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N.Y. Real Property Law Journal

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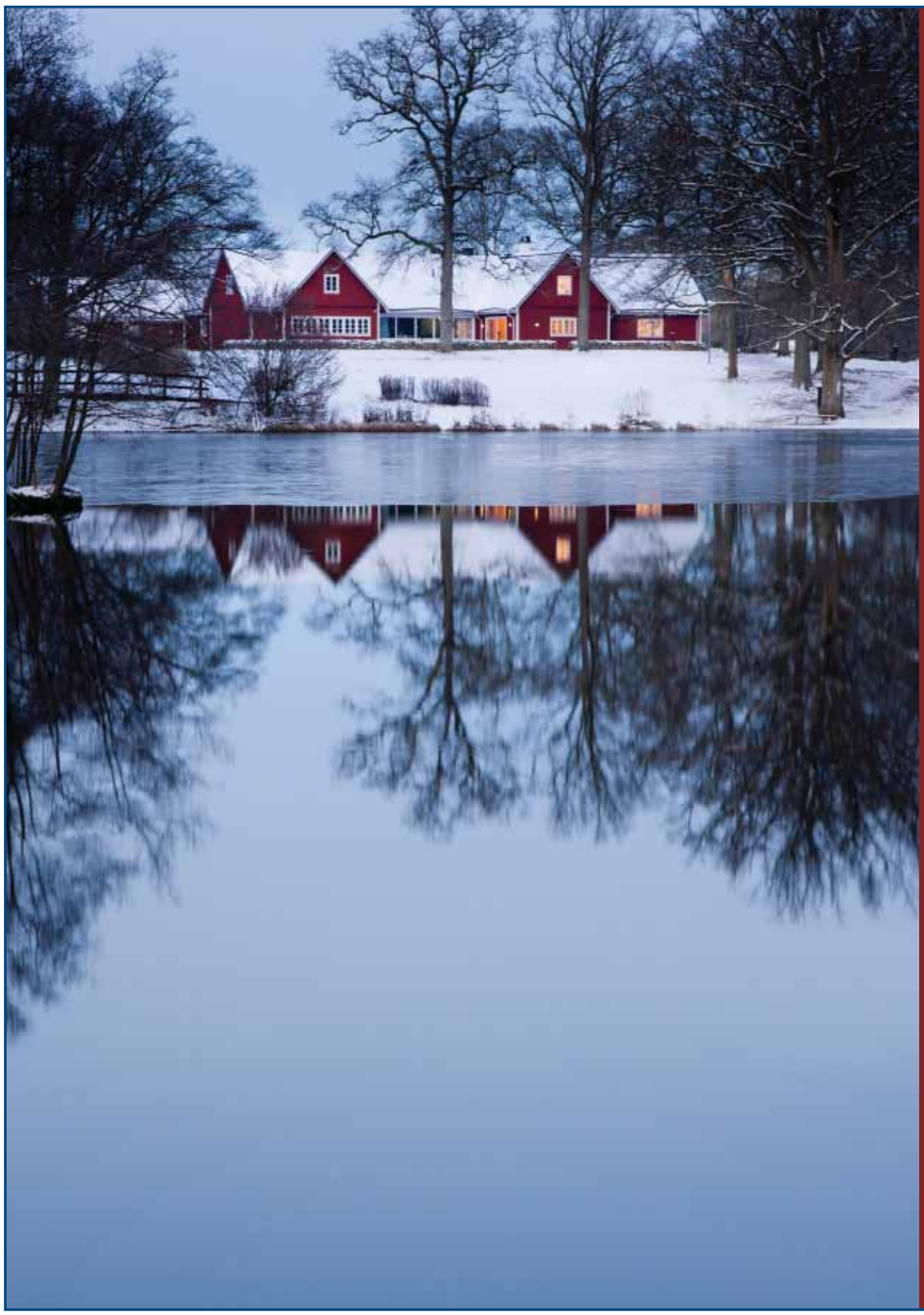

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Message from the Section Chair

As I write this message, we have all just learned of the very sad loss of our wonderful colleague, leader and mentor, John Blyth. The many tributes, accolades and stories which have already been circulated recognize that John was a unique lawyer, professor, scholar, chair and leader of our Section, kind mentor, gentleman and friend. John's enjoyment of the practice of real estate law, its nuances and its lore, was unequaled, and he gladly and warmly transmitted that joy and passion to everyone he met—both personally and professionally. His instinct, insight and delight in the law and his readiness at all times to share his experience and his knowledge were truly special. John was known as an ethical, careful, warm, friendly lawyer and human being, and as a model family man, devoted to his wife, his children and his many grandchildren. May our memories of John remain and endure as an inspiration to us all.

I know that you will all be glad to hear that the Section continues to serve both the New York real estate community and the larger New York community as we move from Fall to Winter.

Most importantly is the initiative taken by so many of our members in helping the entire New York community to survive and recover from Hurricane Sandy, coping with the loss of power and water, relocating and finding shelter given the extensive damage and destruction of so many homes in our area, dealing with fallen trees and blocked driveways, removing sand and debris, pumping water out of basements and street level floors, helping local businesses survive the resulting inability to operate and the loss of business, repairing and rebuilding homes, businesses, and lives—a truly monumental undertaking in which New York real estate lawyers have provided much needed advice, assistance and support, all on a pro bono basis.

At the same time, the members of the Section have continued to advance our mission in several ways. We have extended our efforts to improve the diversity of our Section—agreeing to co-sponsor the Women in the Law program (thanks to Mindy Stern and Nancy Connery for agreeing to participate); preparing and publishing the updated edition of the Tenant's Checklist of Silent Lease Issues (thanks to Joshua Stein and Spencer Compton); focusing on Committee meetings; reducing our expenses while increasing our continuing legal education and outreach programs; taking steps to increase our upstate membership, and enable our upstate members to become more active and involved (thanks to Leon Sawyko); expanding our student intern program which now includes Brooklyn Law School, Hofstra Law School, New York Law School, St. John's Law School and Touro Law School, and by looking to add upstate participants as well (thanks to David Berkey and Stacy Wallach); by expanding our reach to younger and more diverse lawyers through our active participation in the NYSBA's Diversity Challenge II program, through initiatives with the Young Lawyers Section, and through other outreach programs consistent with the goal of increasing the diversity and inclusiveness of our membership, leadership and programs (thanks to Harry Meyer, David Berkey, Jimmy Lathrop, Mindy Stern and Marvin Bagwell); by expanding our continuing legal education offerings and programs (thanks to Larry Wolk and Joe Walsh, and to Ira Goldenberg, Peter Coffey, Karl Holtzschue, Mindy Stern and Anne Reynolds Copps for chairing and co-chairing programs); by increasing the number of meetings held by our subcommittees (thanks to David Zinberg and Beth Holden for holding a terrific meeting of the Commercial Leasing Committee; to Ken Block and Brian Lustbader for holding meetings of the Real Estate Construction Committee; to Peter Coffey for co-chairing the program entitled, "Attorney Escrow Accounts 101—What Every Attorney Needs to Know in New York," and to Ira Goldenberg and Dennis Greenstein for arranging meetings of the Committee on Condominiums and Cooperatives); by continuing to monitor and review legislation (thanks to Karl Holtzschue and Sam Tilton); by keeping us abreast of developments in the title insurance area (thanks to Mike Berey); by overseeing the award of scholarships in memory of Lorraine Power Tharp and Mel Mitzner (thanks to Mindy Stern and Joel Sachs for their leadership); by arranging networking events (thanks to Tiffany Bardwell and Michelle Wildgrube); and by continuing regularly to obtain articles and publish our most important *N.Y. Real Property Law Journal* (thanks to Vince Di Lorenzo, Marvin Bagwell, Bill Colavito and Bill Johnson).

We have also taken significant leadership roles in the NYSBA House of Delegates where Ira Goldenberg was unanimously selected as one of two Section Delegates to the NYSBA Executive Committee and where Joel Sachs, Trish Watkins, Larry Wolk and Sam Tilton have all accepted membership on the several committees of the Section Delegates's Caucus (on the continuing legal education, membership and finance committees).

We have added a new co-chair for the Green Real Estate Committee and we welcome Joel Binstok who joins Nick Ward-Willis in leading this timely and active Committee.

As always, I stress the importance of all of our Committees. It is in committee meetings, programs and activities that the real work of the Section takes place. That is also where we can expand our real estate knowledge, continue to educate and advise New York real estate lawyers, and best serve the real estate community. It is also where you will meet fellow lawyers with similar interests, clients and practices and follow current developments in the areas of the law most relevant to you.

Please be sure your calendars note that Thursday, January 24, 2013 is the date of our Annual Meeting and Program at the New York Hilton. Ben Weinstock has assembled a cast of stellar speakers who will discuss the updated third edition of the tenant's checklist of silent lease issues, the restaurant leasing checklist, using environmental insurance to manage risk in real estate transactions, bad boy carveouts in exculpated loan transactions, the status of mortgage foreclosures, and, in the ethical sphere, recent developments in attorney escrow accounts and the representation of multiple parties in a real estate transaction. The program will also include a panel of experienced real estate lawyers discussing everything you wanted to know about real estate but were afraid to ask—a presentation on specific questions and issues we all raise and wonder about but for which we do not have easy answers.

Please also note the dates of July 11-14, 2013 when we will hold our Summer Meeting at the Mohonk Mountain House. David Berkey is already working on the program and it, too, promises to be timely and interesting.

We hope to see you at both of these meetings and at many of our CLE programs and Committee meetings.

Steven M. Alden

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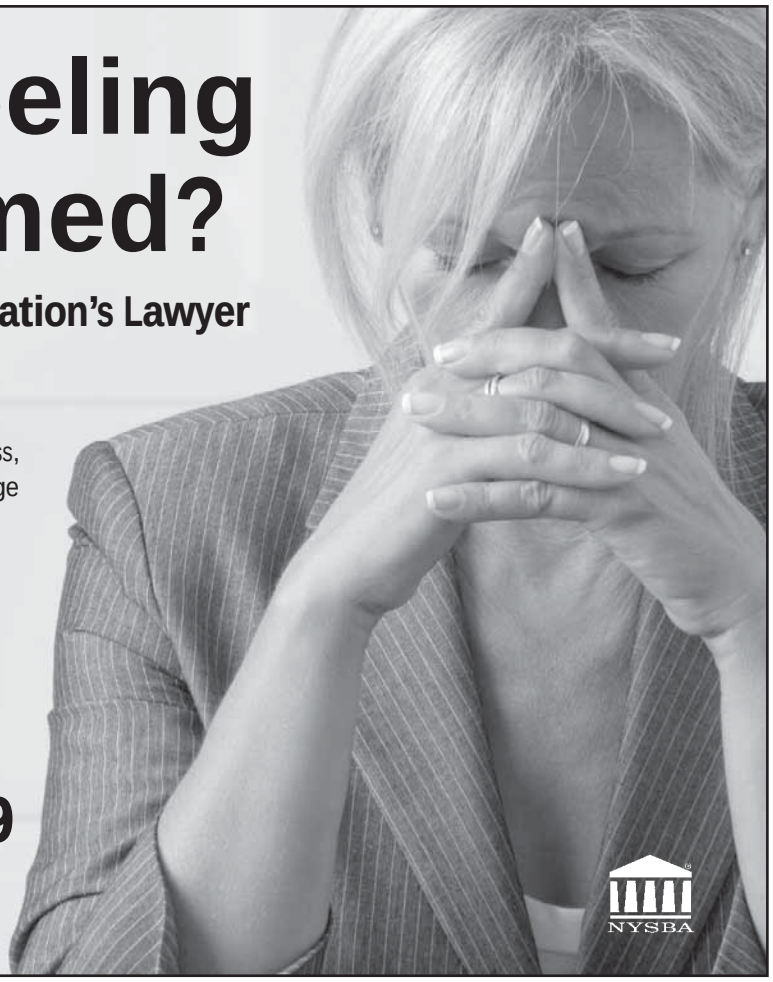

In Memoriam

John E. Blyth
1931-2012

John Blyth was inspirational—a great lawyer, teacher and friend. He loved learning and he loved teaching. When he encouraged me to become involved in the Section, he stated, "There is never a time when I go to an Executive Committee meeting of the Real Property Law Section that I don't learn something." He was constantly on the forefront of real property issues—questioning, researching and writing about whatever issue captured his attention at the time.

It was not easy to be a student of John Blyth. Once after I participated on a panel moderated by John, the late Lorraine Tharp commented, "John Blyth is not an easy taskmaster, but the results are well worth the effort." How true. When John gave a compliment, it was well-deserved.

John was an adjunct professor at Cornell Law School for 23 years. He was devoted to his students and established relationships that went beyond the classroom. His students kept in touch with him for years after they completed law school. John was interested in his students beyond their academic endeavors. He loved interacting with people and broadening his horizons.

John was my mentor for 25 years, and we shared office space for the last 10 years of his practice. I loved working with him because of his intelligence and his principles but also because he made the deals fun. Even difficult transactions had a spirit of levity because of his great sense of humor and perspective. He practiced law on his own terms. In spite of his busy law practice and teaching schedule, John always had time for his family and friends. His family came first, and he frequently stopped in my office to recount with delight the accomplishments of one or another of his grandchildren.

In addition to his family and his law practice, John loved his music. He was a fine organist and played in various churches over the years. The service to celebrate his life reflected his passion for the organ as well as his playful spirit. As the minister noted, John was frequently "reverently irreverent." The organist was a virtuoso brought in for the occasion who had been thoroughly briefed on John's personality. He performed a bit outrageously with great flair and ***volume!*** John would have been delighted. It was a fitting farewell to a man who enjoyed life to the fullest and who gently reminded us to do the same.

In his message as Section Chair, Steve Alden has eloquently described John's contributions. Some of the tributes, accolades and stories to which Steve has referred are set forth below. They are responses from the members of the Executive Committee to the State Bar announcement of John's passing. They reflect the impact that John had on our lives, and they have been forwarded to John's family.

Dorothy Ferguson

Tributes

In Rochester John was legendary. You did not have to be one of John's law students at Cornell to have John teach you the intricacies of real estate transactions. He was from that old school of attorneys who felt that it was his ethical duty to help young attorneys handle matters appropriately. John's dry wit was also always present especially over a gin martini. He had that uncanny ability to suck one into a tall tale and not recognizing it as such until the understated punch line followed by a hearty guffaw. On a personal basis John called me in 1990 and chided me for my commitment to a field as esoteric as real property tax assessments and convinced me to accept the Chair of the Section's Condemnation and Assessment Committee. And once John got me involved he would regularly press me to bring substantive issues of interest to the Executive Committee. So it was always really John who was responsible for my ramblings. I had the great pleasure in the mid 90s to office share with John as he was feeling his oats, having left the big practice, and finding out the joy attorneys have representing clients on all kinds of matters, not just his beloved real estate. But John was no dabbler. He would attack even the smallest matter with intellectual curiosity and tenacity to get his client the relief needed. John was a great friend—a mentor—a community leader and a tremendous advocate for all who practiced real estate law in Western New York. His loss to our Rochester Bar cannot be measured.

Jim Grossman

John wrote some great articles. Decades ago he prepared an article dealing with variations on title insurance work by lawyers and related ethical considerations. More recently he wrote about Apostilles. He had a way of taking complicated, uninteresting subjects and explaining them well in an engaging manner.

Bill Johnson

Very sad news. My most heartfelt condolences to his family.

Ira Goldenberg

I share Ira's feelings. Will the committee Chair or Section convey our collective feelings to the family?

Gerald Goldstein

John was a gentle man, a great lawyer and a tireless ambassador for our Section and the real estate bar. He will be missed by us all. Deepest sympathies to his family.

Richard Fries

May he rest in peace. John was a scholar devoted to the Section. Julie and I express our deepest sympathy to Joanna and his family.

John Hall

At this season of Thanksgiving we should all give thanks that John was able to touch our lives as a very special attorney and human being. He will be dearly remembered.

Joel Sachs

So sorry to hear this. He was a lovely and scholarly person. I enjoyed attending his lectures at the summer meetings. My condolences to his family.

Dennis Greenstein

When I moved to New York from Boston 25 years ago, John was incredibly welcoming to me. He urged me to become involved in the Section, introduced me to many lawyers in the Section as well as others, and invited me to join him as a panelist in CLE seminars. He really helped in my becoming a New York lawyer, which was most generous of him, both in spirit and in time spent.

Steve Horowitz

I have read with interest the many comments. I was doubly saddened as I had just learned at our last executive committee meeting that John had moved to an assisted living facility to care for his wife, and now he is gone and we and she have a loss.

I thought Steve Horowitz's comments quite apt as I too always found John inclusive and a lawyer's lawyer. When I first became involved in Bar activities in mid-90s—one of the highlights was John and Benet Polikoff's writings and lecturing on opinion letters. I always enjoyed my conversations with John and came away the better for them. He was a superb lawyer and a gentleman.

Lawrence Wolk

John served as the informal liaison between the NYSBA RPLS XC and the Monroe County Bar Association Real Estate Section when I first started working in local bar association activities. He would always bring back such interesting information and wisdom from his XC meetings and share his nuggets of knowledge with the up-and-coming attorneys sitting around the table here in Rochester. We enjoyed his wit and wisdom and his passion for real estate law. I always enjoyed his presentations on attorney opinion letters at the annual Monroe County Bar Association Banking Law seminars. Furthermore, his article on attorney approval letters, "A Second Bite at the Apple" (recently updated by his friend and colleague Dorothy Ferguson), is a wonderful treatment on the topic of the use of attorney approvals for residential transactions. He was a gifted individual and a man willing to share his gifts with others. He will be missed.

Charles Russell

It was a sad day last Friday when I first heard that John had passed away. I knew John (and Joanna) for over 30 years, not only as a colleague but as a mentor and friend. The comments made by Jim Grossman and Chip Russell about John are so very true. John was legendary in Rochester. He was a premier real estate attorney and was respected by all who knew him. John never tried to take short cuts in his work, everything was so well thought out and his dedication to the practice of law was so evident. He was an incredibly ethical person and he did not hesitate to take positions on matters, even when his position was not the most popular. John was a dedicated and enthusiastic Chair of our Executive Committee. After his term as Section Chair ended, John continued to remain extremely active on the XC with his numerous writings and the seminars where he would lecture. In the mid to end of the 1990s I was fortunate to work with John. John truly was brilliant and his wisdom was amazing. It was during this time, I came to realize how much family meant to John. He often spoke with such pride of his four children and many grandchildren. His care of and devotion to Joanna, when she started to have medical issues, was the most important thing in John's life. John may be gone, and certainly will be missed, but he will not be forgotten.

Maureen Lamb

I too echo the thoughts of Chip, Maureen and Jim about John as a lawyer and mentor. Personally, I worked with John in my first few years of practice and he did act as my mentor, but we will be forever bonded as when I gave birth to my first son, John was the only non-family member to visit me in the hospital—he was just a few doors down with his first granddaughter, born on the exact day as my son. We got them together a few times over the years and it was quite a sight to see him in a different light than in just a legal setting. John was never more glowing as he was when he was with his family. My condolences to his family.

Heather Rogers

As another once young and now not so young lawyer practicing in Rochester I, too, had the pleasure of many contacts with John over the years. There is little I can add to what my Rochester colleagues have already said about his talent, erudition, kindness and sense of humor. My lasting memory of John will be lunching at Richardson's and seeing John walk in (and it seemed he always lunched there in his most recent years in that I saw him there whenever I happened in) and almost simultaneously with his arrival a martini was placed at his table. John always had a friendly greeting for many in the room and most seemed to know him. In that rather dimly lit restaurant one could only think of a more genteel time, a time when there were secretaries, not admins, messengers, not fax machines, typewriters, not computers and lawyers who took time to enjoy their practices and each other's company. However, John bridged the gap between the two eras, always remembering and living by the best that was and bringing those values into what is now. He was a gentleman always, a scholar with few equals and a friend to countless attorneys. He will be missed. Godspeed! LTS

Leon Sawyko

There was no better known, more respected or more competent real estate attorney in Rochester. John's insight, wisdom and feel for the law were unmatched. His generosity in sharing his time and knowledge will be missed by the entire bar here. In speaking to a colleague about John yesterday he recounted how as a young lawyer John gently "reminded" him of something he "might want to consider." When John was on the other side of a deal, you always knew that not only would it be done correctly but also with integrity. The last deal I did with John was just before his official retirement. He represented his not-for-profit client pro bono. In fact, it was a church where years ago John played the organ. Another talent of his. We will miss you, John.

Jerry Antetomaso

When I initially became a member of the Executive Committee, John was among the first to extend his hand in welcome. He always invited me to dinner whenever he was in New York City for a Committee meeting. It was through these opportunities to break bread and imbibe a little wine and gin that John introduced me through his very wry and dry sense of humor to the Committee's history, lore and unwritten rules. John was also the first program Chair to invite me to participate on a Practicing Law Institute program on title insurance. With John nearby, I learned much more about my chosen field of title insurance than I could ever give back. John was my mentor and advocate. I will miss him greatly.

Marvin N. Bagwell

A Not-So-Brief History of MERS Litigation in New York

By Marvin Bagwell

It has been said often that only the winners get to write history.[1] Here in New York, the courts are often called upon to determine who, exactly, are the winners. Therefore, to understand the history of litigation involving the Mortgage Electronic Registration System ("MERS") in this State, we will examine the writings of the New York judges who bore witness to the pro and con arguments of the litigants and who ultimately decided what would be MERS's fate here in New York. In this article, you are invited to try your hand at being Herodotus. Instead of reading what others have interpreted as MERS's history, it will be your task, if you choose to accept this mission, to read portions of the original opinions and develop your own account of MERS's jurisprudence here in New York. Of course, this author is not willing to surrender total control, but will provide some direction along the way.

In the beginning, there was darkness and chaos

In the early 1990s the county clerk's offices nationwide were in disarray. Here at home in New York, title people will still remember county clerks' offices filled with unopened mail, unrecorded documents strewed in every corner, recording delays of months on end, and untold numbers of lost documents. The gap between a transaction's closing date and the recording date of the documents from that transaction grew to weeks if not months, if the documents were not lost to history. The situation became so dire that the New York State Land Title Association brought a mandamus action against the Nassau County Clerk in the hope that the courts would order the Clerk to record documents promptly and efficiently as the laws required. The Court issued the order, but in vain; nothing really changed. As Newton proved, once a body is in motion, it takes energy to change its motion, and the energy could not be found.[2]

The recordation system was not merely in disarray; it was, as today's teenagers would say, uber-chaotic. One New York Court, in delivering its version of events leading up to the creation of MERS, wrote:

> MERS's implementation followed the delays occasioned by local recording offices, which were slow in recording instruments because of complex local regulations and database systems that had become voluminous and increasingly difficult to search.[3]

And then there was light

Against this backdrop, several large real estate and title-related companies, including the American Land Title Association, Bank of America, Chase, Citimortgage, Fannie Mae, First American Title Insurance Company, Freddie Mac and Stewart Title Insurance Company, among many others,[4] created MERS for the express purposes of removing some of the mounds of paper from the Clerk's Offices, namely mortgage assignments, and instead maintaining the assignment records electronically. Instead of recording mortgage assignments, the assignment chains would be maintained electronically within MERS's database.[5]

Professor Stewart E. Sterk, Mack Professor of Real Property Law at the Benjamin Cardozo School of Law, wrote that

> Participants in the real estate mortgage industry created MERS…to permit electronic processing and tracking of ownership and transfers of mortgage[s]. Members in the system agree to appoint MERS to act as their agent with respect to mortgages. MERS records mortgages acquired by any of its members in the name of MERS, Inc, as nominee. MERS does not record assignments from one MERS member to another, but tracks those mortgages internally in MERS's private electronic system.[6]

MERS itself states that it raison d'être is as follows: "[t]he MERS System was created by the real estate finance industry to streamline the mortgage process and by using electronic commerce to eliminate paper and redundant processes."[7]

MERS began in New York as a godsend but morphed over the next two decades into a casebook study of a good idea gone bad. As in many Greek legends, its comeuppance, at least in New York, can be traced to its hopeful and perhaps overly hyped beginnings.

Controversial from the start

Like much notorious litigation with national repercussions, MERS's history before the courts began in Florida. By August 2005, trial courts in Pinellas and Dade Counties, Florida had dismissed close to 30 foreclosures because MERS was not the beneficial owners of the mortgages at issue and because Florida law did not recognize that an entity designated as a "nominee" had any legal right to foreclose.[8] The controversy continues unabated today. Googling "MERS" in mid-November 2012, when this article was written, resulted in 32 million hits. Googling "MERS foreclosures" gave 1.2 million hits. Obviously, something about MERS incites people to talk and to litigate. "Incites" is the proper word. MERS is one of the few topics that can drive thoughtful, reserved and considerate real property lawyers to tantrums. On July 18, 2012, the date on which the Oregon Supreme Court rendered a decision that many viewed as a defeat for MERS, the Dirt-Real Estate Lawyers List-

serv, lit up with recriminations rarely heard in polite dirt lawyer conversations. One lawyer's "long live MERS, which has saved countless borrowers and lender significant sums of money over the years, and assisted in creating an efficient market for negotiable instruments" was met by another's "you must have missed the last six years, for MERS, as applied, has cost borrowers billions if not trillions. Moreover, contrary to leading to an efficient market, it was part of a business mode that resulted, literally, in trillions of losses."[9] This is heady stuff for the normally sedate real property bar. MERS itself notes that its press has not been as favorable as it would like. The press has described MERS as "a murky system created by banks to hide ownership" and as "Frankenstein's monster of a recording system…designed to replace local recorders."[10] Although the comments came later in MERS's history, the underlying controversy regarding MERS had come before the New York State Court of Appeals.

First, there was victory

In 2001, the New York Attorney General issued an informal opinion that recording a MERS mortgage frustrated the legislative intent of public recordation as set forth in Real Property Law Section 316. Edward P. Romaine, then the Suffolk County Clerk, declined to record and index mortgages, assignments of mortgages and discharges of mortgages, which named the MERS as the lender's nominee. Romaine argued that MERS as nominee was not a proper mortgagee because it had no interest in the underlying mortgage. Legalities notwithstanding, there were more prosaic reasons why the Suffolk County Clerk declined to record MERS's instruments. As noted by Professor Sterk:

> The issue is not simply a matter of principle; an increase in use of the MERS system means fewer recordings in the county clerk's office—and fewer fees collected by that office. Indeed, avoidance of those fees (and fees paid to persons who actually bring the assignments to the county clerk's office) was undoubtedly one impetus that led to creation of the MERS system.[11]

MERS brought suit to compel Romaine to record MERS's instruments. The first question presented to the courts was whether MERS mortgages and assignments were even recordable?

First, the Judges of the Court of Appeals took note of MERS's short history:

> In 1993, the MERS system was created by several large participants in the real estate industry to track ownership interests in residential mortgages. Mortgage lenders and other entities, known as MERS members, subscribe to the MERS system and pay annual fees for the electronic processing and tracking of ownership and transfers of mortgages. Members contractually agree to appoint MERS to act as their common agent on all mortgages they register in the MERS system.
>
> The initial MERS mortgage is recorded in the County's Clerk's office with "Mortgage Electronic Registration Systems, Inc." named as the lender's nominee or mortgagee of record on the instrument. During the lifetime of the mortgage, the beneficial ownership interest or servicing rights may be transferred among MERS members ("MERS assignment"), but these assignments are not publicly recorded; instead they are tracked electronically in MERS's private system. In the MERS system, the mortgagor is notified of transfers of servicing rights pursuant to the Truth in Lending Act, but not necessarily of assignments of the beneficial interest in the mortgage.[12]

The Judges agreed that MERS did indeed have its good points.

Chief Judge Kaye wrote:

> The benefits of the system to MERS members are not insubstantial. Through use of MERS as nominee, lenders are relieved of the costs of recording each mortgage assignment with the County Clerk, instead paying minimal yearly membership fees to MERS. Transfers of mortgage instruments are faster, allowing for efficient trading in the secondary mortgage market, a mortgage changes hands at least five times on average.[13]

The Court of Appeals held that as to mortgages, where the lenders designated MERS as the mortgagee and nominee of record, "[t]he Clerk lacks the statutory authority to look beyond an instrument that otherwise satisfies the limited requirements of the recording statute [Sections 291 and 316-a of the Real Property Law]."[14] The Court also held, based upon Real Property Law Section 321, that the County Clerk was required to record MERS's mortgage assignments and discharges as well.[15]

Ominously, certain Judges, akin to a Greek chorus, peered over the horizon and forecast regarding MERS that they saw gathering clouds, if not of tragedy, then certainly of misfortune. First both Judge Ciparick, in her concurring opinion, and Chief Judge Kaye, in her dissenting opinion, noted the financial impact that MERS would have on local government. Judge Ciparick wrote that, "if MERS succeeds in its goal of monopolizing the mortgage nominee market, it will have effectively usurped the role of the County Clerk that inevitably

would result in a county's recording fee revenue being substantially diverted to a private entity."[16] Chief Judge Kaye, in her dissent noted that "[t]he County Clerks, of course, are concerned about the depletion of their revenue—allegedly over one million dollars a year in Suffolk County alone."[17] However, it was Judge Ciparick, who proved to be the more prescient:

> I wish to note however, that to the extent that the County and various amici argue that MERS has violated the clear prohibition against separating a lien from the debt and that MERS does not have standing to bring foreclosure actions, those issues remain for another day.[18]

MERS had won the day handily. In a few years, MERS could state that over 75 million loans have been registered nationwide since 1997 and that 30 million active mortgage loans are registered on the MERS system today.[19] Even Attorney General Schneiderman took notice, "[m]ore than 70 million mortgage loans, including millions of subprime loans, have been registered in the MERS systems, rather than in local county clerk's offices," thereby saving the real estate industry $2 billion in recording fees.[20] Unfortunately for MERS, the Attorney General was trumpeting MERS's success in a lawsuit he was bringing essentially to put MERS out of business.

Then Came the Great Recession

At the end of 2009, 54,591 foreclosure cases were pending in the New York State courts. By the same time, in 2010, 77,815 cases were pending, a 43 percent increase.[21] The foreclosure crisis had begun. The courts began to look for ways to slow the crisis. Judges soon discovered that because of securitization, the now familiar process by which mortgages were bundled together, sliced and diced to create bonds that were sold to investors, many foreclosing plaintiffs could not produce the original mortgage and note. As foreseen by Judge Ciparick in *Romaine*, standing became an issue.

Standing in the context of a foreclosure action, means essentially that the lender must own the mortgage. Judge Ciparick pointed to a 1867 case, *Merritt v. Bartholick*, 36 N.Y. 44, 45 (1867) in her admonition that MERS lacked standing to bring a foreclosure action if it separated the mortgage from the debt or note. Courts, particularly in the downstate region began to cite as precedent, the more recent leading case on standing, *Kluge v. Kugazy*, 145 AD2d 537 (1988), where the Second Department's Appellate Division wrote, "foreclosure of a mortgage may not be brought by one who has no title to it." Cases following *Kluge* were as follows:

In *Aurora Loan Services v. Grant*,[22] Aurora filed its notice of pendency on November 21, 2006. However, Aurora was not assigned the mortgage until November 29, 2006. Justice Rothenberg of Kings County dismissed the foreclosure complaint and vacated the notice of pendency because Aurora did not own the mortgage at the time it initiated its foreclosure action.

In *Deutsche Bank v. Stevens*,[23] Justice Lewis of Kings County dismissed Deutsche Bank's foreclosure action where it commenced its action on June 2, 2008, but did not receive its assignment from Fremont Investment & Loan until June 11, 2008.

In *Wells Fargo Bank v. Burke*,[24] Wells commenced the first of three foreclosure actions on June 14, 2002. Wells did not receive its assignment of the mortgage until July 22, 2009. Justice Silber of Kings County discontinued the action. It is therefore clear, as the Court stated in *Deutsche Bank v. Stevens*, "an assignee of such a mortgage does not have standing to foreclose unless the assignment is complete at the time the action is commenced."

Commencing the foreclosure action and then back-dating (whoops, sorry, changing the effective date of the assignment), will not work and might just try the Court's patience. In *Wells Fargo v. Marchione*,[25] Wells commenced its foreclosure action on November 30, 2007. Option One assigned the mortgage in foreclosure to Wells on November 30, 2007 with a provision that the assignment became effective on October 28, 2007. Justice Leventhal, writing for the Appellate Division, Second Department, dismissed the complaint for lack of standing because the assignment must be complete at the time the action is commenced. Put another way, the assignment of the mortgage must have occurred prior to the commencement of the action, which is the date of filing.

On Staten Island, on a motion for reconsideration, Justice Maltese reversed himself and dismissed a foreclosure action because the foreclosing plaintiff lacked standing at the time it commenced its action. In *Deutsche Bank, National Trust Co. v. Abbate*,[26] the lender commenced its foreclosure action for two mortgages on March 1, 2007. However, Suntrust did not assign the mortgages to Deutsche until March 7, 2007. The assignments contained a clause making them effective on February 24 and 28, 2007. Justice Maltese held that the Court should have dismissed the action for lack of jurisdiction and he promptly did so, ruling that the court "lacks jurisdiction over the subject matter when the plaintiff has no title to the mortgage at the time it commenced the action."[27]

It is also not a good idea, for the lender at least, to assign a mortgage during the pendency of action, especially in Justice Schack's Court. In *Deutsche Bank National Trust Co. v. Castellanos*,[28] Deutsche Bank commenced a foreclosure action on July 27, 2006. Justice Schack discovered by going on ACRIS that while he was preparing to issue a judgment of foreclosure and sale, Deutsche Bank had assigned the mortgage to MTGLQ Investors, a subsidiary of Goldman Sachs on January 17, 2007. The Court had "no choice but to deny the application for a judgment of foreclosure

and sale without prejudice. Plaintiff Deutsche Bank had no standing to proceed with this action since January 17, 2007."[29]

It was not too long before the courts began to view MERS as a part of the problem.

Justice Schack, in *HSBC v. Yeasmin*,[30] found that the assignment from MERS as nominee for Cambridge to HSBC was invalid in that neither a corporate resolution nor a power of attorney was recorded with the assignment. Further, the person who executed the assignment was an officer of both MERS and HSBC, a clear conflict of interest to Justice Schack.

Justice Schack previously found the same defect (lack of recorded board resolution or power of attorney) regarding the assignment from MERS to HSBC in *HSBC Bank USA NA v. Vasquez*.[31] He dismissed that foreclosure proceeding as well.

Justice Schack is not alone in examining the assignment closely. In *Bank of New York v. Alderazi*,[32] MERS purported to assign the subject mortgage to Bank of New York by empowering an officer by "Board Resolution and/or appointment." However, the Court found no proof of authority recorded with the assignment. Following Justice Schack's lead and citing *Yeasmin*, the Court dismissed HSBC's foreclosure action.

However, it was not until *LPP Mortgage LTD. v. Sabine Properties*[33] that decisions regarding MERS's role in the foreclosure process moved from the quixotic to the truly thought-provoking. On September 15, 2010, LPP claimed on "information and belief" that it owned a $514,000 mortgage executed by Sabine. Sabine submitted the mortgage and note to the court, which showed that Sabine actually took out the mortgage with Wall Street Bankers, Ltd. MERS acting as nominee for Wall Street Bankers. LPP responded by showing a copy of an assignment by MERS to LPP dated December 19, 2008. The Court held that the assignment from MERS to LPP was invalid since MERS, as nominee, had no ownership interest in the mortgage and note. Therefore, LPP had no standing to bring the foreclosure action. The Court dismissed the action. The Court wrote as follows:

> Sabine's argument that MERS has no ownership right in the note is dispositive here. It is well established that "[i]f a plaintiff lacks standing to sue, it may not proceed in the action." [Cites omitted]… It has been held that only "the owner of the note and mortgage at the time of commencement of a foreclosure action prosecute said action." [Cites omitted]… Here, there are no allegations or evidence that MERS was the owner of the note such that it could assign it to LPP. Thus the assignment from MERS was insufficient to confer ownership of the note to LPP and it has not standing to bring this action [Cites omitted]….[34]

Then, things really started to go downhill

The Bankruptcy Court, Robert E. Grossman, J., in *In re Ferrel L. Agard*,[35] wrote one of the fullest dissertations on MERS's ability to foreclose mortgages in accordance with New York law. In September 2010, Ferrel Agard filed for relief under Chapter 7 of the Bankruptcy Code. Select Portfolio Services, as servicer for U.S. Bank National, filed for relief from the automatic stay so that it could foreclose on a mortgage given by Agard to the original lender, First Franklin. Agard argued that the only interest that U.S. Bank held in the underlying mortgage was by way of an assignment from MERS as nominee for First Franklin. The Court noted that Agard's argument raised "a fundamental question as to whether MERS had the legal authority to assign a valid and enforceable interest in the subject mortgage."[36] The Court ruled that since the state court had granted U.S. Bank's motion to foreclose, under the doctrine of res judicata, "this Court must accept…U.S. Bank's status as a creditor secured by the Property. Such status is sufficient…to seek relief from the automatic stay."[37] However, the Court noted that it had deferred rulings on dozens of other motions for relief from stay pending the resolution of the issue whether an entity which acquires its interest in a mortgage by way of assignment from MERS, as nominee, is a valid secured creditor with standing to seek relief from the automatic stay.

Essentially, in support of its position that the mortgage granted to MERS the right to assign the mortgage as "nominee" or "agent" on behalf of the lender, MERS presented four arguments to the Court. First, pursuant to the term of the mortgage, Agard acknowledged that MERS had the right to assign the mortgage and under state law, MERS fell within the definition of "mortgagee." Second, MERS argued that it was the agent of its member banks and as such had the authority to assign the mortgage. Third, MERS argued that even if the Court held against its first two arguments, U.S. Bank held the note and the mortgage and the note were inseparable. Finally, MERS argued that it had the authority to assign the mortgage under the procedures set forth within the MERS system.

In response to the first argument, the Court held that "under New York law," MERS "can prove that U.S. Bank is the holder of the Note by providing the Court with proof of a written assignment of the Note," or demonstrate that U.S. Bank has physical possession of the Note endorsed over to it. The only proof that MERS presented was an "Assignment of the Mortgage" which contained a vague reference to the Note. But "[b]y MERS's own account the Note in this case was transferred among its members while the mortgage remained in MERS's name."[38]

As to MERS's argument that it was nominee or mortgagee of record, "[t]here are several published New

York State trial level decisions that the status of 'nominee' or 'mortgagee or record'" bestowed upon MERS in its mortgage documents does not empower MERS to effectuate an assignment of the mortgage. These cases hold that "MERS may not validly assign a mortgage based on its nominee status, absent some evidence of specific authority to assign the mortgage."[39] Regarding MERS's third argument, the Court found that MERS's own evidence showed that the mortgage and the note had indeed become separated; USBank held the note and First Federal held the mortgage. As to MERS's fourth argument that its membership documents gave it the authority to assign the mortgages:

> [t]he Court finds that the record in this case is insufficient to prove that an agency relations exists under the laws of the state of New York between MERS and its members. According to MERS, the principal/agent relationship among itself and its members is created by the MERS rules of membership and terms and conditions, as well as the Mortgage itself. However, none of the documents expressly create an agency relationship or even mentions the word "agency."[40]

The court's conclusion was "in all future cases which involve MERS, [MERS] must show that it validly holds both the mortgage and the underlying note in order to prove standing before this Court.[41]

Later, a New York State Appellate Division Court also held that MERS did not have the standing to foreclose and therefore could not assign the right to foreclose, albeit for a different reason.

In October 2006, Stephen and Frederica Silverberg borrowed $450,000 from Countrywide. In April 2007, the Silverbergs borrowed additional funds from the same lender. The two loans were consolidated into a $479,000 mortgage in favor of MERS as mortgagee and nominee for Countrywide. A year later, MERS, as Countrywide's nominee, assigned the consolidated mortgages to the Bank of New York (BNY). Shortly thereafter, the Silverbergs defaulted and BNY started a foreclosure action. In defense, the Silverbergs argued that BNY lacked standing to foreclose because neither MERS nor Countrywide ever transferred or endorsed the notes to BNY as required by the Uniform Commercial Code. The issue before the Court was whether MERS, as nominee and mortgagee for purposes of recording, could assign the right to foreclose the mortgage to BNY despite the fact that MERS did not have possession of, and hence lacked the ability to assign the underlying promissory note. First, the Court held that under New York case law, a foreclosing party had standing only when it was the holder or assignee of the underlying mortgage and note. The Court found that Countrywide in the consolidation agreement had given MERS as nominee, the right to assign the mortgage but not title to the note. Nor according to the Court was there any evidence that the note was ever delivered to MERS. As a result, the Court held that the assignment of the mortgage to BNY was a nullity and BNY lacked standing to foreclose. The Court dismissed the complaint against the Silverbergs.[42]

We will follow the Court's logical progression in its own words. The Court's citations have been omitted for purposes of brevity:

> The principal issue ripe for determination by this Court, and which was left unaddressed by the majority in *Matter of MERSCORP* is whether MERS, as nominee and mortgagee for purposes of recording, can assign the right to foreclose upon a mortgage to a plaintiff in a foreclosure action absent MERS's right to, or possession, the actual underlying promissory note.
>
> Standing requires an inquiry into whether a litigant has "an interest… in the lawsuit that the law will recognize as a sufficient predicate for determining the issue at the litigant's request."… Where, as here, the issue of standing is raised by a defendant, a plaintiff must prove its standing in order to be entitled to relief.… In a mortgage foreclosure action, a plaintiff has standing where it is both the holder or assignee of the subject mortgage and the holder or assignee of the underlying note at the time the action is commenced.
>
> As a general matter, once a promissory note is tendered to and accepted by an assignee, the mortgage passes as an incident to the note.…By contrast, "a transfer of the mortgage without the debt is a nullity, and no interest is acquired by it."
>
> Here, the consolidation agreement purported to merge the two prior notes and mortgages into one loan obligation. Countrywide…was not a party to the consolidation agreement.…However, as "nominee," MERS's authority was limited to only those powers which were specifically conferred to it and authorized by the lender…. Hence, although the consolidation agreement gave MERS the right to assign the mortgages themselves, it did not specifically give MERS the right to assign the underlying notes, and the assignment of the notes was thus beyond MERS's authority as nominee or agent of the lender….

> Therefore, assuming that the consolidation transformed MERS into a mortgagee for the purpose of recording—even though it never loaned any money, never had a right to receive payment of the loan, and never had a right to foreclose on the property upon a default in payment—the consolidation agreement did not give MERS title to the note, nor does the record show that the note was physically delivered to MERS. Indeed, the consolidation agreement defines "Note Holder," rather than the mortgagee, as the "Lender or anyone who succeeds to Lender's right under the Agreement and who is entitled to receive the payments under the Agreement." Hence, the plaintiff, which merely stepped into the shoes of MERS, its assignor, and gained only that to which the assignor was entitled… did not acquire the power to foreclose by way of the corrected assignment.[43]

After undertaking a legal analysis similar to that taken by *Agard* Court, the *Silverberg* Court held that:

> [i]n sum, because MERS was never the lawful holder or assignee of the notes described and identified in the consolidation agreement, the corrected assignment of mortgage is a nullity, and MERS was without authority to assign the power to foreclose to the plaintiff. Consequently, the plaintiff failed to show that it had standing to foreclose.[44]

In light of the minority's warnings in *Romaine*, it was probably good for MERS not to appeal *Silverberg* and make it the law of the State.

Even before the *Agard* and *Silverberg* decisions, its users had begun to curtail MERS's ability to foreclose in its own name. On March 30, 2010, Fannie Mae issued an announcement stating that MERS must not be named as a plaintiff in any foreclosure action of a mortgage loan owned or securitized by Fannie Mae.[45] One commentator noted that "[t]his is significant because it appears that Fannie Mae is acknowledging that MERS does not have the capacity to bring foreclosure actions."[46] On July 22, 2011, MERS itself issued a Membership Rule Change prohibiting its members from conducting foreclosures in MERS's name.[47]

Après *Silverberg*, le deluge, at least in New York. On February 3, 2012, New York Attorney General Eric T. Schneiderman brought suit against MERS alleging that the nation's banks use MERS to evade public filings, shortchange localities of $2 billion in fees and compromise the interests of homeowners."[48] Of course, MERS did not shy away from the battle. On April 20, 2012, MERS and the other defendants filed a responsive pleading urging the Court to dismiss the Attorney General's action, arguing that their practices were not deceptive, that they did not violate General Business Law 349(b) or Executive Law 63(12) and that the Attorney General's suit was barred by the separation of powers doctrine.[49] The battle has been joined, but the court has not, as of yet, declared a victor.

But on the other hand

Not all courts have chosen to follow New York in holding that MERS lacks standing to foreclose.[50] A sampling of state courts holding that the doctrine of standing did not prevent MERS from foreclosing in their States include:

Alabama: The borrower argued that MERS did not have the right to exercise the power of sale under the mortgage because the assignee of the original lender was neither the assignee of the mortgage nor of the note when it commenced the foreclosure proceeding. The assignee did not obtain a written assignment of the note until after it started the foreclosure action. That apparently is not the law in Alabama. Because the original lender held the note in 2005, it did not matter that MERS did not assign the mortgage to the assignee until after the assignee commenced its foreclosure action. *Evelyn Coleman v. BAC Servicing*, 2102WL 2362617 (Ala. Civ.App).

California: The complaint was largely based on the theory that MERS did not have possession of the note and thus had no legal authority to assign a beneficial interest in the deed of trust to the foreclosing lender. Under the California Commercial Code and its non-judicial foreclosure act, which provided for a quicker and less expensive alternative to judicial foreclosures, the possession of the note was not necessary for the lender to foreclose. *Taasan v. Family Lending Services, Inc.*, 2012 WL 2774967 (Cal. App.1 Dist.).

Massachusetts: The Trustee contended that the party who receives a mortgage by way of an assignment from MERS lacks the power to foreclose that mortgage. However, under the Massachusetts version of the UCC, a person in possession of a promissory note endorsed in blank is deemed to be the holder of that note with the right to enforce it. Massachusetts does not subscribe to the theory that the mortgage follows the note. Even though MERS as nominee never held the note, it could by virtue of its nominee status transfer the mortgage on behalf of the note holder. *In re David Marron and Robin Soroko-Marron*, Debtors, 455 B.R.1 (2011).

Michigan: The law in Michigan is that if an entity is the record holder of the mortgage, then that entity owns a security lien on the property. Therefore, the entity has standing to foreclose upon properties where it is the record holder of the mortgage even if it does not own the underlying debt. However, in this case, the Court did not permit the lender to foreclose because the lender did not own the debt

at the time it initiated its foreclosure action. Standing of a sort still exists of a sort in Michigan. *Everbank v. Zeer*, 2012 WL 1890184 (Mich. App.).

Texas: Under Texas law, (a nonjudicial foreclosure state) where a deed of trust expressly grants MERS the power of sale, then MERS has that power. MERS also has the right to transfer its right and interest in the deed of trust to a new lender, including the power to foreclose. *Campbell v. Mortgage Electronic Registration Systems, Inc.*, 2012 WL 1839357 (Tex. App.-Austin).

Courts that have held that the doctrine of standing to foreclose prevents MERS from foreclosing mortgages in their State include:

Oregon: Under Oregon law, all assignments of the beneficiary's interest in a trust deed must be recorded in order to utilize the non-judicial foreclosure process. In this instance, MERS had executed the assignment but there was no assignment recorded by the designated lender. The Court held that "[a] beneficiary that uses MERS to avoid publicly recording assignments of a trust deed cannot avail itself of a nonjudicial foreclosure process that requires that very thing—publicly recorded assignments." *Niday v. GMAC Mortgage*, 251 Or. App. 278 (Or. Ct. App., 2012), *filed* (Or., 2012).

Washington: The Federal District Court certified the following question to the Washington Supreme Court: Is MERS the lawful beneficiary with the power to appoint trustees within the deed of trust act if it does not hold the promissory note secured by the deed of trust? The Court held that "beneficiary" under the deed of trust act meant the actual holder of the promissory note or other debt instrument. If the legislature had intended for beneficiary to mean noteholder, it would have said so. *Bain v. Metropolitan Mortgage Group, Inc.*, 175 Wash.2d 83 (2012).

And last but no means least New York: The courts of this State have not uniformly held against MERS's ability to foreclose in its own name. As noted by the *Asgard* Court, a New York Supreme Court held that MERS's status as nominee gave MERS the authority to assign mortgages. *U.S. Bank, N.A. v. Flynn*, 897 N.Y.2d 855 (N.Y. Sup. Ct. 2010). This occurred at about the same time that the Appellate Division, Second Department decided *Silverberg*. In fact in *Silverberg*, MERS argued that in *Mortgage Elec. Registration Sys., Inc. v. Coakley*, 41 A.D.3d 674 (2007), the *Silverberg* Court had held that MERS had standing to foreclose a mortgage. The *Silverberg* Court distinguished *Coakley* by noting that MERS had possession of the Note before starting the foreclosure action.

New York definitely holds the minority position among the states regarding MERS's ability to assign and foreclose mortgages. However, being in the minority does not signify irrelevance. As noted above, in July 2011, presaging *Silverberg* and *Agard*, MERS told its members to no longer foreclose mortgages in MERS's name.

Currently, MERS has not ceded the spoils to anyone. Through sophisticated media presentations as well as public and real estate institutional presentations, MERS is embarking upon writing its own history in New York and elsewhere. However, MERS's battle in New York is fraught with danger. There is a very thin line between the *Silverberg* and *Agard* rulings and a future court holding that mortgages with MERS anywhere in the chain of title are not subject to foreclosure in New York. It is yet to be seen exactly who will be the victor.

If you accepted this mission, then you have almost finished reading over 5,000 words regarding MERS's history. There is a more cogent version. At the conclusion of the of the Dirt Lawyer discussion mentioned much earlier in this article, Max L. Lieberman, an attorney based in Blue Bell, Pennsylvania, wrote the following:

> We can excoriate MERS, and deservedly, in view of how its is being abused, but let us not lose sight of the conditions that gave rise to it. Back in those days, the back offices in local recorders' offices were a mess. They were swamped, under-funded, not digitized or just rudimentarily computerized. As a result, the recording gap could be as much as 9 months or more. Title companies around the country were bringing mandamus actions against the worst offending offices. Simultaneously, DTS Corporation was doing what appeared to be a timely and accurate job of keeping track of stocks, bonds, municipal bonds, etc., and the thought arose that this model could be applied to alleviate the crises in recording mortgage assignments. Unfortunately, in those heady times, no one gave much thought to enforcement of the mortgages that had been nominally assigned to MERS solely for record keeping purposes.
>
> None of this justifies trying to foreclose in the name of MERS, since it is not really a party in interest, or its shortcomings in failing to perform its principal function, which it to keep accurate track of who does actually have the ownership interest in the particular mortgage.[51]

To conclude with another famous aphorism, "Those who fail to learn from history are doomed to repeat it."[52]

Endnotes

1. "History is written by the victors," attributed to Winston Churchill but of unknown origin.
2. *See* Diana Jean Schemo, *Recording by Hand, Nassau Lags Behind*, N.Y. Times, Apr. 11, 1992, http://www.nytimes.

com/1992/04/11/nyregion/recording-by-hand-nassau-lags-behind.html.

3. Bank of New York v. Silverberg, 86 A.D.3d 274, 278, 926 N.Y.S.2d 532, 535 (2d Dep't. 2011); *see also Peterson, Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev 1359, 1366 (2010).

4. MERSCORP, *Shareholders*, www.mersinc.org/about-us/shareholders.

5. *See* Kenneth M. Block & Jeffrey B. Steiner, *Electronic Registration: Mortgage Nominee's Standing to Sue Challenged*, 234 N.Y.L.J. 5 (2005).

6. Stewart E. Sterk, *Court Construes Property Statutes Narrowly*, 238 N.Y.L.J S12 (2007).

7. William C. Hultmam, Vice President, MERSCORP Holdings, Inc., ACMA 2012 Annual Meeting, MERS Update (Oct. 12, 2012).

8. Block & Steiner, *supra* note 5.

9. Posting, dirt@listserv.umkc.edu (July 18, 2012) (on file with author).

10. William C. Hultmam, Vice President, MERSCORP Holdings, Inc., ACMA 2012 Annual Meeting, MERS Update (Oct. 12, 2012) (describing "Myths that MERS was created to…").

11. Stewart E. Sterk, *Court of Appeals Upholds Recording of MERS Mortgages*, N.Y. REAL ESTATE LAW REPORTER, Feb. 2007, Vol. 21, Number 4, at 2-3.

12. Merscorp, Inc. v. Romaine, 8 N.Y.3d 90, 96, 861 N.E.2d 81, 83 (2006).

13. *Id.* at 104, 861 N.E.2d at 88 (Kaye, C.J., dissenting).

14. *Id.* at 97, 861 N.E.2d at 84.

15. *Id.* at 99, 861 N.E.2d at 85; *see* Kenneth M. Block & Jeffrey B. Steiner, *Electronic Registration: Court Says MERS Mortgages Must Be Recorded*, 237 N.Y.L.J 5 (2007); Sterk, *supra* note 11 (for a more detailed discussion of the Court's holding).

16. *Romaine* at 100, 861 N.E.2d at 86.

17. *Id.* at 104, 861 N.E.2d at 89.

18. *Id.* at 100, 861 N.E.2d at 85 (Ciparick, J., concurring); *see generally* Merritt v. Bartholick, 9 Tiffany 44, 45, 36 N.Y. 44 (1867) ("[A] transfer of the mortgage without the debt is a nullity and no interest is acquired by it.").

19. William C. Hultmam, Vice President, MERSCORP Holdings, Inc., ACMA 2012 Annual Meeting, MERS Update (Oct. 12, 2012).

20. *See* People v. JPMorgan Chase Bank, No. 0002768-2012 (Sup. Ct., Kings Cnty. Feb. 3, 2012).

21. *See* Ann Pfau, *2010 Report of the Chief Administrator of the Courts: Pursuant to Chapter 507 of the Laws of 2009*, 4, State of New York Unified Court System (2010), http://www.nycourts.gov/publications/pdfs/foreclosurereportnov2010.pdf.

22. *Plaintiff's Lack of Standing Grants Mortgagor Dismissal of Foreclosure Complaint Against Him: Aurora Loan Services v. Grant*, 238 N.Y.L.J. 20 (2007).

23. *Deutsche Bank Lacks Standing to Maintain Foreclosure Action; Summary Judgment Is Denied*, 243 N.Y.L.J. 20 (2010).

24. *Mortgagee Who Did Not Have Standing to Begin Foreclosure Has No Standing to Accelerate Mortgage*, 243 N.Y.L.J. 27 (2010).

25. Wells Fargo Bank v. Marchione, 69 A.D. 3d 204, 887 N.Y.S.2d 615 (2d Dep't 2009).

26. N.Y.L.J., Oct. 26, 2009, at 20.

27. *Id.*

28. N.Y.L.J., June 6, 2007, at 21.

29. *Id.*

30. N.Y.L.J., June 4, 2010.

31. N.Y.L.J., Aug. 28, 2009, at 28.

32. N.Y.L.J., May 20, 2010, at 26.

33. N.Y.L.J., Sept. 15, 2010.

34. *Id.* at *6.

35. *See* In re Agard, 444 B.R. 231 (E.D.N.Y. 2011).

36. *Id.* at 235.

37. *Id.* at 236.

38. *Id.* at 17.

39. *Id.* at 19.

40. *Id.* at 18.

41. Op. cit. at 22.

42. *Silverberg*, 926 N.Y.S.2d 532, 540, 86 A.D.2d., 284 (N.Y. App. Div. 2011).

43. *Id.* at 536.

44. *Id.* at 539.

45. Fannie Mae, ANNOUNCEMENT SVC-2010-05 3 (2010).

46. Robert E. Brown, *Fannie Mae regulates foreclosure actions brought by MERS*, WALL STREET, MAIN STREET, http://www.wallstreetmainstreet.com/2010/04/fannie-mae-regulates-foreclosure-actions.html.

47. *See* Hultman, *supra* note 7 (Slide 11).

48. John Caher, *A.G. Sues Banks Over Their Use of MERS Electronic 'End-Around,'* N.Y. LAW JOURNAL, Feb. 6, 2012, at 1; *see also*, JPMorgan Chase Bank, No. 0002768-2012.

49. Andrew Keishner, *MERS, Banks Call A.G.'s Suit Factually, Legally Deficient*, N.Y.L.J., Apr. 25, 2012 at 1.

50. However, trial courts in New York are following *Silverberg*. *See* DLJ Mortg. Capital, Inc. v. Dunkowski, N.Y.L.J., Sept. 13, 2012, (Sup. Ct. Queens Cnty.); HSBC Bank USA v. Abass, 34 Misc. 3d 1241 (Sup. Ct., Queens Cnty. 2012).

51. Max L. Lieberman, DIRT@LISTSERV.UMKC.EDU., opt. cit.

52. Attributed to Winston Churchill and George Santayana.

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The New Rules of Foreclosure Litigation

By Adam Leitman Bailey and Dov Treiman

Since the first loans and mortgages changed hands with cloaks and stone in Israel[1] and Greece[2] thousands of years ago,[3] never previously had mortgages caused a worldwide economic collapse of financial markets. Unfortunately, as the federal and state government as well as some judges place barriers and hurdles breaking contracts and preventing lenders from collecting monies owed to them, or foreclosing on the homes pledged as collateral, lenders may eventually run away from traditional lending, leading to a new world of lending where cash and goods are king and bartered in exchange for property. This would destroy most of the equity acquired in an owner's home. Strange judicial decisions have come down and played their part in slowing down the foreclosure process or simply eviscerating the foreclosure action. Fortunately, our appellate courts have come to the rescue and brought the essentials for any government—law and order and predictability of law so that business people and consumers alike can prepare contracts without uncertainty. One of the worst fears of every real estate and dirt lawyer is the unknown of what a court will do if a problem arises with a contract.

Having reviewed all of the appellate foreclosure cases since January 2010, we are discussing some of the most important foreclosure cases decided in that period. Our goal is not to denounce or praise these cases but to teach the practitioner and title professional how to proceed in this new era of mortgage and foreclosure litigation. As a general rule, the courts continue to show far greater restraint against enforcing lenders' claims, but our review has shown that when lender's counsel prepares the papers meticulously in accordance with the new laws, properties do go to judgment and sale.

One interesting pattern emerged. Although the counties of the Second Judicial Department[4] account both for roughly 50% of the population and 50% of owner-occupied housing in the State of New York, over 70% of foreclosures in the State were in the Second Department.[5] While we decline to speculate as to the economic or sociological reasons for the statistical discrepancy, it does mean that the Second Department is leading the way in making foreclosure law.[6]

No Sale Pending Modification

In *Aames Funding Corp. v. Houston*,[7] the Second Department stayed a foreclosure sale pending a determination on his application for a residential mortgage modification pursuant to the federal Home Affordable Mortgage Program (HAMP).[8]

The loan servicer had notified the homeowner that he might be eligible for a loan modification under HAMP, and the homeowner submitted an application to the loan servicer. While the homeowner's application was pending, the lender published a notice of foreclosure sale.

The court cited Version 2.0 of the "Making Home Affordable Program Handbook,"[9] which was in effect at the time the lower court denied the homeowner's motion to stay the foreclosure sale. The Handbook stated, in pertinent part, that "a servicer may not refer any loan to foreclosure or conduct a scheduled foreclosure sale unless and until…the borrower is evaluated for HAMP and is determined to be ineligible for the program."

Since the loan servicer was a participant in the HAMP program, it was barred from scheduling a foreclosure sale during the HAMP process.

Single Lawsuit Rule

Under New York's equitable relief doctrine, when a borrower defaults on mortgage payments, a lender seeking repayment of a loan may proceed either at law to recover a judgment for the mortgage debt, or may bring an action in equity to foreclose the mortgage, but not pursue both remedies at the same time.[10]

However, that does not deprive a foreclosure plaintiff of a money judgment. In the event the foreclosure sale is insufficient to satisfy the debt, attorney's fees, court costs and expenses, the plaintiff may move for a judgment for those sums within the context of the foreclosure action.[11] The plaintiff must move for such judgment within 90 days after the date of the consummation of the sale by the delivery of the referee's deed to the purchaser[12] at the foreclosure sale.

Generally, plaintiffs move for a deficiency judgment simultaneously with moving to confirm the sale, but the deficiency judgment motion does not enjoy the same flexibility as the confirmation motion.[13] Courts strictly enforce this 90-day period and uniformly treat it as a statute of limitations, beginning on the date that a properly executed deed is delivered, not when it is recorded.[14] Failure to serve the notice of motion within this period serves as a complete bar to the entry of a deficiency judgment.[15]

In *Aurora Loan Services, LLC v. Lopa*,[16] the Second Department held that the equitable relief doctrine does not prevent a plaintiff in a foreclosure complaint from also requesting a deficiency judgment.

In *Aurora*, a lender brought suit to foreclose on a mortgage. The lender prayed for deficiency judgment against the homeowner in the event that the amount realized by the sale was less than the amount of the

mortgage debt. The court reasoned that while a lender may not simultaneously pursue both a remedy at law and a remedy in equity, a prayer for deficiency judgment within the context of an actual mortgage foreclosure complaint does not constitute a separate action for a money judgment. Looking to RPAPL § 1371(2), permitting a plaintiff in a foreclosure action to "make a motion in the action for leave to enter a deficiency judgment," the court allowed the prayer for deficiency judgment in the foreclosure complaint as incidental to the principal relief demanded.

Illiteracy No Defense

Although a tax foreclosure and not a mortgage foreclosure, *Matter of City of Rochester (Duvall)* shows the limits on the courts' extent of consideration and mercy, and its ruling applies not only to all species of foreclosures, but potentially to all species of New York litigation altogether. The Third Department clearly sympathized with petitioner-homeowner's situation as an illiterate, 91-year-old man who lost his home to tax foreclosure, but found that defendant's illiteracy was not a proper basis on which to attack foreclosure papers or their predicate notices.

In *Matter of City of Rochester (Duvall),* the respondent, city of Rochester ("the City"), sent notices of an outstanding tax bill and of an impending tax foreclosure action to the homeowner by ordinary mail. After receiving only a small portion of the payments from the homeowner over a two year period, the City sold the property and the homeowner was personally served with a 10-day notice to quit.

In determining whether the notice was reasonable, the majority took into account the status and conduct of the homeowner as well as the burden placed on the City in providing reasonable notice.[17] The Court determined that the City's actions in mailing the notice to the homeowner were reasonably calculated, under all the circumstances, to inform the homeowner of the impending foreclosure action and afford him an opportunity to present his objections.[18]

A two judge dissent, without going into detail, opined that the City was or should have been aware that the homeowner was illiterate, and his illiteracy was a significant circumstance or condition that weighed against a "reasonable calculation"[19] that the usual method of mailing the foreclosure notice would inform the homeowner of the foreclosure action. Consequently, the dissent concluded that the homeowner was not provided with adequate notice of the impending taking. The dissent further concluded that there were reasonable steps that the City could have taken to inform the homeowner of his tax delinquency but refused to set forth what those could have been. We note that a two justice dissent in the Appellate Division, under CPLR 5601, automatically entitles the appellant to an appeal as of right to the Court of Appeals. We find ourselves wondering whether the two dissenting justices were therefore setting up the matter so as to give nature enough time to moot the most serious considerations in the case. Were *Matter of City of Rochester (Duvall)* not decided the way it was, not only in foreclosures, but in any kind of suit, anybody with any kind of inability to read English would seem automatically entitled to special considerations that would make litigation in New York impossible to pursue. The majority holding in *Matter of City of Rochester (Duvall)* therefore seems mandatory, two dissenters notwithstanding.

Due Process

In tax foreclosures, there are special considerations of due process attaching only because the government is seeking to seize property. In *Matter of Orange County Commissioner of Finance v. Helseth,*[20] the Court of Appeals held that the County was only obligated to give singular notice of the foreclosure action, as that was the underlying governmental action threatening the landowners' property interests. However, while it is generally a uniquely governmental function to lay and collect taxes, due process concerns also attach when a government is the lender and bringing a mortgage foreclosure.

The State may not deprive a person of property without due process of law, meaning giving notice "reasonably calculated, under all the circumstances," to inform the party whose rights are to be affected of the opportunity to appear and be heard.[21] Constitutional due process does not require that notice be given for each successive stage of the foreclosure proceedings.

In *Matter of Orange County Commission of Finance*, the landowners owned an unimproved piece of property, not their residence. When the landowners were informed that the County was sending their tax bills to this empty lot, they filed a change of address form with the County. Over a year later, the landowners paid that year's real property taxes at the County Office, directly informing them of their then-current address. Despite these attempts to inform the County of their proper address, the landowners did not receive any additional real estate property tax bills or correspondence for the property.

The next year, the landowners failed to pay taxes on the property and the County commenced a tax lien foreclosure action. The County mailed the notice to the property in conjunction with other forms of valid service.

Following a default judgment of foreclosure, the County sent the landowners a letter by certified mail, return receipt requested, to the property's address informing the landowners that the County had acquired title to the property. The letter further advised the landowners of a local law, which afforded them a release option, permitting them to repurchase the parcel through a release of

the County's interest. This letter came back to the County as "unclaimed."

Since the release option was a discretionary, permissive remedy that was available to the landowners after the property's lawful foreclosure and conveyance to the County, the court found the landowner's property interest lawfully extinguished in spite of the sending of mail to an address the County had reason to know was bad.[22]

The Court of Appeals distinguished the U.S. Supreme Court holding in *Jones v. Flowers*,[23] because in *Jones* the public tax sale was in lieu of a foreclosure proceeding and, therefore, the public tax sale constituted a governmental taking that required due process.[24] The Court held that *Jones* does not expand the municipality's obligations beyond the due process required for the actual tax lien foreclosure sale.

Conclusion

While in the past two years courts have shown themselves particularly solicitous of borrowers' rights in foreclosure proceedings, we see from this brief survey that the courts are far less solicitous of taxpayers' rights. At least when it comes to foreclosure, the courts appear far more willing to give leeway to the government than to banks.

Endnotes

1. There are references in the Old Testament that provide evidence that there was lending among individuals in the ancient world. Both the Books of Exodus and Deuteronomy indicate that there was lending and that personal property collateral was used to assure repayment of loans. Debtors would pledge their personal property to creditors for the creditor to hold until the debtor repaid the loan. If the loan was not repaid, the creditor was able to sell the pledged property. The Books of Exodus and Deuteronomy refer to two types of collateral: cloaks and millstones. Millstones were equipment used to grind wheat into flour and were valuable possessions because an owner would use a millstone to produce a livelihood. Roger D. Billings and Frank J. Williams, *Abraham Lincoln, Esq: the Legal Career of America's Greatest President* 109-112 (2010).
2. In Ancient Greece, placing a pillar or tablet on the land, inscribed with the creditor's name and the amount of the debt indicated a pledge for land. H.W. Chaplin, *The Story of Mortgage Law*, 4 Harv. L. Rev. 1 (1890).
3. The authors wish to credit New York Law School Professor of Law and Director of the Center for Real Estate Studies Andrew R. Berman's article "*Once a Mortgage, Always a Mortgage"—The Use (and Misuse of) Mezzanine Loans and Preferred Equity Investments*, 11 Stan. J.L. Bus. & Fin. 76 (2005) for leading them to authority on the history of mortgages.
4. The Second Department includes Richmond, Kings, Queens, Nassau, Suffolk, Westchester, Dutchess, Orange, Rockland and Putnam Counties.
5. An analysis of http://www.RealtyTrac.com revealed that as of January 2012 there were a total of 1,672 foreclosures in New York and 1,185 of these foreclosures were in the Second Department.
6. Such as, for example, the Third Department's overwhelming presence in corrections law.
7. *Aames Funding Corp. v. Houston*, 85 A.D.3d 1070, 926 N.Y.S.2d 639 (2nd Dept. 2011).
8. Part of the congressional response to the 2008 crisis.
9. One should not mistake the word "handbook" for implying anything less than the full force of law.
10. Real Property Actions and Proceedings Law § 1301.
11. *Steuben Trust Co. v. Buono*, 254 A.D.2d 803, 677 N.Y.S.2d 882 (4th Dept. 1998).
12. Real Property Actions and Proceedings Law § 1371.
13. *Seiden v. Chagnon*, 33 A.D.2d 951, 306 N.Y.S.2d 847 (3rd Dept. 1970).
14. *Cicero v. Aspen Hills II, LLC*, 85 A.D.3d 1411, 1412, 926 N.Y.S.2d 680, 682 (3rd Dept. 2011).
15. *Id.*, at 1412, at 682.
16. *Aurora Loan Services, LLC v. Lopa*, 88 A.D.3d 929, 932 N.Y.S.2d 496 (2nd Dept. 2011).
17. *Matter of Harner v. County of Tioga*, 5 N.Y.3d 136, 140, 800 N.Y.S.2d 112, 833 N.E.2d 255 (2005).
18. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950).
19. *Weigner v. City of New York*, 852 F.2d 646, 650, *cert denied*, 488 U.S. 1005, 109 S.Ct. 785, 102 L.Ed.2d 777 (1994).
20. *Matter of Orange County Commission of Finance v. Helseth*, N.Y. Slip Op. 01324 (2012).
21. *Mullane*, at 314, at 657.
22. *Sheehan v. County of Suffolk*, 67 N.Y.2d 52, 59, 499 N.Y.S.2d 656, 490 N.E.2d 523 (1986).; RPTL § 1123(8).
23. *Jones v. Flowers*, 547 U.S. 220, 224, 126 S.Ct. 1708, 164 L.Ed.2d 415 (2006).
24. *See*, Bailey & Treiman, *Despite 'Jones,' Ambiguities In Title Chain Can Be Cured*, NYLJ June 10, 2009.

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Individual Liability of Board Members After *Fletcher v. The Dakota*

By Vincent Di Lorenzo

Introduction

In *Fletcher v. The Dakota, Inc.* the First Department reconsidered when board members of cooperative corporations will be individually liable for the discriminatory actions of the board.[1] Prior to *Fletcher* board members had relied on the court's decision in *Pelton v. 77 Park Avenue Condominium*.[2] It stated:

> In bringing an action against the individual members of a cooperative or condominium board based on allegations of discrimination or similar wrongdoing, plaintiffs were required to plead with specificity independent tortious acts by each individual defendant in order to overcome the public policy that supports the business judgment rule.....[3]

In *Pelton* the court refused to impose individual liability on board members because neither the complaint nor plaintiffs' submissions "assert a specific claim against any of the individual defendants other than as a member of the 77 Park board."[4] Specifically, plaintiffs failed to show that any board member engaged in "individual wrongdoing…separate and apart from the actions taken by the board members collectively on behalf of the condominium."[5]

Six years later, in the *Fletcher* decision, the First Department concluded that in the *Pelton* decision it had misinterpreted the governing case law.[6] It rejected the independent tortious act requirement and ruled that "although participation in a breach of contract will typically not give rise to individual director liability, the *participation* of an individual director in a corporation's tort is sufficient to give rise to individual liability."[7] Is the *Fletcher* court's interpretation and application of the case law correct? If so, what precise involvement triggers individual liability for board members?

Fletcher's Reading of Prior Case Law—Breach of Contract Actions

The *Pelton* decision's recognition of an independent tortious act requirement was based on the Court of Appeals' decision in *Murtha v. Yonkers Child Care Assn.*[8] *Murtha* involved a claim of breach of a contract of employment by Yonkers Child Care Association. The court addressed the liability of individual defendants in tort for inducing a breach of contract. It concluded that a director or officer of a corporation is not personally liable to one who has contracted with the corporation on the theory of inducing a breach of contract merely because, while acting for the corporation, the director or officer made decisions and took steps that resulted in the corporation's contractual promise being broken.[9] Rather, the officer or director is immune from liability "if it appears that he is acting in good faith as an officer [or director]…[and did not commit] independent torts or predatory acts directed at another."[10]

Although the *Murtha* decision was indeed a decision regarding individual director liability for inducing a breach of contract, the decision did not explain why actions alleging breach of contract, and seeking to impose individual liability on directors, should be treated differently than actions alleging other wrongdoing—e.g. other tortious conduct, or discriminatory conduct. However, the *Murtha* decision cited lower court decisions that did explain why the courts imposed an independent tortious act requirement for personal liability on the part of board members for inducing a breach of the corporation's contract.[11] The First Department explained in *Brookside Mills, Inc. v. Raybrook Textile Corporation*,[12] a decision cited by the Court in *Murtha*, that:

> To hold otherwise would be dangerous doctrine, and would subject corporate officers and directors continually to liability on corporate contracts and go far toward undermining the limitation of liability which is one of the principal objects of corporations.[13]

The court further explained that the actions of the two directors in question were taken on the corporation's behalf in the exercise of business judgment, and if their actions resulted in a breach of the corporation's obligations under the contract in question, it was the corporation alone that was liable.[14] Similarly, in *Buckley v. 112 Central Park South Inc.*,[15] also cited by the *Murtha* decision, the First Department explained that to be immune from individual liability the corporate officers or directors must have been acting in good faith,[16] i.e., in the interest of the corporation. The *Buckley* decision further explained that:

> Running through many opinions upon the subject, there is the thread of thought that an officer of a corporation may have the right and perhaps the duty of inducing the corporation to breach a contract of the corporation with a third party if it appears to him to be for the best interests of the corporation to do so.… This, of course, is but one facet of the freedom of action rule upon which the immunity is based.[17]

Thus, the case law addressing individual director liability for inducing a breach of contract by the

corporation contains two reasons to reject a mere participation standard as the threshold for liability: (a) fear of excessive exposure of board members to litigation, and (b) a recognition that what is wrongful conduct on the part of the corporation, acting through its officers and directors, is not necessarily wrongful conduct on the part of the individual director or officer.

Fletcher's Application of Case Law Involving Tortious Conduct

The *Fletcher* court's refusal to apply the independent tortious act requirement to allegations of discriminatory conduct by board members is also a correct reading of the existing case law. However, the New York Court of Appeals and the Second Circuit have not addressed the exact question at hand. The *Fletcher* court, first, correctly noted that decision-making tainted by discriminatory considerations is not protected by the business judgment rule.[18] The court, second, highlighted that the Court of Appeals has instructed, generally, that the New York City Human Rights Law must be construed "broadly in favor of discrimination plaintiffs, to the extent that such a construction is reasonably possible."[19]

In *Fletcher* the court then ruled that: "the *participation* of an individual director in a corporation's tort is sufficient to give rise to individual liability."[20] The court cited prior case law supporting the position that a corporate director is not liable in tort only when the director commits a tort independent of the tort committed by the corporation. Rather, personal liability may be imposed for an action taken regardless of whether the officer or director acted on behalf of the corporation in the course of official duties.[21] However, the *Fletcher* court's stated threshold for individual liability raises a great deal of uncertainty, because that decision does not clearly indicate how or when a director can avoid liability. It is not clear if "participation" involves merely casting a vote consistent with the decision of a majority of the board, regardless of whether the vote of the particular director was tainted, i.e. could independently be deemed a violation of the civil rights laws.

The case law involving tortious conduct generally on the part of a corporate board states that a director may be held individually liable if the director either participated in the tort or else directed, controlled, approved or ratified the decision that led to the plaintiff's injury.[22] However, the decisions applying this standard have involved proof of some connection to the misconduct in question. Thus, "participation" has been found to exist when the officer or director *directly* committed the tort even though he was acting in his capacity as officer or director of the corporation.[23] No personal liability attaches if an officer or director took no part in the tort committed by the corporation.[24]

A scenario where the Court of Appeals has directly addressed the personal liability of a corporate officer or director for tortious conduct has involved a specific tort, an action for fraud against a corporation and its officers. The Court of Appeals discussed the threshold for individual liability. It noted:

> Joseph Russo's individual liability is another matter. As a general proposition, corporate officers and directors are not liable for fraud unless they personally participate in the misrepresentation or have actual knowledge of it… Mere negligent failure to acquire knowledge of the falsehood is insufficient.[25]

The tort of fraud requires, *inter alia*, an untrue representation of a material fact, known to be untrue or with reckless indifference to truth or falsity, as well as intention to deceive.[26] Thus the Court of Appeals has ruled that the "participation" in a corporate fraud by a corporate officer or director, which can lead to personal liability, requires some direct involvement in the actual wrongdoing.

In summary, the corporate case law that has addressed the individual liability of board members, apart from cases alleging discriminatory conduct, has involved allegations of corporate wrongdoing in the form of inducing breach of contract, commission of a tort generally, and commission of the tort of fraud. In all of these cases, to hold a director or officer individually liable some individual wrongdoing on the part of the director or officer appears to be required.

As discussed above, the action taken by a board member, in his or her capacity as a board member, that might be deemed to be inducing a breach of contract is not necessarily wrongful conduct, since the best interest of the corporation may be served by inducing a breach of contract and the board member must always act in the interest of the corporation. In other words the individual board member's action, distinct from the corporation's action, is not improper. As a result the courts imposed an independent tortious act requirement. Similarly, the case law imposing individual liability on a board member for torts generally has in fact involved some individual involvement in the wrongdoing by the director. Where the tort is the negligent conduct itself, the courts have held a director individually liable when the director was himself guilty of the negligent conduct, or controlled or ratified the negligent conduct of others. Where the tort is fraud, the courts have made it clear that an individual director's conduct becomes actionable when there is also evidence of personal participation in the fraud, or at least actual knowledge of the falsity of a representation made by the board and intention to deceive.

Many cases of discriminatory conduct are arguably similar. The misconduct by the board is not necessarily misconduct by each director. The denial of an application to purchase, for example, is not a wrongful act unless the denial was due to discriminatory reason(s). A member of the board that voted to deny an application to purchase is not engaged in wrongful

conduct unless that particular individual's vote was motivated by discriminatory reason(s).

Case Law Involving Discriminatory Conduct

In the *Fletcher* decision itself the cause of action against an individual director, Barnes, for retaliation against Fletcher for opposing alleged discriminatory conduct by the board while he was president of the board, was dismissed based on a lack of factual allegation that Barnes was aware of Fletcher's protected activity (opposition to alleged discriminatory conduct).[27] However, the action was dismissed without prejudice because discovery may reveal that Barnes was indeed aware of Fletcher's protected activity.[28] Thus, the court's opinion suggests that as long as Barnes was aware of the protected activity and "participated" in the *board's* vote to deny Fletcher the right to purchase an apartment adjacent to his own, Barnes could be individually liable. In other words, if Barnes voted to deny Fletcher's application but did *not* do so for reasons prohibited by the civil rights laws, it is not clear if the court's view of the required threshold of "participation" would allow Barnes to avoid liability.

There is some additional case law in the federal district courts supporting this low threshold for individual director liability. In *Sallee v. Tropic Seas, Inc.* the court considered whether the action against two individual directors should be dismissed.[29] In that case the court certainly did not apply an independent tortious act requirement. Indeed, it did not even require that the individual directors *actively* participated in the discriminatory conduct.[30] Rather, the court reasoned that:

> Because the duty to comply with the Fair Housing Act is nondelegable, a corporation's officers and directors may be held individually liable for their failure to ensure the corporation's compliance… This is so even where the individual director or officer did not actively participate in the alleged discrimination and did not subjectively intend to discriminate against the complainant.[31]

In the *Tropic Seas* case the plaintiffs alleged a violation of the Fair Housing Act Amendments of 1988 which prohibits discrimination based on "familial status."[32] Plaintiffs held a proprietary leasehold interest in a Wakiki cooperative apartment complex. The state circuit court had found that the corporation, Tropic Seas Inc., had violated the statute, and HUD had issued a Determination of Reasonable Cause and Charge of Discrimination against Tropic Seas and members of the board of directors. However, the alleged discriminatory actions were all, seemingly, actions of the board in enforcing an occupancy policy of limiting occupancy to two persons.[33] When denying the motion for summary judgment by two individual directors the court noted that:

> The acts and omissions alleged by the Sallees [plaintiffs] give rise to at least a genuine issue of material fact as to whether Tropic Seas engaged in discriminatory conduct *during the tenures of Worth and Mello*[34] on the board of directors. Summary judgment in favor of Worth and Mello is thus not appropriate. Thus, the formal action(s) *of the board* during the tenure of the individual directors was enough to potentially hold the directors individually liable.[35]

Arguably, however, *Tropic Seas* is a distinct case. The decision to enforce the occupancy policy itself had the effect of improperly denying access to the plaintiffs based on "familial status" because the couple in question had a child. Any board member voting in favor of enforcing the occupancy restriction would be participating in the civil rights violation. However, what level of participation would be required if the decision itself (e.g. to deny an application to purchase) is not necessarily improper, but only becomes improper based on a prohibited basis (reason) for the decision?

The case law involving housing discrimination does not delineate the degree of culpability or involvement of an individual board member in group decisions such as a board decision to deny an application to purchase in such a scenario. The only case law in the cooperative or condominium setting in which board members were *not* liable for alleged discriminatory actions involved a situation in which the individual board members did not participate in the decision at all.[36] Moreover, in the lower federal courts in New York the cases in which a director *was* found to be individually liable involved a situation in which the individual board member, distinct from the board, directly and willfully violated the Civil Rights laws.[37]

Should the Courts Impose a Higher or Lower Threshold?

In the context of individual liability of board members of cooperative corporations or condominium associations, the differing viewpoints found in the recent *Fletcher* decision and the older *Pelton* decision are a difference in viewpoint as to which public policy deserves primacy. The *Fletcher* decision emphasizes the policy that the NYC Civil Rights Law, and no doubt the state or federal civil rights laws, should be construed broadly in favor of discrimination plaintiffs.[38] This is arguably to discourage discriminatory conduct. The *Pelton* decision recognizes that aim. However, it emphasizes the adverse impact of a low threshold for individual liability for board members who volunteer to serve the interests of all unit owners. The court noted that board policies and decisions are controlled by the board collectively and not by any individual member.[39] Yet,

> the Supreme Court's decision, if permitted to

> stand, would, without any evidence of individual wrongdoing, subject these defendants to expensive, intrusive and time-consuming litigation…hardly a fitting reward for those "fellow tenants who volunteer their time, without compensation" as members of a governing body that takes on the burden of managing the property for the benefit of the other owners (see Levandusky, 75 N.Y. 2d at 536-537)… the threat of baseless litigation, with its attendant serious financial and personal burdens, would pose a formidable obstacle to those willing to volunteer their talent, experience and knowledge for the common good of their homeowner communities by serving on such a board.[40]

The risk becomes a serious risk in light of the existing threshold utilized for plaintiffs to establish a prima facie case. Namely,

> Plaintiffs may establish a prima facie case of housing discrimination by showing (1) that they are members of a protected class; (2) that they sought and were qualified to rent or purchase the housing; (3) that they were rejected; and (4) that the housing opportunity remained available to other renters or purchasers.[41]

Thus, under the standard announced in *Fletcher* it is possible that any director that voted with the majority of the board in a decision involving a protected class or activity could be named as a defendant in a lawsuit seeking to hold that director personally liable, even if no evidence is presented that the director in question engaged in any discriminatory conduct, e.g., even if the director had a valid reason to deny consent to a purchase or lease. Such a lawsuit would not be dismissed. Rather, the burden shifts and the individual director now must come forward with evidence that his actions were not motivated by considerations of race, for example.[42] Moreover, in attempting to satisfy that burden of proof the courts will carefully scrutinize reasons that are not objective in nature and view subjective explanations with "considerable skepticism."[43]

Such a scenario would raise the risk of continually subjecting corporate officers and directors to personal liability, a risk the courts sought to avoid by imposing the independent tortious act requirement in cases alleging breach of contract. This was the same risk that had originally persuaded the court in *Pelton* to impose the same requirement for individual liability in cases alleging discriminatory conduct, especially since board members are volunteers taking on the burden of managing the cooperative or condominium. It would be up to the Court of Appeals to decide if this public policy should be paramount and, if so, to recognize an individual "tortious" act requirement when the alleged wrongdoing is a violation of the civil rights laws.

Even if the Court of Appeals chooses not to extend the independent tortious act requirement to civil rights violations, it must clarify what threshold the *Fletcher* court intended to impose for individual liability on the part of board members for alleged discriminatory conduct by the board as a whole. A clarification might be to clearly embrace the commission of tort standard followed in the New York case law. Namely, a director would be individually liable only if he or she personally participated in the discriminatory conduct (i.e., not merely the decision but also the unlawful motivation for the decision) or ratified it.

It is interesting that the case law involving alleged employment discrimination and individual liability of corporate officers or supervisory personnel has also focused on the degree of individual involvement in the wrongful decision. The courts have repeatedly ruled that for an individual to be liable in damages for discriminatory conduct under the New York State or New York City Human Rights Laws the individual must have "actively participated in the discrimination."[44] For liability under §§ 1981 and 1983 plaintiff must show some "personal involvement" by the individual defendant in alleged constitutional deprivations.[45] Such case law suggests that a lower threshold for "participation," seemingly embraced by the *Fletcher* decision, is not the wisest standard to impose.

Endnotes

1. 948 N.Y.S.2d 263 (1st Dep't 2012).
2. 38 A.D.3d 1, 825 N.Y.S.2d 28 (1st Dep't 2006).
3. *Id.* at 9-10, 825 N.Y.S.2d at 34.
4. *Id.* at 10, 825 N.Y.S.2d at 34.
5. *Id.* at 10, 825 N.Y.S.2d at 35.
6. *See Fletcher*, 948 N.Y.S.2d at 268.
7. *Id.* at 266 (emphasis added).
8. 45 N.Y.2d 913 (1978). The court also cited the First Department's earlier decision in *Konrad v. 136 E. 64th Corp.*, 246 A.D.2d 324 (1st Dep't 1998). That decision involved an allegation of breach of fiduciary duty, not breach of contract.
9. *See Murtha*, 45 N.Y.2d at 914-915.
10. *Id.* at 915 (quoting from the Appellate Division's decision in Buckley v. 112 Cent. Park South, 285 A.D. 331 (1st Dep't 1954)).
11. *See id.* at 915.
12. 276 A.D. 357, 94 N.Y.S.2d 509 (1st Dep't 1950).
13. *Id.* at 367, 94 N.Y.S.2d at 519.
14. *Id.* at 368, 94 N.Y.S.2d at 519.
15. 285 A.D. 331, 136 N.Y.S.2d 233 (1st Dep't 1954).
16. *Id.* at 334, 136 N.Y.S.2d at 236.
17. *Id.* at 335-336, 136 N.Y.S.2d at 237 (citations omitted).
18. *See Fletcher*, 948 N.Y.S.2d at 268 (explaining the applicability of the rule in *Pelton*).
19. *Id.* at 268-9, quoting Albunio v. City of New York, 16 N.Y.3d 472, 477-8 (2011). The *Albunio* decision broadly construed the word "opposed" to any practice forbidden by the New York City Human Rights law in the context of a claim of retaliation for opposition to discriminatory conduct.
20. *Id.* at 266 (emphasis added).
21. *See* American Express Travel Related Servs. Co. v. North Atlantic Resources, 261 A.D.2d 310, 311, 691 N.Y.S.2d 403, 403 (1st Dep't 1999).

22. *Fletcher,* 948 N.Y.S.2d at 268 (citing Fletcher, Cyc. of Law of Corporations); *see generally* Martin Petun, *The Curious Case of Directors' and Officers' Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law*, 59 Amer. U. L. Rev. 1661, 1668 (2010).

23. *See e.g., Peguero,* 58 A.D.3d 556 (Jeffrey Farkas, president of the corporation, cannot have the complaint dismissed against him merely because his actions were taken in his capacity as an officer of the corporation. However, the "commission of tort" doctrine permits personal liability to be imposed for misfeasance or malfeasance, i.e., an affirmative tortious act; personal liability cannot be imposed on a corporate officer for nonfeasance, i.e., a failure to act); Savanah T & T Co., Inc. v. Force One Express Inc., 58 A.D.3d 409, 872 N.Y.S.2d 83 (1st Dep't 2009) (defendant Phil Notaro, the corporate defendant's principal, was held personally liable for misappropriation where he withheld plaintiff's goods from them and coerced Edwin Baldin, the plaintiff's principal, into signing a purported lien agreement); Rajeev Sindhwani, M.D., PLLC v. Coe Business Service Inc., 52 A.D.3d 674, 861 N.Y.S.2d 705 (2d Dep't 2008) (the evidence adduced at trial established that Coe was responsible for the determination to withhold the subject records from the plaintiff. Accordingly, the jury rationally determined she personally was liable for conversion).

24. The participation theory of tort liability provides that an officer or director who takes part in the commission of a tort by the corporation is personally liable therefor. However, "an officer [or director] of a corporation who takes no part in the commission of a tort committed by the corporation is not personally liable to third persons for such a tort, nor for the acts of other agents, officers or employees of the corporation in committing it, unless he specifically directed the particular act to be done or participated, or cooperated therein," Mill Run Associates v. Locke Property Co., Inc., 282 F. Supp.2d 278 (E.D. Pa. 2003) (discussing the general, if not universal, rule and citing Fletcher, Cycl. of the Law of Private Corporations); *see also* Clark v. Pine Hill Homes, Inc. 112 A.D.2d 755, 492 N.Y.S.2d 253 (4th Dep't 1985) (a corporate officer is not liable for the negligence of the corporation merely because of his official relationship to it. It must be shown that the officer was a participant in the wrongful conduct); Wesolek v. Jumping Cow Enterprises, Inc., 51 A.D.3d 1376, 1378-9, 857 N.Y.S.2d 859 (4th Dep't 2008) (dismissing action against corporate director).

25. Marine Midland Bank v. John E. Russo Produce Co., Inc., 50 N.Y.2d 31, 44, 427 N.Y.S.2d 961, 968 (1980) (citations omitted); *see also* Ecuador Importadora-Exportadora CIA, LTDA v. ITF (Overseas) Corporation, 94 A.D.2d 113, 117-118, 463 N.Y.S.2d 208 (1st Dep't 1983) (since director Cordero was under the impression Intrafina had more than enough cash to meet its obligations he could not be held personally liable. Even if Cordero could be considered culpable of nonfeasance in this regard to his corporate duties, his liability does not extend to a third party).

26. *E.g.,* Channel Master Corp. v. Aluminum Ltd. Sales, Inc., 4 N.Y.2d 403, 151 N.E.2d 833, 176 N.Y.S.2d 259 (1958).

27. *Fletcher,* 948 N.Y.S.2d at 270.

28. *Id.* at 273.

29. 887 F. Supp. 1347, 1366 (D. Haw. 1995).

30. *Id.* at 1347, 1365.

31. *Id.* at 1365.

32. *Id.* at 1353.

33. *Id.* at 1352.

34. *Tropic Seas,* 887 F. Supp.at 1365 (emphasis added).

35. *Id.* at 1365 (emphasis added).

36. *See* Sayeh v. 66 Madison Avenue Apt. Corp., 73 A.D.3d 459, 460, 901 N.Y.S.2d 26, 28 (1st Dep't 2010).

37. *See* discussion of jury's findings in Biondi v. Beekman Hill House Apartment Corporation, 94 N.Y.2d. 659, 664, 709 N.Y.S.2d 861, 863 (2000) (the jury in the federal action found Biondi willfully violated the Broomes' and Demou's civil rights and imposed personal liability on him); *see also* Broome v. Biondi, 17 F.Supp. 2d 211, 229 n. 4 (S.D.N.Y. 1997) (the jury found Beckman Hill House Apartment Corporation liable, the members of the board of directors liable in their official capacity, and Nicholas Biondi liable in his personal capacity).

38. *Flecther,* 948 N.Y.S. at 268-9.

39. *Pelton,* 38 A.D.3d at 10-11, 825 N.Y.S.2d at 35.

40. *Id.*

41. Mitchell v. Shane, 350 F.3d 39, 47 (2d Cir. 2003); *see also* Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1038 (2d Cir. 1979); Broome, 17 F. Supp. 2d 211, 216.

42. *See Robinson,* 610 F.2d at 1039.

43. *Id.* at 1040.

44. *E.g.,* Hirsch v. Columbia Univ., 293 F. Supp. 2d 372, 378 (S.D.N.Y. 2003) and cases cited therein; Westbrook v. City University of New York, 591 F. Supp. 2d 207, 224 (E.D.N.Y. 2008).

45. *E.g., Westbrook,* 591 F. Supp.2d 207, and cases cited therein.

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With a PCDS, the Purchaser Now Has *More* Than a Ghost of a Chance: An Update on PCDS and Caveat Emptor Cases

By Karl Holtzschue

1. Caveat Emptor Cases

A. Prior Article on Caveat Emptor Cases and Update to June 2012

In my 2007 article on caveat emptor and PCDA cases, I calculated that in 103 cases up to 1999, purchasers had won 47 caveat emptor cases (37%) but sellers had won 83, and from 1999 to 2006, purchasers had won 2 cases (9%), but sellers had won 22 (a combined rate to 2006 of 32%), concluding that "the purchaser hasn't a ghost of a chance."[1]

In my latest update from 2006 through June 2012, purchasers won 9.5 caveat emptor cases (25%), but sellers won 28.5,[2] a smaller percentage for purchasers than the period up to 1999, but better than the dismal 1999 to 2006 period. Nonetheless, the bad news for purchasers under common law caveat emptor claims continues.

B. Rationales for Caveat Emptor Cases from 2006 through June 2012 Remain the Same

The rationales for the wins by sellers in the caveat emptor cases remain the same: (1) the seller has the right to remain silent;[3] (2) even where the seller misrepresented the facts, purchasers lose if they fail to use means available to check them (the most common rationale);[4] (3) no justifiable reliance by the purchaser;[5] and (4) "as is" and merger clauses prevent reliance on prior representations in some cases.[6]

The rationales for wins by purchasers in the caveat emptor cases also remained the same: (1) active concealment by the seller;[7] (2) merger clauses did not preclude a suit for fraud.[8]

Purchasers have won some suits against brokers.[9] They have also won some against inspectors and engineers, but their recovery has been limited by contract to the fee paid.[10]

2. PCDS Cases

A. Prior Article on PCDS Cases and Update to December 2011

The enactment of the Property Condition Disclosure Act (PCDA), effective March 1, 2002, gave purchasers of one-to-four family dwellings (but not coops or condos) rights not available under common law caveat emptor, principally the right to receive a Property Condition Disclosure Statement (PCDS) or a $500 credit at the closing. As I noted in my 2007 article,[11] it has become customary downstate for sellers to give the credit rather than a PCDS, usually on the advice of counsel.

From 2003 through June 2006, purchasers won 1.7 PCDS cases (17%) and sellers won 8.3, better than the 9% rate of success for purchasers under common law caveat emptor from 1999 to 2006, but not as good as the overall combined rate to 2006 of 32% for the caveat emptor cases.[12]

	2003	2004	2005	6/2006	Total
P won:	0	0	0	1.7	1.7
S won:	1	1	3	3.3	8.3

In my latest update from July 2006 through June 2012, purchasers won 6.2 PCDS cases (41%) and sellers won 8.8 cases,[13] much more often than in the bleak first years of the PCDA and a significant statistical improvement for purchasers, though still not a majority. For the full ten-year period, purchasers won 7.9 cases (32%) and sellers won 17.1 cases.

Purchasers won 6 cases from July 2006 through 2009, but sellers won 6.8 cases from 2010 through June 2012, a discouraging recent trend for purchasers. Fifteen of the 25 PCDA cases have occurred upstate, where it is more customary for brokers to prepare the initial contracts and request delivery of a PCDS.

PCDS Delivered (chronological order: name; county and department; year; winner):

Malach (Richmond-2D)(2003)(S);
Korik (Richmond-2d)(2004)(S);
Conanan (Richmond-2D)(2005)(S);
Gabberty (Nassau-2D)(2005)(S);
Renkas (Monroe-4D)(2005)(S);
Fleischer (Suffolk-2D)(2006)(P.7);
Short (Monroe-4D)(2006)(S);
Calvente (2DAT Orange)(2006)(P);
Adrien (AD2D Orange)(2006)(S);
Conanan (Richmond-2D)(2006)(S);
Middleton (Rensselaer-3D)(2006)(S);
McMullen (Yates-4D)(2006)(P);
Ayres (2DAT Orange)(2007)(P);
Simone (Westchester-2D)(2007)(P);
Van DeCarr (Saratoga-3D)(2007)(S);
Anderson (AD3D Tompkins)(2008)(P);
Spinney (Monroe-4D)(2008)(P);
Kurtz (AD3D Saratoga)(2009)(P);
Meyers (AD3D Clinton)(2010)(S.8);
Klafehn (AD3D Tompkins)(2010)(S);
Pettis (AD3D Madison)(2011)(S);
Morgan (Broome-3D)(2011)(S);
Dolansky (AD4D Herkimer)(2012)(S);
Sample (AD4D Monroe)(2012)(S);
Smith (Albany-3D)(2012)(S).

	7/2006	2007	2008	2009	2010	2011	6/2012	Total (2006-6/2012)	Total (2003-6/2012)
P won:	1	2	2	1	0.2	0	0	6.2	7.9
S won:	1	1	0	0	1.8	2	3	8.8	17.1

Court: App Div	Court	Seller Won	Purchaser Won
1st D App Div / AT			
	1st D Sup Court		
	1st lower court		
2nd D App Div / AT		(1) *Adrien*	(2) *Calvente* (AT), *Ayres* (AT)
	2nd D Sup Court	(3) *Conanan, Gabberty, Conanan*	(1) *Simone*
	2nd D lower court	(2) *Malach, Korik*	(1) *Fleischer* (0.7)
Total Downstate:		6	4

Court: App Div	Court	Seller Won	Purchaser Won
3d D App Div		(3) *Meyers* (0.8), *Kalfehn, Pettis*	(2) *Anderson, Kurtz*
	3d D Sup Court	(1) *Smith*	
	3d lower court	(3) *Middleton, VanDeCarr, Morgan*	
4th D App Div		(2) *Dolansky, Sample*	
	4th D Sup Court	(1) *Renkas*	(1) *McMullen*
	4th D lower court	(1) *Short*	(1) *Spinney*
Total Upstate:		11	4

There were no cases in the First Department. Purchasers won 4 of 10 (40%) in the Second Department (which has a larger population than the Third or Fourth Departments); 2 of 9 (22%) in the Third Department; and 2 of 6 (33%) in the Fourth Department. Of the 15 more recent cases, 2 were downstate (Westchester and Orange Counties) (purchasers won both) and 13 were upstate (5 in the Appellate Division Third Department, 2 in the Appellate Division Fourth Department, and 6 in the Supreme and lower courts in the Third and Fourth Departments). Seven of the most recent cases have been in the Appellate Divisions of the Third and Fourth Departments.

Note, however, that in the last six-year period, there were 38 caveat emptor cases and only 15 PCDS cases. Consequently, ***it does not seem that the PCDA has brought about a rash of cases***. The high point for purchasers was in 2007, where they won 3 lower court cases in Orange, Yates and Westchester Counties. In 2010, 2011 and the first half of 2012, they lost 4.8 Appellate Division cases in Clinton, Tompkins, Madison, Herkimer and Monroe Counties and 2 Supreme Court cases in Broome and Albany Counties.

B. Rationales for PCDS Cases from 2006 through June 2012 Remain the Same

(1) The rationales for wins by purchasers in PCDS cases remain the same

(a) The seller made a fraudulent misrepresentation or actively concealed

In *McMullen v. Propester*,[14] the purchaser sued for damages alleging fraudulent misrepresentation, breach of contract, breach of warranty and breach of N.Y. Real Prop. Law § 465. The Supreme Court, Yates County, in 2006 denied the sellers' motion to dismiss, holding that the complaint that the sellers knew that the septic system was faulty, despite the disclaimer in the PCDS, and that the sellers actively concealed the defect and odor, survived a motion to dismiss the complaint. While it may be true that a buyer has no independent cause of action under the PCDA, when the seller makes a false representation in the PCDS, such a representation may be proof of active concealment, and whether a party could have ascertained the facts with reasonable diligence is a factual question for the jury. Whether sellers masked the bad smell of the improper septic system, acts that occurred outside the contract, and whether a party could have ascertained the facts with reasonable diligence are likewise questions of fact. The complaint does

state at least one cause of action. This appears to be the first formulation that a false representation in a PCDS may be proof of active concealment.

In *Simone v. Homecheck Real Estate Services, Inc.*,[15] the purchasers sued the sellers for damages for fraud and breach of contract. The Supreme Court, Westchester County, denied the sellers' motion to dismiss. The Appellate Division, Second Department affirmed, holding in 2007 that the purchasers stated a fraudulent misrepresentation claim as to false representations in PCDS that there were no water leaks and damage, among other things. Such a false representation in a PCDS may be proof of active concealment, citing *McMullen, above*. The court dismissed the breach of contract claim. The specific merger clause in the rider to the contract precluded a claim that the purchaser relied on the sellers' alleged misrepresentations. In addition, the deed having been delivered, the doctrine of merger extinguished any claim as to the contract of sale.

In *Anderson v. Meador*,[16] the sellers sued claiming that the purchasers' refusal to close due to undisclosed title encumbrances constituted anticipatory breach, and the purchaser counterclaimed, asserting fraud in the inducement, negligent misrepresentation and punitive damages after the sellers refused to return the deposit. The Supreme Court, Tompkins County, granted the sellers summary judgment and awarded them the deposit. The Appellate Division, Third Department reversed and modified, holding in 2008 that (1) the sellers' nondisclosure of an easement agreement and a drainage settlement agreement and negative responses on PCDS constituted affirmative misrepresentations; (2) fact issues precluded summary judgment as to whether the sellers' misrepresentations rendered the contract voidable, as to whether the purchasers' performance was excused based on the seller's failure to cure within a reasonable time and as to whether the purchasers' performance was excused based on a failure of the mortgage contingency; and (3) the purchasers sufficiently alleged a cause of action for fraud in the inducement. Having concluded that the contract may be voidable due to a material misrepresentation, a fraud cause of action necessarily exists as long as there is evidence that could support a finding of scienter. A false representation in a PCDS has been held to constitute active concealment, citing *Simone, above*.

In *Kurtz v. Foy*,[17] the purchasers sued for rescission alleging breach of a warranty against encumbrances, fraud and negligent misrepresentation. The Supreme Court, Saratoga County, partially denied the sellers' motion to dismiss. The Appellate Division, Third Department, affirmed, holding in 2009 that the complaint stated a cause of action for fraud and negligent misrepresentation, alleging that the sellers assured the purchasers that a dirt-and-gravel road was private, and the PCDS stated that no one else had a right to use any portion of the property. Before the closing, the purchasers allegedly spoke with the Town Clerk and Town Building Department and were advised that the road was private. In fact, the road was public and the sellers had unsuccessfully petitioned the Town to abandon it. Fraud is established where a defendant knowingly misrepresents a material fact, someone justifiably relies upon that misrepresentation, and the plaintiff is thereby injured. Justifiable reliance does not exist where a party has the means to discover the truth by the exercise of ordinary intelligence and fails to make use of those means. However, a purchaser's failure to determine the truth by inspecting public records is not fatal when the facts were peculiarly within the knowledge of the defendant and were willfully misrepresented. Even if the roadway's public nature was not peculiarly within the seller's knowledge, their unsuccessful petition to have it abandoned by the Town may have been and may have constituted willful misrepresentation. The pleadings sufficiently stated causes of action in fraud and negligent misrepresentation.

In *Meyers v. Rosen*,[18] the purchaser sued alleging that the seller knowingly failed to disclose various property defects in the PCDS or otherwise. The Supreme Court, Clinton County, in 2010 granted in part the seller's motion for summary judgment as to four claimed defects (*see* discussion in section B(2)(b) *below*), but not for claims regarding mice infestation and material defects in the heating system. The Appellate Division, Third Department, affirmed as to four defects, but held that a genuine issue of material fact precluded summary judgment on the claim alleging willful failure to make disclosure about mice infestation in the PCDS. Where a seller does deliver a PCDS, the seller may be liable under the statutory remedy available to the buyer, to the extent of the buyer's actual damages resulting from the seller's willful failure to perform the requirements of the PCDA. Constructive knowledge was rejected as a basis for a claim under the PCDA; the Governor vetoed a similar law because it incorporated a constructive knowledge standard. Because of the 4-1 decision on the 5 defects, I have rated this case a .8 win by the seller and a .2 win by the purchaser. I am told that the judge made it clear that he did not want to try a case about mice infestation!

The essence of the PCDA is to require the seller to make representations to the purchaser by answering the questions in the PCDS. A false representation in the PCDS gives rise to a cause of action that sounds in fraud, requiring proof of a material misrepresentation, justifiable reliance and damages, but under the PCDA the purchaser must also prove that the seller had actual knowledge and made a willful misrepresentation. Consequently, claims of constructive knowledge and negligence under the PCDA should fail.

I note that some judges assert that a misrepresentation in a PCDS

may amount to active concealment. I think that is stretching the point, confusing and unnecessary to analysis of the claim as one of fraudulent misrepresentation. Making a willful misrepresentation does usually involve a type of verbal concealment, but I think the active concealment label would be better applied in cases of physical concealment (such as in *McMullen, below*).

(b) The seller had actual knowledge of the defect

In *McMullen v. Propester*,[19] the purchaser sued for damages alleging fraudulent misrepresentation, breach of contract, breach of warranty and breach of N.Y. Real Prop Law 465. The Supreme Court, Yates County, denied the sellers' motion to dismiss, holding that the sellers knew that the septic system was faulty, despite the disclaimer in the PCDS, and that the sellers actively concealed the defect and odor. The purchaser survived a motion to dismiss the complaint. The complaint did state at least one cause of action.

In *Ayres v. Pressman*,[20] the purchaser brought a small claims action to recover expenses incurred as a result of entering into a contact to purchase residential property. The Justice Court of the Town of Monroe, Orange County, awarded damages of $920, holding that the septic system was defective and located partially on the property of a neighbor in violation of local law and that the sellers were aware of the location of the septic system and deliberately failed to disclose that fact. The Appellate Term, Second Department, affirmed in 2007, noting that the PCDS said that the septic system had no material defects and no features of the property were shared in common with adjoining landowners. The purchaser was entitled to recover actual damages arising out of the material misrepresentation in the PCDS, notwithstanding the "as is" clause in the contract of sale, in this case the cost of the title search and mortgage application fees.

In *Spinney v. Mirabella*,[21] the purchaser sued to recover the cost to upgrade the electric system to 150 amperes. There was a representation in the PCDS that the electrical service was 150 amps, when it was actually 100 amps. The judge in the Justice Court, Town of Webster, Monroe County, in 2008 opined that, unlike consumer protection legislation found in the General Business Law that gives a right of action to the consumer, the PCDA gives no such specific right of action for breach of the PCDS, citing *Malach*. [This unfortunate minority view has not prevailed in higher courts. *See* section B(2)(d) *below*.] In this case, the parties agreed to modify the merger clause in the contract, so that a duty to upgrade the electric system would survive the closing. The judge awarded damages of $1,335 for failure to upgrade the system, presumably for damages for breach of contract. Though the purchaser won, this cannot really be considered a case for breach of a representation in the PCDS.

(2) The rationales for wins by sellers in PCDS cases remain the same

(a) The purchaser failed to prove fraud by the seller or justifiable reliance by the purchaser

In *Middleton v. Calhoun*,[22] the purchaser sued the sellers in the Small Claims Part of the Hoosick Falls Village Court for failure to disclose a defective condition, breach of contract and for fraud. The trial court dismissed the cause of action. The County Court of Rensselaer County affirmed. The PCDS stated that there were no known material defects in the septic sewage system. The Village Court dismissed the purchaser's case because she failed to prove either the seller's actual or constructive knowledge of the condition. The County Court noted in 2006 that, in the handful of reported cases on purchaser's remedies under the PCDA, the decisions offer no consensus and there was no reported Appellate Decision on the matter. One line of cases held that the purchaser had no cause of action, citing *Malach*,[23] and *Renkas*.[24] The court analyzed the opposite conclusion in *Gabberty*[25] and *Fleischer*,[26] but concluded that it agreed with *Malach*, saying that it is for the legislature to create an entire statutory cause of action with specificity as to what actions create liability. [This issue has been since settled by higher courts in favor of a statutory remedy. *See* section B(2)(d) *below*.] The court noted that in General Business Law, Article 11-A (the "New Car Lemon Law") specific remedies are set forth. It also found it difficult to reconcile a cause of action against a seller who lies on the PCDS with N.Y. Real Prop. Law § 462(1), which specifically preserves the parties' ability to enter into an "as is" contract. Even if the court were to find that a cause of action existed for a misrepresentation in the PCDS, the proof offered at the hearing failed to prove that the seller's negative answer to the question of any known material defects was in fact false or that the condition existed while the sellers were in the house. As to breach of contract, the lower court determined that the purchaser did not prove that the seller had actual or constructive knowledge of the condition before closing. As to fraud in the inducement, the purchaser failed to offer proof that the sellers, when filling out the PCDS, possessed a present intent to defraud. The purchaser entered into an "as is" contract, and there was no evidence in the record that she had the sewage system inspected prior to the closing. The contract stated that it was contingent upon a written determination by a qualified person that the premises were free from any substantial sewer defects, which was deemed waived unless the purchaser notified the seller of a failure. The PCDS was not a warranty, nor was it a substitute for an inspection and test. The common law still places a substantial burden on the purchaser to learn everything about the property that can reasonably be learned before the purchase is made.

In *Klafehn v. Morrison*,[27] the purchasers sued for fraud in the inducement due to a fraudulent misrepresentation in a PCDS as to a waste water discharge line in the basement of a four-unit apartment building. [Note that N.Y. Real Prop. Law § 461(5) defines "residential real property" to mean a one to four family dwelling.] The Supreme Court, Tompkins County, denied the sellers' motion for summary judgment. The Appellate Division, Third Department, held in 2010 that the failure to disclose was not fraudulent and reversed, dismissing the complaint. The PCDS disclosed that the building suffered from seasonal dampness in the basement, but no other defects. The inspection report observed that the basement apartment's bathroom sub-floor was soft when walked on and that a sanitary waste line was leaking, but the purchaser did not raise this with the seller and closed. While false representation in a PCDS may constitute active concealment in the context of fraudulent nondisclosure, citing *Anderson* and *Simone*, to maintain such a cause of action the buyer must show that the seller thwarted the buyer's efforts to fulfill the purchaser's responsibilities fixed by the doctrine of caveat emptor. A toilet leak, thought by the sellers to have been repaired, did not give the sellers actual notice of deteriorated pipes under the floor. There was no evidence that the disclosure of "seasonal dampness" constituted active concealment, such that the sellers interfered with or thwarted the purchasers' efforts. The purchaser's own observations and the inspector's report prevented reasonable reliance on representations.

In *Pettis v. Haag*,[28] the purchaser alleged that the sellers knowingly made fraudulent material representations in the PCDS that there were no material defects in the roof and breaker box wiring, no electrical problems, and no flooding. The Supreme Court, Madison County, denied the sellers' motion for summary judgment. The Appellate Division, Third Department, reversed in 2011 as to the roof and breaker box wiring, but not as to the flooding and electrical problems. The purchasers did not justifiably rely on the seller's representations in PCDS of no material defects in roof and breaker box wiring as the inspection report put them on notice. The evidence presented factual issues as to sellers' knowledge of flooding and concealed electrical conditions. Allegations based on a PCDS survive *general* "as is" disclaimers.

In *Dolansky v. Frisillo*,[29] the seller sued the purchaser for breach of contract, and the purchaser counterclaimed for fraudulent misrepresentation. The Supreme Court, Herkimer County, granted the seller summary judgment and damages, and dismissed the counterclaim. The Appellate Division, Fourth Department, in 2012 modified by denying that part of the seller's motion for summary judgment and vacating the award of damages, as there were triable issues of fact whether the parties orally agreed to cancel the contract. The purchasers' allegations of fraud were insufficient to raise an issue of fact. Where the PCDS stated that the garage had water and rot damage and the seller did not know whether there were structural defects, the purchaser could not show justifiable reliance to support a fraud claim. Allegations of fraudulent inducement could not be maintained when there were *specific* disclaimers in the contract, such as an "as is" clause.

(b) The purchaser failed to prove that the seller had actual knowledge of the defect

In *VanDeCarr v. Hahn*,[30] the purchaser sued the trustee of the trust that was the seller for $3,000 in damages, including the cost of the home inspection, penalties for violation of N.Y. Energy Law 17-103(3) ("Truth in Heating Law"), punitive damages and attorney's fees, in small claims court. The trustee had completed a PCDS on behalf of the trust. [That N.Y. Real Prop. Law § 463(7) exempts from the disclosure requirement a transfer by a fiduciary in the course of administration of a trust was not noted in the opinion!] The judge in Justice Court, Town of Clifton Park, Saratoga County, held in 2007 that the purchaser failed to prove that seller knowingly or intentionally made false statements in the PCDS. As to the Truth in Heating Law, which gives the purchaser a statutory right to receive copies of heating and cooling bills for the last two years and certain information concerning insulation, the Judge held that penalties thereunder go to the People of the State of New York and a claim for them is not permitted in a small claims action. [Note that the statute provides that the seller need not honor a request for those documents after a contract is signed.]

In *Meyers v. Rosen*,[31] the purchaser sued alleging that the seller knowingly failed to disclose various property defects in the PCDS or otherwise. The Supreme Court, Clinton County, granted in part the seller's motion for summary judgment, except for claims regarding mice infestation and material defects in the heating system. The Appellate Division, Third Department, held in 2010 that (1) the seller's failure to indicate a material defect in the septic system on the PCDS was not a willful failure to disclose; (2) the seller's denial of actual knowledge of basement seepage in the PCDS did not result in actual damage to the purchasers; (3) the seller had no actual knowledge of a purported defect in the propane line feeding the furnace; (4) the seller's disclosure of actual knowledge of a kerosene leak from the fuel tank located outside the foundation wall in the PCDS did not thwart the purchaser's ability to discover and avoid damage resulting from kerosene in the basement; but (5) a genuine issue of material fact precluded summary judgment on the claim alleging willful failure to make disclosure about mice infestation in the PCDS (*see also* section B(1) (a) *above*). A claim for willful failure to disclose must allege that the seller had actual knowledge

of the condition. Plaintiff's silence (by failing to complete the PCDS) regarding knowledge of any material defect affecting the septic system provided no basis for a remedy under N.Y. Real Prop Law § 465(2) [**N.B.** This would let the seller off the hook if he simply fails to answer one or more questions! I disagree; the seller should at least be liable for the $500 credit for failure to deliver a complete PCDS.]. Even if the seller's disclosure outside of the PCDS before the closing that the sump pump would run every four hours during a heavy rain and that the basement had flooded only once as a result of an ice storm could reasonably be construed as contradicting the seller's representation on the PCDA that the basement did not have seepage resulting in standing water, the record did not support a claim that the PCDS representation resulted in actual damages. Because of the 4-1 decision on the 5 defects, I have rated this case a .8 win by the seller and a .2 win by the purchaser.

In *Morgan v. Silvestri*,[32] the purchaser sued for breach of contract, fraudulent inducement and fraudulent misrepresentations in a PCDS about the foundation. The Supreme Court, Broome County, held in 2011 that the purchaser failed to prove that the seller, an experienced contractor who did a major reconstruction and who represented in the PCDS that there were no known material defects in the foundation, had actual knowledge of any defects in the foundation. The inspection report noted that portions of the foundation were not visible or partially visible and advised that hidden or concealed defects could not be addressed. The purchaser took no further action and closed without any further inspection. Mere constructive knowledge does not suffice. Seller's construction of a cinder block wall did not conceal the condition.

In *Dolansky v. Frisillo*,[33] the seller sued the purchaser for breach of contract and the purchaser counterclaimed for fraudulent misrepresentation. The Supreme Court, Herkimer County, granted the seller summary judgment and damages, and dismissed the counterclaim. The Appellate Division, Fourth Department, in 2012 modified by denying that part of the seller's motion for summary judgment and vacating the award of damages, as there were triable issues of fact whether the parties orally agreed to cancel the contract. The purchasers' allegations of fraud were insufficient to raise an issue of fact. Where the PCDS stated that the garage had water and rot damage and the seller did not know whether there were structural defects, the purchaser could not show justifiable reliance to support a fraud claim.

In *Sample v. Yokel*,[34] the purchasers sued the seller for negligence, failure to perform requirements of the PCDA, fraud, restitution and implied indemnification. The Supreme Court, Monroe County, granted summary judgment to the seller. The Appellate Division, Fourth Department, affirmed in 2012, holding that (1) the seller's disclosure of property defects was accurate, and (2) the seller did not knowingly fail to disclose any defects (condition of a deck). False representation in a PCDS may constitute active concealment, but here the seller submitted evidence that she did not knowingly fail to disclose any defects.

In *Smith v. Realty USA-Capital District Agency, Inc.*,[35] the purchaser sued to recover her deposit due to an inspection report showing major defects and to recover the expense of the property inspection report due to false statements in the PCDS, and the seller asserted a counterclaim for breach of contract. The Supreme Court, Albany County held in 2012 that the seller met his burden of proof that he had no knowledge of the plumbing defect or water damage, so the claim under the PCDS was dismissed, as well as the purchaser's claim for the cost of inspection. The purchaser was entitled to return of her down payment after proper cancellation when the inspection identified major defects, including substantial drainage system leaks, that would reasonably cost over $1,500 to correct, pursuant to the [standard printed form] contract inspection contingency clause, without having to obtain additional repair estimates.

(c) The "as is" and/or merger clause prevented a fraud claim

In *Dolansky v. Frisillo*,[36] the Supreme Court, Herkimer County, granted the seller summary judgment, damages, and dismissed the counterclaim. The Appellate Division, Fourth Department, in 2012 modified by denying that part of the seller's motion for summary judgment and vacated the award of damages, as there were triable issues of fact whether the parties orally agreed to cancel the contract. Neither the statute of frauds nor the contract prohibited oral cancellation of the contract [Fourth Department version of the printed form contract; the downstate and most other printed form contracts prohibit oral cancellation]. The "as is" clause was a *specific* disclaimer. *Contra: Pettis v. Haag*,[37] where the Appellate Division, Third Department, held in 2011 that fraud allegations based on PCDS survive a *general* "as is" disclaimer and *Ayres v. Pressman*,[38] where the Appellate Term, Second Department, said in 2007 that the purchaser was entitled to recover actual damages arising out of a material misrepresentation in the PCDS notwithstanding the "as is" clause in the contract of sale. I believe that the Second and Third Departments have the better view on disclaimer.

The rule often stated by the courts is that a "*specific*" disclaimer will prevent a fraud claim,[39] but I have questioned whether the *general* "as is" disclaimer in a printed form contract should be considered "specific" enough to do that.[40] A "specific" disclaimer should be one that identifies a specific condition or subject and is added to a printed form contract. Boilerplate should not prevent a valid fraud claim.

(d) The PCDA failed to create a statutory cause of action

See the discussion in 2006 in the *Middleton* case, *above*. This position, unfortunately started by the poor analysis in the *Malach* opinion,[41] and repeated in some subsequent early lower court opinions, has been resolved to the contrary by higher courts. Several Supreme Courts and appellate courts have allowed recovery by purchasers,[42] usually without expressly discussing the issue.[43] In the *Meyers* case in 2010, the Appellate Division, Third Department, expressly stated that where a seller delivers a PCDS, the seller may be liable "under the statutory remedy available to the buyer, to the extent of the buyer's actual damages resulting from the seller's willful failure to perform the requirements" of the PCDA. The most common other formulation has been that a false representation in a PCDS may constitute active concealment in the context of fraudulent nondisclosure.[44] Consequently, the issue has been settled in favor of purchasers.

C. Conclusion

Though there have not been very many PCDA cases, purchasers have succeeded much more often against sellers who gave a PCDS in the last 6 years than in the initial 4 years since enactment of the PCDA. The most successful defense of sellers has been that the purchasers failed to prove that the sellers had actual knowledge of the defect, which is just the result intended by the PCDA. Most appellate courts have held that a *general* "as is" clause does not prevent a valid fraud claim. The faulty theory in some early lower court cases that the PCDA does not provide a remedy for failure of compliance has been rejected by the appellate courts. Consequently, with a PCDS, the purchaser now has more than a ghost of a chance in a suit against the seller.

3. Practice Tip: The Seller Can Add an Explanation to the PCDS

One way of coping with delivery of a PCDS would be to take advantage of the opportunity to add explanations of the answers to the questions. Following the last question in the form is a paragraph inviting the seller to use the area below to further explain any item above, and, if necessary, to attach additional pages (indicating on the form the number of additional pages attached). For example, if the basement or cellar is not water-tight, the seller could add: "As to question 31, the cellar is not water-tight and sometimes has seepage; there is a sump pump to remove any standing water." Question 31 asks: "Does the basement have seepage that results in standing water?" If the seller answered "no" to question 31 because standing water from any seepage after a heavy rain is removed by the sump pump, the explanation would help prevent a claim of misrepresentation in the future.

When we were negotiating the wording of the questions in the original PCDS, the original draft asked if the basement had seepage. Since many basements are not completely water-tight and do have seepage of minimal amounts, particularly after a rain, we added "that results in standing water," to try to allow a truthful negative answer where seepage was minimal.

Many of the PCDS questions contain ambiguities and are very broadly drafted, particularly the ones about environmental matters. Adding an explanation may help protect the seller from a claim of misrepresentation in the PCDS.

Endnotes

1. Karl B. Holtzschue, *The Purchaser Hasn't a Ghost of a Chance: Update on PCDA Cases and PCDA Revision*, 35 N.Y. Real Prop. L.J. 7 (Winter 2007). The quote that the purchaser hasn't "a ghost of a chance" is a witticism from Stambovsky v. Ackley, 169 A.D.2d 254, 256, 572 N.Y.S.2d 672, 674 (1st Dep't 1991), where the seller had written an article claiming the house was haunted by a ghost.
2. The partial numbers result from allocations I made in cases where purchasers won on some claims and lost on others in the same case.
3. Ercole v. McGay, 13 Misc.3d 144(A), 831 N.Y.S.2d 359 (Sup. Ct. App. T. 2d Dep't 2006) (Angiolillo. J.P.) (Suffolk County) (11/29/06) (having elected to provide $500 credit in lieu of PCDS, seller had no duty to speak; seller did not actively conceal electrical and plumbing work not in accordance with Town Code); Matos v. Crimmins, 40 A.D.3d 1053, 837 N.Y.S.2d 234 (2d Dep't 2007) (where contract subject to covenants, restrictions and easements of record, seller had no duty to disclose conservation and shade tree easements easily ascertainable from the public record); Daly v. Kochanowicz, 67 A.D.3d 78, 884 N.Y.S.2d 144 (2d Dep't 2009) (sellers did not have affirmative duty to disclose property's history of severe flooding, purchaser's reliance on any representation by sellers that property had no history of water problems was not reasonable in view of several warnings and did not amount to active concealment; not within peculiar knowledge of sellers; purchaser's fraud action barred by specific disclaimer in contract [standard Multibar form!]); Commander Terminals, LLC v. Commander Oil Corp., 71 A.D.3d 623, 897 N.Y.S.2d 151 (2d Dep't 2010) (seller of oil storage facility had no duty to disclose oil seepage from facility into adjacent navigable waters; triable issues of fact whether oil seepage was something purchaser could have discovered).
4. Marsh v. Hasbrouck, 37 A.D.3d 1010, 831 N.Y.S.2d 554 (3d Dep't 2007) (purchaser could have discovered true perimeters of property); Beach 104 St. Realty, Inc. v. Kisslev-Mazel Realty, LLC, 76 A.D.3d 661, 906 N.Y.S.2d 614 (2d Dep't 2010) (any failure of seller to disclose proposed condemnation proceeding did not amount to actionable fraud; condemnation plans were a matter of public record which purchasers could have reasonably discovered with due diligence and were not within the peculiar knowledge of the sellers); 85-87 Pitt Street, LLC v. 85-87 Pitt Street Realty Corporation, 83 A.D.3d 446, 921 N.Y.S.2d 40 (1st Dept 2011) (bedbug infestation not a matter peculiarly within a seller's knowledge and could be discovered by purchaser with diligence and inspection; specific disclaimer as to physical condition in "as is" merger clause extinguished any claims based on alleged misrepresentations as to bedbugs); Ravina v. Hsing Hsung Chuang, 95 A.D.3d 1288, 945 N.Y.S.2d 411 (2d Dep't 2012) (where contract gave purchasers 45 days to inspect for hazardous substances and purchasers failed to do so, they were held to have waived their right to cancel on the ground that there were hazardous

substances and they lost their down payment).

5. Rivietz v.Wolohojian, 38 A.D.3d 301, 832 N.Y.S.2d 505 (1st Dep't 2007) (because condominium purchasers had opportunity to inspect, had detailed report by their architect and there was no evidence of false representations, there was no justifiable reliance to support a claim of false representation); F.A.S.A. Constr. Corp. v. Degenshein, 47 A.D.3d 877, 850 N.Y.S.2d 612 (2d Dep't 2008) (seller's representation that subdivision maps had been filed was not a representation as to validity of filed map; purchasers could not show justifiable reliance on alleged misrepresentations about zoning ordinances as change in them was a matter of public knowledge).

6. Kagan v. Freedman, 55 A.D.3d 558, 866 N.Y.S.2d 216 (2d Dep't 2008) (breach of contract claim due to toxic mold and seller's dissuading purchasers from conducting professional mold inspection barred by "as is" disclaimer in contract and doctrine of merger); Arnold v. Wilkins, 61 A.D.3d 1236, 876 N.Y.S.2d 780 (3d Dep't 2009) (merger doctrine extinguished claims regarding sellers' alleged promise to convey sewage system in good working order; latent defect exception has not been adopted by Appellate Divisions or Court of Appeals in these circumstances); Stollsteimer v. Kohler, 77 A.D.3d 1259, 910 N.Y.S.2d 581 (3d Dep't 2010) (contract merged with deed, which did not include four-acre parcel; fraud claim that seller's son orally indicated that parcel was included was not justifiable as facts were contained in survey and public record and not exclusively within sellers' knowledge); Tarantul v. Cherkassky, 84 A.D.3d 933, 923 N.Y.S.2d 133 (2d Dep't 2011) (contract's specific disclaimer [sounds like downstate Multibar Contract] barred claim of fraudulent inducement, citing Bedowitz v. Farrell Dev. Co., 289 A.D.2d 432, 433, 735 N.Y.S.2d 150 (2d Dep't 2001) and Cohan v. Sicular, 214 A.D.2d 637, 638, 625 N.Y.S.2d 278 (2d Dep't 1995) (purchasers had means to determine condition)); Princes Point, LLC v. AKRF Eng'g, P.C., 94 A.D.3d 588, 944 N.Y.S.2d 493 (1st Dep't 2011) (purchaser failed to establish promissory estoppel or fraud against sellers for negligent misrepresentation as to shoreline revetment seawall, as property was purchased "AS IS…AND WITH ALL FAULTS" and contract represented the entire understanding).

7. Delano v. USA Home Inspection Servs., 15 Misc.3d 142A, 841 N.Y.S.2d 819 (Sup. Ct. App. T. 2d Dep't 2007) (seller actively concealed lack of connecting heating ducts; PCDA did not bar claim for common law fraud in the inducement); Sentlowitz v. Cardinal Dev., LLC, 63 A.D.3d 1137, 882 N.Y.S.2d 267 (2d Dep't 2009) (purchasers stated cause of action for fraudulently concealing that property contained land designated as wetlands by U.S. Army Corps of Engineers); Margolin v. I M Kapco, Inc., 89 A.D.3d 690, 932 N.Y.S.2d 122 (2d Dep't 2011) (buyer stated cause of action for fraud where seller actively concealed water leaks by placing pans above drop ceiling tiles); Camisa v. Papaleo, 93 A.D.3d 623, 939 N.Y.S.2d 559 (2d Dep't 2012) (complaint sufficiently stated cause of action for fraud that sellers of commercial property actively concealed that extensive alterations had been made illegally, by proffering allegedly forged letter from building inspector that no certificate of occupancy was required for residence constructed in 1925 and there were no violations to date).

8. Joseph v. NRT Incorporated, 18 Misc.3d 296, 853 N.Y.S.2d 481 (N.Y. Civ. Ct. N.Y. Cnty. 2007) (purchasers did not justifiably rely on brokers' misrepresentation of number of legal bedrooms in the condo unit because purchasers had means available to discover illegality of two added bedrooms with unlawful windows (offering plan and certificate of occupancy provided); general disclaimer clause did not bar parole evidence); Lieberman v. Greens at Half Hollow, LLC, 54 A.D.3d 908, 864 N.Y.S.2d 539 (2d Dep't 2008) (general language of merger clause did not preclude purchasers' claim of fraud in the inducement or their use of parol evidence to establish reliance upon representations by defendant's employee about location of unit and view of golf course); Cerand v. Burstein, 72 A.D.3d 1262, 897 N.Y.S.2d 789 (3d Dep't 2010) (contract requiring proof of "no open code violations cases" did not merge into deed where contract was silent, but subsequent conduct indicated intent).

9. Misra v. Yedid, 37 A.D.3d 284, 831 N.Y.S.2d 40 (1st Dep't 2007) (fact issues existed whether brokers actively concealed noise of ventilation system located directly above cooperative apartment by tampering with fan speed, precluding summary judgment for active concealment).

10. Clement v. Delaney Realty Corp., 45 A.D.3d 519, 845 N.Y.S.2d 423 (2d Dep't 2007) (action for active concealment of mold against home inspector limited by contract to $440 absent proof of gross negligence); Mancuso v. Rubin, 52 A.D.3d 580, 861 N.Y.S.2d 79 (2d Dep't 2008) (provision in engineering company's contract limiting damages to sum paid for report was enforceable, absent gross negligence; complaint failed to state cause of action for fraudulent concealment by sellers as to termites).

11. *See supra* note 1.

12. In my 2007 article, I calculated that through June 2006 purchasers had won 3 cases (23%) and sellers had won 10. I have since reclassified those cases, deleting 3 cases where no PCDS was delivered. As to partial numbers, see *supra* note 2.

13. The partial numbers result from allocations I made in cases where purchasers won on some claims and lost on others in the same case.

14. 13 Misc.3d 1232(A), 831 N.Y.S.2d 354 (Sup. Ct. Yates Cnty. 2006) (Falvey, J.) (10/30/06).

15. 42 A.D.3d 518, 840 N.Y.S.2d 398 (2d Dep't 2007) (Mastro, P.J.) (07/24/07).

16. 56 A.D.3d 1030, 869 N.Y.S.2d 233 (3d Dep't 2008) (Spain, J.) (Tompkins County) (11/20/08).

17. 65 A.D.3d 741, 884 N.Y.S.2d 498 (3d Dep't 2009) (Garry, J.) (Saratoga County) (08/06/09).

18. 69 A.D.3d 1095, 893 N.Y.S.2d 354 (3d Dep't 2010) (McCarthy, J.) (Clinton County) (01/14/10).

19. 13 Misc. 3d 1232(A), 831 N.Y.S.2d 354 (Sup. Ct. Yates Cnty. 2006) (Falvey, J.) (10/30/06).

20. 14 Misc. 3d 145(A), 836 N.Y.S.2d 496 (Sup. Ct. App. Term Orange Cnty. Mar. 5, 2007) (Rudolph, P.J.) (03/05/07).

21. 20 Misc. 3d 1137(A), 2008 N.Y. Slip Op. 51768(U) (J. Ct. Monroe Cnty. 2008) (DiSalvo, J.) (08/22/08).

22. 13 Misc. 3d 949, 821 N.Y.S.2d 444 (Rensselaer Cnty. Ct. 2006) (McGrath, J.) (09/19/06).

23. 194 Misc. 2d 651, 754 N.Y.S.2d 444 (N.Y. Civ. Ct. Richmond Cnty. 2002).

24. Renkas v. Sweers, 10 Misc. 3d 1076(A), 814 N.Y.S.2d 892 (Sup. Ct. Monroe Cnty. 2005).

25. Gabberty v. Pisarz, 10 Misc. 3d 1010, 810 N.Y.S.2d 799 (Sup. Ct. Nassau Cnty. 2005).

26. Fleischer v. Moreale, 11 Misc. 3d 1004, 810 N.Y.S.2d 624 (Dist. Ct. Suffolk Cnty. 2006).

27. 75 A.D.3d 808, 906 N.Y.S.2d 347 (3d Dep't 2010) (Egan, J.) (Tompkins County) (07/08/10).

28. 84 A.D.3d 1553, 923 N.Y.S.2d 745 (3d Dep't 2011) (Garry, J.) (Madison County) (05/12/11).

29. 92 A.D.3d 1286, 939 N.Y.S.2d 210 (4th Dep't 2012) (Scudder, P.J.) (Herkimer County) (02/17/12).

30. 16 Misc. 3d 1135(A), 851 N.Y.S.2d 61 (J. Ct. Saratoga Cnty. 2007) (Rybak, J.) (09/07/07).

31. 69 A.D.3d 1095, 893 N.Y.S.2d 354 (3d Dep't 2010).

32. 31 Misc.3d 1206(A), 927 N.Y.S.2d 817 (Sup. Ct. Broome Cnty. 2011) (Lebrus, J.) (04/04/11).

33. 92 A.D.3d 1286, 939 N.Y.S.2d 210 (4th Dep't 2012) (Scudder, P.J.) (Herkimer County) (02/17/12).

34. 94 A.D.3d 1413, 943 N.Y.S.2d 694 (4th Dep't 2012) (Scudder, P.J.) (Monroe County) (04/20/12).

35. 35 Misc. 3d 1232(A), 2012 N.Y. Misc. LEXIS 2556 (Sup. Ct. Albany Cnty. 2012) (Lynch, J.) (05/29/12).

36. 92 A.D.3d 1286, 939 N.Y.S.2d 210 (4th Dep't 2012) (Scudder, P.J.) (Herkimer County) (02/17/12).

37. 84 A.D.3d 1553, 923 N.Y.S.2d 745 (3d Dep't 2011) (Garry, J.) (Madison County) (05/12/11).

38. 14 Misc. 3d 145(A), 836 N.Y.S.2d 496 (Sup. Ct. App. Term Orange Cnty. Mar. 5, 2007) (Rudolph, P.J.) (03/05/07).

39. Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 157 N.E.2d 597 (1959) (disclaimer as to "expenses and operation" sufficiently specific); Masters v. Visual Bldg. Inspections, Inc., 227 A.D2d 597, 643 N.Y.S.2d 599 (2d Dep't 1996) (specific disclaimer as to roof leaks); CFJ Assocs. of N.Y. Inc. v. Hanson Industries, 274 A.D.2d 892, 711 N.Y.S.2d 232 (3d Dep't 2000) (disclaimer as to environmental remediation costs was specific); Simone v. Homecheck Real Estate Services, Inc., 42 A.D.3d 518, 840 N.Y.S.2d 398 (2d Dep't 2001) (specific merger clause in the rider to the contract precluded a claim that the purchaser relied on the sellers' alleged misrepresentations).

40. Karl B. Holtzschue, *Holtzschue on Real Estate Contracts and Closings*, 2:2.11[A][5] (Practising Law Institute 2011).

41. See *supra* note 1 (discussing "Theories of Liability Under the PCDA").

42. Gabberty v. Pisarz, 10 Misc. 3d 1010, 810 N.Y.S.2d 799 (Sup. Ct. Nassau Cnty. 2005); Fleischer v. Moreale, 11 Misc. 3d 1004, 810 N.Y.S.2d 624 (Dist. Ct. Suffolk Cnty. 2006); Calvente v. Levy, 12 Misc. 3d 38, 816 N.Y.S.2d 828 (Sup. Ct. App. Term Orange Cnty. Apr. 27, 2006).

43. Ayres v. Pressman, 14 Misc. 3d 145(A), 836 N.Y.S.2d 496 (Sup. Ct. App. Term Orange Cnty. Mar. 5, 2007) (Rudolph, P.J.) (03/05/07); Simone v. Homecheck Real Estate Services, Inc., 42 A.D.3d 518, 840 N.Y.S.2d 398 (2d Dep't 2001) (Mastro, P.J.) (07/24/07); Anderson v. Meador, 56 A.D.3d 1030, 869 N.Y.S.2d 233 (3d Dep't 2008) (Spain, J.) (Tompkins County) (11/20/08); Kurtz v. Foy, 65 A.D.3d 741, 884 N.Y.S.2d 498, (3d Dep't 2009) (Garry, J.) (Saratoga County) (08/06/09); Meyers v. Rosen, 69 A.D.3d 1095, 893 N.Y.S.2d 354, (3d Dep't 2010) (McCarthy, J.) (Clinton County) (01/14/10).

44. Klafehn v. Morrison, 75 A.D.3d 808, 906 N.Y.S.2d 347 (3d Dep't 2010) (Egan, J.) (Tompkins County) (07/08/10) (citing Anderson v. Meador, 56 A.D.3d 1030, 869 N.Y.S.2d 233 (3d Dep't 2008) (Spain, J.) (Tompkins Cnty.) (11/20/08), Simone v. Homecheck Real Estate Services, Inc., 42 A.D.3d 518, 840 N.Y.S.2d 398 (2d Dep't 2001) (Mastro, P.J.) (07/24/07) and Sample v. Yokel, 94 A.D.3d 1413, 943 N.Y.S.2d 694 (4th Dep't 2012) (Scudder, P.J.) (Monroe County) (04/20/12)). A recent article argued that the legislature intended to create a remedy when it enacted the PCDA, noting that N.Y. Real Prop. Law § 465 is titled "Remedy." Brodnick, *The Property Condition Disclosure Act Celebrates its Tenth Birthday*, 40 N.Y. Real Prop. L.J. 9 (Summer 2012).

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Bergman on Mortgage Foreclosures:
When the Court Won't Strike "John Doe" Defendants

By Bruce J. Bergman

Well, this sounds like a hopelessly obscure topic. Arcane it may be, lacking in meaning it is not. And if the courts get it wrong, it is yet another dismaying time waster imposed upon the foreclosure process—precisely why this problem is highlighted here.

"John Does" (or "Jane Does" or any other way these can be styled) are fictitious defendants in foreclosure actions. They are assuredly required in the caption (why to be noted in a moment), later in the case to be removed if shown to be unnecessary. That courts have on occasion recently declined to strike "John Does" when it was needed, which then necessitated reversal on appeal, confirms that this seemingly recondite issue can be troublesome in foreclosure real life. [See *Flagstar Bank v. Bellafiore*, 94 A.D.3d 1044, 943 N.Y.S.2d 551 (2d Dept. 2012); *U.S. Bank, N.A. v. Boyce*, 93 A.D.3d 782, 940 N.Y.S.2d 656 (2d Dept. 2012).]

Why John Does?

One essential goal of a foreclosure action is to have the mortgaged premises sold free and clear of all (or most) interests subsequent, later and subordinate to the mortgage. In that way, the equity cushion, the integrity of the investment, can be preserved. [There is a bit more to this and for an in depth exploration see 1 *Bergman on New York Mortgage Foreclosures* §2.02, LexisNexis Matthew Bender (rev. 2012).] To achieve this end, all those junior parties need to be named in the action—their names are to be in the caption—and they are served with process.

It is the foreclosure search obtained by plaintiff's counsel which reveals these inferior interests. But the search will not often list tenants, nor, obviously, can it recite those whose interests arise after the record has been read but before the foreclosure pleadings (including the *lis pendens*) are filed with the court.

All this means that sometimes there are unknown defendants who need to be named and served. This is readily accomplished by a standard delineation in a foreclosure caption of various numbers of fictitious defendants: hence "John Doe #1" through "John Doe # 12" (or however many possibilities may suit the nature of the case or the property).

Striking the "John Does"

In a New York foreclosure, the next stage after process service is complete is application for appointment of a referee to compute or, if an answer is interposed, a motion for summary judgment, which will also seek the referee's appointment.

Either of these approaches also then addresses "John Does." If unknown defendants *are* found (and served), their names are then sought to be substituted in the caption for the equivalent number of "John Does." All remaining "John Does," who have become unnecessary parties, and thus irrelevant, are asked upon the motion or order (referee's appointment or motion for summary judgment) to be stricken.

And If the Court Declines?

If the motion is granted, the aspect of striking the "John Does" should be granted in the normal course as an inherent incident of the procedure. Fictitious defendants are not to be retained in a case. Even if for some reason a court rejects the main thrust of the motion, so long as "John Does" are shown not to be necessary, at least that item of relief should be granted.

It is impossible to reconcile a refusal to eliminate unnecessary defendants. But it has happened. Should it? The clear answer is "no", as the two recent appeal level rulings have firmly asserted. The principle is as elemental as this. Where it is demonstrated upon the application for an order of reference (or upon a motion for summary judgment) that there are no "John Does," for example, not as tenants, amendment of the caption to delete such defendants should be granted.

While appropriately this is well understood by New York courts at the appellate level, trial courts have stumbled on the point and may yet do so in the future. (Unreported cases confirm that the foregoing are not the only incidents.) The problem this imposes upon foreclosure is a need to either reargue the motion, appeal it, or devote special attention to it at a later stage. All such paths tend to add both further delay and expense to what is already a far too protracted pursuit in the Empire State.

Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, LexisNexis Matthew Bender, is a member of Berkman, Henoch, Peterson, Peddy & Fenchel in Garden City. He is a fellow of the American College of Mortgage Attorneys and a member of the American College of Real Estate Lawyers and the USFN. His biography appears in Who's Who in American Law and he is listed in Best Lawyers in America and New York Super Lawyers.

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Student Case Comment: *Stein v. Doukas, et al.*: Inexcusable and Prejudicial Delay to Assert a Claim by a Property Owner Will Give Rise to an Equitable Defense of Laches

On September 19, 2012, the Appellate Division, Second Department, held in *Stein v. Doukas* that the doctrine of laches precluded an owner's challenge to the purchaser's title to property because the plaintiff, Douglas Stein, inexcusably failed to act despite knowledge that the title to the property might have been fraudulently conveyed to Telcor Co., LLC.[1] In essence, "the equitable defense of laches is prejudicial delay in the assertion of rights."[2]

In 2004, Ted Doukas allegedly "wrongfully manufactured" a deed conveying certain property from Claire Stein to Doukas' Company, Telcor Co., LLC ("Telcor").[3] In August 2007, Telcor conveyed the property to Jay Realty.[4] Eight months later, Douglas Stein, the administrator of Claire Stein's estate, brought suit against Telcor and Jay Realty seeking damages and to set aside both deeds.[5]

The court stated four elements to establish a defense of laches.[6] However, it primarily focused on the inexcusable delay of a property owner to assert a claim.[7] For relief in equity, the defendant must show that the plaintiff failed to assert his claim for relief despite the opportunity to do so.[8] The court noted that, as of February 2007, Douglas Stein knew of the alleged fraudulent conveyance of the property to Telcor and, despite that knowledge, took no action to assert his rights to the property until he commenced an action well over a year later.[9] In the interim, Jay Realty relied on the validity of the recorded deed to Telcor by paying $1.425 million to purchase the shopping center. Jay Realty had no knowledge of Douglas Stein's claim. As a result, the court held that "Jay Realty demonstrated its *prima facie* entitlement to judgment as a matter of law by establishing that the doctrine of laches precluded the plaintiffs from asserting a claim against it."[10]

According to the Second Department, laches alone, without regard to the law of adverse possession, is a basis for barring a record owner from asserting title to property.[11] Therefore, the court concluded, Jay Realty's motion for summary judgment, dismissing the complaint in the lower court proceeding should have been granted.[12] However, Douglas Stein does have a cause of action against Telcor.[13] The court concluded that the lower court properly denied Telcor's motion for summary judgment because there were triable issues of fact on the issue of fraud.[14]

The doctrine of laches is a defense in equity which arises when there is a prejudicial delay by the property owner in asserting his rights and the delay results in prejudice to the property owner.[15] The court noted that the effect of delay may be critical to an adverse party.[16] The court therefore observed that delays of even less than one year can be sufficient to warrant the application of the defense of laches.[17] In this case, the property owner failed to bring an action to preclude Jay Realty from purchasing Claire Stein's property for fourteen months after Douglas Stein learned of the sale of the property to Telcor.[18] The court found that the plaintiff's delay caused damage to Jay Realty in reliance on the validity of the Telcor deed, and that Jay Realty rightfully asserted the defense of laches.[19]

The court's opinion suggests that if Stein had brought the action sooner, he might have prevailed in recovering the property. However, what we don't know from the court's opinion is when a delay is deemed too long.

Although the deed allegedly manufactured by Telcor may ultimately be found to be fraudulent, the purchaser, Jay Realty, is permitted to retain the property. Due to Douglas Stein's unreasonable delay in filing his complaint, his only remedy will be in an action against Telcor seeking financial reimbursement.

Endnotes

1. 2012 N.Y. Slip Op. 06204 at *2 (2d Dep't 2012).
2. *Stein v. Doukas*, 2012 N.Y. Slip Op. 06204 at *1.
3. *Id.* at *1-*2.
4. *Id.* at *2.
5. *Id.*
6. *Id.* (*citing Cohen v. Krantz*, 227 A.D.2d 581, 582, 643 N.Y.S.2d 612. The court states four elements to establish laches: "(1) conduct by an offending party giving rise to the situation complained of, (2) delay by the complainant in asserting his or her claim for relief despite the opportunity to do so, (3) lack of knowledge or notice on the part of the offending party that the complainant would assert his or her claim for relief, and (4) injury or prejudice to the offending party in the event that relief is accorded the complainant.").
7. *Id.*
8. *Stein v. Doukas*, 2012 N.Y. Slip Op. 06204 at *2.
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Stein v. Doukas*, 2012 N.Y. Slip Op. 06204 at *2-*3.
14. *Id.*
15. *Id.* at *2.
16. *Id.*
17. *See id.* at *1; *see also Matter of Schulz v. State of New York*, 81 N.Y.2d at 348.
18. *Id.*
19. *Stein v. Doukas*, 2012 N.Y. Slip Op. 06204 at *2.

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N.Y. Real Property Law Journal

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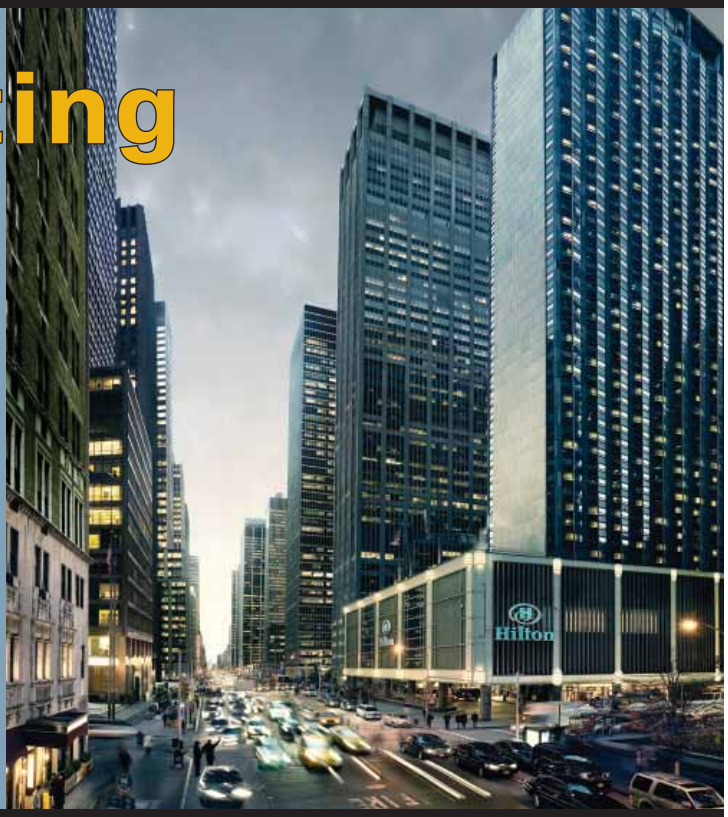

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