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N.Y. Real Property Law Journal

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Inside

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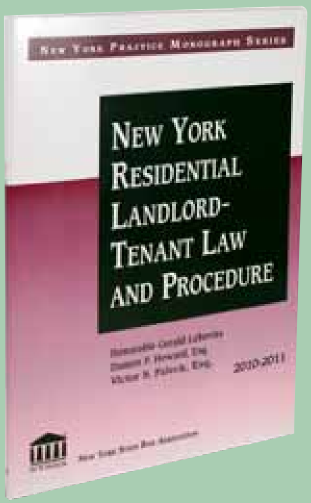

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New York residential landlord-tenant law is daunting to newcomers and the experienced alike, given its patchwork statutory framework, discordant case law, and emotion-laden disputes involving homes, money, and the charged landlord-tenant relationship. This monograph introduces the fundamentals of residential landlord-tenant law and offers a guide to the procedural mechanics practitioners face in landlord-tenant disputes.

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Message from the Section Chair

The terrible news that we received in late September about the untimely death of our friend and First Vice-Chair Ed Baer was a blow to the entire Section. We will all miss his feisty sense of humor, his dedication to his work and his leadership. On a personal level, I will miss his good counsel, his generosity and great kindness. Ed was very protective of his friends. I found my life to be richer from my friendship with Ed. Many can say the same.

As this was going to press, we learned of the unexpected death of our Past Chair Mel Mitzner in a motor vehicle accident on October 16, 2010. Mel was a friend and mentor to all of us. Most members of the Section have shared memories of Mel on the listserve. Perhaps Mindy Stern said it best—he was a "mench." I remember at our summer meeting in Hershey touring the Hershey Gardens with Mel and Roz. It was a treat to share stories about our children and their beloved grandchildren. Mel never missed an RPLS meeting unless it was for his grandchildren.

There is a huge hole in our hearts from these two tragic deaths. They will be sorely missed by all of us. The Executive Committee will be considering appropriate memorials at our next meeting to remember our good friends.

Now to the mundane…

The work of our committees is progressing well. In particular, the Construction Law Committee had an excellent program at the Penn Club in early October. The speakers were quite interesting. The Condos and Co-Ops Committee has been busy responding to proposed federal regulations.

Our CLE chairs, Joe Walsh and Larry Wolk, have been supervising a number of excellent programs this fall. Many of our Section members have chaired programs, produced materials and presented. Our programs consistently received very high marks from the audience members, thanks to the efforts of all involved.

Our Annual Meeting should be very interesting this year. It will be a hot topics format. Brian Lawlor, former Executive Committee member and now Commissioner at DHCR, will be our luncheon speaker. The Section professionalism award will be presented at our luncheon. I hope to see you all there.

All the best for a happy and healthy holiday!

Anne Reynolds Copps

In Memoriam

Edward Baer

Edward Baer, First Vice-Chair of the Real Property Law Section of the New York State Bar Association, died Sept. 20 of this year after a long and courageous battle with pancreatic cancer. He was 53.

Ed was born in Brooklyn on June 25, 1957. He was a graduate of the Benjamin N. Cardozo School of Law and was an undergraduate at SUNY Oneonta. He was a member of the New York Bar and was admitted to practice in the Southern and Eastern Federal District Courts of New York.

Ed was a partner at the Manhattan law firm of Belkin Burden Wenig & Goldman LLP, where he specialized in real estate, bankruptcy and trial practice. Known for his rigorous and combative intellect, Ed was a devoted husband and father and an accomplished litigator who enjoyed life passionately.

He also served as co-chair of the Landlord-Tenant Proceedings Committee of the New York State Bar Association. Ed lectured at seminars sponsored by the Rent Stabilization Association, the New York Association of Realty Managers and the New York State Bar Association.

Prior to joining Belkin Burden Wenig and Goldman, LLP, his professional experience included being a member of the firm of Finkelstein, Borah, Schwartz, Altschuler & Goldstein, P.C. During his nearly three decades of practice in the landlord-tenant area, Ed had been trial counsel on some of the most significant cases in landlord-tenant court. He represented owners of both residential and commercial properties in court and in leasing transactions.

He is survived by his wife Donna of 29 years; children Lindsay and Benjamin; parents Ralph and Terry; and sister Randye. Ed will be deeply missed by all who knew and loved him.

In Memoriam

"Mel"

In the hours following the sad, tragic and shocking passing of Mel Mitzner, the real estate community poured out its heart, soul and love. Spontaneously, poignantly—and filled mostly with shock and despair—we paid tribute to that giant among us, known by one and all simply as "Mel." Hundreds of us did so, within a matter of hours.

The tributes and stories about Mel were touching, eloquent and passionate, bearing witness to his greatness. Unadorned by time to reflect and compose, we recounted for each other (almost like a very large real estate support family) Mel's brilliance, his dedication to the real estate industry and his devotion to his family.

I was honored when, a day later, the editors of the *N.Y. Real Property Law Journal* asked me to write these words of remembrance. I do so with a heavy heart, but one filled with the love, admiration and respect that Mel Mitzner so easily achieved from all of us and so richly deserved.

Mel influenced and helped shape the real estate landscape as we know it, with his encyclopedic knowledge, intellect, judgment, wisdom, integrity and enthusiastic willingness to help us all. He is irreplaceable.

So many of us, probably thousands through the decades, were taught by Mel and came to rely on him. He was our oracle—the real estate industry's finest sage, the final arbiter of the law. Mel's knowledge was Herculean; his mastery of real estate law, tax, the Lien Law, mortgages, title, title insurance, conveyancing, adverse possession, zoning, boundaries, land use—ah, well, everything real estate—was a force of nature of itself. He was brilliant in every way. His grace in sharing that knowledge with all of us was the gift he continued to give, with humor, humility and patience, until his very final days.

As it happens, I spoke with Mel two weeks ago to ask him a complicated question. Of course he knew the answer immediately. And, not surprisingly, he had addressed the topic in a scholarly article in the *New York Law Journal* almost ten years earlier. He even remembered the date of his article! I asked Mel if he still arrives at the office at 6:00 a.m. He said "No, 6:30 these days. I'm slowing down." (Don't we all recall that special and endearing voice mail message: "Monday morning, May 15, I'm away from my desk. Please leave a message and I will call you back. Because I am always here.")

Mel's work ethic was prodigious. Thus, it was his "duty" to go to work the day after 9/11, when all of us were cautioned to stay home. As fate would have it, the FBI called Commonwealth, inquiring about the surveys and maps for the World Trade Center (the deal had closed weeks earlier and Mel was lead title counsel). Mel answered the phone and delivered the documents himself, that afternoon.

Mel sat at the crossroads of law, title insurance and commerce and he counseled us on the largest and most important real estate transactions of the day. He found solutions that were creative, astute and practical. He changed the way we, everyday real estate practitioners, looked at the law. His answers were road maps. His advice was the solution and was accepted as such by generations of us. No question was either too complex or too pedestrian for him. He answered each and every question (for strangers and old friends alike) as if the question had been posed by his son, Jeff. Indeed, Mel treated and embraced the real estate community as his extended family. Each and every one of us, young or old, new to the community or not.

Mel surely was among the most popular and well-known real estate lawyers in New York, if not the country. Who among us will ever forget his presence at the REBNY dinners, in the hallway, outside Commonwealth's party suite, greeting us all with that fabulous smile, recognizing most of us by name—and in many cases by deal. The REBNY events were attended by thousands of real estate industry luminaries. Mel Mitzner towered above the crowd.

Mel also was a legendary force in the Real Property Law Section of the State Bar Association, in so many ways. A former past Chair, Mel was the leader of too many major task forces, projects, and industry-protective initiatives to recount. The Bar Association was a natural forum in which Mel's love and knowledge of the law could shine. He spearheaded significant and monumental legislation. He wrote model documents that are industry bibles. He embraced, promoted and inspired new Executive Committee members and Real Property Law Section members when he was Chair and after that. When Mel spoke at meetings (which, thankfully, was often), his words were pearls.

So many of us had the pleasure of listening to Mel's lectures on so many important and timely topics of the moment. Peering out at us from the podium, with that magnificent smile and that twinkle in his eye, he was always utterly brilliant, insightful, thoughtful and witty. Mel's mastery of his subject matter, overall legal knowledge, photographic recall of cases, statutes and citations and sheer intellect were impressive enough. Mix in that amazing wit and down-to-earth presentation style and you knew you were in the presence of greatness. The law was Mel's passion. Communicating it was his life.

Mel had a greater passion, still. His wonderful family. He was blessed indeed—and he said so often—by his remarkable wife of 49 years Roz, son Jeff (who has become an industry leader in his own right), daughter Elaine and his five beautiful granddaughters. His "little princesses." One recent remembrance sums it up: Last June Mel said he could not attend the Real Property Law Section summer meeting in July—the first time in memory he would miss the summer meeting. He explained the meeting conflicted with visiting days at his grandchildren's camps. He said life was short, time passed quickly and he could not miss the opportunity to be with his grandchildren as they were growing up. Afterwards, Mel said the trip to his grandchildren's camps was one of the great times of his life.

Our industry has lost its legend, its voice, its conscience and its mentor. We have lost a man for the ages.

We will all miss Mel, and everything about him, very, very much.

Richard S. Fries,

On behalf of The Real Property Law Section Executive Committee
October 22, 2010

What Is the Probable Effect of Defective Foreclosure Documents Under New York Law?

By Marvin N. Bagwell and Robert F. Bedford

One of the more tragic consequences of the ongoing financial crisis is the number of residential homes that have gone into foreclosure. Even worse, what is now coming to the fore is that many of the foreclosed-out homeowners may have lost their home due to defective documentation submitted to the courts.[1] Thus, the foreclosure of residential mortgages and the sale of properties recovered by lenders in foreclosure proceedings is a topic that has found itself thrust into the limelight, as well as under the microscope.[2] Everything from challenges to standing, to allegations of robo-signing, and assembly-line foreclosures have left many in the title insurance industry asking themselves, how do we assess the possibility that many of these homeowners may try to reclaim the titles to their home from the insured new homeowners and lenders?[3] Despite the tragedy experienced by foreclosed-out homeowners, for the reasons set forth below, it is our opinion that New York law offers substantial protection for REO (Real Estate Owned) purchasers out of foreclosure actions where some of the foreclosing lenders' documents may have been defective. Our analysis is based upon a fact situation where the foreclosed-out borrower is bringing suit and asking the Court to put him or her back into title and possession of the property because the foreclosing lender's documents allegedly are defective. The defects may have arisen from "robo-signing," unverified affidavits, defective notarizations, etc.

In New York, the most likely course of action for the returning borrower is to bring an action in fraud against the foreclosing lender, the new REO purchaser, and the purchaser's lender. It is possible that the borrower might also sue the title company which insured the new buyer and lender, but it is more likely that the title company would be brought in to defend the new borrower and lender. As a preface, note that New York is a judicial foreclosure state.

> *"In New York, the most likely course of action for the returning borrower is to bring an action in fraud against the foreclosing lender, the new REO purchaser, and the purchaser's lender."*

Difficulty in Pleading Fraud

The first hurdle that the returning borrower would have to overcome is the requirement of Civil Practice Law and Rules ("CPLR") Section 3016 which requires that: "Where a cause of action or defense is based upon misrepresentation, *fraud*, mistake, willful default, breach of trust or undue influence, the circumstances constituting the wrong *shall be stated in detail*." (emphasis added). Mere allegations, or purported fraud, and unsubstantiated statements are insufficient to support a fraud claim.[4] Therefore, to survive a summary judgment motion, the returning and foreclosed-out buyer cannot just say that a fraud occurred; the borrower must state in specific detail how, where and when the fraud occurred. This would mean that the returning borrower will be required to show the court, at a minimum, exactly which documents were defectively executed and their adverse impact upon the plaintiff—not an easy task.

Next, the returning borrower must show the court a "misrepresentation of material fact, intended to deceive [the borrower], which caused injury."[5] Although there are no cases on point in New York involving a title underwriter and mortgage fraud, it is fair to assume that a returning borrower must prove to the court that the "misrepresentation" (the defective documents) caused the borrower's injury. The loss of the borrower's home would be the conceivable injury, but there is case law in another area which suggests that the borrower would have to show that he or she could payoff the mortgage. Otherwise, the court might find that the injury was inevitable and no fault of the foreclosing lender. That law will be discussed shortly in the service of process section.

If the Plaintiff Successfully Pleads Fraud, Upon Whom Does the Loss Fall?

If the returning borrower makes it past a summary judgment motion regarding the alleged fraud, the blame for the fraud must be pinned upon one of the defending parties. In the typical case, presumably those parties would be the REO purchaser, the new REO lender, the foreclosing lender and possibly the title company that insured the new purchaser and lender. The courts have already decided upon whom the blame must fall.

In *Fidelity National Title Insurance Company of New York v. Consumer Home Mortgage,* Fidelity insured several new mortgages, but it was later discovered that the lender's counsel had stolen the pay-off funds from the old mortgages.[6] The lender, Consumer Home Mortgage ("Consumer"), brought suit against Fidelity and sought to recover its loss because Fidelity had insured the new mortgage. However, the court noted that the loss was caused by Consumer's attorney, who absconded with the funds;

in other words, Consumer's own agent was responsible for Consumer's loss. The Court stated the general rule that: "[W]here a loss is caused by the fraud of a third party, in determining the liability as between two innocent parties, the loss should fall on the one who enabled the fraud to occur."[7] Therefore, the loss fell upon Consumer. In the event a foreclosed borrower returned and tried to reclaim his or her former home, certainly the new REO purchaser, the new lender, and the new title insurer can claim to be innocent parties. They had nothing to do with and had no knowledge of the defective documents submitted by the foreclosing lender to the court in the foreclosure action. The only defendant left would therefore be the foreclosing lender. Based upon *Fidelity*, the title underwriter should be dismissed from the action and the loss should fall upon the foreclosing lender.

In the above discussion, the loss will fall upon the foreclosing lender by court ruling without any claimed pay-out by a title insurance underwriter. However, if the court rules that the title underwriter has liability and the underwriter is required to pay the claim, then under the subrogation clauses of the standard title policy[8] the underwriter would "be subrogated and entitled to the rights of the insured Claimant in the Title or insured Mortgage and all other rights and remedies in respect to the claim that the insured Claimant has against any person or property, to the extent of the amount of any loss, costs, attorneys' fee, and expenses paid by the Company." Therefore, as per the subrogation clause, the title underwriter could elect to step into the insured's shoes and bring suit against the Referee who conveyed title and more importantly, against the foreclosing lender to recover the underwriter's loss.

There would be two hurdles for the underwriter to overcome in that scenario. First, the Referee's deed is without warranties. The underwriter would have to find a way to go behind the Referee to the foreclosing lender. Second, the underwriter would have to make a management decision whether it would be good business to sue a lender client. The option, however, is there.

Will the Court Force the REO Purchasers From Their Home?

It is highly unlikely that the court will order the new REO purchasers to leave their home or void the new lender's mortgage. Even in the standing cases in which the New York courts have uniformly dismissed foreclosure actions when the foreclosing lenders have been unable to prove that the lenders actually owned the mortgage at the time the lenders commenced their foreclosure actions, the courts have never voided the mortgages. The courts have always dismissed the foreclosure actions without prejudice. The courts have only required that the lenders start new foreclosure actions once their paperwork is in order.[9] Therefore, in the name of "there is no free lunch," it is likely that the returning borrower's victory will be short-lived and the courts will permit the foreclosing lender to commence a new foreclosure action.

In fact, the courts have held that a good faith purchaser is entitled to retain the ownership of property conveyed by a Referee's deed. If the mortgage on which the REO sale was based is voided, the returning borrower is only entitled to monetary damages and not to possession of the property secured by the mortgage.[10] The returning borrower is unlikely to walk away with the title to the foreclosed-out home.

Statutes of Limitations: Appeals

Under CPLR Section 5513(b), the returning borrower has thirty (30) days from the date of service of the foreclosure judgment upon the borrower to appeal. However, that is only the beginning of the story. Generally, this applies only when the foreclosed owner has appeared in the action and is now appealing the determination made in the judgment of foreclosure and sale. Upon motion to the court, under CPLR 5513(b), foreclosed owners could request permission to appeal and state the basis for their request. Whether or not the court would grant such an appeal would depend on the court's interpretation of the facts of each action; however, a judgment of foreclosure and sale is final and is an adjudication of all the questions at issue between the parties.[11] Therefore, foreclosed owners would have to present a compelling reason that they would have been incapable of arguing during the initial action to justify the grant of an appeal.

The foreclosed owner could also move to vacate the judgment of foreclosure and sale. CPLR Section 5015 (a) provides that the court issuing the judgment or order may, upon motion, relieve a party from the judgment or order upon such terms as may be just, for the grounds of: fraud, misrepresentation, or other misconduct of an adverse party in section 3, or lack of jurisdiction in section 4. Both of these issues have appeared elsewhere in this article. There appears to be no statute of limitations as to when this motion can be brought, particularly under section 4. However, as stated previously, absent a showing that the homeowner can pay off the mortgage, it is unlikely that the court would grant a vacatur motion and the outcome would be for the lender to simply re-foreclose the title.

Statutes of Limitations: Fraud

There are two statutes of limitations governing when an action alleging fraud may be brought in New York. Under CPLR Sections 203(f) and 213(8), if a plaintiff alleges that the defendant committed actual fraud, then the statute of limitations is six (6) years from the date of the fraud, or two (2) years from discovery of the fraud, whichever is later. If the plaintiff alleges that the fraud was constructive, then the six year period runs from the date that the act or omission constituting the fraud occurred. Therefore, the outside period of which the possible defendants may have liability is six (6) years from the date of the fraud. If the documents submitted to the courts from defective foreclosures are dated between 2009 and 2010, the run-out period in New York would be 2015 or 2016. It could be argued that the frauds were discovered in 2010 when news reports started coming out, thereby giving the plaintiffs until 2012 to bring suit. However, such a position might be too aggressive for the courts to bear given that people have lost their homes.

Statute of Limitations: Lack of Personal Service

There is one additional statute of limitation which must be considered. Under CPLR Section 317, a person in any action who is not served by personal in-hand delivery and who does not appear in the action has one year from the date he or she learn of the judgment, but not more than five years from the date the judgment is entered, to move to vacate the judgment of foreclosure and sale, provided that person has a meritorious defense. In *Ameritek Construction Corporation v. Gas, Wash & Go, Inc.*, the court denied the taxpayer the right to re-open a tax sale because the taxpayer never attempted to tender the moneys due to the city.[12] New York title attorneys have always assumed, based upon *Ameritek* and the words "meritorious defense" in Section 317, that a returning borrower who was not served by personal in-hand service (which is the usual situation) would have to prove to the court that he or she can pay off the foreclosed mortgage before the court would re-open the foreclosure action. Although there is no case law in support, we believe that the courts will bring the "meritorious defense" requirement to fraud actions as well. Additionally, a lack of personal in-hand service is not absolute proof of lack of knowledge for the purposes of the motion. A factual showing that the foreclosed owner was aware of the action and judgment, and did not move to vacate within one year from that time, would probably be enough to defeat a motion of this nature.

"Barring, new, unexpected turns in the law, hope upon hope, this may not turn out to be the crisis that the title underwriters fear."

Conclusion

For the foregoing reasons, we do not believe that a suit to set aside a mortgage foreclosure action based upon the foreclosing lender's submitting defective instruments to the court will result in the REO purchaser losing his or her home. Title underwriters may have to defend one or two actions, and bear the defense cost of doing so, but if they lose, the most that will happen is that the court will force the foreclosing lender to re-foreclose the property. The longest possible time period for which underwriters would have liability ends in 2016 and depending upon when the court dates the fraud as occurring, the time period may end in 2012. Barring, new, unexpected turns in the law, hope upon hope, this may not turn out to be the crisis that the title underwriters fear. For foreclosing lenders and regretfully, for the many homeowners who have lost their homes, the results may not be as cheery.

Endnotes

1. Robbie Whelan, *Niche Lawyers Spawned Housing Fracas*, The Wall Street Journal, October 21, 2010, at 1.
2. *See, e.g.*, Gretchen Morgenson, *Flawed Paperwork Aggravates a Foreclosure Crisis*, N.Y. Times, October 3, 2010, at A1.
3. The media have picked up the title industry's concerns. *See* David Streitfield, *Bank of America to Freeze Foreclosure Cases*, *N.Y. Times*, October 2, 2010, at B1.
4. *Fargnoli v. Iacovelli*, 98 A.D.2d 880, 470 N.Y.S.2d 862 (3d Dep't 1983).
5. *Khoury v. Alger*, 174 A.D.2d 918, 571 N.Y.S.2d 829 (3d Dep't 1991).
6. *Fidelity Nat'l Title Insurance Co. of New York v. Consumer Home Mortgage*, 272 A.D.2d 512, 708 N.Y.S.2d 445 (2d Dep't 2000).
7. *Id. See also Greenpoint Mortgage Funding, Inc. v. Stewart Title Insurance Co.*, 49 A.D.3d 687, 854 N.Y.S.2d 185 (2d Dep't 2008).
8. Section 13(a) of the loan policy and Section 12(a) of the fee policy.
9. *Wells Fargo v. Marchione*, 69 A.D.3d 204, 887 N.Y.S.2d 615 (2d Dep't 2009).
10. *Aubrey Equities, Inc. v. Goldberg*, 247 A.D.2d 253, 668 N.YS.2d 598 (1st Dep't 1998).
11. *Cherico v. Bank of New York*, 211 A.D.2d 961, 621 N.Y.S.2d 235 (3d Dep't 1995).
12. *Ameritek Const. Corp. v. Gas, Wash & Go, Inc.*, 247 A.D.2d 418, 668 N.Y.S.2d 663 (2d Dep't 1998).

Marvin N. Bagwell and Robert F. Bedford are the Vice-President and Chief Counsel-New York and Associate Counsel, respectively, for Old Republic National Title Insurance Company based in New York City.

The Warranty of Habitability: An Unexpected Hazard in Foreclosure

By Adam Leitman Bailey and Dov Treiman

Most attorneys and nearly all educated tenants in this State are aware of the existence of the warranty of habitability.[1] Few may know that it is statutory in basis, fewer care that it contradicts the common law, but most would be surprised by the types of occupancy to which it does and does not apply.[2] Even more surprising to most would be the effect it has on the mortgage foreclosure process.[3] While none of these doctrines is exactly new, they are enjoying a newfound prominence in the popular and legal press because tenant advocacy groups are finding that the epidemic of foreclosure has brought with it a renewed pandemic of neglected housing.[4] Where a landlord has lost the ability to pay its mortgage, she fairly predictably stops doing repairs to the building.[5] If the tenants seek to have the building maintained, as through court proceedings, finding a funding source for the repairs can be challenging.[6]

Understanding the Cycle

In order to put the entire process in perspective, one must realize that neglect of repairs and inability to pay the mortgage are, in most buildings, a self-feeding cycle that virtually guarantees that the tenants will live in ever increasing squalor until the building itself is, of public necessity, torn down.[7] While facially a great benefit to tenants, the warranty of habitability, found in Real Property Law § 235-b, winds up working against tenants and for nobody once this cycle initiates.[8]

This is how it goes: the landlord, for whatever reason, starts neglecting repairs. This can be for any number of reasons. These can include, for example, that the landlord is simply unscrupulous and seeking to yank as much money out of the building as possible while spending as little of it as possible back on the building.[9] This was a fairly common model in the late 1970s and early 1980s and led to the devastation of square miles of the South Bronx. The Bronx was particularly vulnerable to this kind of practice due to a number of factors, notably including the construction of the Cross-Bronx Expressway in the 1960s that had destroyed huge swaths of middle class neighborhoods, rendering previously desirable housing undesirable by reason of the sudden presence of an interstate highway as a next door neighbor churning out vast amounts of dust and noise.[10] Similar but less severe results occurred in Brooklyn, when it was disturbed by the earlier construction of the Brooklyn-Queens Expressway.[11]

However, eventually the scars on neighborhoods caused by these mega-highways healed and these neighborhoods, especially those well served by the subway system, became once again desirable places to live and therefore desirable places to invest.[12] That, however, was the setup for the current wave of neglect. The very desirability of these locations drove the prices of the buildings very high, especially as it appeared increasingly easy to build either a cooperative, a condominium, or even a rent-regulated building with the tax breaks associated with the J-51 program.[13]

However, when the financial systems melted down in 2008, there suddenly appeared on the market a glut of overpriced, over-mortgaged buildings, all with negative equity.[14] Even unregulated buildings became unable to carry their own mortgages because the tenants themselves lacked the funds to pay the higher rents.[15] And in regulated buildings, so-called "preferential rents" where a landlord charges significantly less than the law allows, came very much into vogue.[16]

So the landlords found themselves simply unable to pay for repairs to the building, particularly because the building was carrying a mortgage inflated far beyond the building's recession-adjusted equity.[17] Once the landlord started neglecting repairs, tenants, correctly so, started claiming entitlement to an abatement in rent for breach of the warranty of habitability. Since they were right, this meant that the landlord got still less rent and still less ability to effect repairs.[18] He certainly could not fund the repairs by borrowing more on the building—it was already over-mortgaged. So the neglect of repair became more severe, leading to still lower rents, and so on.[19]

Foreclosure became inevitable.

Dangers from Receivers

Now, with income-producing property, one of the most usual early steps in the foreclosure is the appointment of a receiver to take in the income of the property and to disburse it for the purpose of the preservation of the property so it will bring as high a price as possible at the auction that lies near the end of the foreclosure process.[20] Yet, one decision, *Fourth Federal Savings Bank v. 32-22 Owners Corp.*, lies like an alligator under the surface of a pond waiting to snap its jaws at any passing prey.[21] Under *Fourth Federal*, if a receiver seeks to collect rent where there has been a violation of the warranty of habitability, not only is the receiver's claim for rent defeated, but the tenant can procure an order from the receiver's appointing court that the foreclosing party pour more money into the building to effect the repairs required by the warranty and, of course, also required by the various municipal codes. So long as the foreclosing party does not move for such a receiver, there is no case imposing that kind of washback liability. While this could theoretically discourage the bringing of foreclosure actions in the first place, for foreclosure counsel it should certainly make them think twice about moving for the appointment of a receiver.[22]

Limits of the Warranty

While this outcome is supposed to be tenant friendly, consider how tenant hostile it is in actual practice. If there is a receiver, the receiver is as liable on the warranty of habitability as anyone else. If, on the other hand, the tenants start a rent strike under Article 7A of the Real Property Actions and Proceedings Law, the Administrator appointed by the Civil Court is also equally subject to the warranty of habitability.[23] Even if the building is sold for taxes and the building comes under New York City ownership, the City is still bound to the same rigors of the warranty of habitability.[24] Even if after the building is sold for taxes, the City sponsors a cooperative apartment corporation and returns the building to private ownership, it does not help the tenants any.[25] Cooperative apartment corporations are also bound by the warranty of habitability,[26] even as to the common areas.[27] While condominium units are not directly subject to the warranty of habitability, when the City re-privatizes a building, it is always in the form of a cooperative, never a condominium.[28]

Unconventional Wash-Back Liability

In all the scenarios we have discussed, there is no question that the tenant is a tenant; rather it is the "landlord" who may be somewhat difficult to recognize as such. To this is the sole exception of a condominium owner who is no species of tenant at all, but rather the owner of a dwelling in fee simple absolute, the vertical equivalent of owning a one family home.[29] Yet even for these owners, the warranty of habitability can become an issue, though not running in favor of the unit owner, but rather against such owner. That is to say that when a unit owner rents out the unit to what we would normally be inclined to call a "subtenant" but who is in fact a tenant, the unit owner takes on the landlord side of the warranty of habitability, being the warrantor, rather than the warrantee.[30] The situation is somewhat different in a co-op, however. There, the unit owner normally is a tenant.[31] If, however, that tenant rents the place out to a subtenant, the unit owner, being out of possession, has no claim to the warranty of habitability,[32] but rather is responsible for the warranty to the subtenant.[33] The unit owner bears the liability to the subletting occupant; the co-op itself has no such liability.[34]

When we look at all of this through the lens of wash-back liability under *Fourth Federal*, we see that in conventional landlord-tenant buildings, the foreclosing bank may want to think twice before appointing a receiver. In a foreclosure on a cooperative apartment house, the same holds. In foreclosing on an individual cooperative unit, the procedure does not call for a receiver, so there is no issue. In foreclosing on a condominium, the only wash-back liability issues could come from persons to whom the individual unit owners have rented their units.

Other Sources of Liability

Of course, when looking at the questions of repairs to a building, the warranty of habitability only speaks to contract liability. One therefore should not ignore the questions of tort liability, specifically what happens if someone gets hurt by the shoddy condition of the building. The answer to this question has always lain not purely in terms of who owns the building, but also in terms of who controls the building.[35] So, when a mortgagee brings a foreclosure proceeding against the mortgagor, if there is no appointment of a receiver, tort liability remains that of the mortgagor alone up until the very moment the title to the building passes by the execution of the deed as a result of the foreclosure auction.[36] Further, there is no responsibility on the part of an out-of-possession mortgagee (foreclosure plaintiff) to comply with state and local building or housing codes or to make any other repairs.[37] However, any receiver would have such liability both with respect to complying with building and housing codes and in tort if someone is injured.[38]

Mortgagees in Possession

Many older mortgages and some new ones allow for the mortgagee to short circuit the receiver process and step directly into possession. However, this gives the mortgagee the worst of both worlds. First, it makes the mortgagee totally personally liable to its last penny for anything in the building, warranty of habitability, building codes, injuries, anything.[39] Secondly, it places the building in a legal position where nobody has the statutory authority to bring a summary proceeding for unpaid rent.[40]

Conclusion

It is easy in all the situations we have discussed to look for villains. Yet there is nothing villainous about an honest tenant wanting decent housing, nothing villainous about a bank wanting its mortgage repaid, nothing villainous about an honest businessperson simply not being able to make a go of it. So without anyone to blame, there is nobody to point to as the logical one to have to pay for the damage. Several decisions have hinted that the only possible solution lies in legislation, but since there is no government feeling particularly flush at the moment, whatever the legislative solution would be, it can only reallocate the pain.

Endnotes

1. N.Y. Real Prop. Law § 235-b (McKinney 2010) (indicating the types of leases in New York in which a warranty of habitability shall be implied).

2. *Id. See* 7 William X. Weed, Warren's Weed New York Real Property § 82-22(3)(A) (5th ed. Matthew Bender 2010) (indicating that the New York legislature codified the warranty of habitability in 1975 to provide a distinct mechanism to enforce tenants' rights for the purpose of ensuring decent and adequate housing); 2 Robert F. Dolan, Rasch's Landlord & Tenant: Including Summary Proceedings § 18.6 (4th ed. West 1998) (stating that the traditional common law rule, that "no implied warranty that leased property is fit for occupation or is suitable for its intended use," is being reexamined, and subsequently discarded in a growing number of courts). Courts have applied the statutory warranty of habitability to cooperatives, city-owned buildings, administrators appointed under Article 7-A of the Real Property Actions and Proceedings Law (Rent Strike Proceedings), receivers in foreclosure proceedings, and rent-controlled and rent-stabilized buildings, but have not applied it to condominiums or commercial leases. *Id.*

3. *See* N.Y. Real Prop. Acts Law ("RPAPL") § 1325(3)(b) (McKinney 2009) (requiring that a receiver of a multiple dwelling building in a city of one million persons or more must give priority, over the mortgage obligation, to the correction of immediately hazardous or hazardous violations of housing maintenance law); N.Y. Gen. Oblig. Law § 9-101 (McKinney 2010) (stating that receiver "shall be liable, in his official capacity, for injury to person or property sustained by reason of conditions on the premises, in a case where the owner would have been liable"); *see also* Bruce J. Bergman, Bergman on New York Mortgage Foreclosure § 10.15 (LEXIS through 2010) (stating that the responsibility for maintenance is transferred by court order during a foreclosure to a receiver, and a receiver is legally bound to keep the premises in good repair or be liable for damages should that duty be breached).

4. *See* Press Release, New York City Council Speaker Christine Quinn & Council Member Annabel Palma, Housing Advocates and Tenants Announce New Citywide Distressed Housing Program (Sep. 23, 2010), http://council.nyc.gov/html/releases/09_23_10_milbankrpt.shtml (announcing a new citywide housing program that will help tenants living in overleveraged buildings that are dangerous and in utter disrepair); *see also* Sam Dolnick, *Bid to Make Banks Fix Crumbling Bronx Properties*, N.Y. Times, April 21, 2010, at A20.

5. *E.g.*, Manny Fernandez & Jennifer 8. Lee, *Struggling Landlords Leaving Repairs Undone*, N.Y. Times, July 15, 2009, at A21; Cara Buckley, *Rescued From Blight, Falling Back into Decay*, N.Y. Times, July 19, 2010, at A15.

6. *See* 103rd Funding Assocs. v. Salinas Realty Corp., 276 A.D.2d 340, 341, 714 N.Y.S.2d 47, 49 (1st Dep't 2000) (finding, in a residential mortgage foreclosure action, that it was appropriate to approve the receiver's application for a loan of up to $100,000 and to order the receiver to use these funds for repairs and improvements and to correct housing code violations as soon as practicable); Gomez v. S. Williamsburg Better Hous. Corp., 129 Misc. 2d 542, 543, 493 N.Y.S.2d 419, 420 (N.Y. Civ. Ct. N.Y. County 1985) (discussing whether or not it made sense for HPD to provide a loan, especially after emergency repair funds had been provided, given the outrageous conditions present in the building).

7. *See generally* David Reiss, *Housing Abandonment and New York City's Response*, 22 N.Y.U. Rev. L & Soc. Change 783, 786 (1997) ("Private Sector Housing follows a simple rule: to remain as decent, well-maintained private housing, buildings must have a cash flow sufficient to maintain viability…. The landlord may decide a few years in advance to abandon a building, after evaluating whether it could be more profitably sold, demolished or reused. Once the decision is made, the landlord will stop paying property taxes, reducing operating expenses by roughly one-third. Closer to the expected abandonment date, the landlord will stop maintenance altogether, reducing costs by another one-third.").

8. *Compare* RPAPL § 713(5) (McKinney 2010) (stating that a summary proceeding to recover possession can be maintained, after the requisite notice properly served, because there is no landlord-tenant relationship if a property has been sold in foreclosure) *with id.* § 1305 (codifying an extended notice period and also granting protection for tenants in foreclosed residential property). *See generally* Dan M. Blumenthal, *Comparing New State and Federal Laws Designed to Protect Residential Tenants Against Immediate Eviction from Foreclosed Properties*, 38 N.Y. Real Prop. L.J. 2 (2010) (discussing the recently enacted RPAPL § 1305 and its impact on New York mortgage foreclosure actions).

9. *See* Reiss, *supra* note 7 (positing that the decision to abandon is often carefully calculated by a landlord who wants to maximize profits); *see also* Joseph P. Fried, *Housing Abandonment Spreads in Bronx and Parts of Brooklyn*, N.Y. Times, April 26, 1976, at A1 (discussing the abandonment of property generally, but also highlighting how tenant advocates believe many owners keep maintenance to the barest minimum and "milk" buildings for maximum profit).

10. *See* Jim Rooney, Organizing the South Bronx (1995).

11. *See Brooklyn-Queens Expressway: Historic Overview*, Eastern Roads.com, http://www.nycroads.com/roads/brooklyn-queens (last visited Oct. 17, 2010).

12. *See* Editorial, *A Bronx Miracle*, N.Y. Times, http://www.nytimes.com/1995/03/12/opinion/a-bronx-miracle.html?scp=1&sq=bronx%20miracle&st=cse (last visited Oct. 17, 2010); Hugh Son, *Once Blue Collar, Now Exclusive Carroll Gardens' Rise Tough on Old-Timers*, New York Daily News, June 2, 2002, at 6.

13. The J-51 Tax Exemption/Tax Abatement program is authorized by Section 489 of the New York State Real Property Tax Law and Section 11-243 of the New York City Administrative Code. *See* N.Y. Real Prop. Tax § 489 (LEXIS through 2010); N.Y. Admin Code tit. 11, ch. 2, subch. 2, § 11-243 (LEXIS through 2009).

14. *See* James Doran, *U.S. Properties Plunge into Negative Equity*, The Observer (London), Feb. 24, 2008, at 8, *available at* http://www.guardian.co.uk/business/2008/feb/24/useconomy.property (stating that 10.3 percent of U.S. homeowners now owe more on their mortgages than their house is worth as inventories of unsold homes continue to pile up in an already over-supplied market); *see also* David Streitfeld, *A Town in Debt as Home Values Plunge*, N.Y. Times, Nov. 11, 2008, at A1, *available at* http://www.nytimes.com/2008/11/11/business/11home.html?pagewanted=1&_r=1 (stating that First American CoreLogic, a real estate data company, estimates that nearly a quarter of all American home owners with mortgages owe more on their mortgages than their properties are worth, or are close to owing more than they are worth).

15. *See* Penelope Parmes, *Banking, Building, and Business: The Victims of Bankruptcy In 2009 and 2010, in* Bankruptcy And Financial Restructuring Law 2010 Top Lawyers On Trends And Key Strategies For The Upcoming Year 109 (Thompson Reuters/Aspatore, 2010) (describing the cycle of foreclosure, resale, and refinancing stemming from a distressed rental market in which renters cannot afford their rent, leaving landlords without a financeable business).

16. *See id.* (stating the housing market has shown a huge flattening out of rental rates plus huge rent concessions); *see also* Amanda Fung, *In Major Reversal, Apartment Vacancies Rise*, Crain's N.Y. Business.com (Sept. 14, 2010), http://www.crainsnewyork.com/article/20100914/REAL_ESTATE/100919936 (stating that in December of 2009, roughly sixty percent of apartments rented by New York City's largest rental brokerage included concessions).

17. In 2009 the Commissioner of the Department of Housing Preservation and Development testified before a New York City Council committee that a

"small but significant portion of recently purchased multi-family buildings are likely overleveraged," meaning their rent does not generate enough income to repay the debt. *See* William Spirer, Note & Comment, *Roberts v. Tishman Speyer Properties: A Source of False Hope for Low-Income Victims of Predatory Equity*, 18 J.L. & POL'Y 855, 864 (2010) (citing Manny Fernandez and Jennifer Lee, *Struggling Landlords Leaving Repairs Undone*, N.Y. TIMES, Jul. 15, 2009, at A21, *available at* http://www.nytimes.com/2009/07/15/nyregion/15buildings.html (reporting on the trend of small and large apartment buildings being abandoned in a state of disrepair due to landlords who purchased apartment buildings when the real estate market was at its peak, but are now struggling to make mortgage payments)).

18. *See, e.g.*, Javins v. First Nat'l Real Estate Corp., 428 F.2d 1071, 1072–73, 138 U.S. App. D.C. 369, 1970 U.S. App. LEXIS 9377, *1–2, (D.C. Cir. 1970) (holding a warranty of habitability is implied by operation of law into leases, beginning a long history of case law that has since clarified and affirmed tenants' implied warranty of habitability).

19. *See* Duncan Kennedy, *The Effect of The Warranty of Habitability on Low Income Housing: "Milking" and Class Violence*, 15 FLA. ST. U.L. REV. 485, 489, 509–10 (1987) (describing the slumlord practice of "milking" where a landlord treats his property like a wasting rather than renewable asset, understanding that he will soon be out of business, and mitigates his losses by collecting rent as long as possible before abandoning the building; this practice can be motivated by negative equity on a mortgage).

20. *See* Lawrence K. Marks, *Court-Appointed Fiduciaries: New York's Efforts to Reform a Widely-Criticized Process*, 77 ST. JOHN'S L. REV. 29, 29 (2003) (noting New York courts have a long tradition of appointing receivers in foreclosure actions to manage the property while litigation is pending).

21. 236 A.D.2d 300, 653 N.Y.S.2d 588 (1st Dep't 1997).

22. *See id.* at 301–02, 653 N.Y.S.2d at 589–591.

23. *See* Bankers Fed. Savs., FSB v. 247 W. 11th St. Owners Corp., N.Y.L.J., June 5, 1991, at 22, col. 6 (Sup. Ct. New York County); *see also* Dep't of Hous. Pres. and Dev. of the City of N.Y. v. Sartor, 109 A.D.2d 665, 665–66, 487 N.Y.S.2d 1, 1–2, 1985 N.Y. App. Div. LEXIS 47147, *2–5 (1st Dep't 1985).

24. *See Sartor*, 109 A.D.2d at 666, 487 N.Y.S.2d at 2, 1985 N.Y. App. Div. LEXIS 47147 at 3 (citing City of N.Y. v. Rodriguez, 461 N.Y.S.2d 149, 151, 117 Misc. 2d 986, 988–89, 1983 N.Y. Misc. LEXIS 3242, *6–8 (Sup. Ct. App. T. 1st Dep't 1983)); City of N.Y. v. Jones, N.Y.L.J., May 4, 1992, at 24, col. 5 (App. T. 2nd and 11th Jud. Dists.) (holding that warranty of habitability can be asserted against New York City as against any other landlord).

25. *See* 31171 Owners Corp. v. Thach, N.Y.L.J., Apr. 21, 1993, at 21, col. 2 (Sup. Ct. App. T. 1st Dep't); Granirer v. The Bakery, Inc., 54 A.D.3d 269, 270, 863 N.Y.S.2d 396, 398 (1st Dep't 2008).

26. *See Granirer* at 271, 863 N.Y.S.2d at 399.

27. 2121 Shore Condo. Bd. of Managers v. Pennachio, N.Y.L.J., Oct. 4, 1991, at 25, col. 3 (App. T. 2nd and 11th Jud. Dists.).

28. *See generally Neighborhood Entrepreneurs Program; Renovating Bronx Homes*, N.Y. TIMES, November 26, 2000, at 11, *available at* http://www.nytimes.com/2000/11/26/realestate/postings-neighborhood-entrepreneurs-program-renovating-bronx-homes.html (noting the existence of a program which returns city properties to private ownership).

29. *See* Michael L. Utz, *Common Interest Ownership in Pennsylvania: An Examination of Statutory Reform and Implications for Practitioners*, 37 DUQ. L. REV. 465, 467 (1999) (explaining that an owner of condominium owns a fee simple interest in an individual condominium unit); *see also* WEED, *supra* note 2, § 33.02 (noting that owners of condominiums obtain a fee simple ownership in their property the same as homeowners do).

30. *See* Itskov v. Rosenblum, 7 Misc. 3d 135A, 135A, 801 N.Y.S.2d 235, (Table), 2005 NY Slip Op 50764U, *1 (Sup. Ct. App. T. 1st Dep't 2005) (explaining that a subtenant has a cause of action for breach of warranty of habitability against the unit owner of the condominium).

31. *See* WEED, *supra* note 2, § 33.27 (providing other restrictions to subletting such as maximum numbers of years that a tenant may sublet and a percentage of rent that a board may charge the owner for subletting).

32. *See* Park South Tenants Corp. v. Chapman, N.Y.L.J., Aug. 26, 1991, at 24, col. 2 (Sup. Ct. App. T. 1st Dep't) (holding that the warranty of habitability does not apply where the proprietary lessee does not reside on the premises); Clinton Hill Apt. Owners v. Gooden, N.Y.L.J., Jun. 26, 1992, at 24, col. 6 (Sup. Ct. App. T. 2d Dep't) (holding that an award for breach of habitability does not apply to a lease holder who was not in possession as a tenant during the time in question); 142 E. 16 Co-op Owners, Inc. v. Jacobson, N.Y.L.J., Jun. 5, 1998, at 29, col. 3 (Sup. Ct. App. T. 1st Dep't) (holding that a tenant cannot rely on a breach of warranty of habitability claim when he has not resided on the premises of a co-op apartment).

33. *See* Pickman Realty Corp. v. Hess, N.Y.L.J., Jun. 22, 1993, at 27, col. 4 (App. T. 2nd and 11th Jud. Dists.) (explaining that when a tenant as the unit owner sublets a co-op premises, he is responsible for a breach of warranty of habitability claim by the subtenant).

34. *See* Wright v. Catcendix Corp., 248 A.D.2d 186, 186, 670 N.Y.S.2d 15, 16 (1st Dep't 1998) (explaining that subtenants have no cause of action against the cooperative corporation for breach of warranty of habitability, but they do have a cause of action against the sublessor); *see also* McCarthy v. Bd. of Managers of Bromley Condo., 271 A.D.2d 247, 247, 706 N.Y.S.2d 104, 105 (1st Dep't 2000) (explaining that condominium corporation owes no warranty of habitability to subtenant).

35. *See* Mortimer v. East Side Savings Bank, 251 A.D. 97, 98–100, 295 N.Y.S. 695, 697–98 (4th Dep't 1937) (explaining that when the bank took possession from mortgagor, the bank became a mortgagee in possession; and under such title, the bank was liable for the hotel guest's injury that resulted due to an unsafe condition on the premises).

36. *See* Forbes v. Aaron, 27 Misc. 3d 719, 720–21, 897 N.Y.S.2d 849, 849–50, 2010 N.Y. Slip Op. 20087, *1–2 (Sup. Ct. Kings County 2010) (explaining that a mortgagor assumes tort liability until a foreclosure sale is completed; in other words, until the property passes to the other party through the execution of a deed).

37. *See* Greenpoint Bank v. John, 256 A.D.2d 548, 548, 682 N.Y.S.2d 438, 439 (2d Dep't 1998) (explaining that a mortgagee out of possession is not an owner for the purposes of Multiple Dwelling Law § 4 (44)); *see also* 207 Realty Ass'n, LLC v. N.Y. State Div. of Hous. and Cmty. Renewal, 45 A.D.3d 364, 365, 845 N.Y.S.2d 285, 286 (1st Dep't 2007) (explaining that a mortgagee out of possession is not responsible for any repairs).

38. N.Y. MULT. DWELL. LAW § 4 (44) (2010) (casting tort liability on an "owner or owners of the freehold of the premises or lesser estate therein, a mortgagee or vendee in possession, assignee of rents, receiver, executor, trustee, lessee, agent, or any other person, firm or corporation, directly or indirectly in control of a dwelling" for failure to effect repairs).

39. *See* Grant S. Nelson & Dale A. Whitman, *Performing Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1435–36 (2004) (explaining that if a mortgagee remains in possession she assumes an extensive list of liabilities).

40. *See* Singer v. Bermudez, 117 Misc. 2d 708, 710–11, 458 N.Y.S.2d 1018, 1019–20, 1983 N.Y. Misc. LEXIS 3206, *5–7 (N.Y. Civ. Ct. N.Y. County 1983).

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Underwater Underwriting: Title Insurance in the Post-Lehman Era

By S.H. Spencer Compton

From the advent of real estate finance securitization in the early 1980's, through its rise and subsequent crash in 2007, the title insurance industry has grown from an approximately $1.404 billion per year industry in 1980 to, at its peak in 2005, an approximately $17.768 billion per year industry.[1] The single company model, selling only the pre 1980's real estate title guarantee / insurance product, has grown to a parent company owning a bundle of subsidiary companies selling specialized financial services and information as well as a variety of personal property insurance products for such things as watercraft, aircraft and registered securities.[2] Some parent companies of title insurance companies even own their own banks. This profitable expansion of business lines has been accompanied by broader and increasingly sophisticated management and underwriting expertise. By the early 2000's, title insurance companies, long the quiet cousin to the large property / casualty insurance companies, had come into their own, arguably fueled by the massive amounts of money pumped into real estate by Wall Street securitizations.

In my opinion, during the boom years leading up to the real estate crash, government regulators, lending institutions, appraisers and ratings agencies, loosened their risk management criteria or relaxed their standards of ethical business conduct. The title insurance industry did not.[3] That said, as in every period of economic decline, there was an increase in embezzlements by title insurance agents and even a bankruptcy filing by the holding company of one of the largest title insurers arising out of the misuse and loss of funds entrusted to its 1031 Exchange division. Nonetheless, the crucible of trust created by the due diligence and subsequent issuance of title insurance products backed by the deep reserves of Fortune 500 insurance companies remains unbroken and largely unblemished.

So how has the title insurance industry been affected by the 2008 / 2009 financial meltdown? Have our business practices changed? What trends are we seeing in the marketplace?

Claims Paid

In 2003, total title industry claims paid were approximately $558,000,000.[4] In 2008, total title industry claims paid were approximately $1,068,700,000.[5] The rule of thumb among claims counsel is that as premiums rise so claims follow. History has shown that when real estate values descend, many more claims are brought, some legitimate, some not. Additionally, instances of fraud increase and claims arise from that. In response, title insurance underwriters continually examine the sources of claims, and where lax underwriting was the cause, more stringent review standards are imposed or, in the case of title insurance agents with abnormally high claims rates, those agents are dropped. In 2009, this process was in high gear industry-wide.

The 2006 ALTA Owner's and Loan Policies; Elimination of Creditors' Rights Coverage

At near the historical height of the real estate market, the New York State Insurance Department approved the 2006 ALTA Owner's Policy and the 2006 ALTA Loan Policy, as amended by revised forms of standard endorsements, effective May 1, 2007. In addition to providing increased clarity over the 1992 Policy forms, these new policies afforded expanded coverage in the following ways:

The amount of insurance will increase by 10 percent if the insurer pursues its rights to defend a claim and is unsuccessful in establishing the title or the lien of the insured mortgage, as insured.

The definition of "insured" has been expanded to allow for the continuation of policy coverage as of the original policy date for the benefit of, for example, a successor to the insured "by dissolution, merger, consolidation, distribution or reorganization" and the grantee of the insured which is wholly owned by the insured or by an affiliate of the insured. The 2006 ALTA Loan Policy similarly extends the benefits of the policy to other persons or entities.

The co-insurance and apportionment provisions of the 1992 ALTA Owner's Policy, which provided for the insured to become a co-insurer in the event of a loss under certain circumstances and the manner in which a loss would be apportioned if more than one parcel was insured under one Owner's Policy, are not included in the 2006 ALTA Owner's Policy.

The definition of "indebtedness" in the 2006 ALTA Loan Policy includes as compensable items the amount of principal disbursed subsequent to the policy date, prepayment premiums, exit fees, and other similar fees or penalties allowed by law, and amounts expended by the insured lender to pay taxes and insurance.

The title insurance industry considered these expansions of coverage to be consumer-friendly improvements over the 1992 Policy forms. However, as the real estate market deteriorated, a more troubling issue surfaced: When title insurance companies compete with each other to secure business through aggressive underwriting, it is often a race to the bottom.

Until early 2010, ALTA and the California Land Title Association (CLTA) have promulgated endorsements offered in many jurisdictions, but not in the State of New York, usually for an additional premium, for what has been known as "creditors' rights" coverage. Generally, creditors' rights coverage insured against a challenge to the insured transaction vesting title. With respect to a Loan Policy, it covered the transaction creating the lien of the Insured Mortgage, on the basis of the fraudulent transfer or fraudulent conveyance provisions under federal bankruptcy or applicable state law or the preferential transfer provisions under federal bankruptcy law.

Unlike traditional title insurance coverage, which is based primarily on an evaluation of legal risk, creditors' rights coverage in many instances is based primarily on an evaluation of financial risk—an evaluation title underwriters have never been comfortable making. Nonetheless, the marketplace has required it, and—under the theory that "if we won't issue it, our competitors will,"—title insurers have reluctantly issued creditors' rights coverage.

In 2009, as a reaction to the enforcement of a multimillion-dollar claim against a major title insurance underwriter arising out of a creditors' rights endorsement, title companies severely restricted this coverage, requiring financial statements, property appraisals, and stricter underwriting review, as well as significantly increased premiums. Effective March 8, 2010, ALTA voted to withdraw/decertify the ALTA Creditors' Rights Endorsement 21/21-06 as an official ALTA Form. On February 4, 2010, CLTA voted to decertify the corresponding CLTA Endorsement 131/131-06. The Fidelity National Title Group underwriters (which include Chicago Title, Fidelity National Title, Ticor Title, Lawyers Title, LandAmerica and Commonwealth Land Title) subsequently issued bulletins advising that they will no longer issue creditors' rights coverage. First American Title Insurance Company, Old Republic National Title Insurance Company, and Stewart Title also decided to no longer issue creditors' rights coverage. The practice of issuing creditors' rights coverage has ceased.

Limited creditors' rights coverage is still available in most jurisdictions under the ALTA 2006 Form. This insures against challenges arising out of a prior transfer constituting a fraudulent or preferential transfer, but does not apply to the transaction creating the lien of the Insured Mortgage or vesting title in the insured, with respect to an owner's policy. Furthermore, these recent ALTA and CLTA decertifications do not affect creditors' rights coverage under previously issued title insurance policies.

Today, purchasers, lenders and their counsel should be diligent in their transactions to root out fraudulent or preferential conveyance issues. The period under federal bankruptcy law for unwinding a transaction can be as long as two years, and some states' fraudulent conveyance statutes set no time limit for certain types of fraudulent conveyance. Creditors' rights coverage can no longer be a hedge against insufficient due diligence, lax underwriting or careless structuring of transactions.

Creative Underwriting

The trend away from market-driven risk-taking has in certain instances been counterbalanced by a greater willingness to expend underwriting resources to understand and creatively address client needs. For example, First American Title Insurance Company of New York (First American) was recently approached by a major developer, with whom it had not previously done business, for assistance with a transaction that seemed to have hit a dead end. The developer previously had entered into a financing agreement with an institutional lender in order to construct a new project on a parcel adjacent to the developer's existing project. Construction proceeded until, in 2008, due to the financial meltdown, the lender declared the developer to be in default under the financing agreement due to certain financial covenant breaches. When the lender ceased funding, the developer stopped paying its contractors and materialmen and ultimately many millions of dollars in mechanics' liens were filed. Litigation between the developer and the lender ensued with the lender seeking to foreclose its lien and the developer counterclaiming for lender liability. After over a year of negotiations, a settlement was near, but the designated title insurer was unwilling to accept the personal guaranties of the developer and its principals together with a modest escrow fund to insure over the mechanics' and materialmen's liens. With the assistance of the developer, First American was able to review the mechanics' and materialmen's liens and determine that a sufficient quantity of them were either duplicative and/or erroneously filed against the existing parcel only, and not against the expansion parcel where the work was actually performed or the materials actually supplied. Based on this analysis, and with a few additional provisions in the escrow and indemnity agreements, First American was able to work with the proposed collateral package and co-insure the loan modification transaction.

Protecting UCC Insurance Coverage When Restructuring Mezzanine Loan Portfolios

It was not uncommon in 2006 and 2007 to find multi-level mezzanine loans on major commercial real estate deals. There could be just a junior and a senior mezzanine loan, but in some cases there were as many as ten tranches. Reflecting the current economic climate, we are now seeing a restructuring of many of those deals.

With few exceptions, UCC Insurance was utilized on the mezzanine deals of that time. Most of the pledged equities fell under Article 8 of the UCC. They were perfected by control which was in most cases represented by the possession of the certificated interest. Coverage under the UCC Insurance policies fell under the Mezzanine Endorsements describing the equity and the possession. We are now seeing restructuring of those transactions as these loans come due. It is important to remember that the UCC insurance coverage was loan specific. As a loan is terminated for any reason, the coverage and the policy for the pledged equity are terminated as well.

A recent multilevel mezzanine transaction consolidated as many as seven levels of pledged equities into one. The original seven loans were satisfied with a new loan and pledge containing all of the equities in all seven loans. The issues raised included how to continue the coverage of the policies which are no longer in existence. In order to maintain coverage, the UCC insurer needed to create a new policy. While there was no new money and this was not a refinancing, it was a new loan. The new policy would indicate all of the pledged equities and the current lender, an assignee of the original lender, would be listed as holding the considerable number of certificates.

Another area of concern was the tracking of the original certificates from the original policies to the new policy in order to maintain the perfection of the liens. A loss of any one certificate creates a considerable problem for the secured party. The certificates are negotiable instruments endorsed in blank at the time of the closing. A lost certificate sold to a party who can be classified as a protected purchaser under the Uniform Commercial Code would prime any subsequent holder of a new certificate. In order to obtain coverage for a lost certificate under a UCC policy, the provisions of the code are required which include bonding or indemnification. Neither is cheap and readily available.

In restructured deals, counsels may not be aware that they need to obtain new coverage for loans terminated and consolidated. Today, UCC insurers are seeing more and more transactions "reinventing" what was done in years past. Furthermore, in the second quarter of 2010, we have seen new mezzanine transactions including several in the $100 million dollar range.

Conclusion

Like drunks facing their families after an all-night bender, Wall Street and its related service industries await new government regulations, and pledge that, going forward, transactions will be transparent and simple. Financial ads portray bad bankers and brokers being shamed by a new breed of honest lenders and advisors. But as the economic cycle grinds on, the real estate markets are reviving. Slowly, incrementally, lenders are working bad loans off their books. The title insurance industry, which has endured two years of consolidation and streamlining (read layoffs), has become sporadically occupied as all-cash foreign buyers acquire U.S. properties at bargain prices and lenders selectively cease "pretending and extending" and force loans to refinance on realistic terms. Today's deed-in-lieu transactions present unique underwriting challenges. The sellers are financially weak, thus diluting the power of their representations and indemnities. The lenders are not wiping out subordinate liens, because they are not foreclosing. To paraphrase Rahm Emmanuel, the financial crisis has not been wasted in the title insurance industry. Coverages have been expanded, systems and processes have been streamlined—we now do more with less—and certain market-driven risk-taking, such as creditors' rights coverage, has been eliminated.

Endnotes

1. Phone Conversation with Representative, American Land Title Association (ALTA) (2010).
2. Recently, these parent holding companies have been spinning off their title insurance subsidiaries. On October 24, 2006, all of the common stock of Fidelity National Title Group, Inc. was distributed to the shareholders of Fidelity National Financial, Inc. On June 1, 2010, First American Financial Corporation and CoreLogic, Inc. separated into two independent publicly traded companies. *See Fidelity National Title Group, Inc. Reports Third Quarter 2006 EPS of $.060* (Oct. 25, 2006), http://www.investor.fnf.com/releasedetail.cfm?ReleaseID=215972&COMPID=FNT; *First American Financial Corporation And CoreLogic, Inc. Announce Completion of Spin-Off Transaction*, (June 1, 2010), http://www.firstam.com/news/2010/11334.html.
3. Note that the Attorney General of the State of New York has brought a suit against First American Corporation and First American EAPPRAISEIT which litigation is ongoing. *See NY Attorney General Sues First American and its Subsidiary for Conspiring with Washington Mutual to Inflate Real Estate Appraisals*, (Nov. 1, 2007), http://www.ag.ny.gov/media_center/2007/nov/nov1a_07.html.
4. Phone Conversation with Representative, American Land Title Association (ALTA) (2010).
5. Phone Conversation with Representative, American Land Title Association (ALTA) (2010).

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Realtor-Owned Title Agencies: Turn Away From the Quagmire

By Denise P. Ward

With increasing visibility, a new player is emerging in many downstate jurisdictions in the title insurance industry, *the real estate broker*. While, national powerful real estate brokerage houses may be in the title insurance business in other parts of the country, they are relatively new players in the New York title insurance arena. As a result, many questions have been raised by local practitioners regarding the placement of title insurance orders with a title agency owned and controlled by the referring real estate brokerage house. Increasing economic pressure has undoubtedly shifted the delicately symbiotic relationship between local attorneys and local realtors. Realtors find themselves encouraged by their local or nationally owned parent corporation to urge attorneys to "join their business model" to place their title insurance orders with the agency owned or controlled by the broker-parent. Attorneys, however, find themselves in a much more challenging situation. In "playing ball" with the referring realtor, serious long-term consequences arise for the attorney, his or her practice and his or her client. To wit: Is placing the order with the realtor-owned title agent a violation of the recently adopted Rules of Professional Conduct (hereinafter, "Rules")?[1] Does this practice violate the Real Estate Settlement Procedures Act (hereinafter, "RESPA")?[2] Does this practice violate any other New York statutes? It certainly appears that for some realtors, providing settlement services fits neatly into their long term planning, an effort to streamline the New York real estate transaction. To what extent is this move into settlement services a movement towards the unauthorized practice of law? If the attorney is employed by the realtor, can the attorney comply with his or her own ethical obligations to the client? To what extent, if any, does this practice violate the anti-kickback provisions in Insurance Law § 6409(d) (hereinafter "§ 6409")?[3]

After careful research of the statutes and regulations, discussions with attorneys who are experts in this area and discussions with grievance committee attorneys, I have concluded that both RESPA and § 6409 are violated IF the referral of clients to the attorney from the realtor is conditioned upon the placement of title insurance orders with the title agency owned by real estate brokerage firm. The interaction of attorneys, settlement services and realtors, and the fine line delineating the unauthorized practice of law, necessitates careful, frank review. The ethical issues confronting attorneys in this new arena are accordingly more complex in their nature and analysis, but in the opinion of the author, such conduct is an ethical breach *per se*. These questions will be analyzed in detail below.

Real Estate Settlement Procedures Act (RESPA)

The federal statute, the Real Estate Settlement Procedures Act (RESPA), which went into effect in 1975, prohibits kickbacks or any other compensation for the referral of settlement services business.[4] When RESPA was enacted, it contained a strict prohibition against giving or receiving any fee, kickback or thing of value for the referral of settlement service business. In 1983 Congress amended RESPA to permit affiliated or controlled business arrangements, provided certain conditions were met. RESPA retained its prohibition against the giving or receiving of any referral fees; this prohibition still exists. RESPA § 8(a), and the equivalent Regulation X, § 3500.14, prohibit fees, kickbacks, or things of value for the referral of settlement business. A violation requires the presence of three elements: first, there must be a payment or giving of a thing of value; second, the payment or transfer of thing of value must be done pursuant to an agreement to refer business; lastly, the referral must occur.

The U.S. Department of Housing and Urban Development (hereinafter, "HUD") was the regulatory agency charged with enacting regulations regarding RESPA. Regulations promulgated by HUD in connection with § 8 of RESPA were codified in 24 C.F.R. § 3500.14. The relevant portions of said regulations are contained § 3500.14, prohibiting kickbacks and unearned fees.

> (a) *Section 8 violation:* Any violation of this section is a violation of section 8 of RESPA (12 U.S.C. 2607) and is subject to enforcement as such under § 3500.19.
>
> (b) *No referral fees.* No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any referral of a settlement service is not a compensable service, except as set forth in § 3500.14(g)(1). A business entity (whether or not in an affiliate relationship) may not pay any other business entity or the employees of any other business entity for the referral of settlement service business.[5]

Upon reading this regulation (which language mirrors the statute), the attorney must ask—Is the referral of clients by the realtor to the attorney (when the referrals are contingent upon the attorney placing title insurance orders with the realtor owned agency) the giving of a thing of value in return for settlement services (the placement of title insurance orders)? The definition of the "thing of value" must be reviewed in order to make an adequate determination.

Pursuant to RESPA § 2602(2), a "thing of value" includes any payment, advance, funds, loan, service, or *other consideration*. HUD expanded on this in the regulations set forth at § 3500.14 (d) by describing a thing of value:

> Thing of value. This term is broadly defined in section 3(2) of RESPA (12 U.S.C. 2602(2)). It includes, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses, or reduction in credit against an existing obligation. The term "payment" is used throughout §§ 3500.14 and 3500.15 as synonymous with the giving or receiving any "thing of value'' and does not require transfer of money.[6]

Most practitioners would be hard pressed to state that referrals from realtors are not a thing of value. For many, it is a primary source of real estate transactional business. Truly, attorneys face a dilemma in these situations. A simplistic review could convince an attorney that future referrals are not conditioned on using the realtor-owned title agency. The realtor never explicitly said the words "if you do not use our title agency you will not get future referrals," so perhaps the condition is merely a suggestion. Nonetheless, it is clear that by making the "request" to use the realtor's title company, the realtor implicitly states (or, on many occasions *explicitly* states) that in the future, referrals of prospective clients can only be made to attorneys who fit their business model, and thereby, use their title agency. HUD realized that such blatant statements may not occur; therefore, in its regulations at § 3500.14 (e) it described an agreement or understanding as follows:

> an agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.[7]

The referral source may not be cut off after the first failure to use the realtor-owned agency, or even the third or fourth referral. But, inevitably, the referral well will dry, as the realtor faces increased internal pressure from the corporate parent to keep the real estate deal "in house."

Under RESPA § 8, Congress sought to eliminate what it termed "abusive practices"—kickbacks, referral fees, and unearned fees. In describing the § 8 provisions, a Senate Report explained that RESPA "is intended to prohibit all... referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business."[8] The report went on to state that practice, pattern or course of conduct must be reviewed to determine if a violation exists. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business. The referral of prospective purchasers to a transactional attorney is clearly a thing of value; the fees earned from such transactions are the office's lifeblood, ensuring a steady income stream and a viable practice. Moving beyond the obvious conflict of interest and ethical violations discussed in detail hereinafter, to what extent is there a violation of RESPA's § 8? The placement of the title insurance with an agent owned and controlled by the referring realtor is a glaring thing of value being exchanged for the referral, particularly when careful consideration is given to the adequacy of the insurer. Pursuant to RESPA and the accompanying regulations, a referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use a particular provider of settlement services.[9] "*Required use* means a situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service."[10]

Penalties for violation of RESPA § 8 are significant. Violations are punishable by a fine of not more than $10,000 or a prison term of up to one year, or both. In addition, violators are liable for damages in a civil suit up to three times the amount of any charge paid for the settlement service.[11]

NYS Insurance Law § 6409(d)

Section 6409(d) of the Insurance Law provides that no person can give or take anything of value as an inducement for the placement of an order for title insurance:

§ 6409. Filing of policy forms; rates; classification of risks, commissions and rebates prohibited

> (d) No title insurance corporation or any other person acting for or on behalf of it, shall make any rebate of any portion of the fee, premium or charge made, or pay or give to any applicant for insurance, or to any person, firm, or corporation acting as agent, representative, attorney, or employee of the owner, lessee, mortgagee or the prospective owner, lessee, or mortgagee of the real property or any interest therein, either directly or indirectly, any commission, any part of its fees or charges, or any other consideration or valuable thing, as an inducement for, or as compensation for, any title insurance business. Any person or entity who accepts or receives such a commission or rebate shall be subject to a penalty equal to the greater of one thousand dollars or five times the amount thereof.[12]

A thing of value can be as simple and nefarious as a title company handing an envelope full of cash to a broker, banker or an attorney; it can be as Machiavellian as a title agent wholly owned by a national realtor parent, trading referrals of clients with attorneys in exchange for title business. Although the latter situation may not involve cash changing hands, it is no less a violation of Insurance Law's §6409(d). New business models may well emerge in light of economic challenges, but such challenges cannot constitute a rationale to contravene the clear rules against kickbacks, in any form, contained in the statute.

Realtor referrals to local professionals are common—referrals to attorneys, home inspectors, asbestos abatement companies, plumbers or electricians happen in almost any transaction. Some clients would maintain that these referrals are a fundamental rationale for utilizing the services of a local realtor; a good realtor has a well-endowed smartphone. Referrals to attorneys, when properly made by a skilled realtor, have traditionally been based on past performance by that attorney: a prompt response, professional demeanor, experience and reputation are paramount; the ability of the attorney to "get the deal done" is often definitive. As a rule, the expectations of the realtor were a speedy closing, with a happy purchaser who would one day come back as a happy seller, so that everyone could do it all over again. It appears, however, that there is a new condition in play: whether the attorney will place the client's title order with the realtor-owned title agent.

Another approach to the capture of business by the realtor-owned title agency occurs when the prospective purchaser's attorney is recruited to act as a title agent. The attorney then refers business to the title company, but performs no core services. The attorney-agent does not prepare the title report, takes no part in clearing exceptions, and does not produce a policy. Despite this, the attorney receives a part of the premium as a commission. An Insurance Department opinion issued in 2001 clearly states that when an attorney does nothing more than order the title insurance, "…any consideration or valuable thing given to the attorney is not for services rendered but is an inducement or compensation for the title insurance business he refers to the title company. Such compensation is an improper referral fee which is specifically prohibited by §6409 (d)."[13]

The most recent permutation of this scheme in the real estate market is a title agency wholly owned by a parent real estate brokerage firm. In its simplest analysis, it seems to be a perfectly appropriate relationship, a one-stop shopping approach. It certainly fits into the business model many local and nationally owned realtors have sought, with their related financing, insurance and even settlement service arms at the ready for their prospective purchasers. The fly in the ointment here, though, is the attorney, the essential—and at least for now—"outside party" to the realty house; hence, the realtor must maneuver the attorney into the model so that the parts work cohesively in the corporate parent's present business plan. So, what, really, is the problem with this approach?

Unauthorized Practice of Law

Concern is mounting on a number of fronts regarding the "one-stop shopping" concept in real estate transactions. Proponents argue that it is better for the consumer, more economical, quicker, streamlined; opponents argue that this model lacks checks and balances, there is no independent person to review the process and the documentation, no competition regarding pricing. Moreover, some even remind us that promoting "one stop shopping," with its resultant lack of checks and balances, is a major reason for our nation's recession. Within this model, realtors, banks, loan officers, underwriters, appraisers, inspectors all work under one, giant, bank-owned umbrella. Now that foreclosures are nationally at record highs—with all of the disastrous consequences currently facing foreclosing lenders—another venture into a "one stop" approach is potentially at least as catastrophic. Under the scrutiny of foreclosure, those imprudent loans and their supporting documentation—all produced and reviewed by the same, related parties—are often proving less than creditworthy. Those familiar with the conduct of residential transactions in the current environment are well aware of the thick walls currently in place between the service providers in a transaction. Appraisers cannot speak to underwriters; underwriters cannot speak to processors. Processors cannot speak to the person who takes the initial application. Certainly, the recent changes to RESPA regarding disclosure seem directed to the disclosure of any sort of affiliated or related relations. Notwithstanding these changes, if the "master plan" of national brokerage houses comes into New York, the result may very well be to eliminate the independent attorney in the real estate closing process.

The attorney is not part of the real estate transaction in some jurisdictions. Utilizing an "in house" attorney could imbue the entire closing process in this "one stop shop" with an undeserved legitimacy. One attorney recently placed himself in this situation, with dire consequences, and was soon before the Appellate Division of the Ninth Judicial District. In that instance, *In re: Tambini*,[14] the Grievance Committee served attorney respondent Robert Tambini with a petition alleging twenty-four charges of professional misconduct. The Special Referee, after a hearing, sustained all twenty-four of the Committee's charges. These charges included, among other things, forming a partnership with a non-lawyer, in the formation of Expedient Settlement, Inc., which "provided representation and settlement services to lenders in real estate transactions in the State of New York. Through the respondent, Expedient Settlement provided legal services to its clients and / or utilized the respondent's attorney trust account for its clients' transactions."[15] Among other things, Tambini and his non-lawyer partner were found to be fee-sharing, in violation of the Code; the Special Referee also found Tambini to have impermissible conflicts of interest in representing lenders in one or more real estate transactions in New York State for which Expedient, of which Tambini was a principal, "received fees for the title and / or abstract services in such transactions;"[16] he was found to have "failed to obtain the consent of the represented lender after full disclosure of his multiple interests in such transactions," as well as found "guilty of accepting a financial benefit from one other than the client in relation to his representation of or employment by the client."[17] The Special Referee found Tambini to have an impermissible conflict of interest in representing multiple parties in a transaction, representing both the borrower and the lender in numerous closings. The Appellate Division affirmed the Special Referee's report in its entirety, and Tambini was suspended from the practice of law for three years. The Appellate Division stated

> By using his attorney trust account and law office stationery in his "settlement business," the respondent imbued his business with an aura of trust, ordinarily afforded to attorneys by New York banks, who are accustomed to attorneys handling real estate closings. In so doing, the respondent was able to expedite closings, gain an advantage over his competitors, and garner more business.[18]

The creation of these "one stop shops" by the national realtors, in adding the title agency to already over-endowed brokerage houses, is another step down a dark road. The realtor armed with a cadre of "in house closers" certainly can offer a quick and easy closing, but how well does this serve the client? Who is actually advising the client about the status of title, and about the viability of the underwriting insurer? Frankly, there cannot be enough disclosure to cover the situation; it just should not occur. But even more ominously, will attorneys remain part of the residential real estate transaction when the brokerage house controls all the various parties to the deal—the lender, the title agent, and the property? And who is the client? Is it the prospective purchaser, the realtor, the corporate parent, the title agency? Despite recent strides in the unauthorized practice of law cases of late, as well as the statutory change in the laws governing unauthorized practice of law from a misdemeanor charge to a felony charge, this fear is of real concern to many residential real estate transaction attorneys. There remains a strong incentive to urge further legislation regarding the unlawful practice of law, and this topic remains a front burner issue for most attorneys.[19]

How does the placement of title insurance become the unauthorized practice of law? Historically, placement of the title order has been the sole purview of the attorney, for good reason. Title insurance is a relatively new creature, and arises from the no-longer utilized attorney opinion as to the status of title to real estate. For almost a century, attorneys placed their client's title insurance with the expectation that the insurance will be there in the event of a claim; that expectation is based upon statutory requirements mandating underwriters to maintain adequate reserves based upon issued policies to face such claims. What has emerged of late is the condition attached to realtor referrals to attorneys; the realtor now explains to the attorney that the referral of this client is conditioned upon the attorney's placement of the title insurance with the realtor's affiliated title agency. Implicit, or even directly stated, is that if the attorney desires to maintain the referral relationship with the realtor, the attorney must use the affiliated title agency for all title transactions, and not just the transaction referred to by that particular broker! In this situation, no money has changed hands, but a "valuable thing," the referral, and future referrals, has been given and taken as the coin of the realm for the transaction—a direct and clear violation of § 6409 by both the title agent and the attorney.

How does Insurance Law § 6409(d) interact with RESPA; does RESPA, in fact preempt § 6409(d)? Section 6409(d) was enacted in 1975 as a New York State reinforcement of the principles of the federal RESPA legislation. There is a definitive relationship between the state and federal laws. While RESPA appears to provide certain exceptions to the referral prohibition,[20] the enactment of New York's § 6409 introduced a "flat bar on the receipt of rebates for placement of title business by anyone directly or indirectly involved in the real estate transaction."[21]

This particular practice is also a violation of RESPA, as illustrated in *Appendix B to Part 3500—Illustration of Requirements of RESPA*. The following example is from that Appendix.

EXAMPLE 4. Facts: A is an attorney who, as a part of his legal representation of clients in residential real estate transactions, orders and reviews title insurance policies for his clients. A enters into a contract with B, a title company, to be an agent of B under a program set up by B. Under the agreement, A agrees to prepare and forward title insurance applications to B, to re-examine the preliminary title commitment for accuracy and if he chooses to attempt to clear exceptions to the title policy before closing, A agrees to assume liability for waiving certain exceptions to title, but never exercises this authority. B performs the necessary title search and examination work, determines insurability of title, prepares documents containing substantive information in title commitments, handles closings for A's clients and issues title policies. A receives a fee from his client for legal services and an additional fee for his title agent "services" from the client's title insurance premium to B.

Comments: A and B are violating section 8 of RESPA. Here, A's clients are being double billed because the work A performs as a "title agent" is that which he already performs for his client in his capacity as an attorney. For A to receive a separate payment as a title agent, A must perform necessary core title work and may not contract out the work. To receive additional compensation as a title agent for this transaction, A must provide his client with core title agent services for which he assumes liability, and which includes, at a minimum, the evaluation of the title search to determine insurability of the title, and the issuance of a title commitment where customary, the clearance of underwriting objections, and the actual issuance of the policy or policies on behalf of the title company. A may not be compensated for the mere re-examination of work performed by B. Here, A is not performing these services and may not be compensated as a title agent under section 8(c)(1)(B). Referral fees or splits of fees may not be disguised as title agent commissions when the core title agent work is not performed. Further, because B created the program and gave A the opportunity to collect fees (a thing of value) in exchange for the referral of settlement service business, it has violated section 8 of RESPA.[22]

RESPA does not preempt Insurance Law § 6409(d), but instead works with it in concert. 12 U.S.C.A. § 2616 clearly reinforces this point:

> This chapter does not annul, alter or affect, or exempt any person subject to the provisions of this chapter from complying with the laws of any state with respect to settlement practices. The Secretary may not determine that any state law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer….[23]

The New York State Insurance Department further opined, "we believe that our statute gives greater protection to consumers and competition on this and, may not be deemed preempted."[24]

Section 6409 of the Insurance Law, RESPA, and Insurance Department Opinion seem quite clear in directing attorneys, realtors and title agents in their relationships, even in changing, emerging economic conditions.

The Rules of Professional Conduct

Effective April 1, 2009, the New York State Bar Association adopted The Rules of Professional Conduct. These Rules are modeled after ethical rules used in many other states and supersede the former ethical guides contained in the New York Lawyer's Code of Professional Responsibility (hereinafter, "Code"). The former Code implemented a three part approach to ethics, containing Canons, Disciplinary Rules (DRs) and Ethical Considerations (ECs), with the DRs as the only mandatory part of the code. The new Rules encompass many of the former Canons, ECs and DRs. However, the new Rules do not differentiate between mandatory and recommended rules, ergo all Rules appear to be mandatory.

A careful examination of the ethical issues facing the attorney receiving a referral from a realtor insistent on conditioning the placement of title insurance with the realtor-owned title agency is required. The applicable Rules to be examined are Rules 1.4(a)(2) and 1.4(b) (Communication), Rule 1.7 (Conflict of Interest, Current Clients), Rule 2.1 (Advisor), Rule 5.4(a)(c) (Professional Independence of a Lawyer), Rule 5.8 (Contractual Relationship Between Lawyers and Nonlegal Professionals), and Rule 7.2 (Payment for Referrals).

Rules 1.4(a)2 and (b), governing communications, state: "…(a) A lawyer shall…(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished; (b) A lawyer shall explain a matter to the extent reasonable necessary to permit the client to make informed decisions regarding the representations."[25]

It is implicit upon the attorney in any transaction to explain to the client the necessity of title insurance for the protection of the efficacy of the client's real estate ownership. With the introduction of realtor-owned title agencies, the attorney must now guide the client more diligently through informed consent. There are specific nuances to consider: the fact that the realtor-owned title agent is not an independent party to the transaction; the fact that the title agent is wholly owned and controlled by the realtor who has a vested interest in closing the transaction; the fact that the agent may be insuring the transaction through an underwriter with inadequate reserves. Cost considerations, if they exist, must be explained within the context of filed rates and governance by the Insurance Department. The lack of independence by the title agent is critical, and with a poorly financed underwriter, title clearance decisions may be made in the context of "keeping a deal together," rather than in accordance with sound underwriting principles. In many instances, the realtor is a trusted party to this transaction, with whom the client has spent significant time over the past few months finding the "home of their dreams." The attorney is the new party, introduced by the realtor. An attorney may be placed in the unenviable position of dissuading a client from using a realtor-owned title agency. If this occurs, the attorney confronts an adversarial position with the new client—and the referring realtor.

Rule 1.7 (Conflict of Interest, Current Clients) must also be considered. Said Rule states:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:
>
> (1) the representation will involve the lawyer in representing differing interests; or
>
> (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.
>
> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;…
>
> (4) each affected client gives informed consent, confirmed in writing.[26]

The New York State Bar Association comments on this Rule state:

> Loyalty and independent judgment are essential aspects of a lawyer's relationship with a client. The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of the client and free of compromising influences and loyalties. Concurrent conflicts of interest, which can impair a lawyer's professional judgment, can arise from the lawyer's responsibilities to another client, a former client or a third person, or from the lawyer's own interests.[27]

Does a violation of the aforementioned Rule occur if a lawyer places a title insurance order with a realtor-owned title agency, fearing the loss of future referrals from the realtor? Although the realtor may present the attorney with a number of theoretically consumer-oriented reasons for the placement of the title order with his or her agency, included in the "suggestion" is the comment that the realtor will only be able to refer prospective clients to attorneys who use his or her title company and therefore fit in with their corporate parent's "business model." This appears to directly conflict with the mandates of Rule 1.7 (2), where the attorney's own financial interests (the broker as the source of future referrals) are jeopardized by the attorney's ethical obligation to act in the best interests of the client. The attorney's possible loss of the referral source should be, but is not, irrelevant in considering the juxtaposition to the interests of the client.

The most significant provision in the Rules which the attorney must consider when weighing the use of the realtor-owned title agency is the Rule now requiring attorneys to employ "professional independent judgment." A comparison of Canon 5 in the Code ["A lawyer *should* exercise independent professional judgment on behalf of a client"][28] to the new Rule 2.1: Advisor in Rules of Professional Conduct ["…a lawyer *shall* exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social, psychological and political factors that may be relevant to the client's situation"],[29] reveals that the word "should" is changed to "shall," making the exercise of an attorney's independent judgment mandatory, not suggested or recommended, as it had been under the Code. The situation where the attorney places the title insurance with the realtor owned title agency as a condition of, or in consideration for, the referral or future referrals, impedes the attorney's duty to deliver independent professional advice regarding the transaction. In certain situations, such duty to deliver independent professional advice duty might result in a client's withdrawal from a transaction. Such advice is obviously contrary to the financial interests of the realtor and its title agency, who only earn their fees once the transaction is consummated. If an attorney advises a client to terminate a transaction, the client may be protected, but the realtor and the title agent will not get paid. Considerations regarding the referring realtor's income, and the loss of possible referrals in retribution for the "dropped deal" cannot be considered by the attorney when exercising professional judgment on behalf of a client. When the attorney is bound to place the title insurance with the realtor-owned title agency, the Rule's mandates of professional, independent judgment by the attorney are violated. The Rule makes clear that the client's interests are to be paramount in the attorney's analysis. Placing the question of future referrals for the attorney makes that analysis impossible to properly conduct under the Rules. The interests of the attorney, the realtor and the title agent do not belong in the equation. The conflict could not be clearer.

Consideration of Rule 5.4(c) (Professional Independence of a Lawyer) is also necessary in this scenario: "(c)…a lawyer shall not permit a person who recommends… to direct or regulate the lawyer's professional judgment in rendering such legal services…."[30] The realtor, in the recommendation, explicitly or indirectly directs the attorney to utilize the realtor-owned title agent. The attorney is, as noted above, duty bound to carefully assess the title company in the best interest of the client. This assessment should including both past performance by the insurer (expertise, skill, knowledge and reputation) as well as future stability (the financial strength and reserves of the underwriter). Both are essential elements, and both may be lacking in the introduction of the realtor-owned title agencies to the real estate market.

As previously discussed, a significant source of business for the residential real estate lawyer arises from realtor referrals. The New York State Bar Association addressed this issue under the old Code. In NYSBA Opinion 467 the question presented was, "May a lawyer accept repeated referrals from a real estate broker?"[31] The concern raised in that query was that "an attorney who accepts repeated referrals from the same real estate broker may compromise the interests of his client in an effort to avoid upsetting a transaction which the referring broker would understandably want to have consummated." The opinion refers to the following relevant sections of the old code: Canon 5, EC 5-1 and DR 5-107(B). Canon 5 states that "A lawyer should exercise independent professional judgment on behalf of a client."[32] EC 5-1 provides that "[T]he professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client."[33] DR 5-107(B) states that "A lawyer shall not permit a person who recommends, employs or pays him to render legal services for another to direct or regulate his professional judgment in rendering such legal service."[34]

The relevant sections of the new Rules that replace these sections are Rules 2.1, 5.4(c), 5.8 and Rule 7.2(a). Rule 2.1 provides: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice."[35] Rule 5.4(c) provides that "[u]nless authorized by law, a lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal service for another to direct or regulate the lawyer's professional judgment in rendering such legal services or to cause the lawyer to compromise the lawyer's duty to maintain the confidential information of the client under Rule 1.6."[36] With respect to contractual relationship between lawyers and nonlegal professionals, Rule 5.8 discusses the tradition of independence and loyalty to one's clients, who are "guaranteed 'independent professional judgment and undivided loyalty uncompromised by conflicts of interest.' …Therefore a lawyer must remain completely responsible for his or her own independent professional judgment… and otherwise comply with the legal and ethical principles governing lawyers in New York State."[37] The Rule goes on to say in order to protect these core values, there must be a strict division between services provided by lawyers and nonlawyers.[38] In certain instances a lawyer is allowed to have a contractual relationship with a nonlegal professional; however, Rule 7.2 adds "that such referral shall not otherwise include any monetary or other tangible consideration or reward for such…"[39] Rule 7.2(a) further states that "[a] lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client."[40] The recent decision in *Tambini* discussed above illustrates the risks to attorneys in professional relationships with non-lawyer providers.

The committee's opinion based on the Code stated that "[w]hile the position of the lawyer who accepts repeated referrals may be somewhat more fraught with temptation to avoid the strictures of the Code than one who does not, we cannot say that this factor is sufficient to require the lawyer to decline representation of clients to whom he has been recommended by the broker."[41] The committee concluded its opinion with the following comment:

> Nevertheless, although the Code clearly does not require a lawyer to refuse such referrals, he should carefully examine his conduct and be especially wary of any influences which may serve to dilute his professional loyalty or independence. If a lawyer concludes that it is not in the best interests of his client to consummate the transaction for which he has been retained, he must have no hesitancy in advising his client to withdraw.[42]

Under the newly adopted Rules, the committee would probably render a different determination, especially since this practice is no longer merely a question of repeated referrals, but as an added condition, the use of the real estate broker's title agency as a condition for those referrals. Imposition of this condition removes any attempt by the attorney to exercise independent professional judgment even if the client has given written informed consent. Pursuant to the Rules, an attorney is required to exercise *independent* professional judgment when representing a client. The Rules are more stringent and precise in the language, with mandatory rather than precatory or recommended practices, and it seems that at least four different Rules would be violated by an attorney placing title insurance with a realtor-owned title agent to maintain the stream of continuing future referrals. It seems impossible for the attorney to exercise independent professional judgment in this context. Webster's defines independent as:

> 1 **:** not dependent: as *a (1)* **:** not subject to control by others **:** self-governing *(2)* **:** not affiliated with a larger controlling unit <an *independent* bookstore> *b (1)* **:** not requiring or relying on something else **:** not contingent <an *independent* conclusion> *(2)* **:** not looking to others for one's opinions or for guidance in conduct *(3)* **:** not bound by or committed to a political party *c (1)* **:** not requiring or relying on others (as for care or livelihood) <*independent* of her parents> *(2)* **:** being enough to free one from the necessity of working for a living <a person of *independent* means>.[43]

> Black's Law Dictionary defines independent as:

> 1. Not subject to the control or influence of another. <independent investigation>. 2. Not associated with another (often larger) entity<an independent subsidiary>. 3. Not dependent or contingent on something else <an independent person>.[44]

Relying upon either one of these definitions, the attorney facing the ethical dilemmas described herein cannot be described as "independent."

So what is the transactional practitioner to do? Economic challenges face all segments of our society, from realtors trying to hold deals together to attorneys trying to keep the doors open in their offices. Nothing is more frustrating than having a real estate transaction fall apart, especially as a consequence of a title defect. Utilizing a realtor-owned title agent is clearly fraught with professional and ethical issues, of serious consequence for every attorney, indeed, of consequence to the entire nature of the practice of residential real estate attorneys. But just as significantly, for the consumer and purchaser intended to be protected by such regulations as our own Rules, the New York State Insurance Law and RESPA and its accompanying regulations, the long term consequences of imprudently acquired title insurance on behalf of our clients as consideration for continued referrals from realtors is something that could haunt us for years into the future. Delivery of the referral as a thing of value to the attorney, in exchange for which the attorney is directed, encouraged, or expected to place a client's title insurance with a less than desirable title agent affiliated or controlled by the referring realtor, will place the transactional attorney squarely in the sights of any number of regulatory authorities. Headlining a Disciplinary Decision on the front page of the *New York Law Journal* is the last place any attorney wants to be recognized.

Endnotes

1. N.Y. Comp. Codes R. & Regs. tit. Rules of Professional Conduct § 1200.0 (2009) (N.Y.C.R.R.).
2. Real Estate Settlement Procedures Act § 8, 12 U.S.C.A. §§ 2601-2617 (RESPA).
3. N.Y. Ins. Law § 6409(d) (McKinney 2008).
4. RESPA § 8.
5. 24 C.F.R. Part 3500.14.
6. 24 C.F.R. Part 3500.14(d).
7. 24 C.F.R. Part 3500.14(e).
8. N.Y.S. S. Rep. 93-866, at 6551.
9. *Id.*
10. 12 U.S.C. 2602.
11. 12 U.S.C. 2607(d)(1) and (2).
12. N.Y. Ins. Law § 6409(d) (McKinney 2008).
13. NYS Insurance Dep't OGC Op. No. 01-06-18, (June 22, 2001).
14. In re: Tambini, 2010 N.Y. Slip Op. 05778 (2d Dep't June 29, 2010).
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. N.Y. Jud. Law § 478 (Jud Law).
20. See, e.g., 12 U.S.C.A. § 2607(a).
21. Memo from John P. Gemma of the NYS Insurance Dep't to the Governor, (1975).
22. 24 CFR Part 3500, Appendix.
23. 12 U.S.C.A. § 2616.
24. NYS Ins. Dep't OGC Op. No. 05-07-01, Jul. 1, 2005.
25. 22 N.Y.C.R.R. Part 1200.0—Rule 1.4(a)(2) and (b).
26. *Id.* Rule 1.7(a)(b).
27. See NYSBA comments to Rules of Professional Conduct, Comment 1 to Rule 1.7, Apr. 4, 2009.
28. NYS Lawyer's Code of Professional Responsibility, Canon 5, Page 43 (2007) (hereinafter "Code").
29. 22 N.Y.C.R.R. Part 1200.0—Rule 2.1, Page 18.
30. *Id.* Rule 5.4.
31. NYSBA Comm. on Professional Ethics, Formal Op. #467 -4/28/77, (hereinafter "NYSBA Op.").
32. Code, Canon 5, Page 43.
33. *Id.* EC-5.1.
34. *Id.* DR5-1-5.
35. 22 N.Y.C.R.R. Part 1200.0).
36. *Id.* Rule 5.4.
37. *Id.* Rule 5.8.
38. *Id.*
39. *Id.* Rule 7.2.
40. *Id.*
41. NYSBA Op. #467.
42. *Id.*
43. Merrian-Webster online dictionary at http://www.merriam-webster.com, 10/18/10.
44. Black's Law Dictionary, West, 2004.

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The Relationship Between the New York State Division of Housing and Community Renewal and the New York City Housing Court

By Sheldon Melnitsky and Gerald Lebovits

The amalgam of laws regulating residential tenancies in New York City is "an impenetrable thicket confusing not only to lawyers but to laymen."[1] A number of rationales explain their "opacity."[2] "[L]egitimate political pressures and the stress of economic and social tensions"[3] have led to a history of expansion and contraction over 50 years as New York State and New York City align rent laws to meet changing political and economic conditions. As set out in the legislative findings justifying their enactment, the rent laws seek to balance conflicting purposes of encouraging owner investment to transition to a normal market of free bargaining between owners and tenants, and protecting residents from unreasonable rents that can be exacted due to the acute shortage of dwellings.[4] The rent laws' periodic sunsetting leads to negotiated modifications, which the Court of Appeals had described as "temporary makeshifts"[5] enacted as a compromise for their extension. Enthusiastic members of the landlord-tenant bar skillfully and persistently advocate for new interpretations of statutory language that appeared well settled and then aggressively shape the new modifications through litigation.[6]

At its core, the rent laws' complexity arises from what is at stake for owners and tenants: the continued occupancy and preservation of nearly one million rent-regulated apartments.[7]

Tending this thicket is hard. The legislature has created two separate yet energetic gardeners responsible for its care and feeding: the New York City Civil Court, Housing Part ("Housing Court"), and the New York State Division of Housing and Community Renewal ("DHCR").[8]

"This article discusses, in particular, the jurisdictional doctrines that divide responsibility between the DHCR and Housing Court in areas of overlapping authority and some examples of how this has played out in practice."

The relationship between Housing Court and DHCR is often messy and uneasy. Much like the neighboring gardeners in the *Fantasticks*,[9] each is equally proud of its own verdant greenery. They have been known to work at cross-purposes; one might water, while the other might prune. Each dreams of creating some lasting union and order to a collective garden.

This article provides a brief introduction to both DHCR and Housing Court and their respective areas of exclusive jurisdiction. This article discusses, in particular, the jurisdictional doctrines that divide responsibility between the DHCR and Housing Court in areas of overlapping authority and some examples of how this has played out in practice. The article also discusses when courts should or need not defer to DHCR as well as the procedures governing the day-to-day interaction of DHCR and Housing Court.

What Are the Rent Laws?

The rent laws encompass four separate rent-regulatory regimens, two of which apply in New York City. Within New York City are two separate rent regulatory systems: rent control and rent stabilization.[10]

Rent control, enacted in the 1950s, regulates a relatively small number of tenancies in housing accommodations built before 1947[11] and which have not become vacant since 1971.[12]

Rent stabilization's jurisdictional reach is largely the product of two laws: the Rent Stabilization Law of 1969[13] and the Emergency Tenant Protection Act of 1974.[14] Together they cover housing accommodations in buildings of six or more units completed before 1974.[15]

Rent-stabilized tenants maintain continued occupancy through a requirement that owners must offer new and renewal leases of one or two-years' duration.[16] A separate city agency, the New York City Rent Guidelines Board, sets rates for increases on those leases.[17] Additional rent increases are available upon the installation of new equipment or improvements, called Individual Apartment Improvements, or "IAI."[18] Tenant consent to the installation (and to the corresponding rent increase) is required when a tenant is in occupancy,[19] although the rent may be increased and the IAI installed without consent on vacancy.[20] DHCR may, upon an owner's application, order further increases based on the installation of building-wide major capital improvements.[21] Receiving regular guideline increases are conditioned on the owner providing and maintaining apartment services.[22] DHCR is authorized to reduce the rent by the most recent rate of guideline adjustment if an owner fails to provide these services.[23]

When an owner has overcharged a tenant, a court or DHCR may direct a refund with interest.[24] If an owner fails to establish that the overcharge was neither willful nor attributable to its negligence, then the owner's liability is increased to three times the amount of the overcharge.[25] An owner is also entitled to charge the initial agreed-upon rent to the first rent-stabilized tenant renting a formerly rent-controlled apartment, subject to a "fair market rent appeal commenced by the tenant before DHCR."[26]

Various exceptions extend to rent stabilization's jurisdictional reach, some of which can result in evicting a tenant in occupancy, others on deregulation after vacancy. Evicting a tenant can result if a court finds that a tenant has failed to occupy the housing accommodation as the tenant's primary residence.[27] Deregulation can result under a DHCR order issued when a housing accommodation is occupied by tenants whose income exceeds $175,000 for each of two years when the rent exceeds $2,000 ("high-rent / high-income deregulation").[28] Deregulation occurs without a DHCR or court order when a housing accommodation becomes vacant with a rent of $2,000 or more ("high-rent / vacancy deregulation").[29]

Owners are required annually to serve on tenants and file registrations listing the legal rent with DHCR for each housing accommodation.[30] In addition to these annual registrations, an initial registration must be served and filed with DHCR for a formerly rent-controlled accommodation,[31] and a final or "exit registration" must be served on the first deregulated tenant (and filed with DHCR) after high-rent / vacancy deregulation.[32]

What Is DHCR?

DHCR is part of the State of New York's executive department.[33] The legislature created it in 1938, the same year it enacted the Public Housing Law.[34] DHCR runs a variety of affordable-housing and community-renewal programs.[35] These programs fund new construction and rehabilitation and provide for DHCR supervision of their ongoing operation.[36] DHCR provides staff to the New York State Housing Trust Fund Corporation ("HTFC"), which has its own housing construction and preservation programs.[37] DHCR is currently integrating its operations with "New York Homes," an already existing amalgam of the New York State Housing Finance Agency ("HFA") and the State of New York Mortgage Agency ("SONYMA").[38]

On September 22, 2010, these state housing agencies announced their integration under a single leadership structure as the New York State Homes and Community Renewal ("HCR").[39] This new alignment takes similar programs administered by HTFC, HFA, SONYMA, and DHCR and reorganizes them by actual function into three units: Finance and Development, which funds the development of new affordable housing; Community Renewal, which includes programs geared toward community and economic development; and Housing Preservation, which is geared to maintaining and enhancing existing state-supervised housing.[40] Enforcing the rent laws falls within the Housing Preservation Unit's purview.[41]

For the majority of New Yorkers, administering these rent laws is still DHCR's best-known program. DHCR has been the administrative agency in charge of the rent laws since the early 1980s, when the legislature determined that "such laws would better serve the public interest if certain changes were made thereto, including the placing of all of the systems of regulation of rents and evictions under a single state agency."[42]

DHCR has been designated with respect to rent stabilization "as the sole administrative agency to administer the regulation of residential rents as provided in this act"[43] and to adopt and amend implementing regulations, known as the Rent Stabilization Code ("RSC").[44] Regulations governing rent stabilization cannot be promulgated "except by action of the Commissioner of the Division of Housing and Community Renewal."[45]

Administrative proceedings before DHCR under the Rent Stabilization Laws are typically instituted by either tenant complaint or owner application.[46] Tenant complaints usually request either an overcharge award or a rent reduction due to a denial of services. Owner applications are most typically for Major Capital Improvement ("MCI") rent increases. The opposing party in all these proceedings is given an opportunity to file a written answer.[47] After receiving an answer, DHCR has a variety of processing alternatives but may request an additional written filing as it deems relevant.[48] DHCR may grant an oral hearing, but it does so only in the unusual case in which a matter cannot be determined on submitted papers.[49] After the matter is fully submitted, DHCR will issue a determination, signed by one of its Rent Administrators ("RA"). That decision is subject to an internal petition for administrative review to the Commissioner.[50] The Commissioner, after review, will issue the final DHCR determination.[51] Owners or tenants who deem themselves aggrieved by the Commissioner's determination may commence a Supreme Court proceeding under Article 78 of the Civil Practice Law and Rules in order to review it.[52]

What Is Housing Court?

Housing Court is the Housing Part of New York City Civil Court.[53] It was created in 1972 with the passage of New York City Civil Court Act § 110 based on legislative findings that "effective enforcement of state and local laws for the establishment and maintenance of proper housing standards is essential"[54] and that effective enforcement will be greatly advanced by the creation of a court "with jurisdiction of sufficient scope (i) to consolidate all actions related to effective building maintenance and operation [and] (ii) to recommend or employ any and all remedies, programs, procedures and sanctions authorized by federal, state or local laws for the enforcement of housing standards….”[55]

Although its original mission was to resolve code-violations cases, by the time the court opened “nonpayment, holdover, and illegal lockout proceedings were added to the Housing [Court’s] jurisdiction to recognize the mutuality of obligations in landlord-tenant relationships, to promote a unified resolution of landlord-tenant disputes, and to adjudicate cases involving possession over residential premises in New York City.”[56]

In addition to having the authority to grant injunctive relief,[57] Housing Court may entertain counterclaims within Civil Court’s subject-matter jurisdiction if sued upon separately.[58] In summary proceedings, a tenant-respondent is entitled to raise any legal or equitable defense or counterclaim within the court’s jurisdiction.[59]

Jurisdiction

Given these broad delegations of responsibility, both DHCR and Housing Court could seemingly lay claim to jurisdiction over any dispute arising under the rent laws. Each specific remedy and cause of action must be individually scrutinized based on its express statutory authorization and its historical usage to ascertain the legislature’s intent with respect to that remedy.

Broadly, the inquiry falls within one of three categories: whether the litigants seek a remedy in which either the Housing Court or DHCR has exclusive jurisdiction; whether the parties seek a remedy in which there is concurrent, or shared, jurisdiction; and assuming concurrent jurisdiction, whether the parties seek a remedy in which DHCR rather than Housing Court is afforded primary jurisdiction.

Exclusive Jurisdiction

Despite its broad authority, Housing Court is a court of limited jurisdiction. Article VI § 7(a) establishes Supreme Court as “competent to entertain all causes of action unless its jurisdiction has been specifically proscribed” by the legislature.[60] The legislature has the authority to create new causes of action in which Supreme Court’s general jurisdiction is preserved.[61] Where the authority is given to an administrative agency within the executive branch, exclusive original jurisdiction may be conferred on that agency, subject only to court jurisdiction by way of court review of the administrative action.[62]

Sohn v. Calderon[63] is the leading case establishing DHCR’s exclusive jurisdiction over a cause of action under the rent laws. In *Sohn*, the Court of Appeals held that permission to seek the eviction of both rent-stabilized and rent-controlled tenants based on demolition of the premises falls exclusively within DHCR’s purview. The court reached this assessment with respect to rent control based on the express wording of a statute that provided that an eviction order must be issued or determined by the “ ‘[C]ity [R]ent [A]gency’ ”—since 1983, the DHCR.[64] With respect to rent stabilization, the court relied on DHCR’s own regulations and on similar policies of exclusivity exercised by DHCR’s predecessor agency, the New York City Conciliation and Appeals Board, whose policies DHCR had expressly been authorized to continue.[65] Fair Market Rent Appeals are also within DHCR’s exclusively purview.[66]

On the other hand, DHCR was expressly divested in 1983 of the jurisdiction to ascertain the existence of the exemption from rent stabilization protection based on non-primary residency; that residency must be “determined by a court of competent jurisdiction.”[67]

Concurrent and Primary Jurisdiction

Given the breadth of both Housing Court and DHCR authority, concurrent jurisdiction is the norm rather than the exception. Even within areas of concurrent jurisdiction, there are times under the doctrine of primary jurisdiction when Housing Court or even Supreme Court should defer to DHCR to make a determination.

The Court of Appeals has described this doctrine as representing “an effort to ‘coordinate the relationship between courts and administrative agencies,’ generally enjoins courts having concurrent jurisdiction to refrain from adjudicating disputes within an administrative agency’s expertise, particularly where the agency’s specialized experience and technical expertise is involved.”[68] There is flexibility to the doctrine. As the Court of Appeals has noted, “the rule is certainly not without exceptions….”[69]

In *Davis v. Waterside*, the leading case upholding DHCR’s primary jurisdiction, the Appellate Division, First Department, reversed a Supreme Court stay of a DHCR proceeding commenced to determine the applicability of the Rent Stabilization Law to a formerly subsidized housing development.[70] In *150 Greenway Terrace, LLC v. Gole*, an owner’s declaratory judgment action to restrict access to storage space was stayed in favor of a pending service complaint before DHCR.[71] In *Davidson v. 506 E. 88th St. LLC*, the court granted injunctive relief to prevent an owner from engaging in construction that would interfere with the tenant’s exclusive use of a garden. The court noted that an earlier DHCR determination had arguably, but “implicit[ly],” guaranteed the tenant’s garden use. While the parties sought clarification from DHCR, the Supreme Court action would not go forward.[72]

The Appellate Division, First Department, has noted that when faced with a declaratory judgment action on a matter that falls within the more express jurisdiction of Housing Court or DHCR that it seeks injunctive relief, the Supreme Court may consider whether relief is more appropriate for the remedies available to DHCR or Housing Court.[73]

Overcharges: A Study in Concurrent and Primary Jurisdiction

The determination of rent overcharges has long been an area of concurrent jurisdiction.[74] Until recently, it was unsettled whether the doctrine of primary jurisdiction required deferral to DHCR when an overcharge determination required not only applying the appropriate guideline increase but also analyzing the propriety of a claimed increase for IAIs.[75] Neither DHCR nor prior tenant consent is necessary to impose an IAI increase for improvements made after a tenant vacates.[76] The propriety of that increase is tested only through a tenant-overcharge claim.[77] The review requires assessing whether the IAI is actually an improvement or simply a repair.[78] Given the four-year statute of limitations on commencing an overcharge claim, reviewing supporting documentation, including costs, can occur several years after the actual IAI installation.[79]

In *Rockaway One. Co., LLC v. Wiggins* and *Vazquez v. Sichel*, the courts rejected the position that primary jurisdiction bars considering a tenant's counterclaim for overcharges based on IAIs in a summary proceeding.[80]

Both courts noted Housing Court's jurisdiction over counterclaims and the unbroken line of case law regarding concurrent jurisdiction over overcharges.[81] Neither court saw these IAI claims as requiring that DHCR be given the initial opportunity to address them or that a court's fact-specific assessment would ultimately benefit from DHCR's expertise.[82] The *Vasquez* court noted that DHCR's promulgation of regulations over IAIs already enhances the courts' tools in making these determinations.[83] The formula for IAI increases was alternately described as "not complicated"[84] or "foreign to the courts."[85] As noted in *Rockaway One Co., LLC v. Wiggins*, declining jurisdiction would ultimately be inconsistent with Civil Court's adjudicative responsibilities.[86]

Court interpretation of DHCR policy on IAIs nonetheless continues to be a matter of controversy and dispute. In *Jemrock v. Krugman*,[87] the Court of Appeals reversed a divided Appellate Division that had affirmed a divided Appellate Term that itself had reversed Civil Court with respect to an IAI assessment. In light of the extensive nature of the claimed improvements, the majority and dissent split on what level of proof, with respect to both the expenditures and a breakdown between repairs and improvements, was needed to justify the increase. The Court of Appeals remanded the matter to the Appellate Division for further fact-finding. The Court of Appeals noted that both the Appellate Division majority and dissent, although citing DHCR policies, had themselves created new legal standards.[88]

The Court of Appeals instead found that contrary to both parties' contentions, as well as to the Appellate Division's majority and dissenting opinions, the resolution of this issue is not governed by any inflexible rule that an owner is always required, or is never required, to submit an item-by-item breakdown showing an allocation between improvements and repairs if the landlord has engaged in extensive renovation work. Rather, the Court found that "[t]he question is one to be resolved by the fact finder in the same manner as other issues, based on the persuasive force of the evidence submitted by the parties."[89] The Appellate Division on remand ultimately found that the owner's proof was sufficient.[90]

Although DHCR and the courts might make similar factual assessments on the propriety of increases with respect to IAI, their methodologies often differ. More often than not, Housing Court will hold a trial to develop the necessary facts.[91] DHCR, on the other hand, has relied on inspections or, even more simply, on an owner's failure to meet its burden of establishing the propriety of the increase.[92]

Even now there are instances in which parties still dispute whether primary jurisdiction should result in deferral to DHCR to resolve overcharge claims. In *Roberts v. Tischman*,[93] a class action brought on behalf of the tenants of a large rent-stabilized housing complex, the Court of Appeals decided that an owner's receipt of tax benefits under the J-51 program precluded high-rent / high-income and high-rent vacancy deregulation. Although the decision resolved this jurisdictional question, the actual impact of the court's decision, including recovering possible rent overcharges, was left to future litigation. The *Roberts* decision has resulted in similar actions in Supreme Court as well as litigation in Housing Court about possible overcharges in rent-stabilized properties with J-51 benefits.[94] Some courts have made their own overcharge assessments.[95] Others have expressed an opinion that it is more appropriately resolved before the DHCR.[96]

Concurrent jurisdiction over overcharges might also at times cause confusion on what has been determined in a Housing Court proceeding. DHCR routinely sees stipulations resolving Housing Court nonpayment proceedings and must assess whether the stipulations encompass withdrawing or settling an overcharge claim.[97] DHCR will consider a stipulation to resolve overcharges and calculate the legal rent if the stipulation provides that the settlement encompasses that resolution.[98]

If a tenant has filed an overcharge complaint with DHCR, Housing Court will not entertain a counterclaim or defense of rent overcharge.[99] The pendency of a DHCR overcharge complaint does not, however, prevent the Supreme Court from staying a Housing Court proceeding pending the DHCR's determination or the court's awarding something less than full payment of rent as an interim measure while the DHCR proceeding is pending.[100]

Services: A Study in Separate Jurisdiction

Different remedies are available if an owner fails to provide appropriate services. Housing Court might consider that failure as a counterclaim based on a breach of contract.[101] More likely, a rent abatement might be granted based on a breach of the statutory implied warranty of habitability under Real Property Law § 235-b.[102] With respect to DHCR, the Rent Stabilization Law provides that "[i]n addition to any other remedy provided by law," a tenant may apply for a reduction in rent to the level in effect before the most recent adjustment and an order requiring services to be maintained.[103]

Although warranty claims and DHCR rent-reduction proceedings both deal with deprivation of services, the standards for granting relief are significantly different. DHCR's obligation to reduce the rent is mandatory unless the alleged deprivation of service is de minimis.[104] The Appellate Term has noted that the fundamental purpose of Real Property Law § 235-b is to address more significant deprivations of services: "to protect residential occupants from conditions 'dangerous, hazardous or detrimental…life, health [and] safety'…and to afford a remedy for deprivation in those 'essential functions' which a 'reasonable person' would expect a residence to provide."[105]

In *Solow v. Wellner*, the Appellate Term held that "perceived decreases in amenities and conveniences arguably forming the basis for an application to the Division of Housing and Community Renewal [to reduce the regulated rent] based upon the owner's failure to maintain required services…are not within the intended scope of Real Property Law § 235-b."[106]

DHCR's finding that a specific service is required to be provided as an ancillary service can still be binding on a court.[107] Conversely, a Housing Court stipulation that in general terms resolves habitability complaints does not prevent tenants from filing a specific service complaint with DHCR if the owner fails, on a going-forward basis, to provide services.[108]

To prevent duplicative reductions based on the same denial of services, both Real Property Law § 235-b and the Rent Stabilization Law were amended in 1997 to require both DHCR and Housing Court to take into account any reduction already received in the other forum for the same period.[109]

Must DHCR and Housing Court Listen to Each Other?

In light of their concurrent jurisdiction, DHCR and the courts often make their own factual and legal assessments. These assessments might impinge on future decisions independent of those assessments. How bound each forum is by the other's opinion depends on the subject matter of the pronouncement. In furtherance of its statutory responsibilities, DHCR makes administrative adjudications governing specific parties in administrative proceedings. It also issues more general interpretations on the rent laws and the Rent Stabilization Code. Each DHCR assessment is governed by a different standard.

Assuming that DHCR properly exercised its jurisdiction, a final DHCR administrative determination is dispositive of the parties' rights in the administrative proceeding and cannot be collaterally attacked in a court case.[110]

DHCR's more generalized assessment of the meaning of the law it administers is not necessarily entitled to that same deference. The Court of Appeals has enunciated two separate standards of review when DHCR makes a pronouncement regarding its interpretation of the Rent Stabilization Law. One involves DHCR's specialized expertise in evaluating factual data as the legislature specifically delegated to it.[111] The other involves DHCR's apprehension of the legislature's intent.[112] When the interpretation of a statute involves "knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn,"[113] the courts should defer to DCHR as the governmental agency charged with responsibility for administration if that interpretation is not irrational or unreasonable.[114]

On the other hand, if a question is "one of pure statutory reading and analysis dependent only upon accurate apprehension of legislative intent,"[115] the court accords no particular deference to DHCR's interpretation. Statutory construction is the court's function, not a specialized agency's.[116]

DHCR's interpretation of its own regulations is, however, entitled to a greater level of deference.[117] The interpretation given to a regulation by the agency that promulgated it and is responsible for its administration is entitled to deference if that interpretation is not irrational or unreasonable.[118]

Not Listening: Horizontal Multiple Dwellings

To withstand appellate review, neither Housing Court nor DHCR is required to reach the same result when acting as the trier of fact, even when the factual circumstances it adjudicates are arguably similar.

Both DHCR and the courts have been called upon to decide whether ostensibly separate structures are a single building of six or more units, the threshold number of units to be subject to the Rent Stabilization Law. These highly fact-specific "horizontal multiple dwelling" assessments are based on a variety of factors, including common ownership, management, delivery of services, and architectural fixtures. Each case turns on specific facts, with the bottom line that common ownership and a common heating plant is not enough.[119] Housing Court's review of these factors need not mirror DHCR's.

In *Bambeck v. DHCR*, the Appellate Division, in upholding DHCR's determination that the building constituted a horizontal multiple dwelling, distinguished various Housing Court decisions and found that elements of commonality, similar to those in *Bambeck*, were insufficient to constitute a horizontal multiple dwelling.[120] The court noted that some cases have held that contiguous buildings were separate and did not constitute horizontal multiple dwellings. However, the court stated that "significantly" the issues in those cases were presented to the courts in the first instance and not on judicial review of an administrative determination.[121]

In *Howell v. Francesco*, the Appellate Term was faced with the opposite situation: a tenant cited to factually similar DHCR determinations that buildings constituted a horizontal multiple dwelling as precedent although Housing Court had found the tenant's building to be separate premises.[122] The court held that DHCR precedents are not binding on Housing Court.[123] As the Appellate Term explained, DHCR cases supporting a contrary result "arise from administrative determinations involving a more deferential standard of review."[124]

Not Listening and Registration

DHCR and the courts have taken different positions concerning the consequences of an owner's failure to serve the initial rent-stabilized registration when the apartment was rent controlled.

In plenary actions, notably in *Smitten v. 56 MacDougal Street*, the court had determined that an owner's failure to serve the initial registration would result in the first rent-stabilized tenant's rent frozen at the prior rent-controlled rate.[125]

Conversely, rather than freezing the rent at the earlier rent-controlled rent, DHCR held that an owner's failure to serve the registration extended the time to commence a fair-market rent appeal to challenge the initial stabilized rent.[126] In a fair-market rent appeal, DHCR compares the initial stabilized rent against a guideline promulgated by the Rent Guidelines Board with rents generally prevailing in the same areas for substantially similar housing accommodations and directs a refund if the initial rent exceeds those standards.[127]

The Appellate Division has rejected litigation seeking to compel DHCR to follow the *Smitten* rule.[128] As with horizontal multiple dwellings, the Appellate Division held that its own affirmance in *Smitten* was not germane to its review of a DHCR determination in which a court will defer to the agency's own methodology and procedures if they are rationally based.[129]

As noted in subsequent litigation, the use of these two separate standards was eventually extinguished by legislation removing the rent freeze as a possible penalty for failing to serve an initial registration.[130] Nonetheless, this divergence of approach on penalties for registration later replicated itself. In 2000, the New York City Council enacted a requirement that upon high-income / vacancy deregulation, owners must serve an "exit registration" on the first tenant after deregulation.[131] In plenary actions, courts assumed that the failure to serve an exit registration barred the apartment's deregulation.[132]

On the other hand, in a case involving a DHCR determination, the court found that an owner's failure to serve this registration cannot preclude the deregulation of an apartment.[133] State legislation had mandated deregulation, and the City Council could not modify that result.[134]

To gain some consistency in approach, DHCR has proposed legislation that would make this exit registration a state legislative requirement and extend the ordinary four-year period of overcharge review until service of the registration was effected.[135]

Examples of Listening

In several instances, DHCR has departed from its own internal precedent, changing policy on the strength of court cases dealing with the same subject matter.

In *Rosario v. Diagonal Realty*,[136] DHCR appeared as amicus in the Court of Appeals supporting a position that an owner whose tenant is the recipient of a Section 8 voucher must continue that participation in the federal Section 8 rent-subsidy program. Although federal law might not have compelled that continuation, the Rent Stabilization Law's requirement of renewing leases required that the owner continue to accept Section 8 subsidies as a term and condition of the lease. The courts had split on this issue. In its own administrative determination, DHCR initially sided with those courts that had found that Section 8 participation need not be continued.[137] In taking the opposite position as amicus, DHCR disavowed its prior decisions, which had primarily relied on what had become the minority view of those courts that had reviewed the issue.[138]

Another example is preferential rents. In 2003, the legislature codified the rules governing preferential rents.[139] Preferential rents are rents charged to and paid by the tenant that are less than the legal rent allowed under the Rent Stabilization Law.[140] The legislature provided that rents "may be charged upon renewal or upon vacancy…at the option of the owner, be based on such previously established legal rent…."[141] In short, the owner's obligation to accept a lower rent terminated with the actual lease that contained a preferential rent provision rather than continuing through mandated renewal leases.

DHCR initially took the position that this codification overrode agreements to the contrary in which an owner expressly agreed to continue a preferential rent throughout subsequent renewals. Courts had ruled otherwise,[142] and DHCR changed its position to conform to the courts.[143]

How Can Housing Court and DHCR Communicate?

Housing Court and DHCR rarely communicate face to face. DHCR will comply with properly served subpoenas to produce documents (assuming that the production of documents would be appropriate). DHCR personnel cannot be subpoenaed to explain policies, procedures, or the impact of specific orders or to testify about the regulated rent of a housing accommodation.[144] Doing so constitutes coerced expert-opinion evidence that is as inappropriate from government officials as it would be from members of the public.[145]

For DHCR to provide subpoenaed records, a court must issue the subpoena.[146] DHCR may comply through the production of a certified copy of the record without a witness for authentication.[147] Proof of registration, a prerequisite for nonpayment proceedings, has been traditionally obtained this way.

Under a memorandum of understanding between DHCR and the Office of Court Administration, DHCR is making available to Housing Court electronic access to relevant registration data to obviate the need for subpoenas or paper transfers.[148] Housing Court will be able to ascertain whether the apartment is registered, what years it has been registered, the registered rent for the apartment, and the most recently registered owner/agent.

Although this information will satisfy certain affirmative pleading and proof requirements, registration data is not by itself dispositive of the legality of a registered rent or the regulated status of an apartment. Nonetheless, registration data can be useful in resolving or narrowing what might be in dispute.

As to administrative proceedings before DHCR, DHCR may expedite a case at the court's request "where there is a pending DHCR matter which will aid in the resolution of a case before the Court."[149]

> *"The sheer volume of affirmative cases generated by the Rent Stabilization Law and the rent law's complexity makes DHCR's role as adjudicator and specialist important and crucial."*

Even when there is no pending DHCR case, DHCR may respond to written inquires on certain points of law from a court. The legislature has provided that "[i]n any action or proceeding before a court wherein a party relies for a ground of relief…or brings into question the construction or validity of this act or any regulation, order or requirement hereunder, the court…may at any stage certify such fact to the division of housing and community renewal."[150]

Conclusion

Dual jurisdiction is a necessary adjunct of the responsibilities of both Housing Court and DHCR. Resolving matters within the court's purview requires resolving rent-stabilization issues to afford complete relief to the parties. However, many rent-stabilization issues can be raised only in Housing Court by a tenant's affirmative defense or counterclaim. The sheer volume of affirmative cases generated by the Rent Stabilization Law and the rent law's complexity makes DHCR's role as adjudicator and specialist important and crucial.

Although Housing Court and DHCR disagree over specific matters of implementation, the benefits of having these two separate adjudicators outweigh any detriment. In the process of resolving these disagreements, the administration and proper interpretation of the Rent Stabilization Law is enhanced by obtaining different points of view.

Endnotes

1. *See, e.g.*, Roberts v. Tischman, 13 N.Y.3d 270, 295, 918 N.E.2d 900, 913, 890 N.Y.S.2d 388, 392 (2009) (quoting 89 Christopher St. Inc. v. Joy, 35 N.Y.2d 213, 215, 318 N.E.2d 776, 780, 360 N.Y.S.2d 612, 640 (1974)); City of New York v. State of N.Y. Div. of Hous. & Cmty. Renewal, 97 N.Y.2d 216, 219, 765 N.E.2d 829, 830, 739 N.Y.S.2d 333, 334 (2001); LaGuardia v. Cavanaugh, 53 N.Y.2d 67, 69, 423 N.E.2d 9, 18, 440 N.Y.S.2d 586, 586 (1981).
2. *Tischman*, 13 N.Y.3d at 295, 918 N.E.2d at 913, 890 N.Y.S.2d at 388.
3. *89 Christopher St.*, 35 N.Y.2d at 220, 318 N.E.2d at 780, 360 N.Y.S.2d at 618.
4. *See* N.Y. Admin Code tit. 26, ch. 3, §§ 26-401, 26-501 (LEXIS 2009); N.Y. Unconsol. Laws §§ 8522, 8602, 8622 (McKinney 2010).
5. *89 Christopher St.*, 35 N.Y.2d at 220, 318 N.E.2d at 780, 360 N.Y.S.2d at 618.
6. *Id.* (holding that the real resolution lies with legislative authority).
7. *Id.* (noting what is at stake for tenants and landowners).
8. *See New York City Civil Court Housing Part*, New York State Unified Court System, http://www.nycourts.gov/courts/nyc/housing/index.shtml (last visited Oct. 19, 2010); *see also History of DHCR and Past Commissioners*, nysdhcr.gov, http://nysdhcr.gov/AboutUs/history.htm (last visited Oct. 20, 2010).
9. *See* Harvey Schmidt & Tom Jones, The Fantasticks (30th anniversary ed. 1990); The Fantasticks Official Website, http://www.thefantasticks.com/webpages/home.html (last visited Oct. 20, 2010).
10. *See* Fern Fisher & Andrew Scherer, Residential Landlord-Tenant Law in New York, § 4.1 (2009-2010).
11. N.Y. Admin. Code tit. 26, ch. 3, § 26-403(1)(h) (LEXIS 2009).
12. *See id.* § 26-403(9).
13. *See id.* § 26-501.
14. *See* N.Y. Unconsol. Laws § 8621 (McKinney 2010).
15. *See id.* §§ 8625(a)(4)–(5); N.Y. Admin. Code tit. 26, ch. 3, § 26-504(a).
16. *See* N.Y. Admin Code tit. 26, ch. 3, § 26-511(c)(4).

17. *See id.* § 26-510(b).

18. *See id.* § 26-511(c)(13).

19. *See id.*

20. *See id.*

21. *See id.* § 26-511(c)(6)(b).

22. *See* N.Y. Admin Code tit. 26, ch. 3, § 26-511(c)(8).

23. *See id.* §§ 26-511(c)(6)(b), 26-514.

24. *See id.* § 26-511(c)(3).

25. *See id.* § 26-516(a).

26. *Id.* § 26-513(b)(1).

27. *See* N.Y. Unconsol. Laws § 8625(a)(11) (McKinney 2010).

28. *See* N.Y. Admin. Code tit. 26, ch. 3, §§ 26-504.1, 26-504.3.

29. *See id.* § 26-504.2(a).

30. *See id.* § 26-517.

31. *See id.* §§ 26-517(c), 26-513(d)–(e).

32. *See id.* § 26-504.2(b).

33. N.Y. Exec. Law §§ 31(6), 260 (LEXIS 2010).

34. N.Y. Pub. Hous. Law art. II, §§ 10, 226 (LEXIS 2010).

35. *See NYS Division of Housing & Community Renewal: Agency Description*, nysdhcr.gov, http://nysdhcr.gov/AboutUs/AgencyDescription.htm (last visited Oct. 20, 2010).

36. *See NYS Division of Housing & Community Renewal: Office of Community Development*, nysdhcr.gov, http://nysdhcr.gov/AboutUs/Offices/CommunityDevelopment/ (last visited Oct. 20, 2010).

37. *See* N.Y. Private Hous. Fin. Law, art. III, § 45-a (LEXIS 2010).

38. Press Release, *New York's Top Housing Official Announces Consolidation of Housing Agencies to Form Single New Organization* (Sept. 22, 2010), nysdhcr.gov, http://nyshcr.org/Press/News100922.htm (last visited Oct. 20, 2010).

39. *See id.*

40. *See id.*

41. *See id.*

42. Ch. 403, § 1, 1983 N.Y. Laws 698 (McKinney).

43. N.Y. Unconsol. Laws § 8628(a) (McKinney 2010).

44. N.Y.C.R.R. tit. 9, ch. VIII, § 2520 (LEXIS 2010).

45. N.Y. Admin. Code tit. 26, ch. 4, § 26-511(b).

46. N.Y.C.R.R. tit. 9, ch. VIII, § 2527.1.

47. *See* N.Y.C.R.R. tit. 9, ch. VIII, § 2527.4.

48. *See id.* § 2527.5(b).

49. *See id.* § 2527.5(h).

50. *See id.* § 2529.1.

51. *See id.* § 2529.8.

52. For more explanation of DHCR's administrative procedure and Article 78 proceedings, see David Finkelstein & Lucas A. Ferrara, New York Practice Series – Landlord and Tenant Practice in New York, § 17:51 (Westlaw 2009-2010 ed.), *available at* NYPRAC-LT 17:51.

53. *See* N.Y. City Civ. Ct. Act § 110 (McKinney 2010).

54. L.1972, c. 982, § 1(a), as amended by L.1978, c. 310, § 4, eff. June 19, 1978 (legislative findings and statement of policy for N.Y. Civil Court Act §110).

55. *Id.* § 1(b).

56. Schanzer v. Vendome, 7 Misc. 3d 1018(A), 801 N.Y.S.2d 242 (N.Y. Civ. Ct. N.Y. County 2005) (Gerald Lebovits, J.).

57. *See* Central Park Gardens v. Klein, 107 Misc. 2d 414, 414, 434 N.Y.S.2d 125, 126, 1980 N.Y. Misc. LEXIS 2869 (N.Y. Civ. Ct. N.Y. County 1980).

58. *See* N.Y. Civ. Ct. Act § 208(a); *see also* Rockaway Ave. Co. v. Wiggins, 35 A.D.3d 36, 43, 822 N.Y.S.2d 103, 109 (2d Dep't 2006); Vasquez v. Sichel, 12 Misc. 3d 604, 605, 814 N.Y.S.2d 482, 483 (N.Y. Civ. Ct. N.Y. County 2005).

59. *See* N.Y. Const. art. VI, § 7(b).

60. *Id.* § 7(a).

61. *See id.* § 7(b).

62. *See* Sohn v. Calderon, 78 N.Y.2d 755, 761, 587 N.E.2d 807, 808, 579 N.Y.S.2d 940, 941 (1991); Loretto v. Teleprompter Manhattan CATV Corp., 58 N.Y.2d 143, 147, 446 N.E.2d 428, 431, 459 N.Y.S.2d 743, 746 (1983).

63. 78 N.Y.2d at 762, 587 N.E.2d at 809, 579 N.Y.S.2d at 942.

64. *Id.* at 765, 587 N.E.2d at 810, 579 N.Y.S.2d 943.

65. N.Y. Admin. Code tit. 26, ch. 3, § 26-408(b) (McKinney 2009); *see Sohn*, 78 N.Y.2d at 764–68, 587 N.E.2d at 810–13, 579 N.Y.S.2d at 934–36.

66. *See* N.Y.C.R.R. tit. 9, ch. VIII, § 2522.3(a) (McKinney 2010) (stating that a tenant has a right to file the fair market rent appeal with the DHCR if the initial rent exceeds the fair market rent for the housing accommodation); 430 Realty Co. LLC v. Heftler, 185 Misc. 2d 450, 461, 712 N.Y.S.2d 853, 860 (N.Y. Civ. Ct. N.Y. County 2000) (citing Smitten v. 56 MacDougal St. Co., 167 A.D.2d 205, 206, 561 N.Y.S.2d 585, 586 (1st Dep't 1990), *superseded by statute,* N.Y.C. Rent Stab. Law § 2521.1(a)(1) (McKinney 2010), *as recognized in* Ramlie v. Soufer Family LLC, 287 A.D.2d 388, 388, 731 N.Y.S.2d 455, 455 (1st Dep't 2001)).

67. *See* Emergency Tenant Protection Act of 1983, Ch. 403, §55, 1983 N.Y. Laws 739-40 (McKinney) (codified at N.Y. Unconsol. Laws § 8625(a)(11) (McKinney 2010)).

68. *See Sohn*, 78 N.Y.2d at 768, 587 N.E.2d at 812, 579 N.Y.S.2d at 940 (quoting Capital Tel. Co., Inc. v. Pattersonville Tel. Co., Inc., 56 N.Y.2d 11, 22, 436 N.E.2d 461, 466, 451 N.Y.S.2d 11, 16 (1982)).

69. *See Sohn*, 78 N.Y.2d at 768, 587 N.E.2d at 812, 579 N.Y.S.2d at 945.

70. *See* 274 A.D.2d 318, 318, 711 N.Y.S.2d 4, 5–6 (1st Dep't 2000).

71. *See* 2008 N.Y. Slip Op. 30246(U), *2 (N.Y. Sup. Ct. N.Y. County 2008); *see also* In re Young v. Town of Bedford, 37 A.D.3d 729, 729, 831 N.Y.S.2d 224, 225 (2d Dep't 2007); Davidson v. 506 E. 88th St. LLC, 2008 WL 293052, 2008 N.Y. Slip Op. 30246(U).

72. *See Davidson*, 2008 WL 293052, 2008 N.Y. Slip Op. 30246(U) at *2.

73. *See, e.g.*, Bartley v. Watentas, 78 A.D.2d 310, 313, 434 N.Y.S.2d 379, 382 (1st Dep't 1980).

74. *See, e.g.*, Jenkins v. State of N.Y. Div. of Hous. & Cmty. Renewal, 264 A.D.2d 681, 681, 695 N.Y.S.2d 563, 564 (1st Dep't 1999); *In re* Matter of Smith, 254 A.D.2d 424, 424, 678 N.Y.S.2d 745, 745 (2d Dep't 1998); Crimmins v. Handler & Co., 249 A.D.2d 89, 91, 671 N.Y.S.2d 469, 471 (1st Dep't 1998); Draper v. Georgia Prop., Inc., 230 A.D.2d 455, 460, 660 N.Y.S.2d 556, 560 (1st Dep't 1997) (Andrias, J., dissenting), *aff'd*, *Draper*, 94 N.Y.2d 809, 811, 723 N.E.2d 71, 72, 701 N.Y.S.2d 322, 323 (1999); *Smitten*, 167 A.D.2d at 206, 561 N.Y.S.2d at 585 (1st Dep't 1990), *superseded by statute,* N.Y.C. Rent Stab. Law § 2521.1, *as recognized in* Ramlie v. Soufer Family LLC, 287 A.D.2d 388, 388, 731 N.Y.S.2d 455, 455 (1st Dep't 2001).

75. *See* Vazquez v. Sichel, 12 Misc. 3d 604, 607, 814 N.Y.S.2d 482, 485 (N.Y. Civ. Ct. N.Y. County 2005) (discussing both New York City Administrative Code § 26-516(a) as well as N.Y.C.R.R. § 2526.1(a)(1)).

76. *See Vazquez*, 12 Misc. 3d at 608, 814 N.Y.S.2d at 486 (citing Ling Ling Yung v. County of Nassau, 77 N.Y.2d 568, 572, 571 N.E.2d 669, 671, 569 N.Y.S.2d 361, 363 (1991)).

77. *See* H.O. Realty Corp. v. State of N.Y. Div. of Hous. & Cmty. Renewal, 46 A.D.3d 103, 107, 844 N.Y.S.2d 204, 207 (1st Dep't 2007) (Sweeny, J., dissenting); N.Y.C. Rent Stab. Law § 26-516(a) (McKinney 2009).

78. *See id.*

79. N.Y. Admin. Code tit. 26, ch.4, § 26-516(a); *see H.O. Realty Corp.*, 46 A.D.3d at 106, 844 N.Y.S.2d at 206–07 (1st Dep't 2007).

80. *See, e.g.*, Rockaway One Co., LLC v. Wiggins, 35 A.D.3d 36, 39–40, 822 N.Y.S.2d 103, 106–07 (2d Dep't 2006);

Vazquez, 12 Misc. 3d at 611, 814 N.Y.S.2d at 488.

81. *See Rockaway One Co.*, 35 A.D.3d at 38, 822 N.Y.S.2d at 109; *Vasquez*, 12 Misc. 3d at 606, 814 N.Y.S.2d at 484–85.

82. *Rockaway One Co.*, 35 A.D.3d at 38, 822 N.Y.S.2d at 109.

83. *See Vasquez*, 12 Misc. 3d at 607, 814 N.Y.S.2d at 485.

84. *Id.* at 612, 814 N.Y.S.2d at 489.

85. *See Rockaway One Co., LLC*, 35 A.D.3d at 42, 822 N.Y.S.2d at 108.

86. *See id.* at 43, 822 N.Y.S.2d at 109.

87. *See* Jemrock Realty Co, LLC v. Krugman, 13 N.Y.3d 924, 926, 922 N.E.2d 870, 871, 895 N.Y.S.2d 284, 285 (1st Dep't 2010).

88. *See id.*

89. *Id.*

90. *See id.*

91. *See, e.g.*, Fenster v. 37 W. 72nd St. Inc., 906 N.Y.S.2d 860, 864, 2010 N.Y. Misc. Lexis 3481, *12 (Sup. Ct. N.Y. County 2010).

92. *See* Graham Court Owners Corp. v. State of N.Y. Div. of Hous. & Cmty. Renewal, 71 A.D.3d 515, 516, 899 N.Y.S.2d 7, 8 (1st Dep't 2010); Merit Mgmt. LLC v. State of N.Y. Div. of Hous. & Cmty. Renewal, 278 A.D.2d 178, 718 N.Y.S.2d 336, 337 (1st Dep't 2000).

93. Roberts v. Tishman, 13 N.Y.3d 270, 286, 918 N.E.2d 900, 906, 890 N.Y.S.2d 388, 390 (2009).

94. *See, e.g.*, Nezry v. Haven Ave. Owner LLC, 28 Misc. 3d 1226A, 2010 N.Y. Slip Op. 51506(U) (Sup. Ct. N.Y. County 2010*); see also* Independence Plaza N. Tenants' Ass'n, 2010 N.Y. Slip Op. 20353, 2010 N.Y. Misc. LEXIS 4131 (Sup. Ct. N.Y. County 2010).

95. *E.g.*, Vazquez v. Sichel, 12 Misc. 3d 604, 605, 814 N.Y.S.2d 482, 484 (N.Y. Civ. Ct. N.Y. County 2005).

96. *E.g.*, Gerard v. Clermont York Assocs. LLC, Sup. Ct. N.Y. County Index No. 101150/2010 (Aug. 3, 2010) (Sherwood, J.) (unpublished opinion).

97. *See* Firstmark Development Co., Inc. v. N.Y. State Div. of Hous. & Cmty. Renewal, 283 A.D.2d 274, 276, 726 N.Y.S.2d 391, 393 (1st Dep't 2001).

98. *See, e.g.*, 4947 Assocs. v. State of N.Y. Div. of Hous. & Cmty. Renewal, 199 A.D.2d 179, 179, 605 N.Y.S.2d 91, 92 (1st Dep't 1993); Hampares v. State of N.Y. Div. of Hous. & Cmty. Renewal, 283 A.D.2d 311, 312, 724 N.Y.S.2d 844, 849 (1st Dep't 2001).

99. *See* Graham Court Owners Corp. v. Allen, N.Y.L.J., Aug. 17, 1994, at 22, col. 6 (N.Y. Civ. Ct. N.Y. County) (citing Terrace Realty Co. v. Morales, N.Y.L.J., Jan. 5 1994, at 28, col. 6 (Yonkers City Ct.) (previous filing of rent overcharge claim with DHCR is grounds for dismissal of rent overcharge defense or counterclaim)).

100. *See, e.g.*, Gardner v. State of N.Y. Div. of Hous. & Cmty. Renewal, 166 Misc. 2d 290, 297, 630 N.Y.S.2d 744, 748 (Sup. Ct. Bronx County 1995).

101. *See* Missionary Sisters of the Sacred Heart v. Meer, 131 A.D.2d 393, 396, 517 N.Y.S.2d 504, 507 (1st Dep't 1987).

102. *See, e.g.*, Ludlow Props., LLC v. Young, 4 Misc. 3d 515, 520, 780 N.Y.S.2d 853, 857 (N.Y. Civ. Ct., N.Y. County 1994) (holding that a 45-percent rent abatement was appropriate for those months during which the apartment continued to be infested with bed bugs); Port Chester Hous. Auth. v. Mobley, 6 Misc. 3d 32, 34, 789 N.Y.S.2d 798, 800 (Sup. Ct. App. T. 1st Dep't 2004) (holding that the tenant was only entitled to a rent abatement based on the Authority's failure to correct an insect and rodent infestation).

103. *See* N.Y.C.R.R. tit. 26, ch. IV, § 26-514 (LEXIS 2009).

104. *See, e.g.*, Hyde Park Gardens v. State of N.Y. Div. of Hous. & Cmty. Renewal, 73 N.Y.2d 998, 1000, 539 N.E.2d 101, 102, 541 N.Y.S.2d 345, 346 (1989); ANF Co. v. State of N.Y. Div. of Hous. & Cmty. Renewal, 176 A.D.2d 518, 520, 574 N.Y.S.2d 709, 710 (1st Dep't 1991). For de minimis, see N.Y. R.C.N.Y. tit. 9, ch. 8, § 2523-4(e) (LEXIS 2010).

105. Solow v. Wellner, 154 Misc. 2d 737, 740–41, 595 N.Y.S.2d 619, 621 (Sup. Ct. App. T. 1st Dep't 1992) (citations omitted).

106. *Id.*

107. *See Missionary Sisters*, 131 A.D.2d at 394, 517 N.Y.S.2d at 505.

108. *See* Delano Vill. Co. v. State of N.Y. Div. of Hous. & Cmty. Renewal, 245 A.D.2d 196, 197, 666 N.Y.S.2d 617, 618 (1st Dep't 1997); *see also*, Hyde Park Gardens v. State of N.Y. Div. of Hous. & Cmty. Renewal, 73 N.Y.2d 998, 539 N.E.2d 101, 541 N.Y.S.2d 345 (2d Dep't 1989).

109. *See* N.Y. ADMIN. CODE § 26-514 (as amended by Ch. 116 of the Laws of 1997, § 42) (providing that "the amount of reduction in rent ordered by the state division of housing and community renewal under this subdivision shall be reduced by any credit, abatement or offset in rent which the tenant has received pursuant to section two hundred thirty-five b of the real property law, that relates to one or more conditions covered by such order"); N.Y. REAL PROP. LAW § 235-b(3)(c) (McKinney 2010) (added by c.116 of the laws of 1997, § 39) (providing that "where the premises is subject to regulation pursuant to the local emergency housing rent control law, the emergency tenant protection act of [1974], the rent stabilization law of [1969] or the city rent and rehabilitation law, [the court shall] reduce the amount awarded hereunder by the total amount of any rent reduction ordered by the state division of housing and community renewal pursuant to such laws or act, awarded to the tenant, from the effective date of such rent reduction order, that relates to one or more matters for which relief is awarded hereunder").

110. *See* Gild v. Fried, 298 A.D.2d 275, 748 N.Y.2d 736 (1st Dep't 2002); Stone v. Goldberg, 215 A.D.2d 180, 180, 625 N.Y.S.2d 568, 568 (1st Dep't 1995); Chatsworth 72nd St. Corp. v. Rigai, 71 Misc. 2d 647, 651, 336 N.Y.S.2d 604, 609 (N.Y. Civ. Ct. N.Y. County 1972).

111. *See* Ansonia Residents Ass'n v. N.Y. State Div. of Hous. & Cmty. Renewal, 75 N.Y.2d 206, 213, 551 N.E.2d 72, 74, 551 N.Y.S.2d 871, 873 (1st Dep't 1989).

112. *See id.* at 214.

113. *Id.* at 213.

114. *See id.*

115. *Id.* at 214. Although the application of these two standards most often arises in court review of DHCR's determinations, it is not limited to those instances. *See, e.g.*, Roberts v. Tishman, 13 N.Y.3d 270, 918 N.E.2d 900, 890 N.Y.S.2d 388 (2009).

116. *See Ansonia Residents*, 75 N.Y.2d at 214.

117. *See* Gaines v. State of N.Y. Div. of Hous. & Cmty. Renewal, 90 N.Y.2d 545, 548–49, 686 N.E.2d 1343, 1344–45, 664 N.Y.S.2d 249, 250–51 (1997) (citations omitted).

118. *See id.*

119. Salvati v. Eimicke, 72 N.Y.2d 784, 792, 533 N.E.2d 1045, 1048, 537 N.Y.S.2d 16, 19 (1st Dep't 1988); ANDREW SCHERER, RESIDENTIAL LANDLORD TENANT IN NEW YORK §§ 4:32–4:33 (2009-2010 ed.).

120. *See* In re Bambeck v. State of N.Y. Div. of Hous. & Cmty. Renewal, 129 A.D.2d 51, 57, 517 N.Y.S.2d 130, 136 (1st Dep't 1987).

121. *Id.*

122. *See* Howell v. Francesco, 195 Misc. 2d 844, 845, 760 N.Y.S.2d 618, 619 (Sup. Ct. App. T. 2d Dep't 2003).

123. *See id.* at 846, 760 N.Y.S.2d at 619 (noting that "most of the cases cited by tenants as supporting a contrary result arise from administrative determinations involving a more deferential standard of review"); *In re Bambeck*, 129 A.D.2d at 57–58, 517 N.Y.S.2d at 134–135 (1st Dep't 1987).

124. *Howell*, 195 Misc. 2d at 845, 760 N.Y.S.2d at 619.

125. *See* Smitten v. 56 MacDougal Street, 167 A.D.2d 205, 206, 561 N.Y.S.2d 585, 585 (1st Dep't 1990).

126. *See* 430 Realty Co., L.L.C. v. Heftler, 185 Misc. 2d 450, 460, 712 N.Y.S.2d 853, 860 (1st Dep't 2004) (noting that the DHCR exercises exclusive original jurisdiction in fair market rent appeals).

127. *See* N.Y. ADMIN. CODE § 26-513(b)(1).

128. *See, e.g.*, Acunto v. State of N.Y. Div. of Hous. & Cmty. Renewal, 269 A.D.2d 169, 169, 702 N.Y.S.2d 811, 812 (1st Dep't 2000); Dattoma v. State of N.Y. Div. of Hous. & Cmty. Renewal, 262 A.D.2d 54, 54, 689 N.Y.S.2d 634, 634 (1st Dep't 1999).

129. *See Acunto*, 269 A.D. 2d at 169, 702 N.Y.S.2d at 812; *see also Smitten*, 167 A.D.2d at 206, 561 N.Y.S.2d at 585.

130. *See, e.g.*, Tribeca M. Corp. v. Haller, N.Y.L.J., Sept. 17, 2003, at 17, col. 1 (N.Y. Civ. Ct. N.Y. County); *see also* Murray v. Morrison, 181 Misc. 2d 209, 214, 695 N.Y.S.2d 255, 259 (Sup. Ct. App. T. 2d Dep't 1999).

131. *See* N.Y. ADMIN. CODE § 26-504.2(b).

132. *See* Tribeca M. Corp. v. Haller, N.Y.L.J., Sept. 17, 2005, at 20, col. 3 (App. T. 1st Dep't 2006), *aff'g*, 11 Misc. 3d 134(A), 816 N.Y.S.2d 702 (Civ. Ct. N.Y. County 2003) (Gerald Lebovits, J.); *see also*, 430 Realty Co. LLC v. Heftler, 185 Misc. 2d 450, 457, 712 N.Y.S.2d 853, 858 (Sup. Ct. App. T. 2d Dep't 2000).

133. *See, e.g.*, Bronner v. State of N.Y. Div. of Hous. & Cmty. Renewal, 3 A.D.3d 430, 431, 771 N.Y.S.2d 121, 122 (1st Dep't 2004) ("In any event, any alleged failure to serve petitioners with such notice did not extend DHCR's jurisdiction to consider the question of deregulation in the latest proceeding.") (citation omitted).

134. *See id.*

135. Despite the legal possibility of different remedies existing side by side to enforce on the same substantive statutory provision, ultimately it is in the best interest on broad issues that these inconsistencies be resolved. Inconsistent assessments of interest on service orders that a tenant has not enforced and its consequences given the four-year statute of limitations is pending before the Court of Appeals for resolution. *See* In re Cintron v. Calogero, 59 A.D.3d 345, 346, 875 N.Y.S.2d 76, 77 (1st Dep't 2009) (holding that pursuant to Rent Stabilization Law of 1969, DHCR appropriately limited recoverable amount to four years prior to the filing of the overcharge complaint, and the amount of treble damages to the two years prior to the filing of said complaint). *But cf.* Jenkins v. Fieldbridge, 65 A.D.3d 169, 172, 877 N.Y.S.2d 375, 377 (2d Dep't 2009) (finding that the trial court cannot examine the rental history prior to four-year period preceding the filing of the rent overcharge complaint and the trial court could consider the rent reduction order when considering both CPLR § 213(a) and N.Y. ADMIN. CODE § 26-514). *See also* Rich v. 105th St. Assoc. LLC, 906 N.Y.S.2d 23, 25, (1st Dep't 2010) (holding that the proper legal regulated rent for purposes of determining an overcharge is deemed to be the rent charged on the base date, plus any subsequent lawful increases or adjustments, and that the base date in these cases is four years before the filing of the overcharge complaint).

136. Rosario v. Diagonal Realty, 8 N.Y.3d 755, 760, 872 N.E.2d 860, 862, 840 N.Y.S.2d 748, 748 (1st Dep't 2007).

137. *See* Memorandum, Gregory A. Kern, *Landlords Attempting to Opt Out of Section Eight for Rent Stabilized Apartments,* New York City Housing Authority Leased Housing Department (Jul. 23, 2003), *available at* https://a996-housingauthority.nyc.gov/Landlord/view_doc.aspx?id=153 (explaining that in 2002, DHCR released a Commissioner's Order and Opinion which agreed with two decisions from Westchester County that held a landlord of an occupied Section 8 rent-stabilized apartment could offer a tenant a renewal term without a Section 8 subsidy).

138. In re Admin. Appeal of Highland Mgmt. Corp., DHCR Ad Review Docket No. QB910041RO, DRO Docket No. PK910001RV (Nov. 6, 2002) (unpublished opinion) (citing 30 Eastchester LLC v. Healy, 2002 N.Y. Slip. Op. 40066(U), 2002 Misc. Lexis 233 (N.Y. Civ. Ct. Monroe County 2002)).

139. *See DCHR Fact Sheet # 40: Preferential Rents*, NEW YORK CITY RENT GUIDELINES BOARD, http://www.housingnyc.com/html/resources/dhcr/dhcr40.html (last visited Oct. 20, 2010) ("A preferential rent is a rent which an owner agrees to charge that is lower than the legal regulated rent that the owner could lawfully collect.").

140. *See id.*

141. N.Y. ADMIN. CODE § 26-511(c)(14) (as added by Ch. 82 of the Laws of 2003, § 6).

142. *See* Von Rosenvinge v. Wellington Fee, LLC, 19 Misc. 3d 1118A, 862 N.Y.S.2d 818 (Sup. Ct. N.Y. County 2006) (holding that the landlord may charge the legal regulated rent once the period of lease which contains preferential rent provision expires.)

143. *See* 218 E. 85 St. LLC v. State of N.Y. Div. of Hous. & Cmty. Renewal, 23 Misc. 3d 557, 562, 872 N.Y.S.2d 640, 645, 2009 N.Y. Misc. LEXIS 118, *2 (Sup. Ct. N.Y. County 2009) (holding that DHCR's interpretation of the 2003 amendment to the Rent Stabilization Law is rational when DHCR abandoned previous decisions and adopted the position that requires a renewal lease be offered on the "same terms and conditions" as in the previous lease).

144. *See DHCR Operational Bulletin 93-1*, NYSDHCR.GOV, http://www.dhcr.state.ny.us/Rent/OperationalBulletins/orao931.pdf (last visited Oct. 20, 2010).

145. *See* Headley v. City of N.Y., 21 N.Y.2d 786, 787, 235 N.E.2d 450, 451, 288 N.Y.S.2d 478, 479 (1st Dep't 1968) (affirming the trial court's decision refusing to allow the claimants to call appraisers for the city as witnesses).

146. *See* DHCR Operational Bulletin, *supra* note 143 (noting that the Office of Rent Administration will not respond to a subpoena unless it is a "judicial subpoena" that must be marked "So Ordered" and signed by a judge of the court issuing the subpoena).

147. *See* N.Y. CPLR § 2307 (McKinney Consol. 2010).

148. For example, when dealing with housing for persons with special needs, DHCR has developed an electronic system for Living Assistants ("LAS") to support the housing needs of persons with special needs. The system enables LAS to transmit necessary information, track program participation and facilitates prompt payments to landlord. *See NYS Division of Housing & Community Renewal: Housing for Persons with Special Needs*, NYSDHCR.GOV, www.ncsha.org/system/files/NYSDHCR_SN_Special+Needs.pdf (last visited Oct. 20, 2010).

149. *See Fact Sheet #34: Expedited Proceedings*, NYSDHCR.GOV, http://www.dhcr.state.ny.us/Rent/FactSheet/orafac34.pdf (last visited Oct. 20, 2010).

150. N.Y. UNCONSOL. LAWS § 8632(a)(7) (McKinney 2010).

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Condominium Law "Game Changer"?

By Victor M. Metsch and Michael P. Regan

While arguably lacking the devastating impact of "The Punch"[1] and the near-theological sports mystique of "The Immaculate Reception,"[2] the recently decided case of *Board of Managers of the Marbury Club Condominium v. Marbury Corners, LLC*[3] may resonate in the condominium community as "The Shot Heard 'Round the World."[4]

Marbury Corners upsets the (erroneous) conventional wisdom about both the immutable significance of disclosures made in, and the Attorney General's "approval" of, an offering plan, and the near sacred belief in the post-closing sanctity of sponsor-imposed provisions of the plan.

In *Marbury Corners*, several years after all the units had been sold, the court upheld a challenge to a $2.2 million note given to the sponsor by the sponsor-controlled board before the plan became effective. In a suit brought by the unit owner-elected board, the court held that the note, even though disclosed, was not authorized by law.

RPL "Ground Rules"

Real Property Law § 339-jj provides that, to the extent authorized by the declaration and by-laws, the board of managers may incur a debt on behalf of the unit owners. In addition, subject to the declaration and by-laws, the board of managers may incur a debt for limited purposes provided that (a) the debt is incurred no earlier than the fifth anniversary of the first conveyance and (b) a majority in common interest of the unit owners consents.

The sponsor argued that RPL § 339-jj did not apply because the promissory note was disclosed in the offering plan in the section entitled "SPECIAL RISKS," stating that "[u]pon the conveyance of title to the first Unit, the Condominium will execute and deliver to the Sponsor a Promissory Note in the amount of $2,200,000," and further disclosed that "the note would be for a term of 40 years" and "secured by a pledge of the Condominium's rights and interests to common charges, a security agreement and UCC-1 financing statements…." The Court called a "foul," ruling that such disclosure in the offering plan was no substitute for compliance with RPL § 339-jj.

The court also ruled "out of bounds" the sponsor's argument that the Attorney General's acceptance of the plan for filing constituted its approval of the plan's terms. The court noted that the Attorney General's responsibility with respect to a proposed offering plan is very limited. The Attorney General does not undertake an exhaustive investigation into the truth or legality of the plan's contents. Rather, the Attorney General's role is limited to determining whether basic information is being conveyed to prospective purchasers.

Sponsor's "Hail Mary" Justification for the Note

In response to the new board's challenge to the legality of the note, and the sponsor's secured interest in the unit owners' common charges, the sponsor offered the following justification. According to the sponsor, because the Village of Pelham had adopted the Homestead Tax Option under Section 1903 of the New York Real Property Tax Law, the units were going to be taxed at full market value, and sales prices for each unit would function as the basis for assessing taxes.

Because it feared that such tax treatment might turn off prospective purchasers, the sponsor withdrew the offering plan for the condominium and submitted to the Attorney General's office an offering plan for cooperative ownership. Cooperative ownership would, according to the sponsor, allow the building to be treated as a rental building for real estate tax purposes, resulting in lower taxes to the prospective purchasers. According to the sponsor, the Village threatened to rescind its approvals if the sponsor moved forward with its plan to change to cooperative ownership. To allegedly avoid a fight with the Village and delays in construction and completion of the building, the sponsor reverted to the condominium project and implemented a plan to attract purchasers.

The sponsor allegedly "reduced" the sales prices on which the assessed tax valuations would be based, thus making the units more marketable to prospective purchasers. The "balance" of the "full" purchase price for the units—represented by the $2.2 million note—would be paid by the unit owners through their common charges over a period of 40 years, payable interest only at a rate of 4.5% for the first five years, and payable thereafter at an interest rate of 5.5% with the principal to be amortized over a 35-year period.

The unit owners should have been pleased to receive these purported "tax savings," right? Wrong. Nowhere in the offering plan was the purpose or intent behind the note disclosed. The unit owners believed that the purchase price they paid for their units was the actual and full price.

Even if the sponsor had disclosed in the offering plan that the purpose of the note was to deprive the tax authority of tax money and to pay the sponsor the "balance" of the purchase prices, such a scheme would still violate RRL § 339-jj. In the absence of authority to issue the note in the condominium declaration or by-laws, the note was illegal.[5]

Call "Time Out" Before Making an Important Play

The moral of this story is two-fold. First, condominium sponsors must think twice before undertaking "creative" financing and pricing strategies. Unit owners are afforded certain protections by statute and common law, even before they purchase their units. Disclosure in the offering plan, a legal document prepared by the sponsor, does not give the sponsor carte blanche to implement every creative idea. And not all creative ideas are good ones in the eyes of the law.

Second, unit owners would be well advised to know their condominium documents—the declaration, the by-laws and the offering plan. Counsel can assist in that regard as well. To the untrained eye, the offering plan in this case seemed standard. But below the surface it contained illegal terms that might have otherwise cost the owners dearly.

Endnotes

1. On December 9, 1977, during an NBA game between the Los Angeles Lakers and the Houston Rockets, the Lakers' Kermit Washington infamously slugged and nearly killed the Rockets' Rudy Tomjanovich.
2. At Three Rivers Stadium on December 23, 1972, with 22 seconds and no timeouts remaining, Pittsburgh Steelers' running back Franco Harris caught a deflected pass, just before it hit the ground, from Steelers' quarterback Terry Bradshaw for a game-winning touchdown.
3. 28 Misc.3d 1240(A), 2010 WL 3730082, 2010 N.Y. Slip Op. 51650 (U) (Sup. Ct. West. County Sept. 22, 2010).
4. "The Giants Win the Pennant! The Giants Win the Pennant!" The game-ending home run at the Polo Grounds on October 3, 1952 by New York Giants' outfielder Bobby Thompson off Brooklyn Dodgers' pitcher Ralph Branca gave the pennant to the Giants over the Dodgers.
5. The court also granted the condominium's claim for damages and scheduled a conference for the purpose of considering resolution of that claim.

Victor M. Metsch, a Senior Litigation Partner at Hartman & Craven LLP, and Michael P. Regan, a Litigation Associate with the Firm, represented the condominium.

Bergman on Mortgage Foreclosures:
Another Statute of Limitations Loss for a Mortgage Holder

By Bruce J. Bergman

Faithful readers of this column should by now be familiar with the scary hidden dangers the statute of limitations presents for mortgagees in New York. It has happened yet again so the point is well worth reemphasizing. [See *Lavin v. Elmakiss*, 302 A.D.2d 638, 754 N.Y.S.2d 741 (3d Dept. 2003)]. That it was a private (rather than an institutional) lender who suffered the defeat doesn't diminish the peril.

Briefly mentioning anew the underlying principles will help explain the danger. The statute of limitations for a mortgage in New York is six years and it begins to run on each unpaid installment—*unless* the debt has been accelerated. Acceleration, of course, declares the debt due so that means the time period begins running at that moment. (Always remember that acceleration can be accomplished either by sending the appropriate letter declaring the balance due—which is typical—or by the filing of a complaint containing that declaration.)

The facts of the cited case are somewhat intertwined, but they set the stage for the underlying result. A Mr. Lavin bought a mobile home park, secured a first mortgage and a purchase money mortgage second mortgage from the seller (let's call him Elmakiss). By March, 1991, Lavin had defaulted on the second mortgage so Elmakiss duly sent an acceleration letter. There was a default on the first mortgage as well, which elicited a foreclosure action on that mortgage, intercepted by a bankruptcy filing by Elmakiss. The senior foreclosure did not proceed to sale and the junior never began a foreclosure.

The result of all the events (which we needn't relate here) was that in 1997, the borrower (Lavin) started an action against the second mortgagee (Elmakiss) to declare the debt unenforceable. Mortgagee Elmakiss counterclaimed for the outstanding sums due on the mortgage note—and lost.

The debt was accelerated in April of 1991. The junior mortgage holder for whatever reason never pursued its rights, until expressed in the counterclaim when sued by the borrower in 1998. But the acceleration had never gone away; it needed an affirmative act for that to happen.

Whether through foreclosure as plaintiff, or counterclaim as defendant, the action on the debt (foreclosure or on the note) was viable for six years. That expired in 1997 so the lender's counterclaim in 1998 was no good: barred by the statute of limitations.

So the slight twist here: Once there is an acceleration, the lender needs to attend to its rights. And saving those rights some day for a counterclaim won't avoid the calamity of the statute of limitations.

Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (rev. 2009), is a partner with Berkman, Henoch, Peterson & Peddy, P.C. in Garden City, New York, a member of the USFN and an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course. He is also a member of the American College of Real Estate Lawyers and the American College of Mortgage Attorneys.

Student Case Comment:

Adverse Possession—Third and Fourth Departments Provide Guidance on 2008 Amendments to RPAPL Article 5

By Alexander J. Nicas

In July 2008, the New York Legislature amended Article 5 of the Real Property Actions and Proceedings Laws ("RPAPL").[1] Sec. 501(2) of the newly amended act states: "[a]n adverse possessor gains title to the occupied real property upon the expiration of the statute of limitations…provided that the occupancy…has been adverse, under claim of right, open and notorious, continuous, exclusive, and actual."[2] Although the legislature noted that any amendments applied to all claims filed on or after July 2008,[3] uncertainty lingered as to how the legislation would affect a claim that allegedly vested[4] under the previous statute.

On March 19, 2010, the Appellate Division, Fourth Department clarified this issue in *Franza v. Olin*.[5] The plaintiff in *Franza* contended that the amendments were unconstitutional as applied to her because they deprived her of a vested property right. The Supreme Court, Onondaga County, dismissed the petition on the ground that plaintiff's uses—lawn mowing, landscaping, and erection of a shed and satellite receiver—were permissive and not adverse under the newly enacted RPAPL § 543.[6] The Fourth Department reversed, stating: "where title has vested by adverse possession, it may not be disturbed retroactively by newly-enacted or amended legislation."[7] The court further held: "inasmuch as title to the disputed property would have vested in plaintiff prior to the enactment of the 2008 amendments, we conclude that application of those amendments to plaintiff is unconstitutional."[8]

A few months later, the Appellate Division, Third Department addressed the retroactive application of the 2008 amendments to a claim of a prescriptive easement in *Barra v. Norfolk Southern Railway Co.*[9] To succeed on a prescriptive easement claim, a plaintiff must show that the use was open, notorious, continuous and hostile[10] for the prescriptive period.[11] Recognizing that "statutory changes affecting the laws of adverse possession concomitantly alter the common law doctrine of prescriptive easement," a ruling regarding the applicability of the 2008 amendments was necessary.[12] Quoting *Franza*, the court stated: "should plaintiffs succeed in proving their claims, titles to the easement would have vested prior to the effective date of the amendments and, consequently, '[they] may not be disturbed retroactively by newly-enacted or amended legislation.'"[13]

When advising clients regarding adverse possession or prescriptive easements, it is important to ascertain the date when property rights have vested in light of the 10-year statute of limitations for actions to recover possession of real property.[14] If this date is before the effective date of the new statute, the Appellate Division decisions allow litigants to apply the old version of Article 5 of the RPAPL.

Endnotes

1. Ch. 269, 2008 N.Y. Laws, McKinney's Session Law News of N.Y., WL NY-LEGIS 269 (2008).
2. Real Prop. Acts § 501(2) (McKinney 2010).
3. Ch. 269 § 9, 2008 N.Y. Laws, McKinney's Session Law News of N.Y., WL NY-LEGIS 269 (2008).
4. Legal title vests in the adverse possessor at the expiration of the statute of limitations, assuming all necessary elements have been satisfied for the required duration.
5. 73 A.D.3d 44, 897 N.Y.S.2d 804, 2010 N.Y. Slip Op. 02224 (4th Dep't 2010).
6. Under the former version of § 512(1), land was deemed to have been possessed and occupied if it had been "usually cultivated or improved." Evidence proffered by the plaintiff, and subsequently rebutted by current § 543, may have been sufficient to satisfy her burden under the old standard.
7. *Franza*, 72 A.D.3d at 47, 897 N.Y.S.2d at 807, 2010 N.Y. Slip Op. 02224 at *2.
8. *Id.* at 47-8, 897 N.Y.S2d at 808, N.Y. Slip Op. 02224 at *3.
9. 75 A.D.3d 821, 2010 N.Y. Slip Op. 06036, 2010 N.Y. App. Div. LEXIS 5903 (3rd Dep't 2010).
10. Ch. 269 § 2, 2008 N.Y. Laws, McKinney's Session Law News of N.Y., WL NY-LEGIS 269 (2008) (Hostility has been eliminated. The statute now only recognizes a claim of right to satisfy the element of adverse possession.).
11. *Barra*, 75 A.D.3d at 823, 2010 N.Y. Slip Op. 06036 at *2, 2010 N.Y. App. Div. LEXIS 5903 at *4.
12. *Id.* at n.5.
13. *Id.* at 826, 2010 N.Y. Slip. Op. 06036 at *4, 2010 N.Y. App. Div. LEXIS 5903 at *10 (quoting *Franza v. Olin*).
14. N.Y. CPLR 212.

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Student Case Comment: *Bacolitsas et al. v. 86th & 3rd Owner, LLC et al.*

By Matthew G. Ellias

Facts

Plaintiffs Vasilis Bacolitsas and Sofia Nikolaidou, both living outside of New York, entered into a purchase agreement with 86th & 3rd Owner, LLC (the "Sponsor") for a condominium unit in a building called the Brompton on the Upper East Side of Manhattan. Plaintiffs agreed to a purchase price of $3.4 million and paid a deposit of $340,000. The plaintiffs and the Sponsor scheduled two additional payments of $170,000 in the purchase agreement, stipulating that failure to make either payment would constitute an immediate default, with the Sponsor having an option to terminate the purchase agreement and retain the security deposit. The Sponsor later recorded a declaration for condominium ownership in the Office of the New York Register. Prior to executing their purchase agreement, the plaintiffs received a property report as required by the Interstate Land Sales Full Disclosure Act (ILSA). Their purchase agreement, however, was not acknowledged before a notary public. The plaintiffs subsequently failed to make the third installment payment of their deposit and the Sponsor sent the plaintiffs a notice of cancellation, terminating the purchase agreement. The plaintiffs filed an application with the New York Attorney General for the return of their deposit; it was rejected and the $520,662.34 in escrow, representing the original $510,000 plus interest, was released to the Sponsor.

Procedural History

The plaintiffs brought suit to enforce their revocation of the sales contract pursuant to ILSA, which they contended gave them the option to revoke the purchase agreement within two years of its execution.[1] This case came before the United States District Court for the Southern District of New York as a diversity case. The facts were not in dispute, and both parties moved for summary judgment as a matter of law. The plaintiffs' motion for summary judgment was granted.

Reasoning

The court determined that ILSA applied to the transaction in question, and ruled that the plaintiffs were entitled to rescind their purchase agreement and obtain a return of their deposit from the escrow account. Specifically, the court applied 15 U.S.C. 1703(d)(1), which permits purchasers to revoke any contract that does not provide a description of the lot that makes it clearly identifiable, or that is not in a form acceptable for recording. New York law does permit the recording of an executory contract for the sale, purchase or exchange of real property, but without notary acknowledgement a real estate sales contract cannot be recorded.[2] Since the purchase agreement with the Sponsor was not acknowledged, it was not in a form acceptable for recording. As a result, the plaintiffs were entitled to revoke the agreement and obtain a refund of their deposit.

Endnotes

1. ILSA was enacted as part of the Housing and Urban Development Act of 1968, and was designed to protect out-of-state buyers from unscrupulous sales of underdeveloped home sites. Sections 1703(d)(1) and (3) guarantee the unconditional right to revocation of a sale or lease at the option of the purchaser or lessee within a two-year period if the seller fails to provide a description of the property in a form acceptable for recording.
2. N.Y. Real Prop. § 294(1).

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Real Property Law Section Report on

The Federal Housing Finance Agency's Proposed Guidance on Private Transfer Fee Covenants (No. 2010-N-11)

RPLS REPORT # FED-1 October 4, 2010
The Federal Housing Finance Agency
Proposed Guidance on Private Transfer Fee Covenants (No. 2010-N-11)

The Real Property Law Section of the New York State Bar Association provides the following comments on the proposed Guidance on Private Transfer Fee Covenants (No. 2010-N-11) (the "Guidance") concerning restrictions on mortgages on properties encumbered by private transfer fees covenants. The members of the New York State Bar Association, through its Committee on Condominiums and Cooperatives of the Real Property Law Section (the RPLS), have extensive experience in the legal and financial matters involved in the operations of housing developments, homeowners' associations, planned unit developments, condominium associations and apartment cooperative corporations (individually, a "Development," and collectively, "Developments") that would be affected by the proposed Guidance. The RPLS supports what it believes is the main objective of the proposed Guidance—to stop developers from receiving a never-ending source of income long after they have vacated their Developments. However, the RPLS objects to that portion of the Guidance that would effectively prohibit fees payable *to the Development*. This prohibition would have a severe, adverse impact on apartment owners in a Development that requires the payment of a fee to the Development upon sale, as these monies are used by the Development as part of its operating budget or as a reserve for future repairs and improvements.

The FHFA's Stated Concerns

The Federal Housing Finance Agency (the "FHFA") is seeking to issue a guidance to the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal Home Loan Banks (the "Banks"), that they should not "deal in mortgages on properties encumbered by private transfer fee covenants" because "[s]uch covenants appear adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments."[1]

The Guidance defines a private transfer fee covenant as one

> attached to real property by the owner or another private party, frequently, the property developer, and requires a transfer fee payment to an identified third party, such as the property developer or its trustee, a homeowners association, an affordable housing group or another community or non-profit organization, upon each resale of the property. The fee typically is stated as a percentage (*e.g.*, 1 percent) of the property's sales price and often survives for a period of ninety-nine (99) years.[2]

This broad definition includes fees payable by an apartment or homeowner to a developer and may include certain closing costs payable to, for example, the Development's managing agent for administrative costs in connection with a sale or transfer. Indeed, although the Guidance is clearly primarily aimed at developers who continue to receive revenue long after they have sold all their interests in the Developments, the FHFA asserts that the "Guidance does not distinguish between private transfer fee covenants which purport to render a benefit to the affected property and those which accrue value only to unrelated third parties."[3] It expresses concern that "unlike more typical annual assessments," fees that benefit the property "are likely to be unrelated to the value rendered, and at times may apply even if the property's value has significantly diminished since the time the covenant was imposed."[4]

The FHFA's key concern, as expressed in the Guidance, is that

> [t]he typical one percent fee at the time of resale is neither a minimal nor a reasonable amount; further, such fees may be in excess of one percent. Such fees increase by a meaningful amount the seller's and potentially the buyer's burden at the time of a property sale. Expanded use of private transfer fee covenants poses serious risks to the stability and liquidity of the housing finance markets.[5]

As we show, these concerns are not applicable to the transfer fees imposed on Developments in New York State.

New York Apartment Owners Have Relied on the Income Received from Transfer Fees for Decades

"Private transfer fees" in the form of transfer taxes, flip taxes or entrance fees have been used in and relied upon by New York cooperatives, condominiums and homeowners' associations for decades and have specifically been considered with favor by the New York State legislature and the Courts. *See* N.Y. Bus. Corp. Law § 501(c) ("shares of the same class shall not be considered unequal because of variations in fees or charges payable to the corporation upon sales or transfer of shares or appurtenant proprietary leases that are provided for in proprietary leases, occupancy agreements or offering plans, or properly approved amendments to the foregoing instruments"); *Fe Bland v. Two Trees Management Co. and 330 West End Apt. Corp. v. Kelly*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (N.Y. 1985) (upholding transfer fees when provided for in proprietary leases or by-laws and when proportional to the number of shares of selling shareholder; modified by N.Y. Bus. Corp. Law. § 501(c) providing that such fees need not be proportional to number of shares); *Holt v. 45 East 66th Street Owners Corp.*, 161 A.D.2d 410, 555 N.Y.S.2d 340 (App. Div., 1st Dep't, 1990) (upholding transfer fee of $50 per share); *Mogulescu v. 255 West 98th Street Owners Corp.*, 135 A.D.2d 32, 523 N.Y.S.2d 801 (App. Div., 1st Dep't, 1988) (upholding transfer fee of 15% of profit and declining to 5% over period of time); *Amer v. Bay Terrace Cooperative Section II, Inc.*, 142 A.D.2d 704, 531 N.Y.S.2d 33 (App. Div., 2d Dep't, 1988) (upholding option waiver fee); *Quirin v. 123 Apartments Corp.*, 128 A.D.2d 360, 516 N.Y.S.2d 218 (App. Div., 1st Dep't, 1987) (upholding transfer fee); *Pomerantz v. Clearview Gardens*, 77 A.D.2d 651, 430 N.Y.S.2d 387 (App. Div., 2d Dep't, 1980) (upholding cooperative's option waiver fee); *Berglund v. 411 East 57th Corp.*, 127 Misc.2d 58, 488 N.Y.S.2d 947 (App. Term, 1st Dep't, 1985) (transfer fee of 1% not valid because not enacted by shareholder vote); *Jamil v. Southridge Cooperative Section No. 4 Inc.*, 102 Misc.2d 404, 425 N.Y.S.2d 905 (App. Term, 2d Dep't, 1979) (upholding cooperative's option waiver fee); *Mayerson v. 3701 Tenants Corp.*, 123 Misc.2d. 235, 473 N.Y.S.2d 123 (Sup. Ct., N.Y. Co., 1984) (upholding transfer fee of 7½ %); *Raimondi v. Board of Managers of Olympic Tower Condominium*, 53 A.D.3d 330, 859 N.Y.S.2d 191 (App. Div., 1st Dep't, 2008); Richard Siegler and Eva Talel, "Condominiums: Restraints on Alienation," *New York Law Journal*, May 2, 2007, at 3, col. 1.

The collective experience of the RPLS lawyers who practice in this area is that transfer fees payable to the Development, which are either (i) contained within the Development's governing documents and which can be changed or repealed by a vote of the members of the Development or (ii) adopted by the members of the Development, almost always by a super-majority vote, are an essential element of the Development's budget. These fees have been utilized in New York for many years and by many Developments without discernible, negative effects.[6] The fees are usually based on either a percentage of the sale price or a percentage of the profit to be realized by the seller, or are sometimes a multiple of the carrying charges for the apartment. In New York, it is the homeowners who determine whether such a fee should be charged and, if so, the form it should take.

Transfer fees are used, in some buildings, as part of the operating budget and, in others, for a reserve so that when—for example—a roof needs to be replaced, the board does not have to levy an assessment that apartment owners may have difficulty paying in addition to their monthly carrying charges. This is particularly so as "hard costs," such as labor, real estate taxes, water and sewer charges, and insurance premiums, have increased so extensively over the last few years that many apartment owners cannot afford to pay their monthly charges and, at the same time, be burdened by an assessment.[7]

In order to be valid and effective, these transfer fees must be expressly authorized by the Development's governing documents. Some are included in the governing documents at the time of the initial offering of the Development's units, and must be fully disclosed in the offering materials for the Development. After the developer no longer controls the Development, the unit owners can repeal or modify the transfer fee by vote as provided in the governing documents. The majority of these transfer fees, however, are enacted, after control of the Development has passed from the developer, by unit owners through an amendment to the governing documents. Effectively, a super-majority of the unit owners, not the developer, control these transfer fees, and they use these fees to make certain that the Development has adequate capital to fund improvements and maintain the Development, which funds would otherwise have to be raised by increases in maintenance fees or common charges, or by the imposition of assessments.

If the Guidance were to be adopted as drafted and mortgages on these Development units prohibited, the Developments would be forced to eliminate such fees, which would result in economic hardships for the Developments that have relied for years upon these transfer fees and in increased costs to the unit owners. While it is true that the unit owner is required to pay the transfer fee at the time of his or her sale of the unit, this existing practice poses less of an imposition in that the selling unit owner generally has the available funds from the sale of the unit. In addition, sellers and buyers take the imposition of the transfer fee into account when negotiating the sale price for the units. An assessment would place a burden on unit owners when cash might be unavailable, and increased maintenance or common charges would create a significant rise in the unit owner's monthly carrying charges. Finally, although the selling owner who pays the transfer fee does not reap the benefit of his or her payment of the fee, the seller has already reaped the benefit of the transfer fees paid by the Development owners who sold their units before the seller's transfer.

Recommended Alternate Definition

Accordingly, the RPLS suggests that the definition of private transfer fee as set forth in the Guidance be modified, as follows:

> A private transfer fee covenant is attached to real property which is part of a Development (defined below) by the developer, sponsor, owner or another private party and requires that a fee be paid upon each resale of the property to an identified third party, such as the property developer or its trustee, an affordable housing group, or another community or non-profit organization that is not responsible for all or substantially all of the ongoing maintenance, replacement, repairs, additions, alterations, operation or improvement of the property or the development, homeowners association, planned unit development, condominium association or apartment cooperative corporation to which the property belongs or forms a part (the "Development"). The private transfer fee is typically stated as a percentage (*e.g.*, 1 percent) of the property's sales price; the obligation to pay the fee often survives for a period of ninety-nine (99) years; and it cannot be changed or eliminated by property owners in the Development. A private transfer fee does *not* include a payment:
>
> (a) that is (i) created or imposed by the initial state-regulated governing documents of a Development, such as its declaration, by-laws, proprietary lease or covenant, conditions and restrictions (the "governing documents") or (ii) created, imposed or modified, or may be repealed, by an affirmative vote of the property owners as may be required in the governing documents;
>
> (b) that is required to be paid to the Development or its agent at the time of or in anticipation of a sale, transfer or assignment (the "Transfer"); and
>
> (c) that is used for (i) the ongoing maintenance, replacement, repairs, additions, alterations, operation or improvement of the Development or amortization of any underlying mortgage on the Development, including deposit into a reserve fund, working capital fund or other similar fund for the benefit of the Development or its members, shareholders or unit owners; (ii) the one-time closing costs and closing adjustments typically incurred in the community in connection with a Transfer of similar property which are payable at or prior to the closing; or (iii) in the case of a Transfer by a developer or sponsor, as grantor to the initial purchaser (the "Initial Closing"), such closing costs and closing adjustments as are typically incurred in the community in connection with the Transfer by a developer or sponsor, provided same was disclosed in writing to purchasers prior to the time they contracted to purchase the property or otherwise acquired their interest in the Development and provided further that the costs and adjustments are payable on time only at or prior to the Initial Closing or as a closing obligation of the Purchaser, which expressly survives the Initial Closing.
>
> In addition, monies paid or to be paid to a governmental or quasi-governmental agency shall not constitute a private transfer fee.

FHFA's Specific Concerns Do Not Apply to the Transfer Fees Imposed by New York Properties

The specific concerns raised by the Guidance with respect to New York transfer fees are addressed, as they relate to New York Developments, as follows:

(a) *A typical one percent fee is not a reasonable amount:* Not all New York transfer fees are expressed as a percentage of the sale price; some are calculated as a percentage of the profit to be realized by the seller; some are calculated on a per share basis and some are a multiple of carrying charges. In any event, however, it is the members of the Development who determine the proper fee because the fees are contained in the Development's governing documents and can be changed by the apartment owners in accordance with the terms of those documents. *Levandusky v. One Fifth Ave. Apartment Corp.*, 75 N.Y.2d 530, 553 N.E.2d 1317, 554 N.Y.S.2d 807 (N.Y. 1990); *Pello v. 425 E. 50 Owners Corp.*, 19 Misc. 3d 1125(A), 862 N.Y.S.2d 816 (Table), 2008 WL 1869651 (Sup. Ct., N.Y. Co., 2008). The fees may not be related to the unit's interest in the Development (percentage of common interests in the condominium or homeowners' association or shares in the apartment cooperative corporation), but such lack of relation has specifically been authorized by statute.[8]

(b) *The fee increases the seller's (and buyer's) burden at transfer and increases the costs of home ownership:* The New York transfer fee is disclosed during the course of contract negotiations and is typically reflected in the negotiated sale price.

(c) *The fee limits property transfers or renders them legally uncertain:* New York's transfer fees have not been shown to have a negative impact on transfers. They are always disclosed in the Development's governing documents, which, in the case of a condominium or homeowners' association, are recorded where deeds are recorded in that particularly county. The governing documents are reviewed by the attorneys for the purchasers prior to the execution of the sales contract. Being fully disclosed and part of the contract negotiations, New York's transfer fees are not hidden and do not create any "legal uncertainty" at any time during the sale process.

(d) *The fee detracts from the stability of the secondary mortgage market:* Although this may be true of private transfer fees that are fees that "run with the land," it is not true of New York's transfer fees. These fees are generally not imposed on foreclosure sales and do not impact the proceeds received by mortgagees or their investors from foreclosure sales. The fees do not promote instability; rather, the effective elimination of such fees as a result of the Guidance, as currently drafted, would render many Developments financially unstable or impose increased burdens on the unit owners, rendering them, and their mortgages, financially insecure.

(e) *The fee exposes lenders, title companies and secondary market participants to risks from unknown potential liens and title defects:* In New York, lenders, title companies, and secondary market participants are, or are obligated to be, aware of the existence of transfer fees. The fees imposed by homeowners' or condominium associations are set forth in recorded, governing documents that are reviewed by lenders and title companies. With respect to cooperative apartment units, whose governing documents are not recorded, purchasers rarely obtain title insurance on the shares of stock they are purchasing or the appurtenant proprietary leases, and if title insurance is obtained, the title company demands copies of, and reviews, the corporation's governing documents, as well as the contract of sale, in which the transfer fee is also set forth. In addition, the form contract of sale approved by the New York State and New York City Bar Associations provides disclosure of a transfer fee.[9]

(f) *The fee contributes to reduced transparency for consumers because it often is not disclosed by sellers and is difficult to discover through customary title searches, particularly by successive purchasers:* This is simply not true with respect to New York's transfer fees. As stated above, they must be contained in the Development's governing documents to be effective and such document is either of record (and thus discoverable in a customary title search) in the case of condominium and homeowners associations, or in the case of cooperative apartments for which there is no recorded title, supplied to the purchaser's attorney for review prior to the execution of the sale contract and disclosed in the form contract of sale.

(g) *The fee represents dramatic, last-minute, non-financeable out-of-pocket costs for consumers and can deprive subsequent homeowners of equity value:* This is not the case with New York's fees, since they are part of the Development's governing documents and are always known by the seller and disclosed to the purchaser in the sale contract, if not earlier.[10]

(h) *The fee complicates residential real estate transfers and introduces confusion and uncertainty for home buyers:* This has not been the case to date in New York with its transfer fees. It is a simply calculated fee that is fully disclosed prior to the execution of a sales contract, for which provision is made in the contract, so there is no confusion or surprise at the closing. This is not a fee that is buried in an initial deed for a unit which may not be reviewed by a future purchaser or by his or her attorney or title insurer.

Although the FHFA has legitimate concerns about private transfer fees payable to a developer, such concerns are not present in New York's transfer fees. Rather than being imposed on a powerless seller or purchaser by a developer, the fee is controlled by, and imposed by, a super-majority of the unit owners themselves on themselves. The private power of a Development's unit owners to determine how they fund the Development's reserves and maintenance and repair projects should not be decreased—and possibly eliminated—by the enactment of the proposed Guidance, which would be its practical effect. Instead, the Guidance should be revised, as set forth above, to exclude fees as are customarily charged in New York.

Closing Costs and Adjustments

At a typical sale closing for a Development unit (either for a real property interest such as a condominium unit or a personal property interest such as shares in an apartment cooperative corporation with an appurtenant real property interest in the form of a proprietary lease), a variety of fees and taxes are imposed on the seller or buyer, depending on the contract of sale or the applicable state or local law. Examples of such fees are as follows:

> Fee to the transfer agent and/or managing agent for the Development in compensation for its services in connection with the closing transaction;
>
> State and local transfer taxes and tax filing fees (*i.e.*, in New York, the state imposes a transfer tax on sellers ($2 for each $500 of consideration) and a tax of 1% of consideration on purchasers when the consideration exceeds $1,000,000, and a number of municipalities, including New York City, impose a transfer tax on the seller);
>
> Mortgage recording tax (*i.e.*, in New York, both the state and local municipalities impose such a tax, except for a small percentage, on the mortgagor);
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> Fees imposed by title and abstract companies for searches and other services;
>
> Title insurance premiums; and
>
> Local recording fees.

At closings for the initial sale of a Development unit by the developer or sponsor, some Developments charge the purchaser a disclosed fee or require that the purchaser make a contribution to the Development's capital fund. In addition, at such initial closings, the developer typically shifts certain fees that are otherwise imposed on the seller to the purchaser, and collects reimbursement from the initial purchaser for certain costs incurred by the developer, such as previously paid mortgage recording tax. In some Developments, the developer collects post-closing a reimbursement for further costs incurred by the developer, such as fees incurred in obtaining tax abatements on behalf of the Development. *In all such cases*, however, these fees are fully disclosed in the offering materials for the Development (which must be supplied to all unit offerees after having been accepted for filing by the New York State Office of the Attorney General) and in the contract of sale for the unit. *See* New York General Business Law § 352-e, *et seq.*; 13 N.Y.C.R.R. Parts 18, 20, 21, 23, 24 and 25.

Thus, these fees should not be considered "private transfer fee covenants" for purposes of the Guidance.

Conclusion

The RPLS encourages the adoption of the Guidance with respect to the private transfer fee payable to developers as has been revised by the RPLS. This is necessary in order to maintain and promote the financial health and physical condition of New York Developments and thus the mortgages on its units.

Endnotes

1. FHFA Notice of Proposed Guidance, No. 2010-N-11 (the "Notice"), 75 Fed. Reg. 49932 (Aug. 16, 2010).
2. FHFA Proposed Guidance, No. 2010-N-11 (the "Guidance"), 75 Fed. Reg. 49932 (Aug. 16, 2010). As noted in the Guidance, "many [of these] covenants are not intended for purely community purposes and instead, create purely private continuous streams of income for select market participants either directly or through securitized investment vehicles." *Id.*
3. Notice, 75 Fed. Reg. 49932-33.
4. Guidance, 75 Fed. Reg. 49933.
5. *Id.*
6. According to the most recent statistics compiled by the Council of New York Cooperatives and Condominiums, approximately ____ % of Developments in New York impose some kind of transfer fee.
7. In addition, New York has certain communities where transfer fees are payable, ultimately, to a governmental or quasi-governmental agency (i) to pay back taxes for properties that had been *in rem*; (ii) to pay down a subsidized mortgage; or (iii) to pay the government for some other purpose.
8. N.Y. Bus. Corp. Law § 501(c); *see* page 42, *supra*.
9. *See* Form Contract of Sale for Cooperative Apartment Prepared by the Committee on Condominiums and Cooperatives of the Real Property Section of the New York State Bar Association and Approved by the Committee on Cooperatives and Condominiums [sic] of the Association of the Bar of the City of New York and the New York County Lawyers Association, 7/01, paragraph 1.19.
10. The transfer fee is also disclosed in the real estate broker's term sheet for a unit.

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Addendum to the Report

The Condominium and Cooperative Committee adopted the following addition and suggested modification to the Report:

1. Footnote six should state as follows:

6 According to a recent survey by the Community Associations Institute, forty-nine percent (49%) of Developments nationwide impose a transfer fee that benefits the Development. Community Associations Institute, Department of Government & Public Affairs, *For the Common Good: Use of Community Transfer Fees by Community Associations*, September 20, 2010. The Council of New York Cooperatives and Condominiums estimates that at least fifty percent (50%) of apartment cooperatives in New York currently impose some kind of transfer fee.

2. Alternate Definition of "Private Transfer Fee"

Section suggests that the definition of the private transfer fee as set forth in the Guidance be modified, as follows:

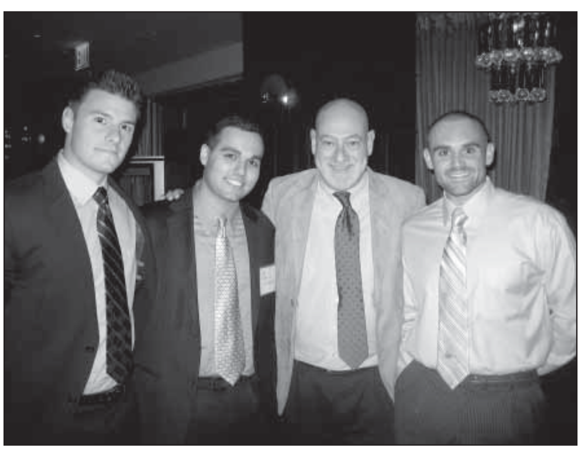
> A private transfer fee covenant is attached to real property which is part of a Development (defined below) by the developer, sponsor, owner or another private party and requires that a fee be paid upon each resale of the property to an identified third party, such as the property developer or its trustee, an affordable housing group, or another community or non-profit organization that is not responsible for all or substantially all of the ongoing maintenance, replacement, repairs, additions, alterations, operation or improvement of the property or the development, homeowners association, planned unit development, condominium association or apartment cooperative corporation to which the property belongs or forms a part (the "Development"). The private transfer fee is typically stated as a percentage (e.g., 1 percent) of the property's sales price; the obligation to pay the fee often survives for a period of ninety-nine (99) years; and it cannot be changed or eliminated by property owners in the Development. A private transfer fee does *not* include a payment:

N.Y. Real Property Law Journal First Annual Landmark Alumni Event October, 14, 2010

On Thursday, October 14, 2010, the St. John's University School of Law, *N.Y. Real Property Law Journal* Student Editorial Board organized a V.I.P. Tour of the Empire State Building followed by a Happy Hour Event at the Empire Lounge.

The event was attended by Prof. Robert Zinman, former editor of the *Journal* and current member of the Real Property Section; Mr. Zinman's wife was also in attendance. Judge Lebovits, who is also a current member of the New York State Bar Association Real Property Law Section Executive Committee, was also in attendance.

All Attendees Before the Tour



Judge Lebovits with Current *Journal* Student Members

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The Real Property Law Section encourages members to participate in its programs and to volunteer to serve on the Committees listed below. Please contact the Section Officers or Committee Chairs for further information about the Committees.

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N.Y. Real Property Law Journal

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