, 76 N.Y. 2d 711 (1990); *25 W. 13th Street Corp v. Gerevitz*, 488 N.Y.S.2d 597 (1985).
12. *See generally Piccione v. 1165 Park Avenue, Inc.*, 677 N.Y.S.2d 891 (1988), *aff'd*, 685 N.Y.S.2d 242 (1999); *Brook v. H.E. Swezey & Son Motor Transportation, Inc.*, 137 N.Y.S.2d 267 (1954), *appeal dismissed*, 159 N.Y.S.2d 1015 (1957), *aff'd sub nom. Kohlman v. Alexander* 4 N.Y.2d 823 (1958).

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Going National

By Michael L. Corbett

The last time you attended a party, did all attention seem to focus on the lawyer engaged in an Internet dot.com start up, leaving you wondering whether real estate law is considered a dull profession? Take heart, many new and exciting developments are revolutionizing the real estate industry, one of which is the origination of nationwide title services.

New York title insurance companies are presently willing to close real estate transactions such as purchases or refinances at the office of New York law firms, even though the property being sold or refinanced is located in a state other than New York.

A recent national title transaction involved a New York-based pension fund purchasing a partnership interest in a real estate company which owned seven commercial properties situated in three different states.

In such transactions, the title search is conducted through the title company's office in the state in which the property is located. The title report is then forwarded to the title company's New York office, and a New York clearance officer attends the closing, marks up the fee and/or mortgagee title report, and closes the transaction. A final title insurance policy is issued by the title company's office in the state in which the property is located.

Nationwide title services offers a simplified alternative, enabling the New York law firm to avoid the delays and expense of retaining, and coordinating with, local counsels in each of the different states in which the properties are located.

Challenges for New York attorneys in such nationwide transactions are plentiful since when closing in your New York office, it is easy to forget that the property is located in another state and not subject to the New York rules, customs and recording regulations with which we are so familiar.

Your checklist should include:

1. investigating possible state and municipal property transfer taxes, mortgage taxes, recording charges, etc.
2. obtaining and reviewing the local deed, mortgage, assignment and assumption, verification and other forms which are often different then the New York State forms.
3. discovering if any state or local documents similar to New York's TP-584 and Real Property Transfer Report are required to be filed along with a deed, deed of trust, ground lease assignment, etc.
4. remembering that in many states outside New York the title insurance company acts as an escrow trustee, actually depositing the purchase or loan funds into its own bank account, so be careful to obtain exact written wire transfer information. Any mistake in the wire transfer data can result in embarrassing headaches including lost interest income and become a nightmare when closing large commercial deals.

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A Brief Primer on Encroachments

By Ruddick C. Lawrence, Jr.

Real estate lawyers seldom pay much attention to encroachments and that can be a mistake. The laws governing encroachments are not as obvious as they might at first appear, and, as is true for most of real estate law, many of them spring from archaic origins, and involve subtleties and nuances that are easily overlooked. Thus, this brief primer addresses the most salient of those subtleties and nuances for lawyers who practice in New York.

An encroachment is an unauthorized intrusion of an improvement on real property onto an adjoining property. A projection is a portion of an improvement on real property that extends over and above an adjoining property. For purposes of this article, both encroachments and projections are referred to as encroachments.

There are two general rules with respect to encroachments: 1) the owner of property encroached upon may bring an action of ejectment (also known as an action to recover real property) seeking removal of the encroaching structure and/or damages;[1] and 2) an encroachment onto a property to be conveyed, or an encroachment by a structure on a property to be conveyed onto an adjoining property, renders title to the property to be conveyed unmarketable.[2] The balance of this article will address the many exceptions to these two general rules.

The threshold issue with regard to an encroachment is "whether the encroachment is substantial enough to seriously interfere with the use and enjoyment of the premises" encroached upon,[3] or whether it is *de minimis.*[4] If it is deemed to be *de minimis,* it does not render title to the property encroached upon unmarketable[5], and an action for ejectment will fail.[6] Unfortunately, "no hard and fast rule can be laid down that one inch or two inches of encroachment, irrespective of the nature of the building and the effect of such encroachment upon the value of the property will be sufficient to justify the court in relieving a purchaser of his purchase."[7] Thus, title will not be found to be unmarketable if an encroachment onto an adjoining property is easily removable.[8]

It is possible to draft a sales contract to avoid marketability issues with respect to encroachments. The contract may provide that the property will be conveyed subject to specified encroachments, or those set forth on a certain title report. The contract may also provide that it is subject to any state of facts an accurate survey would show, provided that it does not go on to promise that such survey shall not render title unmarketable. While such drafting may avoid the breach of a sales contract due to unmarketability, it does not eliminate the actual encroachments.

It is useful to consider encroachments onto private property as a separate concept from encroachments onto public property, because they are both treated differently under both common law and statutory law.

Encroachments onto Private Property

The statutory language of § 611(2) of the New York Real Property Actions and Proceeding Law provides that, in the event that there is an encroachment by a portion of the exterior wall of a building that does not exceed six inches in width, and a building on the encroached upon property abuts such wall, then the owner of the encroached upon property has one year after the completion of the encroaching wall to maintain an action for the removal of such wall and two years after the completion of the encroaching wall to maintain an action for the recovery of damages. If an action for the recovery of damages is brought within such two-year period, then, upon satisfaction of a judgment for damages, title to the encroached upon strip of land will be transferred to the owner of the encroaching wall. If no action is brought within these time periods, the owner of the encroaching wall will be deemed to have an easement in such strip of land so long as (but only so long as) the wall shall stand, and yet, such an encroachment will not render title to the property on which the encroaching building is located unmarketable.

Agreements

An encroachment may be permitted to remain in place, pursuant to a valid easement or license agreement between the owners of the affected properties. However, such an easement or license, if not revocable-at-will by the owner of the burdened property, continues to render title to the burdened property unmarketable, and must be excepted in any applicable purchase and sale agreement.

Prescription and Adverse Possession

If an encroachment onto private property has existed for ten years, during which time it was open and notorious, hostile, under a claim of right and continuous, and it was not permitted pursuant to any agreement between the respective property owners, the owner of the encroaching property may have obtained an easement by prescription in the land encroached upon, or even ownership of such land by adverse possession.[9] Unfortunately, the vast case law regarding prescription and adverse possession is so contradictory that in most instances marketability cannot be assumed prior to a final judicial determination.

Party Walls

A party wall is a common wall for the support of buildings on adjoining properties. It usually straddles the record line of title between the properties, but it may be located entirely on one of the properties. Rights to a party wall may be created by an express or implied agreement or by easement by prescription. Prescriptive rights to a party wall do not exceed the rights and easements possessed and exercised during the prescriptive period.[10] Nevertheless, each owner has the right to use the party wall for such purposes as are necessary for the proper enjoyment of his property, as long as such use is not detrimental to the other owner,[11] and would not make the wall unavailable for the enjoyment of the other owner.[12] Subject to an agreement to the contrary, either owner may extend or increase the height of a party wall, if it can be done without harming the existing party wall and can be used by both owners.[13]

A party wall is a unique encroachment in that, notwithstanding the creation of mutual easements, a party wall that straddles the record line of title is not considered a legal encumbrance on either property, because the mutual easements are deemed a benefit rather than a burden.[14] The mutual easements are deemed a benefit because the party wall permits each of the adjoining buildings to have more interior space than either would have had if the buildings had been built with two independent walls.[15] Consequently, a party wall that straddles the record line of title does not render title unmarketable. On the other hand, a party wall standing entirely on one property is an encumbrance on the property on which it is located.[16] Similarly, although a party wall may not be an encumbrance, a party wall agreement containing a covenant running with the land that requires the owner to repair or rebuild a party wall is considered an encumbrance.[17]

Subject to an agreement to the contrary, a party wall that straddles the record line of title remains a party wall even if one of the buildings is demolished,[18] and the demolished building may be then be replaced by a new building making use of the party wall. If both buildings are demolished, all or part of the wall may be demolished, or either owner may use the wall in a new building,[19] in which case the wall becomes a party wall again.[20] If a party wall stands entirely on one property and the building on the adjacent property is demolished, it ceases to be a party wall.[21]

Land Under Non-Navigable Waters

In New York, navigable waters are all waters that: 1) are tidal (navigable-in-law), 2) are navigable-in-fact, or 3) form a boundary between the State of New York and another state or nation.[22] Waters that are navigable-in-part are deemed navigable-in-whole.[23] Those waters that are not navigable waters are non-navigable waters. An owner whose property is bounded by non-navigable waters is presumed to be the owner of the land underwater to the middle of the streambed or to the center of the lake or pond.[24] However, a conveyance that describes the property conveyed as bounded by the bank or shore of a non-navigable steam or pond only conveys the property to the low-water mark of that stream or pond.[25] Accordingly, most improvements built on land under non-navigable waters will not be encroachments.[26] Those that are encroachments, for the reason that they extend beyond the middle of the stream, the center of the pond, or the bank or shore of the stream or pond, as applicable, are treated no differently than any other encroachment onto private property.

Encroachments onto Public Property

Encroachments onto Streets or Highways

A local government may remove or compel the removal of a non-*de minimis* encroachment onto a street or highway at any time.[27] Rights to a public street or highway may not be obtained by prescription or adverse possession.[28] Consequently, such an encroachment generally renders title to the property on which such encroachment originates unmarketable, unless the encroachment is a non-structural element of an improvement that can be removed with relative ease, such as a coping, cornice, stoop, lintel, awning, sign, light fixture or fence.[29] However, certain encroachments onto streets or highways are permitted by statute.

The language of § 38(a) of the New York General City Law provides that if the wall of any building erected in a city before January 1, 1960 encroaches not more than six inches on any street or highway, no action or proceeding to compel the removal of such wall may be instituted or maintained by or on behalf of the city, or by or on behalf of any person claiming an easement in or title to the portion of the street or highway on which such wall encroaches. Furthermore, the owner of the property on which such wall stands shall be deemed to have an easement for the maintenance of the encroachment so long as such wall shall stand. The local legislative body of any city may extend the protection provided by § 38(a) to cover the wall of any building built before January 1, 1979. In addition, if the wall of any building erected in a city after January 1, 1960 encroaches not more than six inches on any street or highway, no action or proceeding to compel the removal of such wall may be instituted or maintained by or on behalf of the city, or by or on behalf of any person claiming an easement in or title to the portion of the street or highway on which such wall encroaches, if a person having an interest in such property serves notice of the existence of such encroachment on the corporate counsel of the city, who is required to file such notice with the county clerk, and no suit for the removal of such encroachment is brought within one year. Similar provisions applicable to towns and villages appear in §130(7) of the New York Town Law and §6-632 of the New York Village Law, except that the automatic statutory protection applies only to buildings erected before January 1, 1940 and may only be extended by the local legislative body to buildings erected before January 1, 1965.

Additional protections for certain encroachments are provided in the New York City Administrative Code. §19-134 prohibits an action or proceeding for the removal of an exterior wall of any building built before May 25, 1899, in the County of New York, which extends ten inches or less upon any street, or for the removal of any bay window or oriel window that is part of any building built before May 13, 1896 in the County of New York that extends twelve inches or less upon any street. Consequently, such encroachments will not render title to the property on which such buildings stand unmarketable.[30]

In addition, title 27, art. 8 and 9 of the Administrative Code permit encroachments and projections beyond the street line in New York City by a variety of building elements, subject to specified limitations, including ramps, architectural details, balconies, marquees, light fixtures, flagpoles, signs, awnings, storm enclosures, bridges between buildings, sidewalk cafes, footings, foundation walls, vaults, tunnels between buildings and any part of a building existing before January 1, 1938, so long as such permission is revocable. Because such permission is revocable, however, this permission does not render title to property on which such encroachments originate marketable.[31]

Land Under Navagable Waters

Title to land under navigable waters is vested in the State of New York[32] (other than those lands that have been conveyed to the City of New York, to the towns of Long Island or to adjacent upland owners,), subject to the navigational servitude of the United States under the Commerce Clause of the Constitution.[33] Title to property bounded by tidal waters ends at the high-water mark,[34] which is usually determined by the line of vegetation.[35] That boundary may gradually change, through natural erosion or accretion, but an upland owner does not gain title to land formerly under water when such land was created by avulsion[36] or by human action, such as the adding of fill or the building of a bulkhead.[37] Title to property bounded by non-tidal navigable waters ends at the low-water mark.[38] The State of New York has the power to grant fee title or lesser interests to lands under navigable water to an adjacent upland owner[39] and to delegate such power to state or local governmental agencies.[40] Although adverse possession or prescription may be possible with respect to lands under water held by a governmental entity in its proprietary capacity,[41] most land under water held by a governmental entity is held a governmental capacity, which may not be taken by adverse possession or prescription.[42]

Docks, piers, bulkheads, fill or other improvements onto public land under navigable water are not considered encroachments as the term is generally used. They are subject to a separate body of law regarding littoral and riparian rights, which is a matter for separate discussion.

Conclusion

Good fences make good neighbors, unless your fence encroaches on your neighbor's property. Arguments over even the most minor encroachments can become remarkably contentious and difficult to resolve. Given the complexities of the subject, this article could not be comprehensive, but if it helps the practitioner in the recognition and resolution of potential encroachment issues before they escalate, it will have achieved its intended purpose.

Endnotes

1. N.Y. Real Property Actions and Proceeding Law § 871 McKinney.
2. Generally, if there is a possibility that a purchaser would be required to litigate to defend title to the property, the property is unmarketable. *See Reynolds v. Wynne*, 121 A.D. 272, 105 N.Y.S. 849 (1907).
3. *Ungrich v. Shaff*, 119 A.D. 843, 105 N.Y.S. 1013, 1015 (1907) , *aff'd*, 130 A.D. 902, 115 N.Y.S. 1147 (1909), *aff'd*, 198 N.Y. 565, 92 N.E. 1105 (1910).
4. *See Rosenberg v. Centre Davis Corp.*, 209 N.Y.S.2d 19 (1960); *Wachsmuth v. Stone's Marina, Inc.*, 26 Misc. 2d 466, 214 N.Y.S.2d 15 (1960); *Gelman v. Herrmann*, 118 Misc. 290, 193 N.Y.S. 174 (1922); *Gold v. Calderazzo*, 100 Misc. 598, 166 N.Y.S. 928 (1917); *Ebert v. Hanneman*, 69 Misc. 223, 125 N.Y.S. 237 (1910), *aff'd*, 142 A.D. 898, 126 N.Y.S. 1127 (1910); *Merges v Ringler*, 34 A.D. 415, 54 N.Y.S. 280 (1898), *aff'd*, 158 N.Y. 701, 53 N.E. 1128 (1899); *Levy v. Hill*, 50 A.D. 294, 63 N.Y.S. 1002 (1900); *Macdonald v. Bach*, 51 A.D. 549, 64 N.Y.S. 831 (1900), *aff'd*, 169 N.Y. 615, 62 N.E. 1097 (1902); *Keitel v. Zimmerman*, 19 Misc. 581, 43 N.Y.S. 676 (1897).
5. *Van Horn v. Stuyvesant*, 50 Misc. 432, 100 N.Y.S. 547 (1906); *Leerburger v. Watson*, 75 Misc. 3d, 134 N.Y.S. 818, *aff'd*, 157 A.D. 915, 142 N.Y.S. 1127, *aff'd*, 213 N.Y. 662, 107 N.E. 1080 (1914); *see also McGraw v. Selkis*, 245 A.D. 786, 280 N.Y.S. 921, *aff'd*, 269 N.Y. 534, 199 N.E. 522 (1935); *Ungrich v. Shaff*, 119 A.D. 843, 105 N.Y.S. 1013 (1907), *aff'd*, 130 A.D. 902, 115 N.Y.S. 1147 (1909), *aff'd*, 198 N.Y. 565, 92 N.E. 1105 (1910); *Merges v. Ringler*, 34 A.D. 415, 54 N.Y.S. 280 (1898), *aff'd*, 158 N.Y. 701, 53 N.E. 1128 (1899); *Gold v. Calderazzo*, 100 Misc. 598, 166 N.Y.S. 928 (1917).
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9. *See, e.g., Nazarian v. Pascale*, 225 A.D.2d 381, 638 N.Y.S.2d 661 (1996); *Dittmer v. Jacwin Farms, Inc.*, 224 A.D.2d 477, 637 N.Y.S.2d 785 (1996).

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11. *American Railway Express Co. v. Lassen Realty Co.*, 205 A.D. 238, 199 N.Y.S. 744 (1923); *see Field's Apparel, Inc. v. Brenninkmeyer, Inc.,* 219 N.Y.S.2d 306 (1961); *Adams v. Hahne*, 59 Misc. 2d 827, 300 N.Y.S.2d 420 (1969).

12. *Varriale v. Brooklyn Edison Co.*, 252 N.Y. 222, 169 N.E. 284 (1929).

13. *Negus v. Becker*, 243 N.Y. 303 (1984); *Brooks v. Curtis;* 50 N.Y. 639 (1872); *Herrman v. Hartwood Holding Co., Inc.*, 193 A.D. 115, 183 N.Y.S. 402 (1920).

14. *Brooks v. Curtis*; 50 N.Y. 639 (1872); *Hendricks v. Stark*, 37 N.Y. 106 (1867).

15. *Hendricks v. Stark*, 37 N.Y. 106 (1867); *Partridge v. Gilbert*, 15 N.Y. 601 (1857).

16. *O'Neil v. Van Tassell*, 137 N.Y. 297, 33 N.E. 314 (1893).

17. *Corn v. Bass*, 42 A.D. 53, 59 N.Y.S. 315 (1899).

18. *357 East 76th St. Corp. v. Knickerbocker Ice Co.*, 263 N.Y. 63, 188 N.E. 158 (1933).

19. *5 East 73rd, Inc. v. 11 East 73rd St. Corp.*, 16 Misc. 2d 49, 183 N.Y.S.2d 605 (1959), *aff'd*, 13 A.D.2d 764, 217 N.Y.S.2d 1017 (1961).

20. *Douglas v. Coonley*, 156 N.Y. 521, 51 N.E. 283 (1898).

21. *See 357 East 76th St. Corp. v. Knickerbocker Ice Co.*, 263 N.Y. 63, 188 N.E. 158 (1933).

22. *Trustees of Freeholders and Commonality of Brookhaven v. Smith*, 98 A.D. 212, 90 N.Y.S. 646, *rev'd on other grounds*, 188 N.Y. 74, 80 N.E. 665 (1907); *Fairchild v. Kraemer*, 11 A.D. 2d 232, 204 N.Y.S.2d 283 (1960); *People ex rel New York Central R.R. Co. v. State Tax Comm'n*, 258 A.D. 346, 16 N.Y.S.2d 812, *aff'd*, 284 N.Y. 616, 29 N.E.2d 932 (1940); *People ex rel Lehigh Valley R. Co. v. State Tax Comm'n*, 220 A.D. 1, 221 N.Y.S. 467, *aff'd*, 247 N.Y. 9, 159 N.E. 703 (1928); *Fulton, Light, Heat & Power Co. v. State*, 62 Misc. 189, 116 N.Y.S. 1000 (1909) (water is navigable-in-fact if it can be used in its natural state for trade, commerce or travel, including pleasure boating, regardless of whether it is actually used for those purposes). *Fairchild v. Kraemer*, 11 A.D. 2d 232, 204 N.Y.S.2d 283 (1960); *Morgan v. King*, 35 N.Y. 454 (1866); *People ex rel Lehigh Valley R. Co. v. State Tax Comm'n*, 220 A.D. 1, 221 N.Y.S. 467, *aff'd*, 247 N.Y. 9, 159 N.E. 703 (1928); *People ex rel New York Central R.R. Co. v. State Tax Comm'n*, 258 A.D. 346, 16 N.Y.S.2d 812 , *aff'd*, 284 N.Y. 616, 29 N.E.2d 932 (1940); *St. Lawrence Shores, Inc. v. State*, 60 Misc. 2d 74, 302 N.Y.S.2d 606 (1969).

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26. *People v. New York and S.I. Ferry Co.*, 68 N.Y. 71 (1877).

27. *St. Vincent's Female Orphan Asylum v. City of Troy*, 76 N.Y. 108 (1879).

28. *Burbank v. Fay*, 65 N.Y. 57 (1875); *McMillan v. Klaw & Erlanger Constr. Co.*, 107 A.D. 407, 95 N.Y.S. 365 (1905); *Ackerman v. True*, 175 N.Y. 353, 67 N.E. 629 (1903); *Walker v. Caywood*, 31 N.Y. 51 (1865); *Spinella v. Rindenello*, 19 N.Y.2d 1010, 281 N.Y.S.2d 845, 228 N.E.2d 824 (1967).

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36. *In re the City Buffalo*, 206 N.Y. 319, 99 N.E. 850 (1912) (involving sudden and perceptible addition to land by the action of water).

37. *Rivera Ass'n Inc. v. Town of N. Hempstead*, 52 Misc. 2d 575, 276 N.Y.S.2d 249 (1967); *Hinkley v. State*, 234 N.Y. 309, 137 N.E. 599 (1922); *City of New York v. Third Ave. Ry. Co.*, 294 N.Y. 238, 62 N.E. 52 (1945).

38. *Granger v. City of Canandaigua*, 257 N.Y. 126, 177 N.E. 394 (1931).

39. *People v. D. & H. Co.*, 213 N.Y. 194, 107 N.E. 506 (1914).

40. *Rumsey v. New York & N.E. R.R. Co.*, 130 N.Y. 88, 28 N.E. 763 (1891).

41. *People v. Baldwin*, 197 A.D. 285, 88 N.Y.S. 542 (1921), *aff'd*, 233 N.Y. 672, 135 N.E. 964 (1922); *Hall v. State*, 72 A.D. 360, 77 N.Y.S. 282 (1902); *Delancy Piepgrass*, 138 N.Y. 26, 33 N.E. 822 (1893).

42. *Burbank v. Fay*, 65 N.Y. 57 (1875).

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Bergman on Mortgage Foreclosures:

Deficiency Judgments and the Workout Agreement

By Bruce J. Bergman

Deficiency judgments continue to be a field of landmines in New York. Highly technical and layered with nuance, a foreclosing lender desirous of pursuing a deficiency must be both careful and timely. A new case helps—a little—with more on that after setting the stage so the relevance of the decision can be better appreciated.

A deficiency *is* available in New York and it is measured by the difference between the sums due the plaintiff (as quantified in the judgment of foreclosure and sale) less the *greater* of the amount bid at the sale or the value of the property (as of the date of sale.) *Whether* a lender or servicer chooses to seek a deficiency is purely a business decision based upon many factors, two of which are how much the deficiency is and whether the parties liable have assets to execute upon if the judgment is awarded.

Then there is the problem of all the rules: the post-sale deficiency motion must be served within 90 days of delivery of the referee's deed (not always a moment so easy to pinpoint). Under some circumstances, the motion must be personally served upon the party liable, or his attorney—also not always so easy. Should the parties liable protest the value issue, thereby almost invariably necessitating a valuation trial, the plaintiff will need an appraiser capable of testifying. And this is but a short list of the potential burdens and pitfalls.

"Deficiency judgments continue to be a field of landmines in New York."

Now for the comfort (a bit) offered to mortgage holders by a recent case.[1] If mortgagors agree in a stipulation to waive opposition to the deficiency, then it must be enforced. What was unclear in the decision was whether the mortgagors would have been liable for the deficiency before the stipulation was entered into, or whether that liability was *imposed* by the stipulation. Pursuant to that stipulation, the mortgagors agreed to waive any defenses to the foreclosure and further that they "shall be jointly and severally liable for any deficiency and shall consent to the entry of judgment against them for the full amount of said deficiency."

So when a deficiency was granted and the mortgagors appealed, the appeals court would hear none of it. Somewhat unclear though the decision is, two lessons emerge. First, if for some reason a mortgage does not impose deficiency liability (or does not impose it upon all the people the lender would want or prefer), a stipulation entered into as part of a foreclosure settlement whereby liability is affixed *will* be enforced.

Second, if any foreclosure is settled by a stipulation, clarifying the borrowers' lack of opposition to any deficiency motion is something to seriously consider.

Endnote

1. *National Loan Investors v. Goertzel*, 251 A.D.2d 639, 676 N.Y.S.2d 605 (2d Dep't 1998).

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