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N.Y. Real Property Law Journal

A publication of the Real Property Law Section of the New York State Bar Association

A Message from the Section Chair

Greetings, and Happy New Year!

We had a splendid time at the Real Property Law Section's Summer Meeting, held in July at the Equinox Hotel in Manchester Village, Vermont. Congratulations to Joshua Stein, First Vice-Chair, who arranged an outstanding program as well as memorable social events, including a reception at the Southern Vermont Arts Center and a "farewell" dinner at the Equinox Pond in a spectacular setting. We were very pleased to have President-Elect of the New York State Bar Association, A. Vincent Buzard, attend the entire meeting and offer his insights on significant issues before the Association. We also thank Kathy Heider and Lori Nicoll from the Association for their expertise, assistance and steadfast support throughout.

Building on the success of the program at the Summer Meeting, Joshua Stein has arranged a related and equally compelling program to be held on Thursday morning, January 27, 2005, at the Association's Annual Meeting.

One of the highlights of the Summer Meeting was the ethics presentation by Anne Reynolds Copps. Anne took us through a case study she wrote that triggered a very lively discussion of numerous ethical issues that may arise in "routine" real estate transactions, including conflicts of interest, referral problems, escrow malfeasance and billing disputes. We look forward to part two of Anne's presentation at the

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SCENES FROM THE REAL PROPERTY LAW SECTION'S SUMMER MEETING (SEE PAGE 49)

Annual Meeting, entitled "Legal Ethics in a Transactional Real Estate Practice."

Joshua Stein has announced that the program at the Annual Meeting will also include:

- **Tom Curry, Diane Czarnick** and **Peter Romano** of the New York State Department of Taxation and Finance: New York State mortgage recording and transfer tax issues, wraps and spreaders, partial equity transfers, revolving loans, multistate collateral, tax exemptions and exceptions, and how to get your questions answered;
- **Edward Levy:** How Landlords and Major Corporate Tenants are Dealing with Today's Security Issues: What Works, What Doesn't Work, and Why;
- **Andrew Lance** and **Nancy Connery:** Lease Exit Transactions: Buyouts, Surrenders, Rejection and Corporate Mergers;
- **Richard S. Fries** and **Steven J. Baum:** Target Practice on New York Foreclosures, Judicial and Non-judicial;
- **Edward G. Baer:** How Leases Go Wrong: Tales from the Trenches of Lease Litigation, and Lessons for Leasing Lawyers;
- **Lawrence J. Wolk** and **Margaret Taylor:** Mortgage Modifications, Substitutions of Collateral and Tenancy in Common Loans; and
- **Craig Kravit:** Choosing and Using a Private Investigator.

I hope that you already have this event on your calendar and that you will also attend the reception and luncheon following the program. Fred Harris, Senior Vice President of AvalonBay Communities, Inc., will speak after lunch on "sustainable development" and the growing environmental awareness within the multifamily development community.

In addition to mandatory CLE credit, the Annual Meeting provides plenty of opportunity to meet new attorneys, to renew friendships with practitioners throughout the state, and to take advantage of the entertainment offered in the Big Apple.

Harry Meyer, the Second Vice-Chair of the Section, has arranged for the 2005 Summer Meeting to be held July 14-17 at the Lake Placid Resort Hotel & Golf Club. Harry is planning a fascinating program, and the Hotel offers amenities to suit all tastes—outstanding golf courses, tennis, private beach and indoor pool. The historic village offers breathtaking views of the region's many lakes and mountain ranges. Plan now to attend!

In the near future, we can expect the Association to issue updates of public information pamphlets relevant to real estate lawyers and their clients: Buying and Selling Real Estate, Rights of Residential Owners & Tenants, and The Role of the Lawyer in Home Purchase Transactions. We thank Edward Baer, Gerald Goldstein, Karl Holtzschue and Sam Tilton for reviewing and revising these pamphlets.

Expeditious communication to all members of the Section remains a prime objective. The Computerization and Technology Committee, co-chaired by Michael Berey and Jill Myers, is continually working to provide information to our members via electronic transmission and our Section's Web site. We applaud these efforts and continue to be grateful for the fine work of the editors of this *Journal*, Bill Colavito, Bill Johnson and Bob Zinman.

Our Section is growing rapidly and the momentum continues to make us the largest Section within the Association. Contact any officer or our Membership Committee Co-Chairs, Richard Fries and Karen DiNardo, regarding membership issues. Opportunities abound for committee work, so if you have not yet served on a committee, I encourage you to do so.

Dorothy H. Ferguson

The case of **AXYS, LLC v. CILVE NG** *(New York State Supreme Court, New York Law Journal, June 16, 2004) considered the consequences of building projections and encroachments onto an abutting street, and their effect on the marketability of title to the premises. The decision is the subject of two articles, included herein, written by James M. Pedowitz, Esq. and Marvin N. Bagwell, Esq., both of whom served as expert witnesses during the course of the trial.*

William A. Colavito
Co-Editor

AXYS, LLC v. Ng: A Close Encounter of the Marketable Title Kind

By Marvin N. Bagwell

It is not often that a title person is given the opportunity to participate in history-making litigation. On one extremely busy Thursday afternoon, a late phone call from Rachel Warren,[1] one of defendant's counsel in the matter, *AXYS, LLC v. Ng*,[2] gave me that very opportunity. The litigation involved a quintessential title issue—what exactly is marketable title? As is often the case when legal history is being made, the pending litigation was little known even to the real estate bar. However, this case had the potential of roiling the real property marketplace for years to come. If the court chose to follow legal precedence, the titles to hundreds of townhouses in Manhattan would immediately have become unmarketable. Because of the standing and deference accorded to decisions coming out of the First Department, the case could have had the effect of bringing into question the titles to townhouses in Brooklyn, Queens and similar properties throughout the state. Would the court find that the law has ossified or would it find that it—("it" in this case refers to both the law and the court) had evolved? This is my firsthand (admittedly biased and possibly immodest) account of *AXYS, LLC v. Ng*. And to think, I almost did not take Ms. Warren's call.

The defendants own a townhouse located on East 10th Street in New York City within the Greenwich Village Landmark Preservation District. On December 22, 2003, they entered into a contract to sell the premises to AXYS, LLC for $11.5 million. To seal their deal, the parties executed the standard New York City real estate sales contract and AXYS deposited $1.5 million with the seller's attorney as escrow agent. After several fits and starts to schedule a closing, on April 2, 2004, counsel for the defendants set a time of the essence closing for May 3, 2004. In response, AXYS accepted a June 3, 2004 closing date. However, on April 20, 2004, AXYS notified the defendants that it declined to close because title was unmarketable. AXYS demanded that the defendant return the deposit. The basis of AXYS's unmarketability claim was that the title report disclosed that several parts of the premises either projected into or encroached upon

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The *AXYS, LLC* Decision—Another Point of View

By James M. Pedowitz

When the *New York Law Journal* printed Justice Ramos' decision in *AXYS v. Ng* on June 18, 2004, its headline caption read "BUILDING'S ENCROACHMENTS UPON CITY STREETS CAN BE WAIVED, DO NOT RENDER TITLE UNMARKETABLE." That, however, is not the most significant part of the decision. What it did decide, was that under the particular language of the contract between this seller and its reluctant buyer, that the reluctant buyer's contract had effectively waived all of the street encroachments disclosed by the survey. It also indicated that street encroachments by a building in a landmarked area may not be able to be removed by the City of New York.

A contract of sale can waive all sorts of objections to the title that would otherwise make the title unmarketable.

What was somewhat noteworthy in this case was the broad interpretation given by the court to the standard waiver language in Paragraph 9 of the printed Residential Contract of Sale, and the not-surprising leaning of the court in favor of a seller who was faced with a buyer who had obviously changed its mind about purchasing the property shortly before the closing and who was looking for a way out based upon some significant encroachments on the street.

Although the right to receive "marketable title" is implied in every contract of sale for real property, in the absence of specific contrary provisions, the fact remains that practically every title is unmarketable,[1] and it is the contract of sale that determines if an unwilling purchaser can be compelled to accept the title that is being tendered. That is part of the reason that many printed contract forms now specifically state that:

> Seller shall give and Purchaser shall accept such title as ________________________ shall be willing to approve and insure in accordance with its standard form of title policy approved by the New York State Insurance Department, subject

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the public right-of-way, i.e., East 10th Street. Specifically, the survey revealed that vent pipes, window trim, capstone, roof cornices, leader, and a stoop, among other items attached to the main structure, encroached into East 10th Street by distances ranging from 1-1/4 inches to 6 feet 10 inches. As is wont to happen when that much money is involved, litigation ensued. AXYS brought suit essentially to re-claim its $1.5 million down payment. Early in the litigation, after the normal procedural maneuvering, the parties agreed to close title on a date certain if the court found that title was marketable. Hence, the parties placed the ancient concept of marketability squarely before the court.[3]

The sales contract contained the standard language for "permitted exceptions" for stoops, cornices and other normal encroachments that one would encounter in Manhattan. However, AXYS argued first, that the rider to the contract contained language which supersedes the permitted exceptions clause and second, that the property contained encroachments in addition to the permitted exceptions. Comparing the property survey to the permitted encroachments as set forth in the sales contract, the court found that only the vent pipes, leader and window guards (which were not specifically identified in the contract's permitted exceptions clause) encroached or projected into the street and hence could lead to the title's being rendered unmarketable. Justice Ramos, however, quickly accepted the defendant's arguments that these items were de minimis and did not impact upon marketability. Given that the sales price of the premises was over $11 million and that the buyer did not submit adequate evidence as to the cost of the removal of the encroachments, "none of the remaining items were difficult to move or remove and as such could not rise to the level of encroachments that would render title unmarketable . . ."[4] But that did not end the discussion. The court still had to dispose of additional encroachments which were not eliminated as issues by the terms of the contract.

As is illustrated by the legion of cases appearing under the topic "Marketability of Title" in *Warren's Weed*, under traditional or classical title theory, any encroachment or projection onto the property of another would have rendered title unmarketable. Recognizing that this position was inherently impractical, Justice Cardozo had long ago written that unmarketability of title could not be construed so broadly. He wrote in *Norwegian Evangelical Free Church v. Millhauser* that:

> [T]he law assures to a buyer a title free from reasonable doubt, but not from every doubt. There must be some fairly debatable ground on which the doubt can be justified: something more than a mere speculation or a bare possibility. The test is not the hazard of possible litigation, for, as has been pointed out, it seems to be the inalienable right of any person to start a lawsuit. The test is rather a chance of successful attack.[5]

More recently, but still over a half century ago, the First Department, following Justice Cardozo's reasoning, held in *Whittier Estates v. Manhattan Savings Bank* that, "[T]he test of [marketability] is not the hazard of possible litigation, for as has been pointed out, 'it seems to be the inalienable right of any person to start a lawsuit.' The test is rather the chance of successful attack."[6] These statements provided the analytical framework into which Justice Ramos had to fit *AXYS v. Ng*. Since parts of the property which encroached upon East 10th Street, i.e., the public right-of-way, the litigants agreed that only the City of New York had the right to sue for removal of the encroachments. The parties also agreed that if the City did so, it would prevail. The question thus became whether the City would exercise its inalienable right to start a lawsuit to remove the encroachments, thereby instantly rendering title unmarketable.

As is often in the law, there is a counterweight to the court's general statements as to the meaning of marketability of title. That counterweight was the leading, and seemingly directly on point, decision rendered in 1915 by the Court of Appeals in *Acme Realty Co. v. Schinasi*.[7] The case involved a seven-story apartment building located on 116th Street in Manhattan whose front stoop and windows encroached into the public right-of-way by over four feet. The Court of Appeals ruled that the encroachments rendered title to the building unmarketable as a matter of law even if the City of New York had explicitly authorized the encroachments. AXYS's counsel, relying upon *Schinasi*, argued that title was, in effect, per se unmarketable because of the uncontested mere existence of the encroachments into the public's right-of-way. However, *Schinasi* contained the roots of its own limitation if not outright destruction. As counsel for the defendants and their experts pointed out, the *Schinasi* Court had recognized that the City at that time was removing encroachments so as to widen and develop streets in accordance with its then-policy of promoting the free flow of traffic and commerce. Since 1915, the City's orientation toward its neighborhoods had changed. Instead of destroying neighborhoods to promote unencumbered traffic and commerce, the City, certainly since the vastly unpopular and deeply regretted destruction of the original Penn Station, has pursued a policy of preserving its historical structures and neighborhoods.

Also, counsel for the defendants referred the court to section 26-226 of the City's Administrative Code, adopted in 1938, which explicitly provided that, "[S]uch parts of buildings as project beyond the street line on January first, nineteen thirty-eight, may be maintained as constructed, unless their removal, rearrangement or relocation is directed by the city council or board of estimate." Witnesses for both AXYS and the defendants confirmed that the subject townhouse was constructed in 1840, almost a full century before the City adopted Code provision 26-226. The same witnesses, ranging from Charles Smith, the City's former Department of Buildings Commissioner, and William Higgins, an expert in historical preservation, all testified that in light of the Code provisions and under subsequent Landmark Preservation legislation, absent an emergency, it was extremely unlikely that the City would bring suit to require the removal of the projections and encroachments. This author testified that although *Schinasi* had not been overruled by the Court of Appeals, the lower courts had over time, vastly eroded the *Schinasi* strict unmarketability standard.[8] The insurability of title as represented by the coverage provided by a title insurance policy had largely supplanted marketability. Although title underwriters still insure that title is "not unmarketable,"[9] the considerations of practicality as eliminating the risk that someone might bring suit now govern their risk assessment.[10] In this case, it was and remains the author's opinion that the City through Code Section 26-226 and Landmark legislation had virtually estopped itself from requiring the removal of the offending encroachments and projections. Therefore it was reasonable to insure, as one title insurance company had done, that the defendant's title was marketable.

However, it was not the experts nor even this author who would have the last word. The court wanted more, perhaps even some law. Counsel for the defendants directed the court's attention to the case, *English Speaking Union (New York) Inc. v. Payson*,[11] the fact situation of which was remarkably similar to the case before Justice Ramos. In *English Speaking Union*, Payson contracted to purchase 19-21 East 59th Street, New York City, from English Speaking Union. After several adjournments, the parties finally stipulated to close on August 1, 1957. Payson then sought another adjournment past the August 1 date partly on the basis that title was unmarketable because the property's entrance columns, steps and other attachments encroached into the public street. The court took note of the fact that Payson, a sophisticated real estate investor, must have known of the encroachments when he entered into the contract but that he only raised the objections on the eve of the court stipulated closing. The contract of sale which Payson had entered into contained exactly the same provision as the "permitted exceptions" clause in this case. The *English Speaking Union* court held "[T]his provision is a complete answer to the objection based on the foregoing street encroachments." In other words, having executed the contract of sale, Payson waived any objection to title on the basis of the encroachments which the survey later revealed. The court went on to find that the other objections were trivial and did not make title unmarketable. Further, to the court, section 26-233 of the Administrative Code (now section 26-226) meant that there was little likelihood that the encroachments would be disturbed by the City. Therefore, the court found title to be marketable.

The stage was thus set. Under classical marketability theory, and under *Schinasi*, AXYS's counsel opined that the encroachments clearly rendered title unmarketable. Counsel for the defendants argued that under *English Speaking Union* and in the real world of practicality where homeowners, investors, and risk-averse title insurers exist, classical marketability theory had long been supplanted by hard-nosed calculations as to whether the City would likely bring suit to require the removal of the stoops, fencing and other details that gave this particular property and the neighborhood in which it was located, its desirable and expensive character. Would legal evolution or ossification carry the day?

Now, we return to Justice Ramos's opinion.

Before we digressed, the court, citing *English Speaking Union*, had ruled that most of the encroachments were covered by Paragraph 9 of the contract. Therefore, AXYS had waived any objection as to marketability of the encroachments listed in Paragraph 9. Only three other encroachments and projections, those of the leader, the vent pipes and the window guards, remained. The court held that in addition to being de minimis, these encroachments were open and notorious, were covered by Landmark designation and were specifically authorized by the Administrative Code. Landmark designation in particular was important to the court. The fact that the premises are located within a landmark area reduced the risk to the purchaser (AXYS) that the City would sue to remove the encroachments to a negligible one. Landmark protection, in addition, had the effect of estopping the City from taking action to remove building characteristics which are now prized and protected unless they constitute a safety hazard. In line with Justice Cardozo's admonition that marketability is determined by the probability of the risk that a third party could bring a successful suit to upset the fee owner's title, Justice Ramos held that the risk that the City would bring suit over the encroachments was so negligible that the title was marketable. Times had changed since *Schinasi*. Evolution won.

After finding that title was marketable, the court concluded that it was clear that the plaintiffs brought this suit only to avoid their obligation to purchase and to secure the return of their down payment. Their actions thereby provided support to a thesis which this author proposed in an earlier article to the effect that allegations of unmarketability are most often used as a sword and not as a shield. When a purchaser wants out of a contract of sale, when all else fails, the purchaser will assert that title is unmarketable. However, in this case, since the defendants could not prove that they were prejudiced by the fact that AXYS had waited to the eve of closing to raise the unmarketability allegation, the court did take AXYS's strategy into consideration in reaching its decision. Also, in a blow to the egos of title underwriters everywhere, the court found that the fact that the defendants had obtained affirmative title insurance coverage which covered the cost of remedying the encroachments was not "dispositive." Talk about putting us in our place.

Although the author is somewhat prejudiced by participating as an expert witness for the winning defendants, the court's decision was correct and appropriate. Justice Cardozo's advisory calls essentially for a two-pronged analysis. First, the court must determine whether there will be litigation regarding the issue which is the basis of the unmarketability claim. Then, if it is likely that there will be litigation, the question becomes whether the litigation will be successful. The quandary faced by Justice Ramos, sitting 80 years after Justice Cardozo had established the analytical framework, was that the answer to the second question was a resounding "yes" from both the seller and the purchaser. If the New York City Counsel or the Mayor authorized the bringing of a suit to remove the encroachments in compliance with Code Provision 26-226, all parties agreed that the suit would be successful. Therefore, the first question became seminal. Would the City bring suit? Based upon the landmark area designation, Judge Ramos found the answer to that question to be highly unlikely. Hence, title was marketable.

The importance of the court's decision is in the court's acceptance of the evolutionary nature of the marketability doctrine. *Schinasi*, decided in 1915, established that the very encroachments at issue here made title unmarketable. However, *Schinasi* was a product of City policy at that time. The City's vision has changed. Rather than opening all streets for commerce, the City now seeks to preserve its neighborhoods. The court implicitly recognized that the doctrine of marketability is not immutable or prone to ossification but is evolutionary. This recognition is of great importance to those of us who make a living from or who live in real property located in some of Manhattan's most expensive neighborhoods. After all, had the court ruled differently, the title to virtually every townhouse in Manhattan would have been rendered unmarketable. The impact upon the City's real estate market, and upon the claims departments of those unfortunate title underwriters whose policies did not contain the appropriate exceptions, would have been frightening. Sometimes, common sense, with the help of good lawyering and a perceptive judge, will carry the day. This was one of those days.

Endnotes

1. Larry Hutcher and Rachel L. Warren of the firm Davidoff, Malitto and Hutcher, New York City, represented the defendants. The defendants retained the author as their expert witness on title insurance matters including marketability of title. Joseph H. Lessem of Warshaw Burstein Cohen Schlessinger & Kuh, New York City, represented the plaintiff, AXYS, LLC. The plaintiff retained James Pedowitz to serve as its expert witness on title matters and marketability.
2. N.Y.L.J., June 16, 2004, p. 18, col. 1 (Sup. Ct., N.Y. Co.).
3. Justice Ira Gammerman heard this matter initially. He ruled that if the court determined that the defendant sellers were able to convey marketable title under the contract of sale, then the parties would be required to close at a date certain. Justice Gammerman subsequently transferred this case to Justice Charles E. Ramos to decide the question of marketability of title.
4. *AXYS, LLC v. Ng*, N.Y.L.J., June 26, 2004, p. 18, col. 2 (Sup. Ct., N.Y. Co.).
5. 252 N.Y. 186 at 190 (1929).
6. 181 Misc. 662, 666 (1st Dep't 1944).
7. 215 N.Y. 495 (1915).
8. *See, e.g., Morisseau v. Judicial Title Insurance Agency*, N.Y.L.J., Sept. 8, 1999, (Mount Vernon City Court), (incorrect building permit); *Chu v. Chicago Title*, 452 N.Y.S.2d 229 (2d Dep't 1982) (certificate of occupancy violation); *Logan v. Baretto*, 251 A.D.2d. 552 (2d Dep't 1998) (sanitary code violation); *Wolf v. Commonwealth Land Title Ins. Co.*, 180 Misc. 2d 307 (1st Dep't 1999) (zoning violation); *John Hancock v. 491-499 7th Avenue Associates*, 644 N.Y.S.2d 953 (Sup. Ct., N.Y. Co. 1996) (disclosed oil spill); and *Vandervort v. Higginbotham*, 634 N.Y.S.2d 800 (3d Dep't 1995) (property's value does not render title unmarketable. Even the Court of Appeals without overturning *Schinasi* has found that certain title problems which would have rendered title unmarketable long ago, currently no longer do so.). *See Voorheesville Rod and Gun Club, Inc. v. E.W. Tompkins Company, Inc.*, 606 N.Y.S.2d 132 (1993) (failure to obtain subdivision approval).
9. *See* American Land Title Association's 1992 form of Owner's Title Policy, insuring paragraph 3.
10. *See, e.g., What is Marketability?*, N.Y.L.J., Mar. 13, 2002, p. 5, col. 2; *Marketability—The Legislature (and Title Insurers, of Course) Save the Day*, N.Y.L.J., May 8, 2002, p. 5; and *Marketability—Insuring That There is Something to Sell*, N.Y.L.J., July 10, 2002, p. 5, col. 2.
11. 11 Misc. 2d 669, 174 N.Y.S.2d 775 (Sup. Ct., N.Y. Co. 1958).

Marvin N. Bagwell is the Vice-President and Eastern Divisional Counsel of United General Title Insurance Company in White Plains, New York. Mr. Bagwell is a graduate of Harvard College and Harvard Law School. He has previously served as a claims attorney and underwriting counsel with Title USA, TRW Title, Nations Title and Fidelity Title. Several of his articles have been published in *The New York Law Journal*, *New York Real Estate Law Reporter* and in *Settlement Services Today*. Mr. Bagwell is a certified CLE instructor for Virginia and Pennsylvania. He is admitted to practice in Virginia and in New York. He is a Past President of both the New York State Land Title Association and the Title Insurance Rate Service Association ("TIRSA").

> only to the matters provided for in this contract. (The blank space may name a specific title insurer, or more commonly, "any New York licensed title insurance company.")

In addition, most printed contract forms also contain provisions for Permitted Exceptions in some form. The standard downstate Residential Contract of Sale includes the following:

> **9. Permitted Exceptions.** The Premises are sold and shall be conveyed subject to:
>
> (a) Zoning and subdivision laws and regulations, and landmark, historic or wetlands designation, provided that they are not violated by the existing buildings and improvements erected on the property or their use;
>
> (b) Consents for the erection of any structures on, under or above any streets on which the Premises abut;
>
> (c) Encroachments of stoops, areas, cellar steps, trim and cornices, if any, upon any street or highway;
>
> (d) Real estate taxes that are a lien, but are not yet due and payable; and
>
> (e) The other matters, if any, including a survey exception, set forth in a Rider attached.

Partly because of the vagueness of the concept of marketable title, the American Land Title Association title policy forms contain this definition in its Conditions and Stipulations 1(g).

> (g) "unmarketability of the title": an alleged or apparent matter affecting the title to the land, not excluded or excepted from coverage, which would entitle a purchaser of the estate or interest described in Schedule A to be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title.

In other words, a title is unmarketable under the policy only if a court of law has said so in an action on the contract.

In the instant case Justice Ramos first required that Judge Gammerman, who had previously made a preliminary decision in the case, clarify whether the court was to determine whether the title being tendered was "marketable" or "marketable under the contract of sale between the parties." The response was, as it should be, the latter.

The contract between the parties contained the printed contract provision #9 as to Permitted Exceptions, and also a typewritten Rider, starting with Paragraph 29, as follows:

> 29. This Rider (defined as all paragraphs of this Agreement numbered 29 et seq.) is hereby made a part of the printed section of this Agreement to which it is attached. The provisions of this Rider supplement and are in addition to and not in limitation of the provisions of paragraph 1 through 28 of this Agreement. In each instance in which a provision contained in the Rider portion of this Agreement shall contradict or be inconsistent with a provision contained in the portion of this Agreement containing paragraphs numbered between 1 and 28, the provision contained in this Rider shall govern and prevail, and the contradicted and inconsistent provision included in paragraphs 1 through 28 of this Agreement shall be deemed amended accordingly.

The Rider then continued with Paragraph 30 and added the following Permitted Exceptions:

> 30. In addition to the provisions of Paragraph 9 of the printed portion of this Contract, the premises are also sold and are to be conveyed subject to :
>
> (a) covenants, restrictions, agreements and reservations of record, if any, provided same are not violated by and do not prevent the present use of the present structure on the premises;
>
> (b) any easement or right of use created in favor of any public utility company for electricity, steam gas, telephone, water or other service, and the right to install, use, maintain, repair and replace wires, cables, terminal boxes, lines, service connections, poles, mains, facilities, and the like, upon, under and across the premises;
>
> (c) any state of facts and (sic) accurate survey may disclose; provided that said additional facts do not render title unmarketable;
>
> (d) *deleted, as dealing with violations only.*

The title report contained the following survey exceptions:

> A. ENCROACHMENTS ONTO AND/OR PROJECTIONS OVER EAST 10TH STREET BY:
>
> Vent pipes to 2 feet 9 inches more or less;
>
> Window trim up to 0 feet 5 inches;
>
> Capstone 1 foot 0 inches;
>
> Roof cornice 1 foot 9 inches;

Brownstone wall 0 feet 1-1/4 inches;

Water table 0 feet 2-1/8 inches;

Leader 0 feet 6 inches;

Stoop 6 feet 10 inches;

Coping 5 feet 8 inches;

Area and basement steps 4 feet 0 inches;

Iron fence 4 feet 3 inches;

Iron door over grated area 2 feet 3 inches;

Iron cellar doors 3 feet 7 inches;

Water meter 0 feet 3 inches;

Window guards 1 foot 0 inches.

Both parties recognized that the New York Court of Appeals had ruled in the case of *Acme Realty Company v. Schinasi*[2] that notwithstanding that the City of New York had not been enforcing its rights to eliminate encroachments on its streets that the fact that they nevertheless had the power to do so made property having such encroachments unmarketable.

Public streets are imbued with a public trust in favor of the people of the state, and only state legislative action can change it. The court, however, relied on the fact that the property was located within a landmarked historic district as a strong indication that the City would not compel removal of the various street encroachments and that it would be estopped from doing so in contravention of the landmarks law. The court also indicated that because the architect who had testified as to the substantial cost to remove all of the encroachments had not separated the cost of correcting those that clearly fell within Paragraph 9 of the printed paragraph from those that did not, that in light of the $11 million purchase price, he considered them as "de minimis."

I had been called upon by the reluctant buyer's attorney to give my expert opinion on the marketability of the title under the contract in question. It was my opinion that the Rider was ambiguous as to the interplay between the printed provisions in Article 9 and the typewritten Rider, especially since typed matter usually controls over printed matter in cases of ambiguity. The combination of the language of Paragraph 29 of the Rider that in each instance in which a provision in the Rider "shall contradict or be inconsistent with" the printed provisions, that the provision the Rider "shall govern and prevail," and the contradicted provision in the printed contract "shall be deemed amended accordingly," and the Rider paragraph 30(c) which read "any state of facts and (sic) accurate survey may disclose; provided that said additional facts do not render title unmarketable," certainly seemed to create an ambiguity as to the continued effectiveness of printed paragraph 9 dealing with the survey. In any event, I testified that in my opinion, several of the survey exceptions in the title report were not covered by the Paragraph 9 language. However, the court has the final say and held that the capstone encroachment of 1 foot, the brownstone wall face of 1-1/4 inches and the water table that encroached 1-1/8 inches were all within the category of "trim"; that the iron fence that encroached 4 feet 3 inches was part of "area," as were the iron cellar doors that encroached 3 feet 7 inches. In addition the court dismissed the encroachment of the leader of 6 inches, the vent pipes of 2 feet 9 inches and the window guards of 1 foot as coming within the category of "de minimis."

The decision was not, and will not be appealed, as the parties reached a mutually acceptable financial settlement shortly after the decision was published.

All in all, my opinion is that this decision falls within the category of those where the judge tries to do justice as he or she sees it, and then tailors the broad concepts of applicable law to fit the decision that it has decided to make.

Endnotes

1. The following all make a title unmarketable: mortgage, or any other lien, restrictive covenant, easement, survey encroachments beyond de minimis, break in the chain of title, reverter provisions, need for will construction, fences or hedges that could lead to adverse possession claims, etc., etc. (*See* Friedman on Contracts and Conveyances of Real Property, Sixth Edition, entire Chapter 4, pp. 389 to 772, inclusive).
2. 215 N.Y. 495 (1915).

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Editor's Note: In the western part of New York State, a growing number of title companies, settlement service companies and others are providing real estate closing services traditionally performed by law firms. Out of concern for this drastic change in the nature of entities providing real estate closing services, the Unlawful Practice of Law Committee of the Bar Association of Erie County researched whether non-lawyers performing closings is the practice of law and considered the potentially detrimental implications for the consumers of real estate closing services. The committee's findings were set forth in the following report to that Bar Association's Board of Directors.

Non-Lawyer Closing Agents and the Unlawful Practice of Law

By the Unlawful Practice of Law Committee of the Bar Association of Erie County

I. Introduction

Since September 2002, the Unlawful Practice of Law Committee (the "UPL Committee") has been investigating complaints received from members of the bar, concerning the involvement of non-lawyers in real estate transactions. As part of this investigation, the UPL Committee has solicited the assistance of the Real Property Committee and representatives of the two committees have been meeting over the past several months. For the reasons stated below, the UPL Committee has concluded that settlement service companies and other non-lawyers are very often engaging in the unauthorized practice of law to the potential detriment of the members of the public involved in these transactions. Accordingly, we recommend that a letter of caution be sent to lenders, title companies, settlement agents and others who are engaging in these unlawful practices informing them that their activities constitute the unauthorized practice of law and should be terminated immediately.

II. Statement of Issues

Under consideration are the following issues:

1.) Whether settlement service companies, including those which are owned by or employ an attorney, may represent sellers and purchasers in any or all aspects of a real estate transaction.

2.) Whether settlement service companies, including those which are owned by or employ an attorney,

(Continued on page 10)

Editor's Note: While it is still the norm in the western part of New York State for buyers and sellers of homes to use a lawyer, a number of non-lawyer real estate closing services have started conducting business in that region. To remind the public and lawyers alike of the significant protections which an experienced real estate lawyer provides to buyers and sellers, the Real Property Committee of the Bar Association of Erie County published the following article.

Residential Contract Fine Print and Contingencies—Protections a Real Estate Lawyer Can Provide[1]

By Nancy W. Saia

When you buy or sell your home, you will need the assistance of a variety of professionals. A good real estate agent will help you find the home of your dreams in the location you desire or will market your home to attract the right buyer. The home inspector will find unforeseen defects and help highlight needed maintenance. An experienced loan officer will be sure you can afford it all.

Just as important as these professionals is your real estate attorney. Very often the purchase or sale of a home is the single largest financial undertaking anyone of us ever makes and the entire transaction is controlled by a lengthy and very detailed contract. The sheer size and complexity of this endeavor require that you obtain experienced legal assistance.

New York State law does not allow anyone who is not an attorney to draft real estate contracts unless that contract is subject to attorney approval or is a Bar Association-approved form. The Bar Association of Erie County, in conjunction with the Buffalo Niagara Association of Realtors, long ago created a Bar Association-approved contract. Because of the ever-increasing complexities of real estate law, a major overhaul began in 1995 and the contract became subject to attorney approval in all cases.

The standard real estate contract is designed to address most issues in most cases, but it simply cannot address all of the little nuances of every deal. Virtually

(Continued on page 13)

may prepare and/or supervise the execution of the documents required to close real estate purchases, sales and mortgage loans.

3.) Whether a title company is acting outside the exemption offered by Judiciary Law § 495(5) when it prepares and/or supervises the execution of documents as agent for the mortgage holder and/or one of the parties to the transaction.

III. Statement of Facts

Recently, several "settlement service companies" have emerged in the Buffalo area offering various services for real estate transactions. They solicit representation of businesses and individuals, prepare and review contracts, counsel parties, examine titles, prepare title documents and title curatives, conduct closings, collect and disburse "clients' funds," etc. Although a few or some of these settlement service companies may have licensed attorneys acting in advisory capacities or as employees, their activities are conducted in the corporate form. In most other cases, no attorney is involved at all.

IV. Statutory and Case Law

New York Judiciary Law prohibits the unauthorized practice of law individually and in the corporate form, including drafting and explaining deeds and mortgages. Even basic deeds can have a significant effect on important issues such as estate planning, income taxation and creditors' rights, and require competent legal advice to be provided to the public by a licensed practitioner.

Pursuant to Judiciary Law § 476-a the term "unlawful practice of law" is defined to include ". . . (b) any other act forbidden to be done by any person not regularly licensed and admitted to practice law in this state . . ."

Judiciary Law § 484 provides that . . . "No natural person shall ask or receive, directly or indirectly, compensation for . . . preparing deeds, mortgages, assignments, discharges, leases or any other instruments affecting real estate, . . . unless . . . regularly admitted to practice, as an attorney or counselor, in the courts of record in the state . . ."

Judiciary Law § 478 prohibits the practice of law by non-attorneys. The purpose of this section is to protect the public from the dangers of legal representation and advice given by persons not trained, examined and licensed for such work.

Judiciary Law § 495 states that a corporation or voluntary association either by itself or through its officers, agents, or employees may not practice law or render any services that cannot lawfully be rendered by a non-lawyer, even if the trustee, director, agent or employee performing the services is an attorney. Individuals who engage in prohibited acts are guilty of a misdemeanor. Practices specifically prohibited include preparing deeds, mortgages, assignments, discharges, leases or any other instruments affecting real estate.

Judiciary Law § 495(5) provides an exemption for corporations or voluntary associations lawfully engaged in the examination and insuring of titles to real property. This exemption allows for the preparation of deeds, mortgages, assignments, discharges, leases or any other instruments affecting real property but only "insofar as such instruments are necessary to the examination and insuring of titles, *and* necessary or incidental to loans made by any such corporation or association." Title companies may employ an attorney or attorneys to perform these activities but only "in and about its own immediate affairs or in any litigation to which it is or may be a party."

In *People v. Lawyers Title Corporation*,[1] the court held that the exception offered to title companies by Judiciary Law § 495(5) applied only to services necessary to its title work. In addition, the court determined that whether papers prepared to close a real estate transaction require the skill of a lawyer is irrelevant when determining if the companies are acting unlawfully.

The interpretation of what constitutes unlawful practice of law by a non-lawyer real estate broker or salesperson has been guided by relevant portions of the Judiciary Law and by the seminal case of *Duncan & Hill Realty. Inc. v. Department of State*.[2]

In *Duncan & Hill*, the court upheld the Department of State's determination that a real estate broker who was not a licensed attorney engaged in the unauthorized practice of law when he prepared documents that included detailed mortgage terms.

The court referred to Judiciary Law § 478, which forbids anyone from practicing law who is not "duly qualified and licensed to do so." Recognizing the intent to protect the public to ensure that real estate brokers and salespersons do not exceed the bound of their competence and prepare documents the execution of which requires a lawyer's scrutiny and expertise, the court went on to state, ". . . it is not proper for . . . a broker to undertake to devise the detailed terms of a purchase money mortgage or other legal terms beyond the general description of the subject property, the price and the mortgage to be assumed or given."[3]

The court found that by inserting into a contract detailed terms of that mortgage, the broker "engaged in the practice of law." Insertion of such terms was said by the court to be the same as advising the purchaser that such terms are normal, reasonable, and proper. The court concluded that "[W]here the insertion of the terms in the contract constitutes the giving of legal advice, the broker or agent must refrain from offering his services therefor."[4]

During the creation of the current residential real estate contract, the Real Property Law Committee and Bar Association's Board of Directors determined that a standard contract jointly drafted and approved by the Bar Association and the realtors' association with an attorney approval contingency would satisfy the requirements of *Duncan & Hill*. Thus, the entire residential real estate contract and any addenda are subject to attorney review and approval.

Judiciary Law § 476-a allows the attorney general, or a bar association if the attorney general fails or refuses to act upon written notice from the bar association, to pursue a civil action for the unlawful practice of law. A bar association may investigate alleged unlawful practice of law through its unlawful practice committee, which may apply to the court for a subpoena.[5]

V. Ethics Opinions

In an opinion adopted by the Board of Directors in April of 2003, the Ethics Committee considered whether it is a violation of the Code of Professional Responsibility for an attorney, at the direction of the purchaser in a real estate transaction, to forward title documents in connection with a real estate transaction to an individual who is not an attorney in order for that individual to examine title and presumably prepare instruments affecting real estate.

Basing its opinion on Professor Simon's *Simon's New York Code of Professional Responsibility Annotated*, (2002 Edition, page 328), the Committee concluded that the individual was practicing law without a license. Disciplinary Rule 3-101A states that a lawyer shall not aid a non-lawyer in the unauthorized practice of law. The Ethics Committee's research did not identify any decision or opinion that defined the mere act of forwarding documents to a non-lawyer as aiding a non-lawyer in the practice of law; however, to avoid even the appearance of any impropriety, it was recommended that the attorney deal directly with the purchaser.

New York State Bar Association Ethics Opinion #677 addressing the provisions of Disciplinary Rule 1-104(A) and Ethical Considerations EC 1-8; EC 3-1; EC 3-5 and EC 3-6 permits a paralegal to attend a real estate closing only if the lawyer maintains a direct relationship with the client, supervises the delegated work, has complete professional responsibility for the work product, is available by telephone and the activity of the paralegal will be ministerial.

VI. Observations

The prohibition against the practice of law by non-lawyers is grounded on the need of the public for integrity and competence of those rendering legal services. A lawyer is subject to licensing rules, educational requirements, ethical standards, court supervision and malpractice claims. Non-lawyer providers of "settlement services" are not. Their corporate or limited liability status specifically exempts the individual participants from potential malpractice claims of the consuming public.

It is important to note that settlement service companies are providing far-reaching services, not merely performing ministerial acts. They often handle all aspects of the real estate transaction. The consequences of their activities on the unprotected public affect a broad range of issues including how title is held, title marketability, tax consequences, estate planning, creditors' rights, etc.

We make no differentiation between residential and commercial real estate transactions. Regardless of the monetary size of the transaction or the type of improvement on the land, the issues of conveying and encumbering land and the consequences thereof to the affected parties are the same and we should not be swayed by the economics of the transaction to afford one less care than the other.

Interest in this issue is not limited to Erie County. In addition to members of the local bar, the Committee has also heard from attorneys in Chautauqua and Monroe Counties. The Northern Chautauqua County Bar Association has taken a particular interest in response to a Chautauqua County title company providing closing services to unrepresented buyers and sellers in purchaser money mortgage transactions. This issue has attracted national attention as well. In October 2003, the ABA's Standing Committee on Lawyers' Title Guaranty Funds sponsored a Symposium on Unauthorized Practice of Law in Residential Real Estate Transactions, attended by representatives of bar associations in Illinois, Florida, Georgia, Connecticut, Virginia, Washington, D.C., Maryland, Kentucky, Massachusetts and New York as well as a representative of the Antitrust Division of the U.S. Department of Justice.

VII. Conclusion

The work that is involved in real estate transactions clearly falls into the practice of law, and according to New York Judiciary Law, statutory law and case law, settlement service companies and other non-lawyers performing these services are engaging in the unauthorized practice of law.

A settlement service may not even engage in the preparation of closing documents, as the Judiciary Law only allows a corporation to prepare deeds, mortgages or any other instruments affecting real property if those "instruments are necessary to the examination and insuring of titles, *and* necessary or incidental to loans made by such corporations or associations" (emphasis added). Thus, the only corporation which may prepare deeds, mortgages and other documents affecting real property is a title insurance corporation and even a title insurance corporation may only do so when such document preparation is in "furtherance of a loan made by such title insurance corporation."

Having an attorney on staff or as an owner does not protect the settlement service company because these services are for the general public and the Judiciary Law only allows the lawyer to provide such services for the corporation's immediate affairs or in any litigation to which it is or may be a party.

VIII. The Committee's Recommendation

The Unauthorized Practice of Law Committee concludes that settlement service companies and other non-lawyers are very often engaging in the unlawful practice of law.

This Committee recommends that a letter of caution be sent to lenders, title companies, settlement agents and others who are engaging in these unlawful practices informing them that their activities constitute the unauthorized practice of law and should be terminated immediately. Thereafter, if the illegal activity continues, the Board of Directors should further investigate specific complaints and pursue further legal remedies as provided for in Judiciary Law § 476-a.

This Committee further recommends that the Bar Association of Erie County advise other bar associations in New York State of its position and to encourage the New York State Bar Association to take an active interest in the potential public harm that is and may result from the unlawful practice of law in this area.

In the meantime, this Committee will continue to investigate complaints and to work with the Real Property Committee to educate attorneys and members of the public on the proper role of lawyers and laypersons in real estate transactions. To that end, the topic for WNED-AM's Law Line program on December 20, 2003 was "Why You Need A Lawyer to Buy Real Property." The topic for this Committee's Noonday Lecture on February 11, 2004 was "The Proper Use of Paralegals and the Need for Attorney Supervision at Real Estate Closings."

Endnotes

1. 282 N.Y.2d 513, 27 N.E.2d 30 (1940).
2. 62 A.D.2d 690, (4th Dep't 1976), *app. dismissed*, 45 N.Y.2d 821, 381 N.E.2d 608, 409 N.Y.S.2d 210 (1978).
3. *Id.* at 701.
4. *Id.* at 702.
5. *See Application of O'Hearn*, 55 Misc. 2d 540 (1967).

every transaction has at least one little twist that is beyond the norm.

One of the primary functions of your real estate attorney is to conduct a comprehensive review of your contract. Seemingly innocuous terms in the contract can have very serious consequences. You need to be informed of these consequences and you need to be protected from potential adverse results. The three (3) business day "Attorney Approval Period" affords your counsel the opportunity to do just that. In fact, throughout the transaction your attorney will inform you of and protect you from the pitfalls of the deal.

One common contract pitfall is the Home Inspection Clause. Very few people realize that the contract requires that you must not only complete the home inspection by the deadline listed in the contract, but you must also notify the Seller or the Seller's attorney in writing of any objectionable results from the inspection within that time. If you miss the deadline, your complaints are waived and you must accept the property with the defects you discovered. You are in the same boat if your real estate agent merely sends the list of problems to the listing agent and not to the Seller or Seller's attorney. These are very severe consequences resulting from minor mistakes. Obviously, it is important to consult with your attorney if you have issues resulting from your home inspection.

Lately, I have seen a number of home inspection problem lists which state that Purchaser "requests that Seller repair the . . ." When the Seller signs this Addendum is the Seller agreeing to make the repairs or is the Seller merely acknowledging the Purchaser's "request"? The repair language must be clear and complete. It is also important for the repair Addendum to address who will actually make the repairs. Can the Seller fix the frayed electrical wire himself or is a licensed electrician needed? It also makes sense to require that the repairs be completed at least in time to permit the Purchaser to inspect the repairs to be sure they were properly made. Your attorney knows the issues to raise and how to resolve them.

Sometimes the Purchaser's lender requires that certain repairs be made prior to closing. If the Seller refuses to pay for this work, the Purchaser may decide to take responsibility for these repairs. Some would think that the Seller should simply allow the Purchaser to have access to the property to make the repairs. However, what happens if the Purchaser decides to do the work himself and is not qualified to make the necessary repairs? What if the Purchaser damages the property while he is there or makes the problem worse? On the other hand, what happens if the Purchaser pays $3,000 to have the foundation fixed and the Seller cannot close because the title to the property is bad? Is the Purchaser reimbursed for his expenses or is his money lost? Again, your attorney knows the issues to raise and how to resolve them.

Our standard contract contains nine (9) potential contingencies, not to mention the eight (8) more in the various riders. Each of these affords one or both of the parties the opportunity to cancel the deal. You need to know if and when any of these terms applies to you and what you can do to promote your interests. The purchase or sale of a house is not only a large financial investment, it is a huge personal and emotional upheaval. With the logistics of packing, moving, transferring schools and changing jobs, you do not need or want to worry about making legal mistakes. Protect yourself with sound, professional legal counsel.

Endnote

1. A brochure containing an explanation of a lawyer's role in real estate transactions similar to that found in this article is available through the New York State Bar Association.

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The author wishes to acknowledge the contributions to this article of Bar Association of Erie County members Vincent Moore and William Johnson of the Real Property Law Committee, and Nancy Langer, Chairperson of the Unlawful Practice of Law Committee as well as insights from other members of those committees.

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New Directions in Mortgage Law: Restatements and Uniform Laws

By Dale A. Whitman

Traditionally, mortgage law was regarded as static, or even dull. That view is outmoded; mortgage law has been evolving at a rapid rate. While many innovations are a result of case decisions, this article will focus instead on the output of two national organizations that have been active in developing mortgage law: The American Law Institute, which publishes Restatements that are intended to provide guidance to courts, and the National Conference of Commissioners on Uniform Laws, which publishes uniform acts for adoption by state legislatures.

Four specific sources of law will be covered in this article:

- The Restatement (Third) of Property (Mortgages) (1997)
- The Uniform Nonjudicial Foreclosure Act (2003)
- The Uniform Residential Mortgage Satisfaction Act (expected 2004)
- The Uniform Security Interests in Rents Act (expected 2005).

I. The Restatement (Third) of Property (Mortgages)

In 1997 the American Law Institute adopted the first Restatement in its history covering mortgage law. While not binding on any court, the mortgages Restatement has already been followed in a number of decisions (although no New York court has yet cited it). The Restatement is not merely a statement of existing majority views, but rather attempts to state the best view taken by American courts. Some of its more interesting positions are discussed below. Section numbers refer to sections of the Restatement. The indented paragraphs give a very brief summary of New York law on each issue.

§ 1.2. Consideration

Consideration is not necessary for a valid mortgage, provided the underlying obligation is enforceable. The case law is full of statements that a mortgage must be founded on consideration, but this seems plainly wrong. The mortgage, after all, is merely security for an obligation. It's true that the *obligation* may need to be supported by consideration under the law of contracts, but if the obligation is enforceable, the mortgage should be equally enforceable. Even if the obligation is not enforceable (for example, a promissory note given as a gift for no consideration), the mortgage itself is enforceable if intended as a gift and is not tainted by fraud, mistake, undue influence, duress, or the like. When a mortgage secures a preexisting debt, it may be arguable whether consideration is present or not, but under the Restatement the question is irrelevant; the mortgage is generally enforceable.

> New York law appears to agree in substance with the Restatement. While there are many statements in New York cases concerning the necessity of consideration for a mortgage, they all appear to refer in fact to consideration for the underlying obligation that the mortgage secures. See, e.g., *Fidelity Nat. Title Ins. Co. v. Consumer Home Mortg., Inc.*, 272 A.D.2d 512, 514, 708 N.Y.S.2d 445, 446 (2d Dep't 2000): "where as here, the underlying debt has not been satisfied [funded], the mortgage it was meant to secure must fail."

§ 2.3. Priority of Future Advances

All future advances take the priority of the original mortgage; the "optional/obligatory advance" doctrine is abolished. However, the mortgagor can give the mortgagee a notice at any time cutting off all future advances and capping the principal balance at its current level. This "cutoff notice" procedure has been implemented by statute in about a dozen states, but the Restatement proposes that it be judicially recognized. The "cutoff notice" procedure is not available if terminating future advances would unreasonably jeopardize the mortgagee's security, or would prevent the mortgagee from fulfilling its contractual duty to other persons to make further advances. Hence, the "cutoff notice" will not usually be available in a construction loan case, since it could result in a cutoff of funds when the project is only partially completed. See Grant S. Nelson & Dale A. Whitman, *Rethinking Future Advance Mortgages: A Brief for the Restatement Approach*, 44 Duke L.J. 657 (1995).

> New York Real Property Law § 281 provides that the advances under a "credit line mortgage" (up to the maximum stated in the mortgage) made within 20 years of the recording of the mortgage shall take the priority of the original recording whether they are optional or obligatory. Hence, for "credit line mortgages" the Restatement's cutoff notice procedure is unnecessary. The statute does not apply to "building loan mortgages"—i.e., construction loans.
>
> Under New York Lien Law § 13(2), building loan mortgages generally have priority over mechanics' liens as to advances made before the filing of a notice of lien. As against other types of inter-

> vening liens, the common law optional/obligatory advance doctrine continues to apply in New York; see *Briarwood Towers 85th Co. v. Guterman*, 136 A.D.2d 456, 523 N.Y.S.2d 98 (1st Dep't 1988), upholding the priority of a construction loan mortgage, as against an intervening mortgage. The construction advances were held to be obligatory upon the lender, notwithstanding that they were subject to certain objective conditions relating to title insurance.

§ 2.4. Dragnet Clauses

Advances are secured under a dragnet clause only if they are similar in character to the original loan, the mortgage describes them with reasonable specificity, or the parties specifically agree at the time of a particular advance that it is secured by the mortgage.

> It is unclear whether New York would apply this limitation to dragnet clauses. The New York case law on dragnet clauses is mixed and does not specifically address the issue mentioned in the Restatement. In *Coolidge East Equities, LP v. Babcock*, 283 A.D.2d 968, 724 N.Y.S.2d 242 (4th Dep't 2001), the court refused to apply a dragnet clause, in a mortgage executed by husband and wife, to a secure a later debt incurred by the husband alone. On the other hand, the Court of Appeals, in *State Bank of Albany v. Fioravanti*, 51 N.Y.2d 638, 435 N.Y.S.2d 947 (1980), enforced a dragnet clause against a buyer who had purchased the property after the dragnet mortgage was imposed on it, holding that the buyer's payment of the original note in full did not discharge the mortgage. See also *Schantz v. O'Sullivan*, 288 A.D.2d 536, 731 N.Y.S.2d 808 (3d Dep't 2001).

§ 3.4. Installment Contracts

A contract for deed (real estate installment contract) is a mortgage; the real estate security can be realized upon only by foreclosure. A forfeiture clause is regarded as an unenforceable clog on the equity redemption under § 3.1.

> New York case law has treated installment contracts as the equivalent of mortgages in some circumstances. See *Call v. LaBrie*, 116 A.D.2d 1034, 1035, 498 N.Y.S.2d 652, 653 (4th Dep't 1986) ("defendants' payments of over 12% of the principal balance of the land contract over a period of nine years was sufficient to convert this land contract into an equitable mortgage and represents a substantial investment which should be protected from forfeiture."); *Madero v. Henness*, 200 A.D.2d 917, 918, 607 N.Y.S.2d 153, 154–55 (3d Dep't 1994) (purchasers "had paid almost one third of the $75,000 purchase price, as well as over $20,000 in interest, and had made over 40 of the 100 principal payments called for by the contract. * * * And, their tardiness in making payments, although perhaps a technical default on the contract, is not sufficiently egregious to trigger the agreement's forfeiture provisions.")
>
> Nonetheless, it appears to remain possible for an installment vendor in New York to declare a forfeiture of the land. See, e.g., *Murray v. Breski*, 227 A.D.2d 867, 716 N.Y.S.2d 810 (3d Dep't 2000), in which the purchasers claimed relief from forfeiture because they had made improvements on the land and made substantial payments. The court held that the forfeiture complaint stated a cause of action, but that the purchasers might be able to prevail on their equitable defenses.

§ 4.6. Waste

Waste is broadly defined by the Restatement, and includes physical damage, failure to make reasonable repairs, failure to pay prior tax liens, failure to comply with mortgage covenants respecting the physical care of the property, and failure to turn over rents to which the mortgagee has a right. If waste occurs and impairs the mortgagee's security, it may foreclose, seek an injunction, or seek damages. These remedies are available only if the mortgagee's security is impaired. Impairment of security is defined as an increase of the loan-to-value ratio above its scheduled level.

> New York had adopted a broad definition of waste. See *Aetna Life Ins. Co. v. Avalon Orchards, Inc.*, 118 A.D.2d 297, 505 N.Y.S.2d 216 (3d Dep't 1986) (failure of mortgagor to manage property competently was waste); *Travelers Ins. Co. v. 633 Third Associates,* 14 F.3d 114 (2d Cir. 1994) (intentional failure to pay property taxes may constitute waste).
>
> New York has always limited the mortgagee's recovery to the amount by which the security has been made inadequate by the waste; *Van Pelt v. McGraw*, 4 N.Y. 110 (1850); *President & Directors of Manhattan Co. v. Mosler Safe Co.*, 246 A.D. 785, 284 N.Y.S. 145 (2d Dep't 1935). However, the method of measuring impairment of security is not well established. See *Albany Sav. Bank v. Novak*, 151 Misc. 2d 956, 574 N.Y.S.2d 140 (Sup. Ct., Orange Co. 1991) (recovery is the amount by which the waste has reduced

the property's value below the mortgage debt). The Restatement approach to defining impairment of security is much more clear-cut than existing New York law, and could well be adopted by the New York courts.

§ 4.7. Insurance and Condemnation Proceeds

The mortgagee has the right to casualty insurance proceeds (if the mortgage required the mortgagor to carry the insurance) and eminent domain awards, to the extent security has been impaired. The test for impairment of security is the same as for waste under section 4.6. The mortgagee must apply the funds toward reduction of the mortgage debt. However, upon the mortgagor's request, the mortgagee must allow use of the funds for restoration of the property if feasible, unless the mortgage specifically provides the contrary. The mortgagee can impose reasonable conditions on the use of the funds for repair.

> Under New York case law, the mortgagee is entitled to recover and retain insurance proceeds to the extent of the unpaid mortgage debt; *San Roman v. Atlantic Mut. Ins. Co.* 250 A.D.2d 585, 672 N.Y.S.2d 396 (2d Dep't 1998). Unless the mortgage so provides, the mortgagee has no obligation to allow use of the insurance proceeds to restore the damaged property; *Savarese v. Ohio Farmers' Ins. Co.*, 260 N.Y. 45, 182 N.E. 665 (1932). Moreover, the fact that the property is worth as much as before the loss, or is adequate security, does not stand in the way of the mortgagee's retention of the insurance proceeds, up to the balance owing on the mortgage debt; *Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co.*, 28 N.Y.2d 332, 321 N.Y.S.2d 862 (1971).

§ 5.5. Payment to the Assignor After Assignment of the Mortgage and Debt

If the debt has been transferred, payment to the transferor is good if made before the payor has notice of the transfer. The Restatement's rule applies only to nonnegotiable notes, since negotiable notes are governed by U.C.C. Article 3. This reverses much existing case law, which holds that the payor pays at his or her peril if a transfer of the debt has occurred before the payment.

> New York has traditionally held that payment to the original mortgagee, even on a nonnegotiable note, will not count if the note has been assigned. *Assets Realization Co. v. Clark*, 205 N.Y. 105, 98 N.E. 457 (1912) (as to final payment). This is true despite the fact that the mortgagor has no notice of the assignment. See also *Felin Assocs., Inc. v. Rogers*, 38 A.D.2d 6, 326 N.Y.S.2d 413 (1st Dep't 1971) (dictum). The New York rule, in effect, expects the mortgagor to demand to see the note before making payment, a completely unrealistic expectation.

§ 6.1. Prepayment

Prepayment is free unless the mortgage or note restricts or prohibits prepayment. This reverses the traditional presumption that prepayment is not allowed unless the documents expressly permit it.

> New York follows the traditional default rule that prepayment is not permitted, unless the mortgage, note, or other agreement so provides; *Russo Enterprises, Inc. v. Citibank,* 266 A.D.2d 528, 699 N.Y.S.2d 437 (2d Dep't 1999); *Arthur v. Burkich*, 131 A.D.2d 105, 520 N.Y.S.2d 638 (3d Dep't 1987); *Geller v. Fairmont Assocs.*, 172 A.D.2d 915, 568 N.Y.S.2d 202 (3d Dep't 1991) (where mortgage was silent as to right to prepay, court could consider language in parties' contract of sale which authorized prepayment).

§ 6.2. Restrictions on Prepayment

Clauses restricting or prohibiting prepayment are enforceable. Such clauses may either bar prepayment entirely or may impose a fee or "penalty" for prepayment. However, the mortgagor may free the real estate without prepayment of the debt if substitute security (that is substantially the equivalent of cash) is provided. See Dale A. Whitman, *Mortgage Prepayment Clauses: An Economic and Legal Analysis*, 40 UCLA L. Rev. 851 (1983).

> New York case law supports the mortgagee's right to recover a prepayment fee when a voluntary prepayment occurs and such recovery is provided for in the loan documents. However, these cases indicate that the fee may not be collected if the prepayment is a result of acceleration caused by either the mortgagee's default, see *3C Assoc. v. IC & LP Realty Co.*, 137 A.D.2d 439, 524 N.Y.S.2d 701 (1st Dep't 1988); *Nutman Inc. v. Aetna Business Credit*, 115 Misc. 2d 168, 453 N.Y.S.2d 586 (Sup. Ct., Queens Co. 1982), or condemnation of the property by public authority, see *Silverman v. State*, 48 A.D.2d 413, 370 N.Y.S.2d 234 (3d Dep't 1975). It is questionable whether these cases would be followed today if the mortgage documents expressly provided for collection of a prepayment fee in the context of condemnation or acceleration for default; see *Westmark Commercial Mortgage Fund IV v. Teenform Assoc.*, L.P., 827 A.2d 1154 (N.J. Super. App. Div. 2003), (approving fee collection in cases of accelera-

tion for default, as long as the documents provided).

New York General Obligations Law § 5-501(3), applicable to owner-occupied one-to-six-family residences, provides that no prepayment fee may be collected after one year from the loan date. A fee may be collected within the first year if the loan agreement provides; N.Y. Real Property Law § 254-a, construed in *Hughley v. Gillespie*, 219 A.D.2d 584, 631 N.Y.S.2d 374 (2d Dep't 1995) (prohibiting collection of a prepayment fee if the prepayment results from the lender's exercise of a due-on-sale clause).

The substitution of other collateral (the "equivalent of cash") for the real estate is not expressly authorized by law in New York, but is frequently authorized by language (termed a "defeasance clause") in the loan documents, particularly with securitized mortgage loans.

§ 6.3. Prepayment from Insurance or Condemnation Proceeds

No prepayment fee may be charged for prepayment from casualty insurance or eminent domain proceeds if the proceeds could feasibly have been used to restore the property instead.

No New York case law suggests the sort of restriction on collection of prepayment fees in the insurance or eminent domain contexts that is called for by the Restatement.

§ 7.6. Subrogation

One who pays off another's mortgage debt in full is subrogated to the debt and the mortgage, if necessary to prevent unjust enrichment. A mortgage lender who pays off a prior mortgage in full (a refinance) is entitled to be subrogated to the prior mortgage's priority if the refinancing lender "reasonably expected to receive a security interest in the real estate with the priority of the mortgage being discharged, and if subrogation will not materially prejudice the holders of intervening interests in the real estate."

In the context of refinancing, New York has a relatively liberal view of subrogation. The refinancing lender is entitled to subrogation as against an intervening lien so long as it has no actual knowledge of the lien, even if the lien is recorded and could have been discovered by a diligent title examination. See *King v. Pelkofski*, 20 N.Y.2d 326, 282 N.Y.S.2d 753 (1967); *U.S. v. Baran*, 996 F.2d 25 (2d Cir. 1993). See also *R.C.P.S. Associates v. Karam Developers*, 238 A.D.2d 492, 656 N.Y.S.2d 666 (2d Dep't 1997) (stating no subrogation if the lender seeking it had actual knowledge of intervening lien); *Pawling Sav. Bank v. Jeff Hunt Properties, Inc.*, 225 A.D.2d 678, 639 N.Y.S.2d 462 (2d Dep't 1996) (concluding no subrogation if mortgagee paying off prior loan had no reasonable expectation of having priority over intervening lien). Cf. *Roth v. Porush*, 281 A.D.2d 612, 722 N.Y.S.2d 566 (2d Dep't 2001) (positing lender seeking subrogation may be required to conduct diligent inquiry).

New York also continues to follow the "volunteer" rule, which the Restatement rejects; see *Bermuda Trust Co. Ltd. v. Ameropan Oil Corp.*, 266 A.D.2d 251, 698 N.Y.S.2d 691 (2d Dep't 1999).

§ 8.5. Merger

The merger doctrine does not apply to mortgages or affect the enforceability of a mortgage obligation. This approach should simplify the process of mortgagees' obtaining deeds in lieu of foreclosure.

Although New York continues to recognize the concept of merger in mortgage law, it is disfavored and generally will not be applied where it is contrary to the intent of the party acquiring the mortgage interest; see *Arch Assets, Inc. v. AL & LP Realty Co.*, 227 A.D.2d 295, 642 N.Y.S.2d 315 (1st Dep't 1996). But see *Cambridge Factors, Inc. v. Thompson*, 215 A.D.2d 427, 626 N.Y.S.2d 259 (2d Dep't 1995), (applying merger where the mortgagor held mortgages on his own property in the names of aliases and alter egos as a device for perpetrating a fraud on the junior lienholder).

II. The Uniform Nonjudicial Foreclosure Act

This Act, adopted in final form by the Commissioners on Uniform Laws in 2002, has the essential purpose of providing a nonjudicial method of foreclosing security interests in real estate. New York currently permits nonjudicial foreclosures of nonresidential mortgages under New York Real Property Actions and Proceedings Law, article 13, but the Uniform Act applies to both residential and nonresidential mortgages, and has several additional advantages over the current New York statute.

1. Types of Security Instruments

Every type of real estate security interest can be foreclosed under the act, including existing mortgages, deeds of trust, real estate installment contracts, and other forms of security devices. However, the act is available only if the security instrument either states that the act's procedures can be used to foreclose it, or contains general language authorizing foreclosure of the security interest by nonjudicial process. In most states that do not currently permit nonjudicial foreclosure, it is unlikely that language of this sort would be found in many mortgages or other security agreements. Hence, in those states as a practical matter the act will be available only for foreclosure of security agreements entered into after the act is adopted. In New York, a mortgage that provides for foreclosure under the existing nonjudicial procedure would probably be foreclosable under the new Uniform Nonjudicial Foreclosure Act as well.

2. Availability of other Foreclosure Methods

The act does not provide an exclusive method of foreclosure. For example, judicial foreclosure, currently available in every state, can continue to be used. So can other methods now in use, unless a particular state's legislature chooses to repeal them when it adopts the uniform act. For example, states that presently authorize forfeiture by the vendor of installment sale contracts could continue to do so.

3. Notice of Default and Right to Cure

The act requires that the debtor receive a notice of default and an opportunity to cure before foreclosure can be instituted, provided that the default is curable. The "cure" spoken of here is of the unaccelerated debt; thus, it can be accomplished (in the case of a monetary default) by the debtor's paying the delinquent payment or payments, plus any accrued interest and costs. Ordinarily a minimum of 30 days is allowed for the cure of a monetary default, and 90 days for a nonmonetary default if the cure has commenced within 30 days and is being diligently pursued. However, in the case of a nonresidential loan, the cure period may be reduced by the security agreement to as little as ten days.

It is significant that, even in nonresidential loans, the parties cannot by agreement completely eliminate the notice of default and the cure period. Some lenders who make commercial loans may object to this concept; sometimes nonresidential loan agreements do not require notice of default at all, but rather permit the lender to accelerate and commence foreclosure immediately upon the occurrence of the default, even though the default is in its nature curable. It is questionable whether the courts will enforce such a provision, but in all events the drafting committee considered it to be fundamentally unfair to force a borrower—even a nonresidential borrower—into foreclosure with no opportunity whatever to cure a curable default.

4. Types of Foreclosure

The act provides for three different methods of foreclosure at the election of the foreclosing creditor. The first, termed "foreclosure by auction," is similar to the traditional method used in present judicial and nonjudicial foreclosure procedures. One important difference is that the act provides for thorough mailed notice to the debtor and all persons holding subordinate interests in the property; by comparison, many existing nonjudicial foreclosure statutes provide no direct notice to junior interest-holders at all. This feature of the act should obviate some of the concerns about compliance with constitutional due process that have been raised with respect to existing statutes.

The second type of foreclosure permitted at the foreclosing lender's option, is termed "foreclosure by negotiated sale," and allows the lender to locate a buyer of the property and enter into a contract under which the buyer will purchase the property. This information is then communicated to the debtor, along with a net amount that the lender agrees to allow against the debt on account of the sale. The third method, termed "foreclosure by appraisal," permits the lender to obtain and give to the debtor an appraisal of the property, and to accompany it with an offer of a proposed net amount that the lender agrees to allow in return for taking title to the property. This latter method is somewhat like strict foreclosure, in the sense that the lender winds up owning the real estate.

In both of these latter methods of foreclosure, the debtor is given an opportunity to decide whether to accept or reject the lender's offer. The proposed selling price of the property (in the case of "foreclosure by negotiated sale") or the appraised value of the property (in the case of "foreclosure by appraisal") provides some information that can help the debtor decide whether to accept the lender's offer or not. However, the lender's offer may be lower or higher than the negotiated sale price or the appraised value. If the debtor rejects the lender's offer, the usual result is that the proposed foreclosure by negotiated sale or by appraisal is dropped, and the foreclosure must be carried out under the traditional auction format instead.

If the lender's offer under either of these latter methods of foreclosure is a reasonable one, the debtor is likely to accept it, particularly in light of the widely recognized fact that auction foreclosure sales rarely bring fair market value. However, if the debtor insists on having an auction sale that is his or her right. Hence, the supposed debtor protection inherent in an auction is not lost as a consequence of availability of the other two methods of foreclosure. In most cases it is believed that lenders will use these other methods and will make reasonable offers that will be in the interest of debtors to accept. In the long run, both lenders and debtors should be better off—lenders because they can avoid some the delays and uncertainties associated with auction sales, and debtors because they will in general be credited with higher prices for their properties, thus reducing their risk of deficiency liability and increasing the probability of a surplus.

5. Deficiency Liability

Another innovation of the act lies in the area of deficiency judgments. If a foreclosure is conducted under the act, deficiency judgments are available against nonresidential debtors to the extent that the loan documents provide for personal liability. However, residential debtors are exempt from deficiency liability if they have acted in good faith. Good faith means that they have not defrauded the lender, have allowed reasonable access to the property before the foreclosure, have not committed intentional waste or intentionally contaminated the property and have not failed to take reasonable precautions to prevent others from doing so, and have relinquished possession promptly after completion of the foreclosure.

Lenders generally agree that cases in which deficiency judgments can actually be collected from residential debtors are rare; hence, little is lost by exempting them from deficiency liability. Nonetheless, the threat or risk of deficiency liability is generally considered to have a significant impact on the behavior of debtors. Therefore, the expectation is that these provisions will give debtors a strong incentive to act responsibly with respect to the property even when they cannot pay the debt. The result should be greater peace of mind for responsible debtors and greater recoveries in foreclosure for lenders.

Conclusion

The act builds on time-tested foreclosure concepts but also offers some novel and, what the drafters believe, highly attractive features. It represents what the drafters consider a fair and equitable balance between the demands of lenders and borrowers, and some of its aspects will be considered an important step forward by both groups. The act may provide an opportunity for New York to rethink the issues surrounding nonjudicial foreclosure, and hopefully will be adopted.

III. The Uniform Mortgage Satisfaction Act

A mortgagee's failure to provide a timely satisfaction of mortgage when the mortgage is paid off has become a significant problem throughout the United States. There was a time when attorneys and title companies received an executed satisfaction and payoff statement by the existing mortgage holder at the closing. Then when the closing agent transmitted the payoff to the lender, it would be instructed and authorized to record the satisfaction. Unfortunately, this practice has largely disappeared as more and more mortgages are traded on the secondary market and held at locations remote from the property's location. Today, the existing mortgagee typically waits until receiving the payoff before preparing and recording the satisfaction. Furthermore, it has become common for a paid mortgage to go for many months or even years before a satisfaction is recorded because of (1) poor record-keeping, (2) large volumes of refinances, (3) mergers and acquisitions of financial institutions, and (4) multiple transfers of both mortgages and mortgage servicing. As a result, since title insurers are expected to provide "clean" policies to new owners and new mortgagees, they are usually forced by business necessity to "insure over" the old mortgage even though its satisfaction has not been recorded. This is a risk the title insurance industry has not accepted cheerfully.

The Uniform Residential Mortgage Satisfaction Act is designed to provide some solutions to this problem. The Act received final approval by the Commissioners in August 2004. Its main features are described below.

1. Residential Mortgages Only

The Act is limited to residential mortgages, which is defined as security instruments on real property used primarily for personal, family, or household purposes and improved by one to four dwelling units. The drafters believe that excluding commercial mortgages is likely to make the Act easier to enact, and in any event, the major problems of untimely satisfactions exist in the residential mortgage market.

2. Payoff Statements

The Act requires a mortgage holder to issue a payoff statement at the request of an "entitled person." An "entitled person" includes both the owner(s) of the security property and persons liable for payment of the secured debt. Indirectly, the Act also includes attorneys and title insurers who act on the authorization of an "entitled person." The mortgage holder who issues the payoff statement must do so within ten days of the "entitled person's" request. Failure to do so makes the creditor liable for actual damages plus $500. Additionally, the secured creditor must provide one payoff statement without charge during any six-month period, but thereafter may charge $25 for each additional statement. Also, a reasonable transmittal charge may be made for sending the payoff statement by facsimile or by means other than first-class mail.

It has become common for a mortgagee to issue payoff statements that are qualified by such language as "subject to final audit." Obviously, it is difficult for a closing agent to rely on such a statement. For this reason, the Act provides that if the statement is qualified, the creditor must provide a means for the closing agent to obtain an unqualified updated statement on the payoff date or on the last business day free of charge.

3. Estoppel Effect of Statement

The Act provides that a creditor who sends a payoff statement stating an erroneous amount may not deny its accuracy as against any person that reasonably and detrimentally relies on the amount stated. This may be the most important feature of the Act, although it largely tracks existing case law. In other words, statutory estoppel means that a closing agent who in fact transmits a payoff amount in reliance on a payoff statement is absolutely entitled to have a satisfaction issued and recorded. Hence, the risk to a title company of "insuring over" a paid-off but unsatisfied mortgage is essentially eliminated. The creditor is still entitled to collect any amount not included in the payoff statement from the persons who were liable on the mortgage debt, but that claim will now be unsecured.

4. Obligation to Record Satisfaction

The Act requires that the secured creditor record a satisfaction within 30 days of receiving full payment of the debt. A creditor who fails to do so is liable for the actual damages that result. Additionally, if the landowner, after the 30-day period has expired, sends the creditor by certified mail a demand for a recorded satisfaction, and the creditor fails to provide the satisfaction within 30 additional days after receiving the demand, the creditor becomes liable for an additional $500, and for reasonable attorneys' fees and costs.

No liability arises if the creditor has established a reasonable procedure to achieve compliance with the Act and follows that procedure, but is unable to comply with the Act because of circumstances beyond its control. As an illustration, the creditor might be unable to comply with the Act if its local post office was closed because of an anthrax scare, and it consequently did not receive the landowner's demand.

5. Satisfaction by Affidavit

The Act authorizes lawyers and title insurance companies (called satisfaction agents) to record an affidavit that has the effect of discharging a mortgage. The satisfaction agent must act with the landowner's authority, and may do so only if the secured creditor has failed to record a satisfaction within the 30-day period mentioned above. The satisfaction agent must then give the creditor notice by certified mail indicating his intent to record an affidavit of satisfaction after an additional 30 days has passed. If the creditor records a satisfaction during the 30-day period, or notifies the agent that the mortgage is not in fact satisfied or has been assigned, the agent may not record the affidavit.

A satisfaction agent who records an affidavit that is false or erroneous is liable for the creditor's actual loss, attorneys' fees and costs. However, if the agent gave the proper notice that the affidavit would be filed, and the creditor failed to make any needed correction within 30 days, the filing is not considered erroneous.

	New York Statute	Uniform Act
Time allowed to secured creditor to issue payoff statement	30 days	10 days
Penalty for failure to timely issue statement	Actual damages	Actual damages plus $500
May creditor require confirmation of statementat at a later date?	Yes, on day of payoff	Yes, on day of payoff or previous day
Time allowed to creditor to record satisfaction after receiving payoff	45 days before seeking court order; 90 days before penalty applies	30 days
Penalty for failure to timely record satisfaction	$500 or the economic loss	Actual damages, plus $500 and attorneys' fees if additional 30 days elapse after demand
Who may record satisfaction affidavit	Attorney	Attorney or title company
Conditions for recording satisfaction affidavit	May file with recorder 90 days after payoff; becomes recorded after additional 35 days unless mortgagee files verified objection	Give notice 30 days after payoff; may record after additional 30 days

6. Comparison with Existing New York Law

Real Property Law § 274-a requires mortgagees to provide payoff statements similar to those required by the Uniform Residential Mortgage Satisfaction Act. Also, New York Real Property Actions and Proceedings Law § 1921 contains provisions for the recording of an affidavit of satisfaction similar to those of the Uniform Residential Mortgage Satisfaction Act.

Perhaps the most significant difference is that RPAPL § 1921 makes no reference to an estoppel against a mortgagee issuing a payoff statement. However, Restatement (Third) of Property (Mortgages) § 1.6 (c) (1997) provides that "[a] mortgagee who discloses erroneous information may be estopped to deny its accuracy as against one who has reasonably and detrimentally relied on the disclosure." It is possible that New York courts would impose such an estoppel even without statutory authority for doing so.

Other differences are summarized in the table at left. It is apparent that New York law is much more generous in the time periods allowed to lenders than the Uniform Residential Mortgage Satisfaction Act.

IV. Uniform Assignment of Rents Act

Few topics in mortgage law have engendered as much confusion as the creation of security interests in rents. Nearly every mortgage on income-producing real estate will include, or be accompanied by, an "assignment of rents." While the assignment will often be described in the documents as "absolute," it will in virtually every case actually be given as additional security for the mortgage debt. Confusion and difference of opinion from state to state have prevailed on many points. Is the security interest in rents merely a constituent of the mortgage on the real estate? How does the secured creditor "perfect" such an interest? How does the creditor actually realize on it?

The Uniform Assignment of Rents Act is designed to answer these questions and numerous others in a way that will meet the needs of commercial mortgage lenders and borrowers, and will hopefully become uniform throughout the nation. The principal issues addressed in the Act are summarized below. The reader should bear in mind that at this writing the Act has not had a "first reading" before the Commissioners on Uniform Laws. The comments here are based on the draft that was presented at the "first reading" in August 2004. The "final reading" (usually leading to final approval) is expected to occur in August 2005. Hence, there are likely to be some important changes in the Act before it is finalized.

1. Distinct Form of Collateral

The act confirms that a security interest in rents is distinct from a mortgage on the underlying real estate, and may be realized upon without waiting for foreclosure on the real estate.

2. Perfection

Under the act, a security interest in rents is perfected by recording in the real estate records. No further action is necessary for perfection (as distinct from realization) of the interest. This overrules some case law suggesting that the security interest is "inchoate" or ineffective until the mortgagee takes action, after default, to enforce the interest.

3. Absolute Assignment

Under the act, merely calling an assignment "absolute" does not make it such. If the purpose of the assignment is security, it will be treated as security. The practice of calling assignments "absolute" has represented an attempt by some lenders to enhance their positions in bankruptcy court by arguing that, with an absolute assignment, the rents are fully owned by the creditor and are not property of the bankruptcy estate. A few courts have accepted this view; see, e.g., *In re Carretta*, 220 B.R. 203 (D.N.J. 1998). However, the Restatement (Third) of Property (Mortgages) § 3.2 (1997) and most of the cases have rejected it. By analogy to the case law declaring so-called "absolute deeds" to be mortgages, they have held that an "absolute" assignment of rents creates only a security interest if its purpose is to secure payment of a debt. The act agrees.

> New York law would apparently recognize the (quite illusory) distinction between an absolute assignment and a security assignment; see *Vecchiarelli v. Garsal Realty, Inc.*, 111 Misc. 2d 157, 443 N.Y.S.2d 622 (Sup. Ct., Onondaga Co. 1980).

4. Entitlement to a Receiver

The act provides clear standards for appointment of a receiver. The mortgagee is entitled to a receiver if (1) the criteria stated in the mortgage are satisfied; (2) it appears likely that the property undersecures the debt; (3) the owner has failed to turn over rents to which the mortgagee is entitled; or (4) other law of the state would entitle the mortgagee to a receiver.

> The New York case law suggests that criteria for appointment of a receiver may include inadequacy of the security (see *Fed. Home Loan Mortgage Corp. v. Jerwin Realty Assocs.*, No. CV-92-4626, 1992 WL 390264 (E.D.N.Y. Dec. 14, 1992)). If the statutory mortgage form is used, it expressly gives the lender the right to a receiver upon default, and supposedly no showing of inadequate security is necessary; see N.Y. Real Property Law § 254 (10). However, New York courts have been wary of appointment of receivers; see *First Nat'l Bank of Glens Falls v. Caputo*, 124 A.D.2d 417, 418, 507 N.Y.S.2d 516, 517–18 (3d Dep't 1986) ("appointment of a temporary receiver is only to be made with extreme caution in the exercise of the court's equity powers because of the drastic nature of the remedy. * * * Indeed, even when the mortgagor's consent has been embodied in the mortgage itself, it has been held that a court of equity nevertheless retains the discretion, in appropriate circumstances, to deny the application").

5. What Are Rents?

The term "rent" is technically fairly narrow, and requires the existence of a landlord-tenant relationship. However, many types of income-producing property generate revenues despite the absence of such a relationship. Examples arguably include hotels, nursing care facilities, golf courses, and marinas. The act defines rents very broadly, to include any sum paid by a tenant, licensee, or other person for the right to possess or occupy real estate. The existence of a landlord-tenant relationship is not essential.

6. Enforcement of the Security Interest

The act permits a mortgagee to enforce its security interest in rents merely by making a written demand to the mortgagor if the loan is in default. A mortgagor who fails to turn over rents received after such a demand is liable for conversion of those rents. The act also allows the mortgagee to give notification to tenants demanding that they make future rent payments directly to the mortgagee. It provides a standard form for this purpose, and it addresses the liability of the tenant for making payments to the mortgagor after receiving such a notification.

> New York law apparently agrees, at least if the mortgage so provides; see *Fed. Home Loan Mortgage. Corp. v. Dutch Lane Assoc.*, 775 F. Supp. 133, 139–140 (S.D.N.Y. 1991) ("Once the [lender] notifies [the borrower] in writing of a breach of the mortgage and states it is exercising its rent rights, the [lender] is immediately entitled to all rents without any further action required"); *Lincoln Sav. Bank v. Amerasian Realty Corp.*, 168 Misc. 2d 391, 637 N.Y.S.2d 619 (Sup. Ct., New York Co. 1995).

7. Earmarked "Additional Rent"

Many commercial leases provide for collection, as "additional rent," of the tenant's pro rata share of the landlord's property taxes, insurance premiums, common area maintenance expenses, and perhaps other items. The question arises whether a mortgagee, upon enforcing its security interest and commencing to receive the rents, should be obligated to expend them for these purposes. This issue has proven controversial among the members of the drafting committee. The current draft requires the mortgagee to apply the earmarked "additional rent" toward payment of taxes and insurance, but not toward maintenance. The drafting committee intends to discuss this matter further.

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When Does a "Principal Residence" Exemption Excuse a Non-Resident from Making Time-of-Sale Estimated N.Y. State Income-Tax Payments?

By Joel E. Miller

Gains realized by non-residents on the sale of real property within New York have long been subjected to New York State income taxation. At least, that was so in theory. In practice, though, over the years many non-residents either were unaware of the rules or simply declined to make payment, and, because there was no efficient enforcement mechanism, considerable revenue was lost. In 2003, the legislature added to the Tax Law a new provision—section 663—that established a procedure designed to plug that loophole. A non-resident selling New York real estate was in effect required to file *at the time of sale* a newly-created income-tax form—IT-2663—and then and there pay any estimated tax shown thereon.[1]

When it enacted section 663, the legislature was of course aware that sales proceeds excluded from federal gross income are, because of the "piggyback" nature of the New York State income tax, automatically excluded from New York taxable income as well. The legislature was also aware that many sales of residences would, because of a certain Internal Revenue Code provision, generate no federal income-tax liability and, it followed, no New York State income-tax liability. Accordingly, it included in section 663 a provision ("the 2003 relief provision") that clearly was intended to afford relief from the section 663 requirements in certain situations involving residences. It was also clear that the 2003 relief provision was inapplicable if the property being sold had not been the seller's main home within the five-year period preceding the sale. Beyond that, however, there was great uncertainty, due to the fact that, even though the legislature had employed language that seemed to be saying one thing, it had almost certainly intended to say something else. And the two possible readings, which are described below, would in some cases produce radically different results.

That was a situation in which the public could rightfully expect the agency charged with implementing the law—the New York State Department of Taxation and Finance ("the Department")—to tell us which way the 2003 relief provision should be read. But that did not happen. Although the Department did issue various forms of guidance setting forth certain rules, those rules were stated in confusing and imprecise terms; and some of them seemed to be consistent with only one of the two possible readings, while others seemed to be consistent with only the other of the two possible readings. Moreover, for no apparent reason the Department never expressly adopted one of the two possible interpretations—indeed, the Department seemed unaware of the fact that two interpretations were possible—with the result that a number of well-intentioned taxpayers were left unsure of what they were supposed to do, while others felt free to adopt whatever interpretation best suited their purpose at the moment. And, when some practitioners suggested that the Department add a few simple statements that would provide at least some clarification, the Department declined to do so.

This year the legislature modified the Tax Law again, and one of those modifications made sales of New York cooperative apartments by non-residents subject to reporting and paying requirements that essentially parallel those applicable to realty sales (the form in this case being IT-2664).[2] And, consistent with what it had done the year before, the legislature included a relief provision ("the 2004 relief provision") that was, with only necessary word changes, the same as the 2003 relief provision. The Department thus had another opportunity to provide clarification, but it again failed to do so.

This article will describe the two possible interpretations of the relief provisions, showing how they differ significantly from one another, and then discuss what the Department has done in this area.

Internal Revenue Code § 121

Because both of the subject relief provisions refer to section 121 of the Internal Revenue Code ("section 121"), a brief review of the basic operation of that section is in order.

In general (with exceptions an understanding of which is not essential for present purposes), section 121 permits a taxpayer to elect to exclude from gross income up to a determinable amount ($250,000 in the ordinary case) of gain realized by him or her on the sale of an asset if at the time of the sale[3] the following three conditions are satisfied:

1. The taxpayer owned the asset for at least two of the five years preceding the sale.

2. The taxpayer used the asset as his or her "principal residence" for at least two of the five years preceding the sale.
3. The taxpayer did not use section 121 to shield gain on a sale made less than two years prior to the sale in question.

It is important to note that—even though "principal residence" is a key term in applying it—section 121 does not define "principal residence." That does not, however, mean that the term does not have a fairly well-settled meaning. On the contrary, there are Treasury regulations interpreting it,[4] as well as a body of case law interpreting the same term under the present and former Code sections. For present purposes, it is sufficient to observe that a taxpayer's section 121 "principal residence" is essentially the place where he or she is truly residing at the time in question—where he or she would likely say that he or she "lives" if asked the question—and that it follows that a person can at any given point in time have only one "principal residence" as that term is used in section 121.

Another thing to note is that section 121 does *not* say that gain on every sale of what it refers to as the taxpayer's "principal residence" is eligible for exclusion. The section simply is not written that way. Rather, that the sold asset is or was the taxpayer's section 121 "principal residence" is only one of the things that must be shown (as part of the second requirement listed above). In other words, a taxpayer can sell an asset that is or was his or her "principal residence" as the term is used in section 121 and still not be entitled to any exclusion thereunder; all three of the requirements must be satisfied. Or, to put the same thought still another way, a conclusion that the taxpayer sold an asset that at the time was his or her "principal residence" as the term is used in section 121 is very different from a conclusion that he or she is entitled to any exclusion under section 121. As an easy example, consider the case of a person who voluntarily sold an asset that undoubtedly constituted his or her "principal residence" as that term is used in section 121 but had owned it for only one year prior to the sale.

And it is worth emphasizing that section 121 contains no requirement that the sold asset must be the taxpayer's "principal residence" at the time of the sale (although, if course, it may be and often is). All that is required on that score is that the taxpayer must have used the asset as his or her section 121 "principal residence" for two out of the preceding five years. It follows that a taxpayer might be entitled to exclude gain under section 121 on the sale of an asset even though he or she had permanently moved out of it long before—indeed, possibly as much as three years before—the sale.

We must now address a semantic point. Let us suppose that a draftsperson is fashioning a rule that he wants to be applicable to an asset belonging to a person that at the relevant point in time would constitute that person's "principal residence" as that term is used in section 121. The draftsperson cannot do that by referring to the person's then "principal residence as defined in section 121," because, as noted above, the section does not define the term. Under those circumstances, the draftsperson might very well use the phrase "principal residence within the meaning of section 121." As a matter of language, such a reference would define only the nature of the asset, and the reference would operate whether or not a sale of that asset would in fact qualify for gain exclusion under section 121.

However, people—including draftspersons—do not always use language correctly. And a person who wishes to say that a taxpayer made a sale the gain on which qualified for exclusion under section 121—which is quite a mouthful—might carelessly (and, strictly speaking, incorrectly) say instead that the taxpayer made a sale of a "principal residence within the meaning of section 121." In other words, a statement that a taxpayer sold an asset that at the time was a "principal residence within the meaning of section 121" might or might not have been intended to communicate something about where the taxpayer was living at the time of the sale. The obvious possibility is that the speaker might have meant that the asset was in fact the taxpayer's main home at the time of the sale (regardless of whether or not section 121's conditions for exclusion were satisfied). On the other hand, the speaker might not have meant that at all. The speaker might have instead meant that, at the time of the sale, the conditions for gain exclusion under section 121 had been met (whether or not the taxpayer was living there at the time).[5] For convenience, we shall use the label "main-home-at-the-time-of-sale" to refer to the interpretation that the speaker intended to say that the asset being sold was at that time the seller's "principal residence" as that term is used in section 121, and shall use the label "qualifies-for-exclusion" to refer to the interpretation that the speaker intended to say that the conditions for gain exclusion under section 121 had been met at that time.

The Two Relief Provisions

When we turn to the two relief provisions under discussion—each of which excuses a non-resident seller from having to file a special time-of-sale estimated tax form (and possibly having to make a significant payment at that time[6])—we find that the legislature used the phrase a "principal residence of the seller . . . within the meaning of section 121 of the Internal Revenue Code" in each of them.

Specifically, Tax Law § 663(c)(1) exempts a non-resident seller "where . . . [t]he real property being sold . . . is a principal residence of the seller . . . within the meaning of section 121 of the Internal Revenue Code," and Tax Law § 663(c)(4) exempts a non-resident seller "where . . . [t]he proprietary leasehold being transferred in connection with the sale . . . of the shares of stock in a cooperative housing corporation is a principal residence of the seller . . . within the meaning of section 121 of the Internal Revenue Code."

Obviously, in each case the scope of the relief provision depends on whether the "principal residence" phrase is given a "main-home-at-the-time-of-sale" interpretation or a "qualifies-for-exclusion" interpretation.

On the face of it and in the abstract, a "main-home-at-the-time-of-sale" interpretation seems called for. That is what the words mean. But there is a major problem with such an interpretation. How can a person who at that point in time is not considered for New York State income-tax purposes to be a resident of the state have his main home within the state? It could happen—where the seller, despite living in New York, had maintained his domicile elsewhere—but that would be the exceptional case. It is accordingly impossible to believe that the legislature had such a situation in mind when it enacted the relief provisions. One is therefore forced to the conclusion that, when the legislature referred to "a principal residence of the seller . . . within the meaning of section 121," what it meant to say was something like "where the sale qualifies for gain exclusion under section 121."[7] Admittedly, that is a linguistic stretch, but it is an appropriate one, inasmuch as a literal interpretation would render the relief provisions essentially meaningless. Moreover, what would be the point of exempting sales the gain on which would be subject to New York State income taxation in any event (because it is not eligible for a section 121 exclusion)?

On the other hand, giving the "principal residence" phrase a "qualifies-for-exclusion" interpretation would comport with the obvious legislative intent. It would have the effect of excusing a non-resident seller from having to comply with the requirements of section 663 where the sale would in any event produce no income taxable by New York State.[8]

The Department's Pronouncements

In view of the vast differences between the two possible interpretations of the relief provisions' "principal residence" phrase, one would have thought that the Department's first order of business on this score would have been to say in plain language which of the two it was adopting. But the Department never did that. Moreover, some of the statements that it made seemed to be adopting one of those two possible interpretations and some of the statements that it made seemed to be adopting the other of those two possible interpretations.

Consider the bulletin dated August 1, 2003 that the Department issued to announce the enactment of section 663. The following was its entire discussion of the 2003 relief provision:

> A nonresident transferor is exempt from the payment of estimated personal income tax on the transfer of real property under section 663 of the Tax Law if the real property being transferred is used exclusively as a principal residence by the transferor within the meaning of section 121 of the Internal Revenue Code (IRC).
>
> A principal residence means a person's main home within the meaning of section 121 of the IRC. This is the home for which a person is allowed to exclude all or a portion of the gain for federal income tax purposes. Usually the home a person lives in most of the time is his or her main home and can be, but is not limited to, a house, houseboat, mobile home, cooperative apartment or condominium.[9]

Note especially the words "is used." A person reading the quoted passage would almost surely come away with the impression that the Department had opted for a strict "main-home-at-the-time-of-sale" interpretation. And, as noted above, the Department did not say in so many words—and to this day has not in so many words said—that it had not.

However, the Department, both then and up to the present day, has made numerous statements that are incompatible with a strict "main-home-at-the-time-of-sale" interpretation. For instance, at about the same time that it issued the above-quoted bulletin, the Department promulgated a Form IT-2663 and instructions thereunder. Those instructions contained the following passage, which can fairly be described as giving mixed signals:

> A nonresident is not required to file Form IT-2663 if . . . [t]he property being sold . . . is used **exclusively** as the principal residence of the transferor/seller within the meaning of section 121 of the Internal Revenue Code. . . . Section 121 . . . relates to the federal income tax exclusion of gain on the sale of a principal residence.

* * *

> **Note:** Property used exclusively as the principal residence of the transferor/seller qualifies for the exemption even if part of the gain is not excluded under section 121 . . . because the gain exceeds the amount of the exclusion provided for in that section.
>
> * * *
>
> *Principal residence* means your main home within the meaning of section 121 . . . for which you are allowed to exclude the gain for federal income tax purposes. Usually the home you live in most of the time is your main home and can be, but is not limited to: a house, houseboat, mobile home, cooperative apartment, or condominium.[10]

The Department at about the same time also revised both the transfer tax return that had to be filed with every deed—TP-584—and the instructions for that form. It was provided that a non-resident seller who wished to rely on the "principal residence" relief provision had to certify on Part II of Schedule D of the revised TP-584 that "[t]he property being sold . . . was used exclusively as the transferor's/seller's principal residence (within the meaning of section 121 of the Internal Revenue Code) from ____________(Date) to ___________(Date)," and the instructions included the following:

> **Nonresident exemption for principal residence**
>
> If the property being sold . . . is used exclusively as the principal residence of a nonresident transferor(s)/seller(s) . . ., only the transferor(s)/seller(s) who can claim this real property as a principal residence (within the meaning of section 121 . . .) at the time of sale . . . can sign and certify the exemption from the estimated personal income tax provision.
> . . .
>
> **Note:** Property used exclusively as the principal residence of the transferor/seller qualifies for the exemption even if part of the gain is not excluded under section 121 . . . because the gain exceeds the amount of the exclusion provided for in that section.
>
> Transferor(s)/seller(s) . . . who cannot claim this real property as their principal residence at the time of sale . . . should not sign Part II of Schedule D. The transferor(s)/seller(s) must instead complete and submit Form IT-2663 to the Tax Department.

Here again, there were mixed signals, but with stronger indications of a qualifies-for-exclusion interpretation. On the other hand, some of the language—especially the repeated use of the "at the time of sale" phrase—was more consistent with a "main-home-at-the-time-of-sale" interpretation.

The Department has over the months since the enactment of section 663 also made a number of other pronouncements concerning the "principal residence" relief provisions, but none of those statements differ fundamentally from those quoted above.[11]

Conclusion

The bottom line is this. If one carefully (and, it may be said, painfully) studies all of the Department's pronouncements to date on the subject, one eventually can come away fairly certain that the Department has (correctly, in this writer's opinion) chosen to adopt a qualifies-for-exclusion interpretation of the two relief provisions, so that one can feel rather safe in ignoring those portions of the Department's statements that seem to require that the seller must have actually been living in the subject residence at the time that it was sold. However, because the Department had never told us in simple declarative form which interpretation it is applying, a conscientious taxpayer cannot be entirely comfortable about the matter. Moreover, there is no apparent reason that agonizing analysis should be necessary. In short, it would be helpful—and widely appreciated—if the Department were to publish guidance clearly informing the public as to its understanding of the basic meaning of the "principal residence" phrase in the two relief provisions.

Endnotes

1. Tax Law § 663, added by Chapter 62 of the Laws of 2003, as amended by Chapters 63 and 686 of the Laws of 2003. The words "in effect" are included in the statement in the text because what the statute actually provides is that the deed cannot be recorded until the form is filed with, and any required payment made to, the recording officer. Section 663 itself does not require the seller to do anything, but it is to be expected that virtually every buyer (and certainly every one who is obtaining title insurance) will wish to put his deed on record as soon as possible and consequently will pick up at the closing a completed IT-2663 and any necessary check. The reader should bear in mind that, for several weeks prior to the Chapter 686 amendment, a different and much more onerous procedure was in effect, so that statements issued before the change may no longer be accurate.
2. Part H of Chapter 60 of the Laws of 2004, amending Tax Law §§ 631 and 663. The reason that cooperative apartment sales by non-residents had not been covered in 2003 was that it was not until the 2004 modification of section 631 that such sales generally became subject to New York State income taxation. *See* TSB-M-04(5)I, also identified as TSB-M-04(7)R (Oct. 19, 2004); N–04-15 (Sept. 2004).
3. In this context, "sale" obviously refers to a transfer of beneficial ownership, not to the entry into an agreement to sell.
4. Treas. Reg. § 1.121-1.
5. In this scenario it seems clear that the speaker would be intending to say at least that both the ownership requirement and the used-as-principal-residence requirement had been met. What

the speaker might have had in mind as to the not-having-used-the-section-within-the-last-two-years requirement is more problematic, but we shall for present purposes assume that he meant that that requirement had also been met.

6. Because any required payment would be only in effect a deposit, it would be recoverable by way of refund application if it turned out that the seller's New York State income tax liability resulting from the sale was less, but the legislature obviously wished to spare at least some taxpayers—presumably including those who needed to pay no federal income tax on any gain realized on the sale of their main home—the trouble and expense of having to go down that road.

7. In fashioning a formulation of this type, various subordinate issues arise. What if the amount of gain exceeds the limit of what can be excluded under section 121? What if some of the gain must be recognized under section 121(d)(vi), which provides for depreciation recapture in certain instances? What if the seller used section 121 within two years prior to this sale? What if the seller elects out of section 121? Such questions are beyond the scope of this article. It may be noted, though, that many of them have in fact been addressed in pronouncements put out by the Department.

8. Depending on the precise contours of the "qualifies-for-exclusion" interpretation adopted, a taxpayer whose gain was not entirely covered by section 121—because it exceeded that section's dollar limits, for example—might also to be excused. But that is a separate and subordinate issue—and one that is not addressed in this article.

9. TSB-M-03(2)R, also identified as TSB-M-03(4)I (style changes not shown).

10. IT-2663-I (July 2003).

11. In addition to the items cited above, *see, e.g.*, 20 N.Y.C.R.R. § 163.4; TSB-M-03(2.1)R, also identified as TSB-M-03(4.1)I (Nov. 4, 2003); Form IT-2663 and IT-2663-I (2003); Form TP-584 and TP-584-I (Oct. 2003); Form IT-2663 and IT-2663-I (2004); Form IT-2664 and IT-2664-I (2004); Form TP-584 and TP-584-I (Nov. 2004). The Department has also posted questions and answers on its website (http://tax.custhelp.com/cgi-bin/tax.cfg/php/enduser/std_alp.php?p_sid=u82fFNUg&p_lva=&p_li=&p_page=1&p_cat_lvl1=55&p_cat_lvl2=68&p_search_text=&p_new_search=1&p_search_type=3&p_sort_by=dflt).

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Locating Utility Easements: A Detailed Analysis

By Gerald J. Greenan

I am frequently asked to locate utility easements on property being sold by my clients.

Responsibility for locating and evaluating an easement is primarily that of the purchasers' attorney. When I am asked as the sellers' attorney to locate an easement, I presume the request is not made out of laziness. I presume the request is really a polite objection that the public record does not permit the examiner to tell whether improvements on the premises can be disturbed by the owner of the easement.

Definitions and Distinctions

Black's Law Dictionary (Abridged Sixth Edition) defines an "easement" as "a right of use over the property of another." *Black's* defines "right-of-way" as a "term used to describe a right belonging to a party to pass over land of another . . ." In this discussion I use the terms interchangeably.

Please note that an easement is either **the name of an instrument** granting rights in the lands of another **or the rights themselves**.

An easement is **not a pipeline, a pole line or an underground conduit.** Pipelines, pole lines and underground conduits are physical facilities installed in the property of others by virtue of rights granted by an easement.

The distinction is important. Usually when someone asks me to locate an easement, what they really want to know is where the pipes are buried.

Don't Ask

It is not proper to ask a lawyer or surveyor whether a pipe is buried someplace on a piece of property. He or she does not usually know and if he or she did happen to know, it would not address the question of whether a pipe was there as a matter of right.

It is proper to ask a lawyer whether a pipe can be buried in the future through an about-to-be-constructed dwelling or whether a dwelling built over a pipeline can remain as a matter of right.

In Western New York, to determine whether it is safe to dig, the wise contractor or homeowner does not call his lawyer. He calls "Before You Dig" 1-800-962-7962. One call results in all local utilities marking their underground facilities.

When I am asked to "locate an easement," I typically respond, "A copy is in liber 6874 of Deeds at page 348 which is in the County Clerk's Office in the older section of the building."

If the response is, "I know that." I respond, "What does it say in liber 6874 of Deeds at page 348?"

If the other party is unable to respond, I suggest that the instrument be reviewed and that I be provided with a copy of any language deemed to be ambiguous.

Undefined Easements

Frequently an examination of the easement instrument reveals that neither party knew exactly where the final poles or pipes were to be installed nor thought it critical at the time the instrument was executed.

We often see easements given by Farmer Brown which are no more definite than the following: "Bounded north by Bebak, east by Smith, west by the Town line, and south by Clinton Street."

Does the language tell which of Farmer Brown's three parcels on Clinton Street is to be subject to an easement? Does it define the boundaries of the easements or does it simply identify the parcel?

It is "blackletter" New York law that the language of an agreement must be construed most strongly against the party who prepared it, or supplied a form for the agreement.[1]

Reference to general principles of law is not enough to convince most title attorneys, who tend to be (and are paid to be) ultra-conservative.

The location of an easement described, as above set forth is, arguendo, over all of the property in question—what some people call a "blanket" easement.

Blanket Easements

I wince whenever I see a reference to a "blanket" easement. The term is misleading. "Blanket" implies that it covers or affects all of the property. "Undefined" is the correct adjective to describe these easements.

Does having a "blanket" easement imply that a utility company has the right to install pipes or poles any place on the property at will or at whim at any time between the date of the instrument and the date of premises being released from the easement?

NO!

Facilities installed pursuant to an indefinite easement are to be installed where the **owner** of the property wants them to be installed, and not randomly over the entire property described in the easement.

This is well-settled law, although not well-known law.

The Onthank Doctrine

The seminal case is *Onthank v. Lake S. & M.S.R. Co.*[2] A discussion of the topic is found at 49 N.Y. Jur. 2D *Easements* §§ 94-99 (Rev. 2004). I quote, omitting citations and inserting captions, parenthetical material, and paragraph spacing for clarity:

> §94 . . . Where the grant of an easement of way does not definitely locate it, a reasonable and convenient way for all parties is implied, in view of all the circumstances.

First Right to Locate

> If an easement of way is created but not located by a grant, the owner . . . has, in the first instance, the right to designate the location, provided he or she exercises that right in a reasonable manner, having regard to the suitability and convenience of the way so located to the rights and interests of the owner of the dominant tenement (e.g., the utility company).

Second Right to Locate

> If the owner . . . fails or refuses to locate the way, the grantee acquires the right to make his own selection of a location, having due regard to the interests, rights and convenience of the other party (the owner).
>
> An easement granted in general terms, without giving definite location and description, so that the part of the land over which the right is to be exercised cannot be definitely ascertained, **does not give the grantee a right to use the servient estate without limitation as to the place or mode in which the easement is to be enjoyed** (emphasis added).

Grantee Cannot Relocate

> §98 . . . Where a granted easement has been exercised in a fixed and definite course, with the full acquiescence and consent of both parties, it cannot be changed at the pleasure of the grantee.

Refining Location

> §99 . . . Ordinarily, a grant or reservation of a right-of-way "over" a particular area, strip, or parcel of ground is not to be construed as providing for a way as broad as the ground referred to. The grant of a right-of-way "through and over" a space 20-feet wide is the grant of a convenient way within those limits.[3]

Grantor May Relocate Access

Although the *Onthank* decision of the Court of Appeals was handed down in 1877, it is still the law in New York as evidenced by the Court of Appeals' recent decision in *Lewis v. Young*.[4]

In *Lewis*, the Court of Appeals distinguished the one-time right to locate a pipe (citing and referring specifically to *Onthank*) from an undefined right of ingress and egress over the land of another.

The Court reached the conclusion that an undefined right of ingress and egress is a right of passage, and not any right in the physical passageway itself.[5]

The right to relocate is given the servient estate (landowner) without consent of the dominant estate, conditioned upon the relocation being without expense to the dominant estate.

Lewis is an extremely useful case. Even the most well-defined easements customarily have appurtenant undefined rights of ingress and egress for the purpose of repair and replacement.

New York State Electric & Gas Corporation

If private attorneys are generally unaware of the Onthank Doctrine, the same cannot be said of the attorneys for public utility companies.

In the Western New York area, the two local electric utilities have historically taken opposite approaches to the Onthank Doctrine and the approaches are familiar to experienced local title examiners.

New York State Electric & Gas Corporation obtains and records a new easement for every new service line outside a modern subdivision.

In a typical modern subdivision the area reserved for utility easements is relatively definite. It is either shown on a map made a part of the easement agreement, or on the filed "Map Cover," or it is defined in the instrument; for example, ". . . within ten feet of the south line of subdivision lots 20 through 26. . . . "

An examination of a title will frequently disclose three or four practically identical indefinite easements to New York State Electric & Gas Corporation granted prior to inclusion of the property in a modern subdivision.

New York State Electric & Gas Corporation knows that, under the Onthank Doctrine, once the original line has been installed the same instrument cannot be used to install new lines in a different physical location. It, therefore, obtains a new easement agreement.

Niagara Mohawk Power Corporation

Niagara Mohawk Power Corporation, with the same knowledge, frequently does not bother to incur the expense of recording its easements. They cannot be used for future expansion and once a pole line is installed recording is not necessary.

Easement rights to maintain the original pole line are protected by the notice afforded by the physical presence of the poles and wires on the property.

Warren's Weed, New York Real Property, "Easements" § 20.01, "Notice of Easement" provides that ". . . the presence of overhead wires strung from poles and crossing land in clear view was sufficiently open, visible and obvious upon even a cursory examination of the property to constitute constructive notice, to a reasonably careful and prudent buyer, of the existence of some right or claim of right to possession by those maintaining such power transmission line" (multiple citations omitted).

Resolving Encroachments

If a reference to the Onthank Doctrine and its progeny does not resolve the issue of locating an easement and a purchasers' attorney tells me that notwithstanding the Onthank Doctrine, the standard form of contract adopted by the Bar Association and the Board of Realtors provides in paragraph 12(A) that title will be accepted subject to:

> " . . . easements and rights-of-way of record for water lines, sanitary sewer lines, drainage, gas pipe line, electrical lines and telephone lines, provided they are or may be used to service the property and provided the present improvements . . . are or will not be **on the easements or rights of way** . . ." (emphasis added).

I counter with Real Property Actions and Proceedings Law § 2001.

RPAPL § 2001 and the Oneida Doctrine

Most attorneys dealing in real estate are familiar with the use of Real Property Actions and Proceedings Law § 2001 to "cure" violations of building restrictions by establishing that a violating structure has been in place for two years or more.

Many do not realize that the Court of Appeals has construed the statute as applying to all negative easements, not only those contained in building restrictions.[6]

A negative easement is one that gives the dominant estate the right to tell the servient estate not to do something; for example, "[d]on't build under our wires."

The language of the Niagara Mohawk easement in the *Oneida* case does not appear in the Court of Appeals opinion but does appear in the lower court's opinion.[7] The granting clause is as follows:

> . . . the grantor has granted and released and does hereby grant and release . . . a right of way and easement to build, rebuild, relocate, operate, repair, maintain and, at their pleasure remove a single line of so many poles . . . as either of the Companies may now or shall from time to time deem necessary, and to transmit and distribute electricity and render telephone and telegraph service upon, over, across, through, under and beyond the land, including land within the adjoining highways, which the grantor owns or in which the grantor has an interest.
>
> With the right to trim, cut and **remove any trees, limbs, brush or other obstructions** on either side of said lines which either of the Companies may deem likely to interfere with the operation thereof (emphasis added).

Even though the granting clause was indefinite as to location, the mobile homes were clearly encroaching.

The objection of Niagara Mohawk was that the mobile homes were **located directly beneath its 9.6 kilovolt wires**, a position deemed by Niagara Mohawk to be threatening to the lives of those who lived in the mobile homes.

The mobile homes had been in position more than two years,[8] but less than the ten years[9] required to establish prescriptive or adverse use and less than the six years in which an action could be brought to remove an obstruction, which interferes with an affirmative easement.[10]

The Court of Appeals found that RPAPL § 2001 applied and imposed the cost of moving the wires or mobile homes on Niagara Mohawk.

The lower courts have had great difficulty with the negative-affirmative easement distinction found in *Oneida*. They sometimes forget or ignore the fact that the Court in *Oneida* ordered the pole line moved at Niagara Mohawk's expense.

See, for example, *Rahabi v. Morrison*,[11] in which the Appellate Division permitted a suit to continue beyond the two-year period when the suit was for the removal of a chain-link fence which interfered with easement access to plaintiff's property.

The distinction between affirmative and negative easements becomes moot if the "encroachment" on the easement is more than six years old.

Not a Statute of Limitations—A Release

It is interesting and significant to note that section 2001 is not a statute of limitations. Subdivision 5 provides, "If an action governed by this section is not commenced within the time herein provided it shall be **conclusively presumed** that the right of action for the relief for which that action might have been brought has been **released**" (emphasis added).

The Law Revision Commission in recommending the passage of the statute commented:

> Short Statutes of Limitation have been enacted in some jurisdictions limiting actions for enforcement of any restriction on the use of land. . . . A bar framed as a Statute of Limitations, however, is inadequate to solve the problem, since the period may in a particular case, be tolled by disability of a person entitled to enforce the restriction or by nonresidents or absence from the state of the party against whom relief is sought. Uncertainties may also be injected if it is asserted that the bar of the statute has been waived . . . .
>
> Legislation creating a conclusive presumption of release of the right of action, if action is not brought within the time limit, would provide assurance free of these uncertainties. . . .

Improvements Over Two Years Old

Whether the area subject to an easement is well defined, or undefined, improvements in place for two years may remain undisturbed pursuant to the Oneida Doctrine and this area is subject to the conclusive presumption of release under RPAPL § 2001.

Since the easement rights are conclusively presumed released, it is inappropriate to demand a further release. The "present improvements" cannot be deemed "on" or encroaching on the easement under the terms of a "standard contract" and the location of improvements in place for over two years does not affect contract marketability.

Improvements Under Two Years Old

Above Ground

If the area subject to an easement is defined by the instrument creating it—for example "within the south 25 feet of premises"—then a request to "locate the easement" is not a reasonable request. (The examiner should look at the map of survey and draw his or her own conclusion as to how the premises is affected.)

If the area subject to an easement is truly indefinite, a "blanket easement," then a request to "locate the easement" is not a reasonable request when made to an attorney or surveyor. Neither is licensed to change the language of a recorded instrument from indefinite to definite.

The easement area is governed by the Onthank Doctrine and, for above-ground facilities, is "located" by reviewing a current survey.

Below Ground

For underground facilities the survey will give only "clues"—for example, storm and sanitary manholes, cathodic protection for gas transmission lines, backyard drain inlets, telephone pedestals and electric junction boxes.

Since neither the attorney nor the surveyor is equipped with X-ray vision, each public utility's white page telephone listing contains "Call Before You Dig 1-800-962-7962." A call to that number will result in each utility marking the area, which their records and equipment indicate contain underground pipes or wires.

Future Exercise of Easement Rights

But What About the Future Exercise of Easement Rights?

If the area is well defined by the instrument, its terms may prevail, if it conflicts with a structure completed for less than two years.[12]

If the area is undefined by the instrument and its location has not been established by the previous installation of facilities, then the Onthank Doctrine prevails.

Facilities installed pursuant to an indefinite easement are to be installed where the **owner** of the property wants them to be installed, and not randomly over the entire property identified in the easement.

Never Ask?

Does all of the above mean that it is never appropriate to ask a sellers' attorney or surveyor to locate an easement?

No. It means that **it is never appropriate to ask a sellers' attorney or surveyor to locate an easement without first examining the instrument and determining whether it is definite or indefinite.**

If the easement is definite and its location cannot be plotted without information outside the historical title (for example, widening a right of way by the Department of Transportation using physical monuments) then asking a surveyor to locate it using his professional access to records outside the County Clerk's Office is appropriate.

If the easement is indefinite, the next question is whether it became defined by the installation of facilities shown (or not shown) on the map of survey.

If it is above ground, look up.

If it is below ground, call 1-800-962-7962.

If presented with an indefinite easement for a pole line and with an accurate survey showing no pole line, the conclusion under *Onthank* is that the pole line, if it exists, is located outside the parcel surveyed.

It is not appropriate to ask a sellers' attorney or surveyor to locate pole lines outside the parcel surveyed.

If the pole line does not yet exist, then the conclusion under *Onthank* is that it is yet to be located. Surveyors and attorneys are not licensed to predict where lines will be placed in the future.

This does not create a problem, since under *Onthank* and its progeny, the owner has the first right to designate a convenient location.

Conclusion

One who professes ignorance of the location of an easement may be confessing that one did not examine the instrument, or may be confessing that one doesn't understand the law of easements.

Both are easily forgiven so long as they do not transfer the burden of the ignorance to another attorney.

Endnotes

1. *See* 22 N.Y. Jur. 2d *Contracts* § 260 (2004).
2. 71 N.Y. 194 (1877).
3. The authority for the statement is Benjamin Cardozo's Court of Appeals holding in *Dalton v. Levy*, 258 N.Y. 161 (1932). In *Dalton*, the Court of Appeals permitted a garage built 9 feet into a 20-foot right-of-way. *See* 258 N.Y. at 167.
4. 92 N.Y.2d 443(1998).
5. Citing *Bakeman v. Talbot*, 31 N.Y. 366, 371 (1865).
6. *Oneida County Mobile Home Sales, Inc. v. Niagara Mohawk Power Corp.*, 47 N.Y.2d 954, (1979).
7. *See* 63 A.D.2d 385, 388 (4th Dep't 1978).
8. RPAPL § 2001.
9. CPLR 212.
10. 81 A.D.2d 434 (2d Dep't 1981).
11. *Id.*
12. See, however, the "convenient way" discussion at 49 N.Y. Jur. 2D, *Easements* § 99 (Rev. 2004), discussed above under the heading "Refining Location."

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A Report on the Current Use of Title Insurance in International Real Estate Transactions

By J. Carmichael Calder and S.H. Spencer Compton

This article is intended to be a balanced discussion of the current state of title insurance in international real estate transactions and not a sales brochure. Wherever possible, information will be presented without reference to a particular title insurance company, bearing in mind that much of our data arises out of our experiences at First American Title Insurance Company. That said, asking title insurance sales executives to write an article about their business is a bit like asking the fox how many chickens are in the henhouse. The answer may be suspect.

First American began offering international title insurance policies on an infrequent basis in Mexico in the late 1970s. In 1989, the company qualified to sell title insurance in Canada, and began a concerted effort to market its international title insurance policy worldwide. Today, First American has researched the registration and legal systems as well as the regulatory environments in nearly sixty countries where it regularly insures titles to real property (see Appendix 1). In 2003, First American's revenues from selling international title insurance policies were approximately $150,000,000, an increase of over 60% from its 2002 international title insurance revenues. Put another way, in 2002, First American issued 425,000 international policies, and in 2003, 635,000. The company expects to issue 800,000 or more international title policies in 2004. These statistics, although flattering to our company, are presented as evidence of a trend which other international title insurers may be experiencing as well. Over the past two years, the use of international title insurance has increased markedly.

What Is International Title Insurance?

Modeled after the ALTA policies sold in the U.S., international title insurance policies protect insureds against known *and* unknown defects in a property title, including boundary disputes, restrictive covenants, right-of-way issues, adverse possessions, lost deeds and leasehold defects. They confirm that property title is good and marketable. They also insure against costs or legal expenses necessary to defend title, and they provide coverage against a range of other problems such as fraud, forgery and mortgage invalidity. The premium for an international title insurance policy is generally $3.50 per $1,000 of liability plus the cost of searching and examining the real property records. Unlike in the U.S., often the title insurance company will require that the proposed insured pay a non-refundable initial charge before any work is undertaken. This charge, to cover the out-of-pocket costs of local attorneys and searchers, is usually calculated as a percentage of the proposed premium, and is typically less than $10,000. In the Caribbean and Latin America, including Mexico, the premium rate can be even higher ($5.00 per $1,000), although it does drop to $3.50 per thousand above $10,000,000 of liability. Nonetheless, in countries where a title insurance company has a local operation (i.e., in the case of First American: Canada, U.K., Ireland, Australia, New Zealand, Hong Kong, and South Korea), the rates are set locally and are generally well below the $3.50 per $1,000 rate. In these countries, no upfront deposit usually is required.

What Are the Objections to International Title Insurance?

In the U.S., title insurance is accepted as a necessary part of any real estate finance transaction, whereas internationally, that is not yet the case. In many countries, the typical responses to the question "Is title insurance available?" have been: "What's title insurance?" or "You don't need it; we have a perfect registry system" or "We rely on attorney opinion letters." Needless to say, the added cost of a title insurance premium is also an issue. Each of these objections arises out of long-standing custom and use—an "if it isn't broken, don't fix it" mentality—as well as unfamiliarity with the process and the product.

Registry Systems; Government Guarantees

Just as in the U.S., there are property registry systems in each country, some of which systems are of a higher quality than others. However, it is unlikely that there exists anywhere a registry system with no errors and a no-fault, 100-percent government guarantee backing up any and all registry information. More typical is the registry system that has some shortcomings, or a governmental guaranty that is available after all other recourse has been exhausted, and in amounts much less than the property value. Sophisticated lenders, investors and their counsel are realizing that in a perfect world where no claims occur, the limitations of these registry systems and government guarantees would be sufficient. But in a high-value transaction, the assurance of a strict liability insurance policy backed by a U.S. Fortune 300 company may be preferable, not only from a risk-avoidance perspective, but from credit-enhancement and marketing points of view as well, especially where the ownership of the fee or mortgage later will be syndicated or securitized.

At a minimum, where a lender agrees to rely on a registry system and a government guarantee, instead of title insurance, the lender should fully understand the limitations, if any, to the guarantee and the process and cost of enforcement.

Legal Opinion Letters

In certain U.S. jurisdictions, title diligence is established by a lawyer's opinion letter, which in turn is backed up by a title insurance policy. Why in the U.S. marketplace isn't the opinion letter on its own considered sufficient? A lawyer's opinion letter may be of little help. If an investor or lender has relied on an opinion and later has a title problem, the lawyer might not assist in its resolution. A lawsuit against the lawyer would have to show that he or she was negligent in failing to follow the local standard of care—an uncertain and costly process, particularly when no title insurance company is contractually obligated to supervise and pay for the litigation. Now picture the same difficult process in a foreign country where few investors, lenders or their counsel (who may not be nationals of that country) even know the local standard of care. For example, in some parts of Mexico, the standard of care may involve searching no more than seven years of registry records, even though interests older than that may still be good. A lender relying on such an opinion might have difficulty proving negligence by the lawyer who failed to address a ten-year-old mortgage. In any event, that lender would be financing the litigation or trying to collect its costs from the borrower. By contrast, if title insurance were in place and a mortgage had been overlooked, the title insurer would be contractually obligated to defend the claim at its expense and, if unsuccessful, pay the insured lender's losses.

Collecting Damages

Even if negligence in connection with a lawyer's opinion letter is proven, determining and collecting damages is difficult. Professional indemnity insurance is not always required of lawyers in foreign countries, and few carry it in amounts like those in the U.S. Some foreign lawyers have access to local law society indemnity funds, but many of these have problems, too. The fund in the U.K. became insolvent and closed a few years ago, and the fund in Hong Kong was diminished when its primary reinsurer became insolvent. It is difficult to quantify the number of claims against attorneys over their title opinion letters because presumably a number of such claims are dropped or settle without ever reaching a courtroom. Nonetheless, even if there are relatively few such claims each year, the potential barriers to restitution may be unacceptable in a high-value commercial transaction.

Where a lender agrees to rely on an opinion letter, instead of title insurance, the lender should first determine that the local attorney rendering the opinion carries liability insurance and in what dollar amounts.

Expedited Processes; Local Expertise

On a more practical level, title insurance can be a solution to delays or problems in following traditional local title examination practices, especially in multi-site and cross-border transactions. Some recent examples:

A U.K. property company obtained a loan from a U.K. lender to be secured by a ground rents portfolio. In order to avoid a due diligence exercise in which solicitors would have had to examine over 90,000 titles that made up the portfolio, First American's U.K. subsidiary provided a title insurance policy insuring the lender against title losses. The policy saved large amounts of time and expenditures of legal fees.

A Hong Kong developer was attempting to terminate the existence of one of its subsidiaries, whose assets consisted of a loan portfolio, which was to be transferred to a local mortgage company. The mortgage company required certain buyback and other guarantees that would have prevented the developer from collapsing its subsidiary. In lieu of the guarantees, First American provided title insurance for the loans and the assignments of them to the mortgage company, which allowed the developer to avoid contingent liabilities in the subsidiary and collapse it out of existence.

A U.S. insurance company encountered a title issue in connection with the acquisition of a property in London. There was a question as to whether a sub-lease had been created without the freehold owner's permission. Title insurance protected the purchaser against the issue, avoiding the need for title opinions, guarantees, and other costly arrangements.

A title search can involve far more searches than simply the local property registry. In certain parts of the Sydney, Australia, metropolitan area, a diligent lawyer might have to do dozens of local authority searches. In many cases, title policies cover the risks of not having done these searches, saving time, the cost of obtaining the searches from the municipal authorities, and the lawyers' review time.

Title insurance companies also serve as local business consultants, providing a network of regional real estate experts and professionals to assist in financing, due diligence, document production, and other risk elimination processes. In 2003, a U.S.-based petroleum company retained a major real estate consulting/management firm to streamline the petroleum company's property division. In an effort to make procedures for property acquisitions in the

Caribbean/Central America as similar as possible to those in the U.S. and to overcome issues and concerns about local title advice, First American was asked to provide title insurance on local retail service station site acquisitions.

Fraud Protection

The incidence of fraud in mortgage lending, through identity theft and otherwise, is increasing rapidly worldwide and particularly in Canada and Australia against residential mortgage lenders. One highly publicized incident in the Vancouver area included a lawyer's participation in the fraud, and mortgage losses in excess of $50 million. Some, but not all, of the mortgages were title-insured. The balance relied on the assurances in a lawyer's opinion letter, which typically excludes fraud from the matters it addresses.

With respect to fraud cases, to the extent government registration guarantees exist, they may be difficult to collect upon. Fraud cases often involve the expenditure of considerable additional lawyers' fees. Title insurance not only provides protection for fraud, but it also pays for lawyers' fees to enforce the mortgage and investigate the fraud.

Defense Costs; Recent Claims

Many international lenders, investors and attorneys today know that title insurance is more than a document to be filed away after the premium is paid at closing. Rather, it creates an ongoing partnership, often for decades. Some recent examples:

A major U.K. grocer obtained title insurance for an easement to allow employees to get from an off-site parking area to the store site. Shortly before the busy year-end holiday season, the owner of the property traversed by the easement attempted to block it. Without the easement, the grocer's employees would have had to park in the customer lot, leaving limited parking available for customers. First American's U.K. subsidiary, which issued the title insurance, resolved the claim within days, allowing the employees to use the off-site lot and the customers to use the lot at the store site.

In Nicaragua, First American is currently providing defense to a developer insured for a housing project. A prior deed from the local municipality is being challenged by the current, soon-to-be lame-duck administration of that municipality, apparently on the basis that the earlier administration did not charge enough for the land. First American has been advised by its lawyers in Nicaragua that the municipality's suit will fail, but in the meantime, First American's policy coverage provides for the legal defense at the title company's cost, not the insured developer's.

Credit Enhancement

In the U.S., when title to real property in a securitized transaction is insured by a national underwriter, that transaction will receive a more favorable credit rating from the applicable credit rating agency than it would had the title not been insured. The more favorable a transaction's credit rating, the lower the risk to return on investment and, therefore, the less the principals have to give away in order to attract investors. In recent years, international securitized transactions involving real estate have not capitalized on the credit enhancement offered by title insurance. International offices of the major ratings agencies and credit enhancement providers are still in a learning phase regarding the operation and financial resources of title insurance companies and the benefits of title insurance. As international markets become more "Americanized," title insurance industry analysts expect an increasingly greater use of title insurance to enhance the credit of transactions going to market. Such an attitudinal shift may be underway. In 2003, an Australian lender decided to undertake a securitization program for its residential loans. In order to facilitate the securitization process, to obtain credit enhancement and to streamline mortgage origination and settlement, the lender included title insurance from First American's Australian subsidiary in its mortgage protocol.

Conclusion

For over a century, there was no title insurance in the United States and properties were conveyed, leased and mortgaged in the normal course, and at the pace, of business in the marketplace. The term *caveat emptor*—"let the buyer beware"—was the rule of the day. In the 1800s, even one of America's most famous presidents, Abraham Lincoln, lost two of his family's farms due to title defects. But as losses ensued, market practices evolved, and title insurance became the rule, not the exception.

Today, globalization is the driving force in international commerce. The Internet continues to increase transaction speed and promulgate uniform systems and processes. The emergence of international standards for commercial mortgage-backed securities exemplifies this trend. The cash flow derived from securities in title-insured loans logically is more reliable than in uninsured loans where there is a risk of a title loss. International lenders are becoming more familiar with the protections and benefits of title insurance, and, consequently, it is playing an increasingly greater role in the evolution of standardized international transaction systems and processes.

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transactions, for overseeing and conducting due diligence on potential new areas, and for development of policy forms for those new areas. Calder is in his 28th year in the title industry and 23rd year with First American. Mike is recognized for his expertise in title registration and conveyancing systems around the world. He has consulted with various companies outside the U.S. concerned about title transfer issues in other parts of the world and is very knowledgeable in international title issues. Calder graduated with undergraduate honors from Hamilton College in Clinton, New York, and with a Masters in Business from the University of Northern Colorado.

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Editors' Note*: Other underwriters also offer international title insurance and this article is not intended to favor a particular company, but rather to provide information to our subscribers on the topic. The* N.Y. Real Property Law Journal *is always willing to consider article submissions from a variety of sources and does not intend to promote any particular title insurance company or law firm in publishing an article.*

APPENDIX 1
Approved Countries
(As of January 2004)

AFRICA/MIDDLE EAST:
Israel
South Africa

ASIA/PACIFIC:
Australia*
Guam
Hong Kong*
Japan
New Zealand
Northern Marianas Islands
Singapore
South Korea*

CANADA*

CARIBBEAN:
Anguilla
Antigua & Barbuda
Aruba
The Bahamas
Barbados
Bonaire
British Virgin Islands
Cayman Islands
Curaçao
Dominica
Dominican Republic
Grenada
Guadeloupe
Jamaica
Martinique
Puerto Rico
Saba
St. Barthélemy
St. Eustatius
St. Kitts & Nevis
St. Lucia
St. Martin
St. Vincent & Grenadines
Trinidad & Tobago
Turks & Caicos Islands
U.S. Virgin Islands

EUROPE:
Czech Republic
France
Germany
Greece
Hungary
Italy
The Republic of Ireland
Poland
Slovakia
Spain
United Kingdom* (England, Scotland, Northern Ireland & Wales)

LATIN AMERICA:
Argentina
Belize
Brazil
Chile
Costa Rica
El Salvador
Guatemala
Honduras
Mexico*
Nicaragua
Panamá
Perú

Other countries will be considered on a transaction-by-transaction basis.

* *Direct Operations*

Joint and Several Liability of Individual Condominium Unit Owners

By Vincent Di Lorenzo

Should individual unit owners in a condominium development be subject to joint and several liability for injuries to third parties sustained in the common areas of the condominium? The recent decision in *Pekelnaya v. Allyn*[1] suggests that condominium unit owners can indeed face such liability. This article critiques the court's decision, and argues in favor of, at most, limited liability based on the unit owner's ownership interest in the common areas.

The Court's Decision

In the *Pekelnaya* case a pedestrian walking on the street outside a highrise condominium building was seriously injured when a chain link fence fell from the rooftop and struck him. Plaintiff initially sued the condominium association, its board of managers and the sponsor. When plaintiff discovered that the condominium carried only $2 million in liability insurance, he sued the individual condominium unit owners as well.[2] The individual unit owners moved for summary judgment. The court denied the motions. In reaching its decision the court addressed the tort doctrine of res ipsa loquitor and the statutory imposition of liability in Multiple Dwelling Law § 78.

Plaintiff sought recovery under the theory of res ipsa loquitor. The court acknowledged that this doctrine requires, *inter alia*, that the event in question was caused by an agency or instrumentality within the exclusive control of the defendant. Defendants argued that the board of managers and not the individual unit owners controlled the maintenance and repair of the roof. The court disagreed. It ruled that the unit owners collectively control the board and that it is the agent of the unit owners. As a result, the court found that plaintiff had established a prima facie case for application of the doctrine of res ipsa loquitor.

The defendants then argued that Multiple Dwelling Law § 78 places liability on the board of managers of the condominium and not on the individual unit owners. They admitted that the statute imposes liability on the "owner." However, they argued that this was true only when the owner controls the building, and the board of managers, not the individual unit owners, control the common elements in a condominium. The court disagreed. It viewed the situation as similar to one in which an owner delegates maintenance and repair obligations to another. In such a situation, as discussed below, the courts have ruled that an owner's liability under Multiple Dwelling Law § 78 is non-delegable.

Relevant Statutory Provisions and Legislative History

Two statutes are relevant in helping to resolve the issues raised in the *Pekelnaya* case: the Condominium Act and the Multiple Dwelling Law. The New York Condominium Act contains no provision explicitly addressing the tort liability of unit owners. The Condominium Act does provide that the unit owners are the owners of the common elements,[3] as tenants in common. It also provides that:

> each unit owner shall be deemed the person in control of the unit owned by him or her, and the board of managers shall be deemed the person in control of the common elements, for purposes of enforcement of [the multiple dwelling law, the multiple residence law, or any state building construction code as to multiple residences].[4]

The Multiple Dwelling Law also does not provide a clear or certain answer to the issue of tort liability of individual condominium unit owners. Section 78 of the Multiple Dwelling Law imposes the obligation to comply with its provisions on the "owner." Literally applied this would be the condominium unit owners since the board does not own any portion of the common elements. However, the term "owner" is defined in the Multiple Dwelling Law as follows:

> The term "owner" shall mean and include the 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.[5]

Thus, we are left with the question: did the legislature intend that the board of managers would be responsible for compliance with, and would be liable for failure to comply with, the Multiple Dwelling Law in lieu of the unit owners, or in addition to the unit owners?

The legislative history of the Condominium Act contains one reference to the issue of tort liability of unit owners. The Governor's Bill Jacket to the Act contained a 1963 Report of the New York State Division of Housing. In that report, the

Division reviewed and commented on the proposed legislation that was eventually enacted in 1964. The Division warned that the legislation would expose individual unit owners to unlimited liability in tort.[6] The legislature subsequently adopted the legislation without addressing the issue of tort liability. A court could use this legislative history as evidence that the Condominium Act's provisions granting "control" over the common elements to the board of managers was not intended to relieve unit owners of tort liability. However, legislative inaction is a weak and controversial basis for legislative intention. Arguably, the legislature might have disagreed with the Division's interpretation of the proposed bill. An alternative conclusion available for a court is that section 339-ee of the Condominium Act had a meaning supplied by the existing case law, namely when an entity other than the owner is in exclusive control of the premises it is that entity, and not the owner, that is liable under the Multiple Dwelling Law. The claim would be that the legislature was aware of this case law and meant to embrace it.

Analysis of Judicial Decisions Before *Pekelnaya*

Three types of judicial decisions deserve attention: (1) case law other than *Pekelnaya*, if any, addressing the issue of tort liability of individual condominium unit owners, (2) case law interpreting the provisions of Multiple Dwelling Law § 78, particularly cases involving an owner's liability when the owner does not control the maintenance and repair of the building, and (3), case law analyzing common law tort liability in situations in which the owner does not control the maintenance and repair of the real estate.

Tort liability in a condominium context has been addressed by the New York courts, but never in a situation identical to that in *Pekelnaya*. Case law has permitted third parties to sue the condominium association for injuries occurring in the common areas.[7] However, this case law has not addressed the issue of the liability of individual unit owners in such instances. Case law has also permitted third parties to sue individual unit owners for injuries occurring as a result of defects within the unit.[8] These cases are not similar to *Pekelnaya* because the individual unit owner both owns and controls the unit.[9] However, the individual unit owner owns a part of the common elements but does not control the common elements.

Tort liability of owners pursuant to MDL § 78 has been addressed in prior case law as well. These cases draw a distinction between an owner hiring a third party to perform maintenance and repair obligations on its behalf, i.e., an agent, and an owner actually relinquishing control of the real estate to a third party. In the former situation, courts have ruled that an owner's duty is non-delegable.[10] However, in the latter situation the case law applying MDL § 78, as well as the case law applying general tort principles, has stated that the owner is relieved of liability when the owner grants exclusive control over maintenance and repairs to another, such as a tenant. More specifically, the case law explained that the owner is relieved of liability when the owner parts with a right of entry and the power to perform an otherwise existing duty to maintain the premises in a safe condition.[11]

As noted above, the doctrine that an owner that has relinquished control over the premises is not liable for injuries to third parties is a long-standing common law doctrine.[12] It is true that the courts typically describe the doctrine as being applicable when the owner is out of possession and the owner neither retains control nor is contractually obligated to remedy the unsafe condition.[13] However, the doctrine is premised upon the owner's lack of control,[14] with lack of possession being evidence of lack of control.

The individual condominium unit owners are not out of possession of all of the common areas. They have a right of access to some common areas—e.g., hallways in a high-rise condominium development—and are denied access to others. However, individual unit owners are denied control over all common areas, e.g., denied the right to repair common areas.

Thus, the question in situations like the *Pekelnaya* case is whether a condominium association should be treated as similar to a maintenance company, or an elevator repair company, hired by the owner to maintain and repair all or a portion of its building. The court in *Pekelnaya* embraced this analogy. An alternative analogy, however, is to treat the individual condominium unit owner as similar to a real estate owner that has parted with the right and power to control the repair and maintenance of the real estate and for that reason should not be liable for injuries suffered by third parties in the common areas.

While there are no cases other than *Pekelnaya* addressing this precise issue, there are cases that have considered whether the unit owner or the condominium association is in control of the common areas and therefore should be responsible for compliance with the Multiple Dwelling Law and similar housing codes. They have ruled that the unit owner does not control the common areas, or their repair, and therefore responsibility for repair rests with the condominium association.[15] These cases address the duty to make repairs, and not liability to third parties. However, they support the conclusion that a court should embrace the latter analogy, i.e., the unit owner owns the common areas but has no power or control over them, rather than the former analogy, i.e., the association is merely an agent of the unit owner who retains a non-delegable duty of repair and liability for failure to repair.

This conclusion is supported by the typical provisions contained in the governing documents of condominium developments. Such documents, e.g., the bylaws, provide for election of the board of managers by the unit owners and stipulate that all maintenance and repair of all common areas is to be conducted exclusively by the board of managers. The error in the *Pekelnaya* decision is to equate the power of all unit owners as a class and the power of each individual unit owner. Unit owners as a class have the power to elect and remove the board of managers. Moreover, the board does serve as agent of all unit owners not only when it makes repair and maintenance decisions but all management decisions, which must be made on behalf of and in the interest of all unit owners as a class. However, each individual unit owner exercises no control over the board or its decisions.

Thus, a court's more reasonable choices would be to permit an action (a) only against the board, or (b) against either the board or the unit owners as a class with each member of the class responsible for his or her pro rata share of the judgment. However, it was an unreasonable choice in *Pekelnaya* to allow an action imposing joint and several liability on an individual unit owner because that individual is unable to make or control any decisions made regarding repair and maintenance of the common elements.

Another View—Case Law in Other States

As discussed above, a court could conclude that an individual unit owner has no control over the common elements and therefore should not be subjected to a lawsuit for injuries sustained in the common areas. Such a position could be maintained under existing case law, both under the Multiple Dwelling Law and under the common law. However, if the courts are reluctant to dismiss the action entirely, they could embrace a compromise position embraced in other states. The leading case for the New York courts to examine, as persuasive authority, is *Dutcher v. Owens*,[16] decided by the Texas Supreme Court. In that case the lower court had found that an individual unit owner was jointly and severally liable for the negligent act of the association that occurred in the common area. The Texas Supreme Court reversed that judgment. Initially it concluded that the Texas condominium statute did not address the issue of tort liability of individual unit owners.[17] However, since each unit owner had no control over the maintenance and repair of the common areas, the court refused to impose joint and several liability on the individual unit owner. It explained ". . . to rule that a condominium co-owner had any effective control over the operation of the common areas would be to sacrifice 'reality to theoretical formalism,' for in fact a co-owner has no more control over operations than he would have as a stockholder in a corporation which owned and operated the project."[18] The court then suggested that the most "efficient" approach is to permit a lawsuit against the association and its board, as representatives of all unit owners, as well as any individual unit owner directly responsible for the injuries sustained.[19] Nonetheless, it permitted the suit against the individual unit owner but limited defendant's liability. It held:

> . . . because of the limited control afforded a unit owner by the statutory condominium regime the creation of the regime effects a reallocation of tort liability. The liability of a condominium co-owner is limited to his pro rata interest in the regime as a whole, where such liability arises from those areas held in tenancy-in-common.[20]

The court found this conclusion was not inconsistent with the legislature's intention, since the condominium statute allocates other financial responsibilities proportionately.[21]

Conclusion

The court's decision in the *Pekelnaya* case improperly applies existing case law to impose joint and several liability on each individual condominium unit owner. It incorrectly characterizes the condominium association and the board of managers as agents of each individual unit owner. However, the more appropriate characterization is to treat each unit owner as an individual with no control over the common elements or the decisions of the board. Therefore, an individual unit owner should not face tort liability for injuries sustained in the common areas. The association or board of managers or, perhaps, all unit owners as a class should face that liability. In turn, the financial responsibility of each owner should be limited, as it is for other financial obligations suffered by the condominium, to the unit owner's pro rata interest in the common elements.

Endnotes

1. *Pekelnaya v. Allyn*, Index No. 116732/02 (Sup. Ct., N.Y. Co. 2004).
2. Jay Romano, *Liability Concerns for Condos*, N.Y. Times, February 29, 2004, section 11 at 7.
3. N.Y. Real Property Law § 339-i (RPL).
4. RPL § 339-ee(1).
5. N.Y. Multiple Dwelling Law § 4 (44) (MDL).
6. Division of Housing and Community Renewal, Preliminary Report on 1963 New York Condominium Bill, October 24, 1963 (text at notes 145-151). However, the Division did not reiterate this

objection in its comments on the 1964 bill. Comments of Division of Housing and Community Renewal, February 28, 1964, Governor's Bill Jacket, Chapter 82, Laws of 1964.

7. *See Secof v. Greens Condominium*, 158 A.D.2d 591, 551 N.Y.S.2d 563 (2d Dep't 1990).

8. *See, e.g., Kaplan v. Adams*, 271 A.D.2d 211, 706 N.Y.S.2d 388 (1st Dep't 2000). *See also Antich v. McPartland*, 293 A.D.2d 953, 740 N.Y.S.2d 728 (3d Dep't 2002) (unit owner not liable because he had no notice of defect within unit).

9. RPL § 339-h (exclusive ownership and possession of the unit vested in unit owner).

10. *Mas v. Two Bridges Associates*, 75 N.Y.2d 680, 555 N.Y.S.2d 669 (1990); *Rogers v. Dorchester Associates,* 32 N.Y.2d 553, 347 N.Y.S.2d 22 (1973); *Camaj v. East 52nd Partners*, 215 A.D.2d 150, 626 N.Y.S.2d 110 (1st Dep't 1995).

11. *Appel v. Muller*, 262 N.Y. 278, 186 N.E. 785 (1933) (discussing common law liability of owner, but in this case owner retained right to enter and make repairs); *Worth Distributors, Inc. v. Latham*, 59 N.Y.2d 231, 464 N.Y.S.2d 435 (1983) (applying MDL § 78, and citing the *Appel* case regarding owner's lack of liability where it has completely parted with possession and control; owners in this case reserved the right to enter for inspection and repairs); *Torres v. United States*, 324 F. Supp. 1195 (E.D.N.Y. 1969) (owner has shown that it so completely parted with possession and control that it is unable to perform its duty of care). *See also Dorman v. 19-20 Industry City Associates, Inc.*, 4 Misc. 3d 1007(A) (Sup. Ct., Kings. Co. 2004) (involving liability of owner under NYC Administrative Code; owner granted summary judgment in situation in which it leased the premises and did not retain control over the premises nor was contractually obligated to repair the premises).

12. *Appel*, 262 N.Y. 278; *Cullings v. Goetz*, 256 N.Y. 287, 176 N.E. 397 (1931) (liability in tort must be confined to the lessee, whose possession and dominion were exclusive and complete).

13. *E.g., Ingargiola v. Waheguru Management, Inc.*, 5 A.D.3d 732, 774 N.Y.S.2d 557 (2d Dep't 2004); *White v. Jeffco Western Properties, Inc.*, 304 A.D.2d 824, 759 N.Y.S. 2d 138 (2d Dep't 2003); *Levy v. Daitz,* 196 A.D.2d 454, 601 N.Y.S.2d. 294 (1st Dep't 1993).

14. *Appel*, 262 N.Y. 278.

15. *Pershad v. Parkchester South Condominium*, 174 Misc. 2d 92, 662 N.Y.S.2d 993 (Civ. Ct., N.Y. Co. 1997), *aff'd*, 178 Misc. 2d 788, 683 N.Y.S.2d 708 (Sup. Ct., App. T., 1st Dep't 1998) (it is inconceivable and illogical to argue that the unit owner would be responsible for correcting the problem in the common area which is solely in the control of the building association); *Smith v. Parkchester North Condominium*, 163 Misc. 2d 66, 619 N.Y.S.2d 523 (Civ. Ct., N.Y. Co. 1994) (common areas are in sole control of the association; unit owner has no control that would enable him to correct the violations).

16. 647 S.W.2d 948 (1983).

17. The court concluded that the statute is silent and the legislative history is so scant that the most that can be said is that the Act is silent as to the matter of the individual condominium unit owner's tort liability. *Id*. at 950.

18. *Id*. at 950.

19. *Id*.

20. *Id*. at 951.

21. The court also considered and rejected legislative inaction as a source of legislative intention. Two bills had been submitted in the legislature that reapportioned liability on a pro-rata basis, and neither bill had passed. The court refused to draw inferences regarding the legislature's intent from such inaction. *Id*. at 950.

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Tenancy by the Entirety in New York

By James M. Pedowitz

The decision of the United States Supreme Court in the case of *United States v. Craft*[1] has generated considerable comment.[2] Michigan is one of 13 states in which marital property owned in tenancy by the entirety is not subject to a lien, whether voluntary or involuntary, against either spouse individually. Unless a lien is against both the husband and wife, it cannot be enforced against real estate owned as tenants by the entirety. The *Craft* case dealt with a federal tax lien against the husband only and the court found that each tenant has a sufficient property interest even in Michigan, to be enforced under federal law. If the property had been in New York, there would have been no question as to the enforceability of the lien.

Whenever real property is conveyed to two persons who are legally married under New York law, they acquire their title as tenants by the entirety, unless the deed provides otherwise, whether or not they are so described in the deed. The fiction that is employed is that as husband and wife they are one person, and the glue that supports this fiction is the existence of a valid marriage of the parties.

If two persons, as grantees are described as husband and wife, but they are not in fact married to each other, they do not take as tenants by the entirety. In fact, prior to the enactment of New York Estates, Powers & Trusts Law 6-2.2, effective September 1, 1975, they would have been tenants in common. Now, however, they are joint tenants because of that statute.

Although New York recognizes the estate of tenancy by the entirety,[3] including the unity of the estate owned by husband and wife, New York courts recognize that each spouse can mortgage, convey, or otherwise encumber their separate interests, so long as the right of survivorship of the other tenant by the entirety, or his or her possession is not affected.[4]

Under these circumstances, the purchaser of a tenant by the entirety interest steps into the shoes of the selling tenant, and must await the death of the first to die of the original two tenants. When that happens, as it must eventually, the interest will either disappear or be converted to the full title, depending on whether the grantor-tenant by the entirety dies first or survives.

In the interim the purchaser of the single tenant by the entirety interest can share in the income, if there is any, but may not oust the other tenant by the entirety from his or her possession. Because of the nature of this interest, it is rarely the subject of a negotiated sale. Rather, it usually occurs as the result of a sheriff's sale or a bankruptcy sale.

The *Craft* case developed through a tax lien assessed by the United States for nonpayment of income taxes by the husband alone. The federal courts recognized that state law determines the nature of the property rights of the taxpayer. However, federal law determines what "property" is, that is subject to the federal lien under Internal Revenue Code, 26 U.S.C. § 6321.

Under New York law, neither tenant by the entirety nor a successor can bring a partition action.[5] However, the tenancy by the entirety is automatically converted into a tenancy in common by one of the following events:

A—Annulment of the existence of a valid marriage; or

B—Legally recognized judgment of divorce or separation by court order; or[6]

C—Voluntary written agreement of the parties.

The following points further indicate various aspects of the nature of the estate of tenancy by the entirety in New York:

A conveyance by one spouse to a stranger, either voluntarily or involuntarily, does not defeat the right of survivorship of the other original tenant by the entirety.[7]

If the husband (H) conveys his interest to X, X acquires H's possessory and survivorship right but it is subject to the wife (W)'s concurrent possessory and survivorship rights. If W also conveys her interest to Y, Y acquires W's interest including her possessory and survivorship rights. However X and Y's rights will still be based upon the original survivorship between H and W, the original tenant by the entirety's, even though they no longer have an interest in the property.[8]

When both husband and wife die simultaneously, and it cannot be established as to who died first, EPTL 2.1.6 provides that as to a ½ interest it is deemed that H survived, and as to the other ½ interest it is deemed W survived, so the result is the same as though they had each owned a ½ interest.

A bankruptcy of only one of the tenant by the entirety can result in a sale of the debtor's interest in the property, but if it is the debtor's principal residence, it may be subject to the homestead exemption of $10,000 under Civil Practice Law & Rules 5206. The homestead exemption applies to the sale of the debtor's principal residence by the trustee or debtor in possession, in which event the first $10,000 goes to the debtor.

However, in bankruptcy, it is possible that the entire interest of both the debtor and the non-debtor spouse could be sold under section 363 of the Bankruptcy Code; but before the Trustee or debtor-in-possession can use that power, court approval must be obtained and the criteria of section 363(b) satisfied. Those criteria also include non-economic factors affecting the non-debtor spouse.[9]

11 U.S.C. § 363(h) now permits the sale of both the estate's interest and the interest of a non-filing co-owner, in conjunction with 11 U.S.C. § 363(b), after notice and hearing if all of the following conditions are met:

(1) partition in kind of the property among the estate and the co-owners is impracticable;

(2) sale of the estate's undivided interest would realize significantly less than sale free of the interest of the co-owners;

(3) the benefit to the estate outweighs the detriment to the co-owners; and

(4) the property is not used in the production, transmission, or distribution for sale, of electric energy or of natural or synthetic gas for heat, light or power.[10]

A conveyance to a husband (H) and wife (W) and to "Y," a third party, creates a tenancy by the entirety in an undivided 50% percent interest in the H & W and a 50% percent interest in Y. The joint interests of husband and wife, and of Y are treated as tenants in common, each with a 50% interest.[11] Here, too, husband and wife are treated as one person.

A deed to John Jones and Mary Jones, his wife, and Richard Roe and Jane Roe, his wife, created two tenancies by the entirety in each of the two named couples as to a 50% interest each; and each couple holding as a tenant in common with the other couple.[12]

A judgment or lien against one spouse in a tenancy by the entirety ceases to be a valid lien after the death of the judgment debtor. The title that vests in the surviving spouse is free and clear of all liens created by the deceased tenant. The marriage of two tenants in common or joint tenants will not convert the estate into a tenancy by the entirety.[13] They must be married to each other at the time of the acquisition for a tenancy by the entirety to be created.

Where husband and wife owned the premises as tenants by the entirety, a conveyance by the wife to her husband of "All of her undivided one-half right, title and interest" vested an undivided one-half interest in the husband, but the other one-half interest was still held in entirety.[14]

Where both husband and wife contracted to sell realty and both died before the conveyance, the executor of the last surviving spouse can convey good title.[15] The entire title had vested in the survivor.

The survivorship rights of a tenant by the entirety cannot be destroyed by the act of only one of the tenants, i.e., if H & W own premises as tenants by the entirety and H makes a deed to X, X holds a tenancy in common with W and subject to the survivorship rights of W.[16]

A husband and a wife owned real property as tenants by the entirety. The wife forged the husband's signature and conveyed title to herself and subsequently conveyed to a bona fide purchaser for value who had no notice of the fraud. The court held that since the first deed was a forgery, it was, therefore, void. The purchaser took only the wife's interest and became a tenant in common as to possession with the husband and subject to the husband's right of survivorship.[17]

The purchaser at the execution sale of the interest of only one tenant by the entirety cannot disturb the actual possession of the other tenant by the entirety. If, however, the property produces net income, they both share.

Termination of any estate, including a tenancy by the entirety, by a wrongful act such as murder, will not result in the guilty party succeeding to the estate.[18]

This rule does not result in the forfeiture of the interest of the wrongdoer. He or she is still entitled to their rights during their lifetime. It is the right of the survivorship that cannot be exercised, and is lost.[19]

Notwithstanding the title by the entirety, when there is marital discord among tenants by the entirety that leads to matrimonial litigation, Domestic Relations Law § 234 gives the court broad discretion in dealing with the possessory rights in marital property,[20] but not with respect to title to the property. However, the Equitable Distribution Law, DRL § 236, Part B is much broader and permits the court to award the property to one spouse, irrespective of how title is held, whether as tenants by the entirety, or in the name of the other spouse. (DRL § 236, Part B(5).) The equitable distribution provisions only apply to property acquired on and after July 19, 1980, when the law became effective, unless acquired as "separate property" within the statutory provisions.

Equitable distribution can be pursued in New York after a foreign divorce (DRL § 236), irrespective of whether the foreign divorce was ex parte or not. However, if the foreign jurisdiction had the power to deal with the marital property, and failed to do so, the matter may be res judicata.[21]

In the case of an ex parte foreign divorce, although New York may recognize that the marriage is terminated, it does not recognize that the tenancy by the entirety has been affected.[22] This has been called the "divisible divorce" doctrine. However, the party who obtained the ex parte foreign divorce has been held to be estopped from asserting tenancy by the entirety survivorship rights, because she was the one who procured the foreign ex parte divorce, and would not be permitted to claim the benefits of a marriage that she had unilaterally terminated in the foreign jurisdiction.[23] There is a good discussion of how these rights play out in *Radcliffe v. Radcliffe*.[24]

Since the estate of tenancy by the entirety applies only to real property or a co-op apartment, the proceeds from a taking by eminent domain or other involuntary transfer, are also subject to the survivorship; but if the transfer results from some voluntary act, different rules apply, and the proceeds are shared.

The insurance proceeds after a fire are treated as the personal property of both H & W and divided between them. The rationale is that the proceeds are derived from the insurance contract voluntarily entered into by both H & W.[25] The same rule applies to surplus money derived from a foreclosure sale.

After a condemnation award, resulting from an involuntary transfer, the funds are treated in the same manner as the realty, although interest on the award, if any, prior to the death of one of the tenants, is shared equally.[26]

Some of the caveats to be gleaned from the foregoing are that, in New York:

(1) In conveyancing, always remember that H & W as tenants by the entirety both own all of the property and not ½ each.

(2) A lien against only one of the tenants by the entirety is enforceable, but only against that one tenant's interest and that a purchaser at the sale or foreclosure will not be permitted to disturb either the possession or the survivorship interest of the other tenant.

(3) A lien against only one of the tenants by the entirety expires, when the tenant's life ends, if that tenant dies before the other tenant. Caveat. This rule may not apply to a federal tax lien, or in bankruptcy.

(4) Divorce,[27] annulment[28] or a judicial legal separation[29] automatically converts a tenancy by the entirety into a tenancy in common.

(5) The proceeds of a fire insurance loss[30] or other conversion into money, is held as tenants in common, but only if a court finds that it resulted from some voluntary act. Surplus monies resulting from a mortgage foreclosure sale are deemed to be the result of a voluntary act, the making of the mortgage, and they are held as tenants in common.[31]

Endnotes

1. 535 U.S. 274 (2002) (The enforcement of a federal lien against a husband only that was held in a tenancy by the entirety on real property located in Michigan).
2. *See, e.g.*, Albert F. Rush, United States v. Craft *Saying Goodbye to Tenancy by the Entirety*, 17 ABA Real Prop., Prob. & Trust L.J. 59 (2003).
3. *See* EPTL 6-2.1, 6-2.2.
4. *See, e.g., Hiles v. Fischer*, 144 N.Y. 306 (1895); *Novak v. Novak*, 516 N.Y.S.2d 878 (1987).
5. N.Y. Real Property Actions & Proceedings Law § 901.
6. *Steltz v. Shreck*, 128 N.Y. 263 (1891); *Kahn v. Kahn*, 43 N.Y.2d 203, 401 N.Y.S.2d 47 (1977).
7. *See, e.g., Goodrich v. Village of Otsego*, 216 N.Y. 112 (1915).
8. *See, e.g., Lawriw v. City of Rochester*, 14 A.D.2d 13, 217 N.Y.S.2d 113 (4th Dep't 1961); *aff'd*, 11 N.Y.2d 759, 226 N.Y.S.2d 695 (1962).
9. *See* Harold B. Klienberg, *Selling Tenancy by the Entirety in Bankruptcy*, 230 N.Y.L.J. 5 (2003).
10. 11 U.S.C. § 363(h); *see also* Warren's Weed, New York Real Property, "Sale of co-tenancy or tenancy by the entirety," § 9.03.
11. *Bartholomew v. Marshall*, 257 A.D. 1060, 13 N.Y.S.2d 568 (3d Dep't 1939).
12. *Goodrich v. Village of Otego*, 216 N.Y. 112 (1915); *Price v. Pestka*, 54 A.D. 59, 66 N.Y.S.2d 297 (2d Dep't 1900).
13. *Hiles*, 144 N.Y. 306; *Novak*, 516 N.Y.S.2d 878.
14. *Karp v. Karp*, 2 A.D.2d 796, 153 N.Y.S.2d 312 (3d Dep't 1956).
15. *O'Meara v. O'Meara*, 278 A.D. 1009, 105 N.Y.S.2d 825 (2d Dep't 1951).
16. *Hiles v. Fisher*, 144 N.Y. 306 (1895); *Goodrich v. Village of Otego*, 216 N.Y. 112 (1915); *Finnegan v. Humes*, 232 A.D. 385, *aff'd*, 277 N.Y. 682 (1938).
17. *Field v. Field*, 130 Misc. 2d 751, 497 N.Y.S.2d 586 (Sup. Ct., Kings Co. 1985).
18. *Riggs v. Palmer*, 115 N.Y. 506 (1889); *Bierbrower v. Moran*, 244 A.D. 87, 279 N.Y.S. 176 (4th Dep't 1935).
19. Warren's Weed, New York Real Property, "Tenants by the Entirety," § 8.03.
20. *Kahn v. Kahn*, 43 N.Y.2d 203, 401 N.Y.S.2d 47 (1977); *Szabo v. Szabo*, 71 A.D.2d 32, 421 N.Y.S.2d 500 (4th Dep't 1979).
21. *O'Connell v. Corcoran*, 1 N.Y.3d 179, 770 N.Y.S.2d 673 (2003).
22. *Vanderbilt v. Vanderbilt*, 1 N.Y.2d 342, 153 N.Y.S.2d 1 (1956); *In re Nicholson*, 180 A.D.2d 685, 580 N.Y.S.2d 65 (2d Dep't 1992).
23. *Schiller v. Schiller*, 80 A.D.2d 164, 439 N.Y.S.2d 476 (3d Dep't 1981).
24. *Radcliffe v. Radcliffe*, 137 Misc. 2d 859, 522 N.Y.S.2d 823 (Sup. Ct., Suffolk Co. 1987).
25. *Hawthorne v. Hawthorne*, 13 N.Y.2d 82, 242 N.Y.S.2d 50 (1963).
26. *In re City of New York*, 252 A.D. 103, 297 N.Y.S. 415 (2d Dep't 1937).
27. *Kahn v. Kahn*, 43 N.Y.2d 203, 401 N.Y.S.2d 47 (1977).
28. *In re Kutick*, 33 Misc. 2d 580, 226 N.Y.S.2d 869 (Sup. Ct., Queens Co. 1962).
29. *Schiller v. Schiller*, 80 A.D.2d 164, 439 N.Y.S.2d 476 (3d Dep't 1981).
30. *Hawthorne v. Hawthorne*, 13 N.Y.2d 82, 242 N.Y.S.2d 50 (1963).
31. *National Bank and Trust Co. of Norwich v. Rickard*, 57 A.D.2d 156, 393 N.Y.S.2d 801 (3d Dep't 1977).

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Bergman on Mortgage Foreclosures: Use and Occupation in Strict Foreclosure

By Bruce J. Bergman

This is a title apparently designed to lose readers immediately. The concept of use and occupation is a sidelight primarily in the eviction world (so it is not everyone's cup of tea in any event) and strict foreclosure is a seemingly rare post-foreclosure pursuit. Combine two obscurities and what amalgam emerges? Actually, something of more relevance than might initially appear.

First, strict foreclosure. It is inevitable through a group of foreclosure actions that some prospective defendant who should have been named and served was not: a party missed by the foreclosure search, a tenant unnoticed by the process server, a person in hiding or out of the country for whom the expenditure of time and expense would have been too great. The result of failing to serve a person or entity with an interest junior to the mortgage being foreclosed is that the interest survives the foreclosure intact.[1]

How significant the omission will be is a fact issue tied to the particular circumstances of the case and property itself. It is, however, often enough meaningful and always creates title issues. The remedy—the most common methodology—to dispose of an interest hitherto unaffected by the foreclosure action is a post-sale strict foreclosure. Testament to the arcane nature of the procedure is foundation case law mostly of nineteenth century vintage. (Recall from law school days the prolix and florid language of those times which made for difficult reading.) Yet, strict foreclosure actions have lately become more common with the precipitous increase in mortgage foreclosure volume beginning in the late 1980s so that new cases are being reported. In short, strict foreclosure is no longer the hidden pursuit it once was.[2]

While a strict foreclosure is less cumbersome than the underlying foreclosure action, it can still readily consume six months—and with service problems or opposition, much more time. If the object of the strict foreclosure is a tenant, that passage of time can be ever more meaningful. To collect rent from that tenant, however, could possibly serve as an attornment and torpedo the strict foreclosure. While the mere acceptance of rent does not alone give rise to an attornment, combined with other factual circumstances it could portend danger to the party pursuing the strict foreclosure. To the contrary, use and occupation can be perceived as payment which is the equivalent of rent but *sans* the legal baggage carried by a continuing tenancy. This then leads to the question, can the tenant repose payment free for whatever period prosecution of the action engenders? Answer: "no."

Enter use and occupation which *is* available in the strict foreclosure case.[3] An analysis of the cases explaining the proposition offer an intriguing exercise, but for purposes here, knowing that use and occupation can be sought seems the valuable point for the moment. The owner unburdening his property from an unwanted tenancy should appreciate counsel's knowledge of this helpful adjunct to the process.

Endnotes

1. That this distinctly simple concept can be a source of much mischief is clarified at 1 Bergman on New York Mortgage Foreclosures § 12.03[3] (Matthew Bender & Co., Inc., rev. 2004).
2. Although now more common, strict foreclosure still encompasses some recondite principles and so attention is invited to 3 Bergman on New York Mortgage Foreclosures, ch. 32 (Matthew Bender & Co., Inc., rev. 2004).
3. *Davis v. Cole*, 193 Misc. 2d 380, 747 N.Y.S.2d 722 (Sup. Ct. 2002). *See also NYCTL 1996-1 Commercial REO v. El Pequeno Restaurant Food Corp.*, ___Misc. 2d___, 765 N.Y.S.2d 465 (Sup. Ct. 2003); RPL § 220.

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Case Note

Seneca Nation of Indians v. New York, 382 F.3d 245 (2d Cir. 2004)

This case concerns the disputed ownership of the Niagara Islands, a group of about 40 small islands in the Niagara River between Lake Erie and Niagara Falls. The disputed ownership stems from numerous treaties that the Seneca Indians had made, both with Great Britain and the United States, as well as the location of the Islands at the United States-Canada border. The litigation in the federal courts has spanned a decade, and the claim has been litigated before the Indian Claims Commission as far back as the 1950s. This case was appealed to the Second Circuit from *Seneca Nation of Indians v. New York*, 206 F. Supp. 2d 448 (W.D.N.Y. 2002). The District Court held in favor of the state of New York.

The Niagara River connects Lakes Erie and Ontario, and it forms part of the present-day border between the United States and Canada. It runs in a northerly direction over Niagara Falls into Lake Ontario. The largest of the Niagara Islands, the 19,000-acre Grand Island, splits the Niagara River into two channels about five miles north of Lake Erie. The original United States-Canada border had run directly through Grand Island; however, in 1822 it was determined that the western channel actually formed the border, given that it was the main channel. This left Grand Island, along with the rest of the Niagara Islands, within the United States.

The Senecas began inhabiting the Islands as seasonal hunting grounds in the 17th century, and disputes over ownership of the Islands stem that far back as well. The French first established a presence in the Niagara Region in 1678. The British settled in the area not much later, and friction soon persisted. In 1689, King William's War broke out, and the Iroquois and Senecas sided with the British. The tribes suffered heavy losses in the war, and as a result they signed the Treaty of Peace of 1701 which provided that they would remain neutral in future wars. (The British and French continued to fight over the area, and it was not until the Treaty of Paris in 1763 that the hostilities finally ended.) Also in 1701, they deeded a large tract of land, including the Niagara Region, to the British, but retained rights for themselves and their heirs to continue hunting in the area under British protection. This was formalized in a Royal Proclamation in 1763, which reserved to the Indians a large tract of land, including the Niagara Region. The Royal Proclamation also restricted the Indians' ability to convey land to anyone without prior permission from the British.

A faction of Senecas hostile to the British joined what is commonly known as "Pontiac's Rebellion." The British put down the rebellion and signed two peace treaties with the Senecas in 1764. The first treaty, signed in April 1764, provided that the Senecas cede to the British "for ever, in full Right," a tract of land four miles wide on either side of the Niagara River in the "northern strip," the area of the river between Lake Ontario and Niagara Falls. (The Niagara Islands are in the "southern strip," and were not ceded in this treaty.) Because of security concerns in the area given the recent rebellion, the British Superintendent for the Northern Indian District, Sir William Johnson, wanted an expansion of the lands ceded in April to include lands in the "southern strip," including the Niagara Islands. The treaty of August 1764 ceded the "southern strip" to the British, and it was recognized that it was ceded because of the "trouble" the Senecas had caused.

When the Senecas ceded the "southern strip," they ceded the land to Johnson personally. The treaty even provided that Johnson take title to the lands. However, when Johnson accepted the lands, he did so as a representative of the British Crown. He did not want to offend the Senecas by refusing their offer, so he accepted the lands. The Senecas insisted that Johnson take the land, not wanting to cede it to the Crown. Johnson, knowing of the Royal Proclamation's restriction on unapproved private acquisitions of land, accepted the land with the sole intention of reconveying it to the Crown. Johnson mentioned this intention both in a letter to the Crown and also in a separate letter to a friend.

The 1768 Treaty of Fort Stanwix formalized a new boundary line between Indian and British territory. This treaty drew a boundary line in a northeast direction from the juncture of the Ohio and Mississippi Rivers to Fort Stanwix (at present-day Rome, N.Y.) and ceded to the British all land east of that line; the Niagara Region was west of that boundary line. It also included a stipulation that "none of the Provinces or their people shall attempt to invade [the land west of the 1768 boundary line] under color of any old deeds, or other pretences whatsoever."

During the Revolutionary War, the Senecas were one of the hostile Indian nations that fought with the British. After the war started, the Continental Congress began to draft the Articles of Confederation and started to draft borders between the states. When New York ceded lands to the United States in 1782 it retained the Niagara Region. The Articles of Confederation gave the United States the "sole and exclusive right and power" to make war and peace with the Indians but gave to the states the power to purchase or preempt Indian land within their borders and to extinguish Indian land claims.

In 1783, the Treaty of Paris ended the hostilities and set the boundary with Canada in the "middle" of the Niagara River, but did not mention the Islands at all. But hostilities with the Indians continued, and New York tried unsuccessfully to negotiate a peace treaty early in 1784. In the course of negotiations New York asked for the Niagara and Oswego lands, and the Iroquois negotiator told New York that the United States already owned this land through its treaty with Britain.

The 1784 Treaty of Fort Stanwix established new boundaries, and the Niagara Region was well within the boundary of lands granted to the United States, and Congress ratified this treaty. In the 1786 Hartford Compact between New York and Massachusetts, New York "retained both sovereignty and the right of preemption" over lands which included the Islands.

The Constitution gave the federal government sole power over Indian affairs. The 1802 Non-Intercourse Act forbade all conveyances of Indian land without approval from Congress.

The Senecas continued to fight with the United States, partially because of discontent with the boundaries of the 1784 treaty. The 1794 Treaty of Canandaigua set the Senecas' western boundary "along the river Niagara to Lake Erie," but did not mention the Islands.

In 1811, the New York legislature, concerned with security in the region, authorized Governor Tompkins to purchase the land from the Senecas. Governor Tompkins did not believe that the Islands belonged to the Senecas, arguing that the metes and bounds of the treaty excluded the Islands from their lands. Tompkins also argued that when the Iroquois nations gave the land to Johnson back in 1764, it passed to him, then to his son, and finally back to New York.

When the War of 1812 broke out, the Senecas sided with the United States, and after the war the 1814 Treaty of Ghent formed a commission to establish an international boundary between the United States and Canada. New York also resumed its negotiations with the Senecas to purchase their lands. Even though Tompkins still did not believe that the lands belonged to the Senecas he paid them anyway, to keep up the good relations in place at the time. On September 12, 1815, the Senecas sold the land to New York for $1,000 and a perpetual annuity of $500. However, there was no federal commissioner present.

In 1822, the international boundary was set and the Islands were confirmed to lie within the United States. New York subsequently authorized the partition of Grand Island into lots, and those lots were auctioned in 1825.

The Senecas claim that the 1794 Treaty of Canandaigua gave them "recognized title" to the Islands; alternatively they claim that they held aboriginal title in 1815. "Recognized title" is stronger because it has been recognized by treaty or statute; aboriginal title is a weaker form of title, as it can be extinguished without the requirement of compensation for the lands.

The court recognizes that Indian treaties should be interpreted in favor of the Indians and should take into account the extent to which the Indians understood them. All ambiguities should be resolved in favor of the Indians, but that should not be held to strip a state of any land where the state did not intend to divest itself of that land.

The court held that New York held title to the lands prior to the 1794 Treaty of Canandaigua. The 1764 Treaty of Fort Stanwix ceded the lands to the British, extinguishing the Senecas' claim to the land. After the Revolutionary War, title on the land passed to New York.

The language of the 1764 treaty demonstrates the Senecas' unambiguous intent to cede the land and to extinguish their own title. The treaty contained language such as "cede," "grant," "for ever, in full Right" and "always appropriated to [His Majesty's] sole use." Even though this treaty was negotiated with the British, the court has interpreted the treaty in the same manner that it would interpret a United States treaty, given that Great Britain is a prior sovereign.

The Senecas argue that they merely intended to convey possessory rights to the lands, and that if this treaty is read with the 1701 and 1726 treaties that the language is ambiguous. Their claim mentions the fact that they retained some rights for travel and hunting upon the lands. However, the court rejects this and mentions specific provisions in the treaty, surrendering some lands to the Crown and other lands to Johnson. The Senecas expressed concern in the treaty over British settlement in the area, and that it might interfere with Seneca hunting grounds nearby. However, the concern in the treaty does not mention the Islands; thus, there was no intent at all to retain any rights at all in the Islands.

The court also held that the cession of the Islands to Johnson in 1764 did not violate the 1763 Royal Proclamation. The court acknowledged that the Treaty specifically mentions Johnson, but it also finds that Johnson was accepting the land on behalf of the Crown and not accepting it personally. His letters on the matter specifically mention his intent to accept the lands so as not to offend the Senecas, as well as his intent to reconvey the lands to the Crown.

The court also found that the 1768 Treaty merely established a new "boundary line" and did not revoke any previously ceded land, including the land ceded in 1764. The concern over re-entry into Seneca land was a specific concern regarding lands that had been fraudulently conveyed, and where others had taken advantage of the Senecas in previous dealings. The court found that the Islands were not covered by this concern, and that the Senecas did not intend to reclaim the Islands, as is evidenced by the fact that the British retained and maintained a post they had established there.

Furthermore, the court held that the Islands passed to New York after the Revolution. New York, Vermont and Massachusetts were all negotiating their boundaries, Vermont and Massachusetts were "landed states" whose charters extended from sea to sea, while New York was a "landless state" with no such "sea to sea" claim. It was common at the time for the landless states to make concessions on their eastern borders to keep the peace with the landed states. In exchange, the new Confederal government would give generous concessions to the landless states on their western borders. Even though New York had not established its eastern border with Massachusetts until 1786, it retained its title to the Islands back in 1782 when it ceded some land to the Confederal government and established its western boundary at that time.

Consequently, the 1784 Treaty did not impair New York's title to the Islands. When Congress ratified that treaty, it specifically adopted language that the treaty should not be held as "interfering with the right of any such state to the jurisdiction or soil" in regards to lands the state already possessed. Even if the Articles of Confederation could be interpreted as allowing the Confederal government to appropriate state lands for its own use (which the court held that it could not), the 1784 treaty stipulated merely that the Indians "yield to the United States what rights they may have had to them." Since they had already ceded the lands to Johnson in 1764, they had no rights to convey in 1784.

Furthermore, the court held that the 1794 Treaty of Canandaigua did not divest New York of title to the Islands. The court examined two possibilities; first, that the term "along the River Niagara" did not include the Islands; and second, assuming that even if the Islands were part of that cession of land, and that the United States had the power to convey state land, it was a taking for which just compensation was not paid. The court agreed with the first and did not speak to the second. The "along the river" language is too ambiguous to find that the Islands were part of the land. The court looked to the rule in *United States v. Minnesota*, 270 U.S. 181 (1926). There, the Supreme Court prohibited construction of treaties where a state's intent to divest itself of land was manifested "beyond reasonable question." At common law, when the sovereign granted land along a navigable river, the grant extends to the water's edge; the riverbed and any islands were retained by the sovereign.

The court then examined the definition of "navigable." There are numerous ways to define "navigable"; possible definitions include "a royal river" affected by tides, or it could be that it was actually navigable (a "public highway"). Another definition implied merely that the river be "usable." Because of the confusion over the definition of "navigable," the court concluded that the "along the river" language was ambiguous. Thus, it cannot be found that New York intended to divest itself of the Islands.

Because the Islands were not part of the 1794 Treaty of Canandaigua, New York's title to the Islands remained undisturbed. Therefore, the 1815 "purchase" was not valid and not subject to the Non-Intercourse Act. The District Court decision in favor of New York was affirmed.

—Matthew A. D. Canzoneri
Class of 2006

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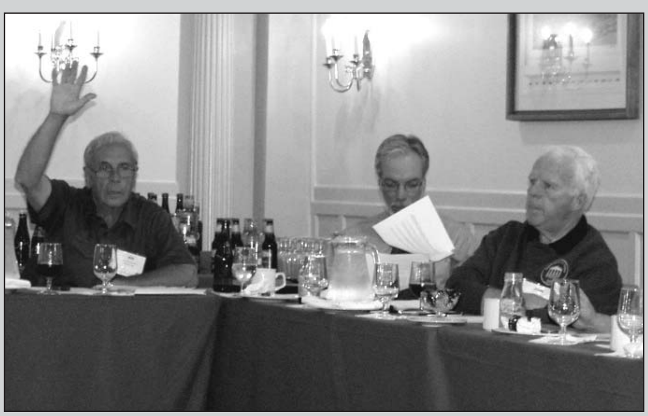








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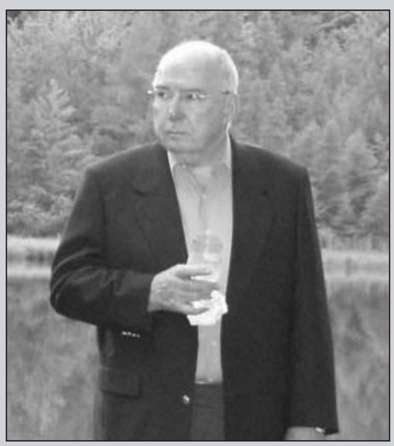

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