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A Message from the Section Chair

I am of the generation who grew up in the Cold War Era and remembers euphemistic statements such as "Peaceful Co-Existence through Mutual Deterrence." This statement was more aptly translated by *MAD Magazine* with a cartoon of Nikita Khrushchev saying "Peace in our time or we wipe them out."

Thankfully, lawyers, even in disagreements amongst themselves or other parties, rarely resort to violence.

Unfortunately, increasingly we are seeing real estate targeted by all sorts of unscrupulous individuals who clearly do not have the public good as any objective. In its extreme, fraudulent practices are being utilized to victimize both innocent and unsophisticated parties, as well as more sophisticated institutions such as lenders and title insurance companies. There is one very telling series of articles published late last year by the *Chicago Tribune* which summarized things as follows: "If you are still making money selling drugs, you are an informant or about to be busted. Mortgage fraud is the thing to do now." (www.chicagotribune.com/mortgage). We should all be concerned that the effect of such activity involving, in the aggregate, billions of dollars, will ultimately convince legitimate investors that risk capital can be put to better use in other sectors of the U.S. economy.

Accordingly, with this concern in mind, I have established a new Task Force on Fraudulent Practices which is Co-Chaired by former Section Chair Harold Lubell of the Bryan Cave firm and Joe Friedman from Ticor Title Insurance in New York City and Elizabeth Wade of Gateway Title Agency in Albany. Particularly, Elizabeth has volunteered as recruiter for the Task Force and has solicited more Section members to join as well as to provide evidence of specific practices. We all encourage your participation and comments.

Thankfully, lawyers, even in disagreements amongst themselves or other parties, rarely resort to violence.

In addition, David Billet, Director of Legislative & Governmental Affairs for the New York State Banking Department, has asked for our assistance with a comprehensive study of mortgage closing funding problems that are occurring with greater and greater frequency: in simple terminology, we all plan for a closing on Wednesday, papers are dated and executed Wednesday, but no money materializes to fund the transaction and any consequential transactions until Thursday, Friday or possibly even the following Monday. Co-Chairs of our Title and Transfer Committee, Sam Tilton and Joe DeSalvo, will act as point persons for the Section to collect information and coordinate matters with the State Banking Department.

Another area of significant activity is the effort underway in the State Legislature to enact a Title Agent Licensing Bill. One version strongly supported by the NYS Land Title Association has buried in its middle, Section 2161 dealing with "Controlled Business Activity." When you examine the verbiage you will find that the purpose of the Section is to preclude banks, developers, and most law firms from writing title insurance for their clients. As regards lawyers, this legislation has been cloaked by the New York State Land Title Association as serving the public good because they feel that lawyers are prohibited by ethical rules from so writing title insurance. Not only did NYSLTA avoid seeking our input on this issue, moreover, certain of their key members repeatedly denied that the verbiage meant just that until, when pressed in a meeting, they stated that the choice had been purposeful because they knew that it was illegal and unethical for us to be involved with writing title insurance. That was news to lawyers, and the whole approach may go beyond the anti-trust protection afforded by the Noerr-Pennington Doctrine.

The Co-Chairs of our Title Insurance Committee, Tom Hall and Gerry Antetomaso, as well as former TI Co-Chair, now Co-Chair of CLE, Larry Wolk, and the Co-Chair of Unlawful Practice of Law, George Haggerty, and Bill Johnson, Co-Chair of Publications, have been especially active in attempting to correct this misimpression. All the Section's officers were especially impressed by the written testimony which Tom Hall put together as part of his testifying at hearings held by the New York State Insurance Commissioner on November 3 in New York City. Lawyers have a long-standing and legitimate role in the issuance of title insurance.

George Haggerty and his Co-Chair of Unlawful Practice of Law, Nancy Langer, are commended for prodding the State Bar Association officers and UPL Committee to carry through on the plan to hold statewide hearings on the unauthorized practice of law, particularly with respect to the increasing efforts of non-lawyers to handle real estate closings.

Also special recognition is due the members of the Attorney Escrow Task Force for a careful and sensitive study of alternative approaches in response to the charge given to our Section by then-NYSBA President

Vince Buzard. Task Force Chair Ira Goldenberg and the other members worked very hard on fashioning their Report and, equally important, touching base with IOLA and various legal services funded by IOLA.

Further, at the State Bar's Eminent Domain ("Kelo") Summit held at the Bar Center in late October, our Co-Chair of the Condemnation, Certiorari and Real Estate Taxation Committee, Jon Santemma, continued to show that he is one of the preeminent lawyers in this field in New York.

Finally, as regards new specific programs I am embarked on an effort to have more active participation and representation of Legal Aid Societies and other public interest organizations which, by sheer volume, see more consumer real estate activity than most private law firms. Accordingly, I have established a Public Interest Committee and am actively working with members such as Peter Coffey (2nd Vice-Chair), Anne Copps (Co-Chair of Professionalism), Kathleen Lynch (Co-Chair of Legislation) and Lillian Moy, Executive Director of the Legal Aid Society of Northeastern New York and others to locate appropriate Co-Chairs who will better connect us with the public interest community.

Harry G. Meyer

Editors' Note

At page 93 of the Fall 2006 issue of the *Journal* (Vol. 34, No. 2) we included an article entitled "RPLS Task Force on Attorney Escrows Current Practice, Alternatives and Improvements." For the benefit of our readers, we should note that the Task Force which prepared the report was established in November 2005 following a request made of our Section by then Association President A. Vincent Buzard that we study what practical methods are available to prevent the theft of real property escrow funds by lawyers.

The Task Force's report was originally scheduled to be presented to the Association's Executive Committee and House of Delegates at their November 2006 meetings. In advance of those meetings, as is the custom with other significant reports scheduled for consideration, the Task Force's report was circulated to other potentially interested groups, particularly other sections and committees, for review and comment.

Several groups responded, including, from within the Association, the Commercial and Federal Litigation Section, Committee on Legal Aid, President's Committee on Access to Justice, and the Committee on Attorney Professionalism. Comments were also received from the Interest on Lawyer Account Fund and the New York State Project Directors' Association. Their comments raised concerns with respect to the proposed bank escrow deposit agreement contained in the Task Force report and its potential impact on IOLA funding.

Based on the concerns that were raised, Association President Mark H. Alcott withdrew the Task Force report from the November agenda of the Executive Committee and House of Delegates and requested that our Section reconsider the report in light of the comments and to develop a revised plan to address the misuse of escrow funds. To assist this process, he designated past President Buzard, who remains a member of the Association's Executive Committee, to act as liaison from that Committee to our Section.

We felt it would be helpful for our readers to be aware of the current status of matters, and we will keep you advised concerning future developments.

The Purchaser Hasn't a Ghost of a Chance: Update on PCDA Cases and PCDA Revision

By Karl B. Holtzschue

> "While I agree with the Supreme Court that . . . in his pursuit of a **legal** remedy for fraudulent misrepresentation against the seller, ***plaintiff hasn't a ghost of a chance***, I am nevertheless moved by the ***spirit*** of **equity** to allow the buyer to seek rescission of the contract of sale and recovery of his downpayment. New York law fails to recognize any remedy for damages incurred as a result of the seller's mere silence, applying instead the strict rule of caveat emptor. Therefore, the theoretical basis for granting relief, even under the extraordinary facts of this case, is elusive if not ***ephemeral***. [emphasis supplied]"[1]

1. The Case Law of Caveat Emptor

a. Overview of Caveat Emptor Cases: up to June 1999

My first analysis of the strict caveat emptor rule stated in *Stambovsky* (quoted above) was set forth in my 1997 article for the *N.Y. Real Property Law Journal*.[2] In a subsequent survey in 1999 for *Warren's Weed Law of New York Real Property*, I evaluated over 130 significant appellate and trial court caveat emptor cases.[3] The statistics were very bad for the purchasers: they won 47 cases, but the sellers won 83.

b. Overview of Caveat Emptor Cases: June 1999 to June 2006

In a recent update, the results for the purchasers were even more disastrous: the purchasers won 2 (+ *Gizzi v. Hall*) and the sellers won 22.[4] A purchaser in the Third Department won where the seller failed to disclose an underground sewer problem.[5] The other win for the purchaser was an anomaly because the *seller* was held to be in a superior position to protect *itself* to determine the truth as to the lack of a water meter and illegality of the structure.[6] *Gizzi*[7] could be considered a win for the purchasers because dismissal of their fraud and fraudulent concealment actions by the trial court was reversed and an offset was allowed for damages to the purchaser against the amount due on the mortgage. The overview of these cases is that, in recent years, the purchaser could win an appellate caveat emptor claim only in the Third Department and only if there was an undisclosed sewer problem!

c. Cases Where the Seller Was Silent

The vast majority of cases are clear that the seller normally has the right to remain silent (except for a fiduciary relationship, active concealment, an affirmative misrepresentation or partial disclosure).[8] A recent outrageous example is *Venezia v. Coldwell Banker Sammis Realty*,[9] which held that the seller had no duty to speak about contamination of groundwater, *even where the seller was the plaintiff in a class action against the polluter!* In *Stambovsky*,[10] where the seller said nothing to the purchaser, both the majority and dissent held that the seller had no duty at law to volunteer to the purchaser that she had written articles asserting that the house was haunted. But a bare majority still decided to grant the buyer rescission on equitable grounds. The majority opinion also noted the practical problem in looking for a ghost: "Who you gonna call as the title song to the movie 'Ghostbusters' asks?'"[11]

A couple of cases allowed an exception where the seller had "superior knowledge," that was not available to the purchaser through a reasonable inspection.[12] In *Richardson v. United Funding, Inc.*,[13] the Appellate Division Second Department said that the purchaser's failure to have the house inspected established, as a matter of law, that the purchaser did not exercise reasonable diligence and precluded the purchaser from bringing a fraud claim against the seller. The court went on to state as *dictum*, however, that: "The doctrine of caveat emptor does not apply to conditions which the plaintiff could not have discovered with due inquiry and/or inspection," adding that in that case the defects were observable. A similar formulation of a rule protecting a purchaser was articulated in *Schumaker v. Mather*,[14] but *Schumaker* is always cited for its further statement that if the facts are not peculiarly within the seller's knowledge, the purchaser must use means available of knowing the truth about any representation the seller makes. The *Schumaker/Richardson* rule, which plugs a gap in the protection for a purchaser, is unfortunately generally ignored by the courts. Curiously, though *Stambovsky* and *Schumaker* are almost always cited as defenses for the seller, in both cases the purchaser won. Finally, in a few rare cases, the seller has been held liable for failure to disclose hidden environmental conditions.[15]

d. Cases Where the Seller Misrepresented the Facts

More troubling than the silence cases, even when the seller has spoken and *misrepresented* the facts, the purchasers frequently lose for failure to use means available to check out the condition, usually citing *Schumaker* or one of its progeny. For example, in *Jablonski v. Rapalje*,[16] the court held that there was *no duty on the seller or the seller's agent to disclose* bat infestation; there were issues of fact as to active concealment, fraudulent misrepresentation and thwarting of purchaser's ability to discover; and the building inspector had no duty to inspect for bat infestation. The dissenters said there was no issue of fact as to active concealment, no justifiable reliance on the misrepresentation, and the purchaser had ample opportunity to inspect. The sellers and their agent were denied a motion for summary judgment by a vote of 3-2. By far the most frequent reason that purchasers lost in recent cases was that the courts held that the purchaser could not justifiably rely on the representation because the purchaser failed to use means available. Personally, I think of this as the "*Blame the Victim*" defense!

The other defense of the seller is that the purchaser could not rely on the representations due to the *"as is" and general merger clauses* in the contract. *Danann Realty Corp. v. Harris*[17] is by far the most cited authority in caveat emptor cases, either for merger or failure to use means available. In several cases, the question of whether the purchaser had the means available of knowing the truth was held to be a question of fact for the jury. *See e.g., Jablonski*.[18] The Court of Appeals has made clear, however, that neither the "as is" nor the merger clause will protect the seller from a claim of fraud.[19]

2. The Property Condition Disclosure Act Cases

a. The PCDA Changed the Ground Rules

Enactment of the Property Condition Disclosure Act (PCDA), effective March 1, 2002, changed the ground rules significantly.[20] The most important thing that the PCDA did was to require the seller to speak—to answer 48 questions in the Property Conditions Disclosure Statement (PCDS)—or to give the purchaser a $500 credit against the purchase price at the closing. The PCDA provided three protections to the seller: (1) the answers to the questions were to be based on the seller's *actual* knowledge—constructive knowledge was rejected as the standard at the last moment in the legislative process;[21] (2) a violation of the obligation to deliver a true and complete PCDS had to be *willful*; and (3) the remedy was *actual* damages (presumably excluding punitive damages).

I have discussed in a prior article the reasons why I believe the seller has the right to "buy out" of the PCDA by giving the $500 credit at the closing.[22]

b. Reaction of the Bar

The Real Property Law Section undertook two surveys of the reaction to the PCDA: (1) a survey by mail to 80 bar associations in January of 2004; and (2) a survey by e-mail to 3,500 members of the Real Property Law Section (RPLS) on June 17, 2004, both requesting reactions to the PCDA.[23]

The reactions of the bar associations were decidedly mixed: some urging repeal of the statute; some upstate finding that the law was working satisfactorily; and many indicating that changes needed to be made in the text of the law.

Individual RPLS members responded that: (1) downstate, the PCDS is rarely given, but upstate it is generally provided; (2) potential liability was the reason most often given for failure to give a PCDS; (3) among problems reported were confusion over the effect of the $500 credit on the price, confusion over some of the questions, inconsistent assistance from brokers and increased attorney workload; (4) respondents overwhelmingly opposed increasing the $500 credit; (5) respondents overwhelmingly opposed adding or deleting questions; and (6) surprisingly, very few suggested amendments to the questions.

The Report cited above summarizes the responses received and concludes with a recommendation to the Executive Committee of the Real Property Law Section that the Section's Task Force on Disclosure meet with the New York State Association of Realtors (NYSAR) to review and discuss NYSAR's review of the PCDS and proposed changes. The results of those discussions are discussed below.

c. Reactions of the Courts

To date, there have been two appellate level cases on the PCDA and eleven lower court decisions reported.[24] The purchasers are doing poorly in these cases, too: they have won 3 and lost 10.

d. The First Reported Decision: *Malach*

Unfortunately, the first reported case was *Malach v. Chuang*,[25] where the sellers, who answered "unknown" on *PCDS* Question 20 as to "rot in structures," were held not liable under the PCDA or for common law fraud where *seller did not have actual knowledge* of rot in their swimming pool (the seller answered "unknown" 30 times). I say "unfortunately" because I feel that the faulty analysis of the PCDA in that case has led to a great deal of confusion.[26] While Richmond County Civil Court Judge Straniere made the right decision that the sellers were not shown to have known of the defect in the swimming pool, the Civil Court opinion was unnecessarily lengthy (14 pages) and included a great number of erroneous interpretations of the statute as *dicta*.

The opinion attempted a lengthy analysis of the entire PCDA, most of it faulty. The judge concluded that the *PCDA did not provide a cause of action* to the plaintiff under the terms of the Act (except for failure to deliver the $500 credit where no PCDS was delivered), primarily because "it is not clear that a reasonable person can understand what it [§ 465(2)] means;" unlike consumer protection legislation, no specific right of action was stated.

The judge also wrongly concluded that any rights under the PCDA were merged into the contract and did not survive the delivery of the deed at the closing. Having cited no cases in his opinion, the judge was apparently unaware of cases holding that a cause of action for fraudulent misrepresentation survives both the contract and the deed.[27] The judge in *Malach* correctly concluded that there was no cause of action for breach of contract because the seller did not have actual knowledge of the defect (without stating how that related to a breach of contract action). Most of the other numerous errors of analysis in the opinion are discussed in the article cited above.

e. Court Reactions to *Malach* (chronological order)

The *Malach* opinion has been cited in six reported cases, according to Lexis: *Gabberty*, *Bishop*, *Delano*, *Renkas*, *Fleischer*, and *Calvente* (all cited and discussed below).

In an additional unreported case, *Koric v. Gallo*,[28] Judge Straniere cites his *Malach* opinion as a ruling that the PCDS does not create its own private right of action for failure to truthfully complete the form (*dictum* and not relevant in *Koric*, where the seller was not sued).

In *Gabberty v. Madarasz*,[29] Nassau County Supreme Court Judge Roberto states "the Court *does not agree* with the defendant, citing a decision of the Civil Court of the City of New York (Straniere, J.)[30], that no cause of action exists under the statute at all."[31] Judge Roberto states that RPL § 465 "clearly provides for claims should a seller not comply with the statute."

In *Bishop v. Graziano*,[32] Suffolk County District Court Judge Hackeling agreed with *Malach* that the remedy portion of the PCDA had no effect upon sellers who elect to "opt-out" other than to impose a $500 credit, though opt-out sellers are still subject to the common law or existing statutory theories. He did *not*, however, adopt *Malach's* reasoning that the tendering of a proper PCDS vitiates common law and statutory remedies.

In *Delano v. Umbreit*,[33] Suffolk County District Court Judge Hackeling merely cites *Malach* for the proposition that § 467 expressly preserves plaintiffs' common law rights and remedies, ruling in favor of the purchasers.

In *Renkas v. Sweers*,[34] Monroe County Supreme Court Judge Stander cites *Malach* for the proposition that there does not appear to be any right and remedy under the PCDA for a breach of contract cause of action. He states that the appropriate cause of action for a misrepresentation in a PCDS was a *common law action for fraudulent misrepresentation*, holding that there was *no justifiable reliance shown* where the purchasers failed to pursue their investigation of the basement.

In *Fleischer v. Morreale*,[35] Suffolk County Supreme Court Judge Hackeling (formerly District Court) states that he is *not persuaded* by *Malach*'s argument that the PCDA does not expressly give the injured purchasers "standing" to sue, ruling for the purchasers. He further states that the statement in the PCDS that the sellers "may" be liable does not vitiate a claim. He also *rejects Malach*'s assertion that the remedy section is unclear and equivocal.

In *Calvente v. Levy*,[36] the Supreme Court Appellate Term, Second Department, affirming an Orange County Justice Court decision, held that upon the seller's willful failure to disclose in the PCDS a prior basement flooding problem, the purchaser was entitled to recover actual damages, citing *Malach* as "*contra*."

In summary, the analysis in *Malach* was rejected in the three cases where the purchaser recovered damages (*Delano*, *Fleischer* and *Calvente*, discussed in more detail below), as well as most of the other cases. The *Renkas* judge agreed with Malach, however, that the PCDA did not create a statutory cause of action. The *Malach* notion that statements in the PCDS are merged in the contract and the deed was rejected, expressly or impliedly, in the cases where the purchaser recovered. As the Court of Appeals has said in *Bridger v. Goldsmith*,[37] the doctrine of merger cannot prevent a fraud claim.

f. The Other Reported PCDA Decisions after *Malach* (chronological order)

In *Korik v. Gallo*,[38] the sellers built a patio without a permit; *delivered a PCDS* [which does not ask about that; Question 9 asks only if there is a certificate of occupancy]. Richmond County Civil Court Judge Straniere held that the purchasers did not show that their attorney or his abstract company could have discovered the violation, so they lost. The purchasers did not sue the seller.

In *Goldman v. Fay*,[39] Richmond County Civil Court Judge Straniere held that the *seller was not proven to have known* that an air conditioning pipe in the condominium was cut, so the purchaser correctly lost. To Judge Straniere's astonishment, *no PCDS* was delivered because none was required for a condominium. The judge held that the PCDA's exclusion of cooperatives and condominiums was an unconstitutional violation of the equal protection clause, noting ruefully that he as a Civil Court Judge did not have jurisdiction to stay enforcement and appealing to the legislature for a remedy. Though I have not researched the equal protection argument, it seems very implausible in this context.

In *Conanan v. Oliveri*,[40] Richmond County Supreme Court Judge Gigante held that a *purchaser who did not read the PCDS* before signing the contract, but did at the closing, *could not show reliance* necessary to support a fraud claim about termite infestation and damage based on a denial in the *PCDS*, so the purchaser lost. The result seems correct, but the very unusual circumstance that the purchaser received but did not read a PCDS seems unlikely to be repeated.

In *Gabberty v. Pisarz*,[41] Nassau County Supreme Court Judge Roberto held that the sellers' *failure to answer PCDS questions* as to flooding or drainage problems and basement seepage *entitled the purchaser to the $500 credit*, but *put the purchaser on notice of missing information, precluding a claim under the PCDA* for chronic basement flooding or under common law fraud where there was no proof of active concealment. The purchaser claimed that the seller failed to disclose in the PCDS and intentionally hid a chronic basement flooding and/or water seepage condition, which the purchaser discovered after she purchased the home. The inspectors were sued for professional negligence in failing to report the water condition. The purchaser lost the use of the home until an environmental firm removed mold and other contaminants. The seller failed to answer PCDS Questions 30 and 31 as to flooding and basement seepage.

As to the statutory claim, Judge Roberto said that the question was whether the PCDA provided a remedy in this case. There was no discussion in the Senate Memorandum regarding the nature of any new cause of action created by the statute. The judge said that he must strictly construe any new rights given to the buyer. Accordingly, any analysis of the remedies available to the buyer must take into account the traditional responsibilities of the buyer, as well as the seller, as both remain. In this case, the seller delivered a PCDS that was not complete, and the purchaser was not given a $500 credit at the closing. *The judge said that he did not agree with the purchaser, citing* Malach, *that no cause of action exists under the statute at all*. The buyer did not ask for a $500 credit, but the court found that *the buyer was entitled to the credit because the seller left questions unanswered*, citing RPL § 462(2) as to an incomplete statement. Whether the failure to answer was willful could not be known on the record. However, assuming willfulness, the court could not permit a § 462(2) claim to proceed because that would necessitate forgiving the buyer for her own failures and ease her burden under existing law. The buyer was on notice that important information was missing, and therefore could not claim she relied on the PCDS.

Judge Roberto said that "willful failure to perform the requirements of this article" means: (1) a deliberate misstatement or misstatements in a fully and timely delivered PCDS regarding the defective condition complained of (2) that would tend to assure a reasonably prudent buyer that no such condition existed and (3) which a professional inspector might not discover upon an inspection of the premises that would meet generally accepted standards in the trade. Making it any easier on the buyer would cut a swath through the doctrine of caveat emptor that cannot be reconciled with the statements of legislative intent noted in the opinion. The buyer cannot make out a claim under § 465(2) because she accepted the PCDS with omissions regarding the intrusion of water, which should have led her to inquire further. The lack of a provision in the PCDA for incorporation of the PCDA or PCDS into the contract of sale, by reference or otherwise, was a further indication of the Legislature's intention not to alter in their entirety rights and responsibilities that exist under the common law. Accordingly, any claim under § 465(2) was dismissed, but the buyer was granted judgment for the $500 credit.

The holding that failure to answer all the PCDS questions merits a $500 credit seems correct, but not very helpful monetarily. Whether the PCDA created a statutory cause of action is discussed below. Holding that the buyer was on notice that important information was missing and therefore could not claim that she relied on the PCDS seems correct, continuing to place a heavy burden on the buyer. Addition of the requirement as to a professional inspector seems not to have a basis in the statute.

As to the common law claim, there was no proof that sheet rocking, painting and carpeting the basement a year before the closing and lining the wall with storage were done for the purpose of actively concealing the water and mold condition. As there was no claim of a misrepresentation outside of the PCDS, the common law claim was limited to fraudulent concealment, which was not proven.

The judge said that although the result may seem harsh, the court could not change the common law in this state that still places a substantial burden on the buyer to learn everything about the property that reasonably can be learned before the purchase is made.

In *Bishop v. Graziano*,[42] Suffolk County District Court Judge Hackeling held that the seller's election to *opt out* by giving a $500 credit *did not vitiate the purchaser's common law fraud claim for damage to the floors*, but there was no fraud claim where no representations were made. The buyer sued for fraud as to patent damage to the floors. The sellers elected not to deliver a PCDS and paid the $500 credit. The buyer had the property inspected. The court said the issue presented was: can a common law fraud claim survive tender of a "merged" deed if the seller elects not to deliver a PCDS? The PCDA attempted, somewhat unsuccessfully, to effect a sea change in a well settled area of New York's real property law: previously New York was unequivocally characterized as a "caveat emptor" state. Curiously, the legislature created an "opt out" mechanism. Surprisingly, there exist only a handful of reported cases where the seller delivered a PCDS and none where the seller elected to give the credit.

Judge Hackeling adopted *Malach*'s *dictum* that opt-out sellers are still subject to common law or existing statutory theories. However, the court did *not* adopt *Malach*'s reasoning that tendering a proper PCDS vitiates common law and statutory remedies. *The only viable cause of action under a contract with a merger clause sounds in fraud in the inducement*, citing *Cohan v. Sicular*.[43] Noting that mere silence of the seller is not actionable fraud, the court dismissed the complaint. In footnote 2 the court stated that, though a remote possibility, it is conceivable that a seller could make a subsequent oral misrepresentation in conjunction with an opt-out which would cause the buyer to rely on it and would be actionable.

The judge correctly held that the PCDA did not eliminate a common law fraud claim. But since there was no misrepresentation, there was no fraud.

In *Delano v. Umbreit*,[44] Suffolk County District Court Judge Hackeling held that though the seller opted out of delivering a PCDS, active concealment by use of dummy heating vents was actionable fraud. After the closing, the purchasers discovered that two rooms in the house had no heat source and that the heating vents were only cosmetic and not connected to the furnace. They sued to recover the cost of hooking up the furnace, asserting a fraud cause of action. The sellers elected not to deliver a PCDS. During a post-contract inspection, one of the sellers represented to the purchasers' home inspector that the heating system was in working order.

The judge said that, notwithstanding the PCDA, the purchaser may still assert common law "fraud in the procurement," citing *Cohan v. Sicular*.[45] As a general matter, a seller who pays the $500 credit cannot be found liable in fraud, as misrepresentation and reliance can not be established, citing *Bishop* above (opinion by this same judge). However, § 467 expressly preserves the purchasers' common law right to establish fraud, citing *Malach*. A post contract/preclosing misrepresentation which induces reliance by facilitating the closing is not covered by the opt-out and is still actionable. Casual misrepresentations to the purchasers' home inspector may not be sufficient to rebut the PCDA presumption of no reliance. However, active concealment of a latent defect is per se inferred fraud where the seller constructed a dummy ventilation system. The sellers installed the dummy system, lied about it post contract and later admitted knowing about the subterfuge, which established the purchasers' fraud claim despite the provisions of the PCDA. The purchasers were awarded $2,200 for the paid cost to install duct work to the furnace.

The purchasers' claim against the inspector was not established; they fully understood that it was only a "patent defect" inspection. The escrow agent was not liable for having released the escrow funds in reliance upon the purchaser's attorney's written demand requesting payment of a judgment of a court.

Note that the judge found that a "post contract/preclosing misrepresentation that induced the purchasers to close could be actionable, but that such a misrepresentation only to the purchasers' inspector may not be sufficient. Active concealment was certainly actionable.

In *Renkas v. Sweers*,[46] Monroe County Supreme Court Judge Stander held that where the PCDS was incorporated in the contract, the purchasers lost their suit for fraudulent misrepresentation as to water in the basement by *failing to show justifiable reliance* on oral or PCDA representations. The *PCDA did not create a cause of action beyond the common law*; nor did the PDCA create a cause of action for breach of contract or negligence. The buyers sued for: (a) breach of contract; (b) negligence; (c) fraudulent misrepresentation; and (d) punitive damages. The buyers alleged that the seller knew of significant water problems in the basement and misled the buyers. After the closing, the buyers found puddling that made the basement unusable. The contract provided that the addenda as to seller disclosure (PCDS) would be incorporated into the contract. On a summary judgment motion, Judge Stander said that he must view the evidence in a light most favorable to the buyers: the seller made oral misrepresentations and misrepresentations in the PCDS as to water in the basement.

As to the *action for fraudulent misrepresentation*, the buyers alleged that the sellers had knowledge of the defective condition in the basement and misled the buyers both orally and in the PCDS. To prove fraudulent misrepresentation, the judge said, the buyers must establish: (1) misrepresentation which was false and known to be false; (2) misrepresentation made to induce the buyers to rely on it; (3) justifiable reliance of the buyers; and (4) injury. The essential element is *justifiable reliance*. Under caveat emptor, the seller has no duty to disclose (*citing Caeci v. DiCanio Construction Corp.*[47] and *Gizzi v. Hall*).[48] The fact that the seller offered oral information does not in and of itself create a fraudulent misrepresentation cause of action. Summary judgment was warranted for the seller based on the contractual language, the statutory provisions and the lack of any justifiable reliance on any alleged misrepresentations; the seller met his burden. Notwithstanding the seller's showing, the motion must be denied if the buyers show facts requiring a trial of any issue of fact. To recover for active concealment, the buyers must show that the seller thwarted the buyers' efforts. Courts have said the buyer must use means available (citing *McManus v. Moise*;[49] *Mosca v. Kiner*;[50] *Gizzi v. Hall*;[51] *Bennett v. Citicorp Mtge Inc.*;[52] *Jablonski v. Rapalje*[53]). The burden is on the buyers to show an issue of fact whether the buyers justifiably relied on the seller's misrepresentations. The conduct of the seller did not thwart the ability of the buyer to inspect. The engineer's report was inconclusive because stored items blocked the walls. The buyers did not pursue any further investigation. The buyers exercised their right to inspect and had the opportunity to inspect and to move stored items blocking the walls.

The seller asserted that the representations in the contract merged in the deed. The buyers agreed to buy "AS IS," subject to inspections. The seller's answers, oral and in the PCDS, did not thwart the buyers. The PCDS says it is not intended to prevent an "AS IS" contract. Even accepting that the PCDS is part of the contract, the PCDS advised the buyers that disclosures are not a warranty and not a substitute for inspection. This supports common law caveat emptor. *The PCDS does not create a duty to disclose that supersedes the common law nor does the PCDA create a cause of action beyond the common law*. The buyers failed to show justifiable reliance on oral or PCDS representations. The condition was not peculiarly within the seller's knowledge and the buyers had means available. There was no question of fact on justifiable reliance of the buyers because they inspected, knew of water marks, had an inconclusive inspection, failed to investigate further and closed "AS IS."

As to the *action for breach of contract*, the buyers asserted that the PCDS was specifically incorporated as part of the contract. The judge noted that the entire PCDS was incorporated into the contract, not just the representations. Incorporation of the PCDS is consistent with and does not override the contract terms to purchase "AS IS." Footnote 8 says: *There does not appear to be any right and remedy under the terms of the PCDA for a breach of contract cause of action (citing Malach)*. "AS IS" is a specific contract disclaimer and thwarts a breach of contract claim (citing *Mosca*; *McManus*). The contract had a merger clause that the complete agreement was in the contract and that no verbal agreements or promises were binding. The buyers could not rely on oral statements for their breach of contract claim. The buyers failed to show a question of fact.

As to the *action for negligence*, the evidence showed no duty to the buyers to disclose the condition. Under caveat emptor, the judge said, there is no duty to disclose (citing *Caceci*; *Gizzi*). No duty was created by the oral representation because the contract has an integration clause. The buyers had to argue that there was a duty under the PCDA for the seller to accurately answer the PCDS and that there was a breach of that duty by providing incorrect answers. To determine if a cause of action not recognized in the common law was created by the legislature, the judge looked to the legislative history. Legislative findings made clear to him that the PCDA does not diminish the responsibility of the buyers and should not be construed as limiting any existing legal cause of action or remedy at law. Together these statements demonstrated that the statutory provisions in the PCDA were not intended to change the common law. *Further, the statute also does not create a cause of action.* Legislative findings and statutory language indicate that the Legislature intended for caveat emptor to remain the standard. Legislative findings, statutory language and existing common law and equitable remedies led the judge to conclude that the *PCDA was not intended to establish a new cause of action*. There was no independent private cause of action by the buyers against the seller nor a basis for a negligence cause of action based upon the PCDA. The buyers failed to show an issue of fact.

Summary judgment dismissing the complaint was granted. Claims for punitive damages, damages relative to health-related injuries, and attorney fees and disbursements were denied.

The fraudulent misrepresentation analysis seems correct. Whether the PCDA creates a cause of action is discussed below. The analysis of the breach of contract and negligence claims seems correct.

In *Fleischer v. Morreale*,[54] Suffolk County Supreme Court Judge Hackeling (formerly District Court) held that where a PCDS disclaimed defects, the *buyers recovered costs* to repair the roof and basement flooding, but not for a security system purchasers knew was inoperable. The buyers sued to recover $15,000 for repair costs for the roof, basement and alarm system. The sellers delivered a PCDS showing no material defects in the roof or security system and no flooding problems. After the closing a severe storm resulted in multiple substantial roof leaks resulting in one to four inches of flooding in the basement; the alarm system was not operational. The buyers paid $6,500 to repair the roof, $4,500 to install a basement flooding drainage system and $1,402 to make the security system operable. The court found that the sellers knew or should have known [*sic*; the PCDA standard is *actual* knowledge] about the roof problem and that the buyers knew that the alarm was not operable. The court rejected the buyers' claim that a possession agreement gave them a 72-hour "protest period" after delivery of possession.

As to the PCDA, Judge Hackeling said: "At first blush, the intent of the State Legislature to create a *statutory cause of action* appears obvious" [emphasis added]. He then noted that two of the three reported cases have held to the contrary, citing *Malach* and *Renkas*. Rejecting the *Malach* "standing" argument, the court said that it would be hard pressed to accept the proposition that no New York statute can be enforced in the courts unless it expressly mentions the party who has standing to assert it. Similarly, the court rejected *Malach*'s assertion that the use of "may be liable" in the PCDS somehow was inconsistent with the requirement that the seller shall deliver a PCDS. In support of this, the court made extensive reference to "the detailed and voluminous judicial construction instructions contained in New York Statutes."

The court rejected *Malach*'s statement that the PCDA was unclear and equivocal, noting the "working definition" of "willful failure to perform the requirements of the Article" in *Gabberty*:[55] (1) deliberate misstatement (2) that would assure a reasonably prudent buyer that no condition existed and (3) which a professional inspector might not discover. The court also dissented from the *Renkas* holding that the PCDA did not provide a "remedy" for willful misrepresentations in addition to the common law.

The court found that the seller was aware of the roof leaks and basement flooding and made contrary written misrepresentations resulting in damages to the buyer of $6,500 to repair the roof and $4,500 to install a basement drainage system under a § 465(2) cause of action. The court rejected the *Gabberty* standard's requirement of a misstatement that a professional inspector might not discover because that would create a new remedy that would be harder to prove than the existing common law remedy. Neither the purchaser nor the inspector tested the non-operating security system. The purchasers were aware that the PCDS was inaccurate on this. The court adopted the substitution of the "reasonably prudent buyer" standard, which it said "appears to relax the common law 'reliance test'," but declined to apply the "professional inspector discovery" test.

The court rejected the sellers' assertion that his oral statements regarding the PCDS items are a defense, as the buyers did not then "rely" on the PCDS. "Any common law 'non justifiable reliance upon oral misrepresentations' defense such as sustain [sic] by the *Renkas* Court was expressly vitiated by § 464 which provides that all PCDS inaccuracies can only be rectified by a formal written disclosure statement amendment." The court was precluded from delving into any common law reliance issues raised by extraneous oral PCDS amendments. Only a formal PCDS amendment could be raised as a § 465(2) defense to the security system misrepresentation. Judgment was awarded to the purchasers for $11,000.

Notably, the judge rejected the view in *Renkas* that the PCDA did not create a statutory cause of action. Rejection of the *Gabberty* standard's addition of the professional inspector seems correct, as does the observation that that would make the existing common law fraud remedy harder to prove. Note also that the judge adopted the *Gabberty* "reasonably prudent buyer" standard. Why that should be adopted and why it relaxes the common law "reliance" test is not explained. The holding awarding damages for defects not known to the purchaser, but not for defects known to the purchaser, seems eminently correct.

In *Short v. Valone*,[56] Rochester City Court Judge Miller held that the purchaser was aware of the condition of the roof and *did not justifiably rely* on the PCDS. The seller delivered a PCDS. A home inspection report indicated that the main roof's age was 12-14 years old and there should be a "budget for a new roof." Broker listings said the roof was 6 years old. The seller argued that even if misrepresentations were made, the purchaser was aware of the condition of the roof through a home inspection and negotiated the condition of the roof by receiving a $1,000 credit toward replacement. The court found that the purchaser *failed to prove an action for fraudulent misrepresentation*, citing *Renkas*. The opinion seems correct.

In *Calvente v. Levy*,[57] the Supreme Court, Appellate Term, Second Department held that the *purchaser was entitled to actual damages* for seller's willful failure to disclose a prior basement flooding problem in PCDS. The court noted that the seller delivered a PCDS, answering "No" to Question 30 about flooding on any portion of the property. It was uncontroverted that the seller had actual knowledge of water leakage in the basement during a severe storm, but the seller did not disclose it because the seller considered it to be an "anomaly." The seller argued that the PCDS did not survive the contract of sale due to the merger aspect of the "as is" clause. The lower Orange County Justice Court gave judgment to the buyer for $1,500 in damages. The Appellate Term unanimously affirmed, stating that the statute clearly provides that the "as is" clause does not vitiate the PCDS, *nor waive the buyer's cause of action specifically provided for under RPL § 462(1)* (citing *Malach* as *contra*). The court said that nothing in the statute suggests that the "as is" provisions should be deemed inconsistent with a PCDS or that the PCDS should be superseded by an "as is" provision. Upon the seller's willful failure to disclose the prior flooding problem, the buyer was entitled to recover actual damages. The opinion seems correct on all counts.

In *Adrien v. Estate of Peter Zurita*,[58] the Appellate Division Second Department held that where a PCDS disclosed tenants, the purchaser *could not justifiably rely* on the seller's attorney's expressions of opinion on the future outcome of a holdover proceeding. The buyer sued the seller and the seller's attorney to recover damages for fraud. The seller disclosed in a PCDS that there were tenants on the property, and the buyer was aware of the tenants based on his inspection. The buyer closed fully aware that a holdover proceeding had been commenced against the tenants that would not be decided until after the closing. Nevertheless the buyer alleged that the seller's attorney's oral representations regarding the future outcome of the holdover proceeding were misrepresentations. The Orange County *Supreme Court* denied a motion by the seller's attorney for summary judgment dismissing the complaint as asserted against him. The *Appellate Division reversed*, dismissing the complaint against the seller's attorney. Pursuant to the doctrine of caveat emptor, the buyer had a duty to inquire about the tenants, so the buyer's *claim of justifiable reliance was unsupportable*. The parties agreed to hold $4,000 in escrow to cover the expense of the holdover proceeding. The seller's attorney's oral representations were mere expressions of opinion of present or future expectations, upon which the buyer could not justifiably rely. The court rejected the buyer's claim that the attorney's misrepresentations rather than his own failure to exercise due diligence caused him damages when the holdover proceeding was determined in favor of the tenants. The Appellate Division opinion seems correct.

In *Conanan v. Oliveri*,[59] Richmond County Supreme Court Judge Gigante held that a second action by the plaintiff purchaser against the same defendant for "active concealment" of termite infestation and damage was barred by *res judicata*.

g. Theories of Liability Under the PCDA

The PCDA opinions have expressed varying theories of liability:

(1) *The PCDA did NOT Create a Statutory Cause of Action*: *Malach* (statute incomprehensible; did not specify remedy); *Korik* (citing *Malach*); *Renkas* (proper claim is common law fraudulent misrepresentation; defense is no justifiable reliance); *Short* (citing *Renkas*). The extensive faulty dicta in the *Malach* Richmond County Civil Court decision simply do not contribute to the discussion, as stated in my article cited above.[60]

The analysis of Monroe County Supreme Court Judge Stander in *Renkas*, on the other hand, is thoughtful and fairly persuasive. He approached the subject from the point of view of a litigator: what causes of action were available to the plaintiff buyer? He asserted that the buyers did *not* have a claim of *breach of contract* based on the representations made by the seller in the PCDS and found that the *PCDA does not create a breach of contract action*. He *rejected* a *negligence* claim because there was no duty of the seller under caveat emptor to disclose the defect. To determine if a cause of action not recognized under the common law was created by the statute, the judge looked at the legislative history, finding that the legislative findings and statutory language led him to the conclusion that the *PCDA was not intended to establish a new cause of action*.

The *Renkas* judge found that a common law *fraudulent misrepresentation* claim was the proper theory for recovery, and the essential element of that claim was *justifiable reliance*. A similar theory was *active concealment*, which the buyers failed to prove. Finding that the buyers were on notice of suspicious conditions and failed to inquire further and that the sellers did not thwart the buyers' ability to use means available to check the condition of the basement, the court rejected the buyers' claims on both theories.

The *Renkas* opinion is a logical way to analyze the causes of action. Finding that a knowingly false misstatement in a PCDS establishes the first element of a common law fraudulent misrepresentation action certainly clarifies the analysis of how to enforce the PCDA. It also leaves in place the common law remedy, including the defense of lack of justifiable reliance, which so many plaintiff buyers have failed to prove. The court did not have to address, however, whether the PCDA's actual knowledge, willful violation and actual damage standards should also be applied as a modification of the common law fraudulent misrepresentation cause of action.

In *Short*, the Rochester City Court Judge held that the purchaser who received a PCDS failed to prove a *fraudulent misrepresentation* cause of action, citing *Renkas* but without expressly addressing the statutory cause of action issue.

(2) *The PCDA DID Create a Statutory Cause of Action*: *Gabberty*; *Fleischer* (purchaser won); *Delano* (implied; purchaser won); *Calvente* (purchaser won).

In *Gabberty,* Nassau County Supreme Court Judge Roberto stated that RPL § 465 "clearly provides for claims should a seller not comply with the statute." A third factor as to the *inspector* was added by the judge on his own. The judge said that "*willful failure to perform the requirement of this article*" means: (1) a deliberate misstatement or misstatements in a fully and timely delivered PCDS regarding the defective condition complained of (2) that would tend to assure a reasonably prudent buyer that no such condition existed, and (3) which a professional inspector might not discover upon an inspection of the premises that would meet generally accepted standards in the trade. Note that the Standards of Practice and Code of Ethics of the American Society of Home Inspectors, Inc. (1993) only requires inspectors to observe readily accessible home systems and components and to list any found to be in need of immediate major repair; it does not require home inspectors to make an intrusive inspection. This is the first time that the actions of a professional inspector have been said to be a necessary part of the cause of action.

In *Fleischer*, Suffolk County Supreme Court Judge Hackeling rejected the Malach court's argument that the PCDA was not intended to establish a *new cause of action*. On the other hand, he rejected the addition of the inspector requirement in *Gabberty*, saying that this would create a new remedy that would be harder to prove than the existing common law remedy. The *Fleischer* judge adopted the substitution of the "reasonably prudent buyer" standard, which it said "appears to relax the common law 'reliance' test" (without saying just how that works). In *Gabberty* the buyer lost because it was on notice of the defect; in *Fleischer* the buyer won on two defects, but lost on one that it had knowledge of.

In *Calvente*, the Appellate Term, Second Department said that sale of the property "as is" did not waive the buyer's *cause of action specifically provided for under Real Property Law § 465(2)*, citing *Malach* as "*contra*." The court held that upon the seller's willful failure to disclose in the PCDS, the purchaser was entitled to recover actual damages.

If the PCDA did create a statutory cause of action, several questions arise:

(a) what are its elements and what are the defenses?

(b) does the common law fraud defense of no justifiable reliance apply in full?

(3) Several Opinions Did Not Discuss a Statutory Cause of Action.

In *Goldman*, Richmond County Civil Court Judge Straniere was shocked to find that the PCDA did not apply to a condominium, so the issue of a cause of action under the PCDA never came up.

In *Bishop,* Suffolk County District Court Judge Hackeling did not expressly state that the PCDA did not create a cause of action, but did state that the *only viable cause of action* under a contract with a merger clause is a common law claim of *fraud in the inducement*. In *Bishop*, no PCDS was delivered. The *Bishop* judge rejected the *Malach* court claim that tender of a proper PCDS vitiates common law remedies. Noting that mere silence of the seller is not actionable fraud, the court dismissed the complaint. As dictum, the court noted that, though a remote possibility, it was conceivable that a seller could make a subsequent oral misrepresentation in conjunction with an opt-out which would cause the buyer to rely on it and would be actionable.

In *Delano,* Suffolk County District Court Judge Hackeling held that the buyers successfully asserted a common law fraud action where the seller did not deliver a PCDS. The opinion did not address whether the PCDA created a statutory cause of action.

In the first *Conanan* case, Richmond County Supreme Court Judge Gigante held that, in a cause of action for fraud, a purchaser who did not read the PCDS before signing the contract could not show reliance on it without addressing the statutory cause of action issue.

In *Adrien*, the Appellate Division Second Department opinion held that in an action to recover damages for fraud, the purchaser did not show justifiable reliance, without addressing the statutory cause of action issue.

All these opinions leave some hard questions in suits under the PCDA:

(a) did the PCDA create a statutory cause of action or not?

(b) how harsh is the burden on the purchaser to use means available under the PCDA?

(c) is "reasonably prudent buyer" under the PCDA a relaxation of the common law standard?

(d) what happens under the PCDA if the purchaser and/or the inspector have no way to check out the condition?

3. Proposed Revisions to the PCDA

a. NYSAR Proposed Revisions

The New York State Association of Realtors (NYSAR) has proposed several revisions of the PCDS and PCDA to make them a bit more user-friendly. After several exchanges of comments and five drafts, the RPLS PCDA Task Force has approved the revisions in NYSAR's latest 04/05/06 draft. Other than improvements in wording, the principal changes are:

1. The $500 credit is set forth in all caps in boldface type on the first page. A new "Note to Buyer" emphasizes that the PCDS is not a warranty or a substitute for inspection.
2. "Unknown" has been deleted as an option. The questions are revised to ask "Do you know. . ." Yes/No/Not Applicable.
3. Any certificate of occupancy is to be listed or attached (Question 4).
4. New question: If improvements have been made, do you know if they required a permit? (Question 5).
5. The "working order" test will now apply to eleven systems (as we requested), rather than the "material defect" (still undefined) test.
6. RPL § 424 will be revised to make clear that the seller need not send a revised PCDS solely because of receipt of an inspection report from the purchaser's inspector.
7. RPL § 465 will be revised to require a $500 credit if the buyer does not receive a "complete" PCDS.

NYSAR asked the Real Property Law Section to support their proposal of the revisions to the original bill's sponsors, who will have the right to their own opinions, of course. The RPLS has approved the proposed changes. NYSAR decided not to formally propose them in the legislative session that ended in June of 2006.

b. Clarification of Statutory Remedy under the PCDA

In light of the questions raised in the PCDA opinions about whether the PCDA established a statutory cause of action, shouldn't the PCDA remedy sections be clarified?

The legislative history of an amendment (and perhaps the text of the remedies sections as well) could recite that the legislature intends to create a statutory cause of action similar to a common law action for fraudulent misrepresentation. The elements of the statutory cause of action would be: (1) a representation by the seller in the PCDS that the seller had *actual* knowledge was false when made; (2) the misrepresentation was made *willfully*, not negligently; (3) any representation made in a PCDS is deemed to be made to induce the buyers to rely on it; (4) the buyer must have justifiably relied on the misrepresentation; and (5) the buyer must have suffered *actual* damages.

Clarification of the existence of a statutory remedy under the PCDA would seem to be a benefit to judges, not to mention practitioners.

Appendices

1. List of Recent Caveat Emptor Cases 06/99 to 06/06
2. List of Recent PCDA Cases

Endnotes

1. Rubin, J., *Stambovsky v. Ackley*, 169 A.D.2d 254, 256, 572 N.Y.S.2d 672, 674 (1st Dept. 1991) (3-2). The opinion is full of puns and well worth reading, even though the invocation of equity to reach the result was questionable. In my view, a better justification would have been that the seller knew of (in a way, created) a defect that the purchaser did not have means to detect.
2. Holtzschue, "*Caveat Emptor* Ain't What It Used to Be: New Developments, Trends and Practice Tips", 25 *N.Y. Real Prop. L.J.* 3 (Winter 1997).
3. Holtzschue, "Caveat Emptor" in *Warren's Weed New York Real Property* (Matthew Bender).
4. See Appendix 1: Recent Caveat Emptor Cases. For the early cases and subsequent cases to date, *see also* 1 *New York Practice Guide: Real Estate* § 2.11[5] or *Holtzschue on Real Estate Contracts* (Practising Law Institute) §2.2.11.
5. *Cetnar v. Kinowski*, 693 N.Y.S.2d 730 (3d Dept. 1999).
6. *Boothe v. Alpha Dev. Corp.*, 14 A.D.3d 702, 789 N.Y.S.2d 269 (2d Dept. 2005) (buyer did not fraudulently induce seller to lower purchase price at closing; seller was in superior position to determine the truth as to lack of water meter and illegal structure).
7. 300 A.D.2d 879, 754 N.Y.S.2d 373 (3d Dept. 2003). The procedural result is confusing, but the case is often cited for its statement of the law of caveat emptor.
8. *Stambovsky v.Ackley*, 169 A.D.2d 254, 572 N.Y.S.2d 672 (1st Dept. 1991).
9. 704 N.Y.S.2d 663 (2d Dept. 2000).
10. *See* note 8 above.
11. *Stambovsky v. Ackley*, 169 A.D.2d 254, 257, 572 N.Y.S.2d 672, 675 (1st Dept. 1991).
12. *Young v. Keith*, 112 A.D.2d 625, 492 N.Y.S.2d 489 (3d Dept. 1985) (failure to disclose serious disrepair of water and sewer systems held to be concealment of material fact with intent to defraud, cited in *Stambovsky* as "*contra*," without further comment) (like *Cetnar*, note 5 *above*, a Third Department sewer case).
13. 16 A.D.3d 570, 792 N.Y.S.2d 511 (2d Dept. 2005).
14. 133 N.Y. 590, 596, 30 N.E. 755 (1892).
15. *Hi Tor Industrial Park, Inc. v. Chemical Bank*, 114 A.D.2d 838, 494 N.Y.S.2d 751 (2d Dept. 1985) (underground storage tanks).
16. 14 A.D.3d 484, 788 N.Y.S.2d 158 (2d Dept. 2005). The facts in this case are hilarious.
17. 5 N.Y.2d 317, 157 N.E.2d 597, 184 N.Y.S.2d 599 (1959).
18. *See* note 16 above.
19. *Bridger v. Goldsmith*, 143 N.Y. 424, 38 N.E. 458 (1894) (a person who commits a fraud cannot contract for immunity).
20. Holtzschue, "Property Condition Disclosure Act Enacted," 30 *N.Y. Real Property Law Journal* 15 (Winter 2002). NYRPLJ articles from and after Vol. 26, No. 1 (Winter 1998) are available to Section members at http://www.nysba.org/RealPropertyJournal.
21. *Id.*
22. Holtzschue, "Property Condition Disclosure Act: Implications of the $500 Credit," 30 *N.Y. Real Prop. L.J.* 100 (Summer 2002). NYRPLJ articles from and after Vol. 26, No. 1 (Winter 1998) are available to Section members at http://www.nysba.org/RealPropertyJournal.
23. Tilton, Sachs and Holtzschue, "Report on Surveys About PCDA," 33 *N.Y. Real Prop. L.J.* 183 (Fall 2005). NYRPLJ articles from and after Vol. 26, No. 1 (Winter 1998) are available to Section members at http://www.nysba.org/RealPropertyJournal.
24. *See* Appendix 2: Recent PCDA Cases.
25. 194 Misc.2d 651, 754 N.Y.S.2d 835 (Civil Court, Richmond County 2002) (N.Y.L.J., Jan. 1, 2003) (Straniere, J.).
26. *See* Holtzschue, "Property Condition Disclosure Act: First Case Has Right Result for Wrong Reasons," 31 *N.Y. Real Prop. L.J.* 5 (Winter/Spring 2003) or 75 N.Y. State Bar J. 31 (March/April 2003). NYRPLJ articles from and after Vol. 26, No. 1 (Winter 1998) are available to Section members at http://www.nysba.org/RealPropertyJournal.
27. *See Bridger v. Goldsmith*, note 19 above.
28. N.Y.L.J., March 3, 2004.
29. 10 Misc. 3d 1010, 810 N.Y.S.2d 799 (Supreme Court, Nassau County 2005).
30. Note 4 in the opinion, citing *Malach*.
31. Note 5 in the opinion, citing Holtzschue article in N. Y. State Bar J. in note 26 above].
32. 10 Misc. 3d 342, 804 N.Y.S.2d 236 (Suffolk County District Court 2005).
33. 10 Misc. 3d 1054A, 809 N.Y.S.2d 481 (District Court, Suffolk County 2005).
34. 10 Misc. 3d 1076A, 814 N.Y.S.2d 892 (Supreme Court, Monroe County 2005).
35. 11 Misc. 3d 1004, 810 N.Y.S.2d 624, (Supreme Court, Suffolk County 2006).
36. 13 Misc. 3d 38, 816 N.Y.S.2d 828 (Supreme Court App. Term 2d Dept. 2006).
37. *See* note 19 above.
38. N.Y.L.J., March 3, 2004 (Civil Court, Richmond County 2004) (Straniere, J.).
39. 8 Misc. 3d 959, 797 N.Y.S.2d 731 (Civil Court, Richmond County 2005) (06/02/05) (Straniere, J.).
40. Index No. 10284/03 (Supreme Court, Richmond County 2005) (Gigante, J.) (09/13/05).
41. 10 Misc. 3d 1010, 810 N.Y.S.2d 799 (Supreme Court, Nassau County 2005) (Roberto, J.) (09/22/05).
42. 10 Misc. 3d 342, 804 N.Y.S.2d 236 (Suffolk County District Court 2005) (Hackeling, J.D.C.) (10/18/05).
43. 214 A.D.2d 637, 625 N.Y.S.2d 278 (2d Dept. 1995).
44. 10 Misc. 3d 1054A, 809 N.Y.S.2d 481 (District Court, Suffolk County 2005) (Hackeling, J.) (10/13/05). Though the date of this opinion predates the opinion by the same judge in *Bishop* (*see* note 42), the *Bishop* opinion appears earlier in the reports and expressly states that there was no prior case where the seller elected to give the credit.
45. 214 A.D.2d 637, 625 N.Y.S.2d 278 (2d Dept. 1995 [not 2004, as stated in the opinion]).
46. 10 Misc. 3d 1076A, 814 N.Y.S.2d 892 (Supreme Court, Monroe County 2005) (Stander, J.) (11/07/05).
47. 72 N.Y.2d 52, 526 N.E.2d 266, 530 N.Y.S.2d 771 (1988).
48. *See* note 7 above.
49. 262 A.D.2d 370, 691 N.Y.S.2d 166 (2d Dept. 1999) (termite infestation).
50. 277 A.D.2d 937, 716 N.Y.S.2d 543 (4th Dept. 2000) (deeded lake rights).
51. *See* note 7 above.
52. 8 A.D.3d 1050, 778 N.Y.S.2d 806 (4th Dept. 2004) (description and boundary).
53. *See* note 16 above.
54. 11 Misc. 3d 1004, 810 N.Y.S.2d 624 (Supreme Court, Suffolk County 2006) (Hackeling, J.) (01/31/06).
55. *See* note 40 above.
56. Index No. 2005-SC-21753 (Rochester City Court 2006) (Miller, J.) (04/18/06).
57. 13 Misc. 3d 38, 816 N.Y.S.2d 828 (Supreme Court App. Term 2d Dept. 2006) (Rudolph, P.J.) (04/27/06).
58. 29 A.D.3d 498, 814 N.Y.S.2d 709 (2d Dept. 2006) (Florio, J.P.) (05/02/06).
59. 12 Misc. 3d 1161A, 2006 N.Y. Misc. LEXIS 1292 (Supreme Court, Richmond County 2005) (Gigante, J.) (05/26/06).
60. *See* note 26 above.

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Appendix 1

Recent Caveat Emptor Cases 06/99 to 06/06: 06/19/06

Bedowitz v. Farrell Dev. Co., Inc., 735 N.Y.S.2d 150 (2d Dept. 2001) (specific disclaimer defeated fraud claim, citing *Busch, Danann* and *Masters*; *defects could have been discovered* by purchasers, citing *Busch*)

Bennett v. Citicorp Mtge. Inc., 8 A.D.3d 1050, 778 N.Y.S.2d 806 (4th Dept. 2004) (reliance by purchasers on listing agent's alleged misrepresentation as to acreage was not reasonable and *purchasers had means available* to know the truth)

Berger-Vespa v. Rondack Building Inspectors Inc., 740 N.Y.S.2d 504 (3d Dept. 2002) (*purchasers had adequate opportunity* to observe wet condition of basement and did not justifiably rely on alleged misrepresentations; no active concealment by sellers; *inspector's limitation* of two years to make a claim held effective)

Boothe v. Alpha Dev. Corp., 14 A.D.3d 702, 789 N.Y.S.2d 269 (2d Dept. 2005) (buyer did not fraudulently induce seller to lower purchase price at closing; *seller was in superior position* to determine the truth as to lack of water meter and illegal structure) [P WON}

****Cetnar v. Kinowski***, 693 N.Y.S.2d 730 (3d Dept. 1999) (fraud not to disclose sewer problem) [PURCHASER WON IN 3D DEPT.!]

CFJ Assocs. of New York Inc. v. Hanson Industries, 711 N.Y.S.2d 232 (3d Dept. 2000) (purchaser did not reasonably rely on vendor's representations regarding environmental remediation costs, citing *Schumaker*; *disclaimer as to remediation costs was specific*, citing *Danann*)

Dero v. Gardner, 700 N.Y.S.2d 507 (3d Dept. 1999) (even if seller represented that campground complied with state health codes, purchaser could not rely thereon, having received notice of noncompliance from Health Department; *purchaser had means available*, citing *Danann* and *Schumaker*)

Duane Thomas LLC v. 62 Thomas Partners, LLC, 751 N.Y.S.2d 441 (1st Dept. 2002) (*purchasers could have discovered* misrepresentations and non-compliance of skylights and fire doors mentioned in notice of violation by making additional relevant inquiries, citing *Dyke*)

Dyke v. Peck, 719 N.Y.S.2d 391 (3d Dept. 2001) (*purchaser did not justifiably rely* on misrepresentations of owner or agent as to slab floor; crawl space not inaccessible; standard "as is" clause not sufficiently specific to bar fraud claim)

Fabozzi v. Coppa, 774 N.Y.S.2d 555 (2d Dept. 2004) (fraudulent inducement claim by purchaser barred because action commenced more than six years after alleged fraud occurred and more than two years after it could have been discovered with reasonable diligence; fraud claims barred by merger clause and *purchaser had means available* to know the truth)

Gizzi v. Hall, 754 N.Y.S.2d 373 (3d Dept. 2003) (*fraud not a defense to mortgage foreclosure action*; mortgage to builder may not be set aside solely because underlying transaction tainted by fraudulent representation as to defects in new home, *questions of fact exist whether reasonable inquiry by purchasers would have revealed the problems* and trial required to ascertain whether any damages to purchasers may be offset against the mortgage; enforcement of judgment of foreclosure and sale *stayed* on condition purchasers deposit sums due in court) [P didn't lose]

****Glazer v. LoPreste***, 717 N.Y.S.2d 256 (2d Dept. 2000) (*seller and brokers had no duty to disclose sex offender*; newspapers published articles)

Helfand v. Sessler, 8 Misc.3d 96, 799 N.Y.S.2d 347 (1st Dept. 2005) (purchaser could not obtain equitable relief for implied indemnification to recover rent overcharges where *purchaser had opportunity to investigate*)

Huron Street Realty Corp. v. Lorenzo, 798 N.Y.S.2d 438 (2d Dept. 2005) (misrepresentation that tenant was using apartment for commercial purposes did not support fraud in the inducement claim where *purchaser had means available* of obtaining truth by visiting the building)

**Jablonski v. Rapalje*, 14 A.D.3d 484, 788 N.Y.S.2d 158 (2d Dept. 2005) (*3-2*) (*no duty on seller or seller's agent to disclose* bat infestation; issues of fact as to active concealment, fraudulent misrepresentation and thwarting of purchaser's ability to discover; building inspector had no duty to inspect for bat infestation. *Dissent*: no issue of fact as to active concealment; no justifiable reliance on misrepresentation; *purchaser had ample opportunity to inspect*)

Kay v. Pollak, 761 N.Y.S.2d 664 (2d Dept. 2003) (i.e., taxes *could have been discovered* by purchaser; specific disclaimer barred other fraud claims, re HVAC and collapsed dry wells)

McManus v. Moise, 691 N.Y.S.2d 166 (2d Dept. 1999) (after report advised further inspection for termite damage behind sheet rock wall, *purchaser failed to inspect*)

Meyer v. Tyner, 709 N.Y.S.2d 618 (2d Dept. 2000) (sellers not liable to prospective purchasers injured when they fell through insulation in attic where unfinished floor was *readily observable*)

Micciche v. Homes by the Timbers, Inc., 767 N.Y.S.2d 56 (2d Dept. 2003) (purchaser not entitled to rescind because he *could easily have ascertained* truth of misrepresentation as to location of lots identified on map)

Mosca v. Kiner, 716 N.Y.S.2d 543 (4th Dept. 2000) (*purchaser had means to discover* absence of deeded lake rights, a matter of public record; "as is" was specific disclaimer)

Platzman v. Morris, 724 N.Y.S.2d 502 (2d Dept. 2001) (illegal second floor kitchen not peculiarly within knowledge of sellers and *purchaser made no effort to investigate*, citing *Glazer* and *McManus*; no active concealment, citing *London* and *Stambovsky*; "as is" clause, citing *Busch*)

**Richardson v. United Funding, Inc.*, 16 A.D.3d 570, 792 N.Y.S.2d 511 (2d Dept. 2005) (*purchaser's failure to have house inspected* precluded fraud claim against seller)

Roland v. McGraime, 22 A.D.3d 824, 803 N.Y.S.2d 163 (2d Dept. 2005) (fraud action based on oral representations before conveyance *barred by specific disclaimer* provisions)

**Venezia v. Coldwell Banker Sammis Realty*, 704 N.Y.S.2d 663 (2d Dept. 2000) (*seller had no duty to speak* about contamination of groundwater, even where seller was plaintiff in class action against the polluter!)

Witt v. Merrill, 797 N.Y.S.2d 218 (4th Sept. 2005) (homeowner's suit against engineer for failure to discover that soil was unsuitable for construction of residence was *untimely* because cause of action accrued when report issued)

P won: 2 (+ *Gizzi*?)
S won: 22

For a discussion of earlier cases, see Holtzschue, "*Caveat Emptor* Ain't What It Used to Be: New Developments, Trends and Practice Tips," 25 *N.Y. Real Prop. L.J.* 3 (Winter 1997); or Holtzschue, "Caveat Emptor" in *Warrens Weed New York Real Property* (Matthew Bender)

P won: 47
S won: 83

Caveat Emptor Cases by Location and Result: June 1999 - June 2006

	Seller	Purchaser
1st Dept.	2	
2d Dept.	14	1
3d Dept.	4	1 + Gizzi?
4th Dept.	2	_
	22	**2 + Gizzi?**

Appendix 2

Recent PCDA Cases (chronological): 08/16/06

******Malach v. Chuang,*** 194 Misc.2d 651, 754 N.Y.S.2d 835 (Civil Court, Richmond County 2002) (NYLJ 01/10/03) (Straniere, J.) (seller who answered "unknown" on *PCDS* Q 20 as to rot in structures [no PCDS question as to swimming pool] not liable under PCDA or for common law fraud where *seller did not have actual knowledge* of rot in swimming pool; *many faulty dicta as to PCDA*) (S answered UNK 30 times) P lost

Korik v. Gallo, N.Y.L.J., March 3, 2004 (Civil Court, Richmond County 2004) (Straniere, J.) (sellers built patio without a permit; *delivered PCDS [which does not ask about that*; Q 9 asks only if there is a certificate of occupancy]; *purchasers did not show their attorney or his abstract company could have discovered the violation*) [purchasers did not sue seller] P lost

****Goldman v. Fay***, 8 Misc. 3d 959, 797 N.Y.S.2d 731 (Civil Court, Richmond County 2005) (06/02/05) (Straniere, J.) (*seller not proven to have known* that air conditioning pipe in condo was cut; *no PCDS* required for condo; PCDA's exclusion of coops and condos unconstitutional; repairs by unlicensed home improvement contractor not reimbursable) P lost

****Conanan v. Oliveri***, Index No. 10284/03 (Supreme Court, Richmond County 2005) (Gigante, J.) (09/13/05) (*purchaser who did not read PCDS* before signing the contract but did at closing *could not show reliance* necessary to support fraud claim about termite infestation and damage and denial in *PCDS*) P lost

****Gabberty v. Pisarz***, 10 Misc. 3d 1010, 810 N.Y.S.2d 799 (Supreme Court, Nassau County 2005) (Roberto, J.) (09/22/05) (sellers' *failure to answer PCDS questions* as to flooding or drainage problems and basement seepage *entitled purchasers to $500 credit*, but *put purchasers on notice of missing information*, *precluding claim under PCDA* for chronic basement flooding or under common law fraud where there was no proof of active concealment) P lost on fraud claim

****Bishop v. Graziano***, 10 Misc. 3d 342, 804 N.Y.S.2d 236 (Suffolk County District Court 2005) (Hackeling, J.D.C.) (10/18/05) (seller's election to *opt out* by giving $500 credit *did not vitiate purchaser's common law fraud claim for damage to floors*, but no fraud claim where no representations were made) P lost

****Delano v. Umbreit***, 10 Misc. 3d 1054A, 809 N.Y.S.2d 481 (District Court Suffolk County 2005) (Hackeling, J.) (10/13/05) (though seller opted out of delivering PCDS, active concealment by use of dummy heating vents is actionable fraud) P WON

****Renkas v. Sweers,*** 10 Misc. 3d 1076A, 814 N.Y.S.2d 892 (Supreme Court, Monroe County 2005) (Stander, J.) (11/07/05) (*PCDS incorporated in the contract*; purchasers lost suit for fraudulent misrepresentation as to water in basement by *failing to show justifiable reliance* on oral or PCDA reps; *PCDA did not create cause of action beyond common law*; PDCA did not create cause of action for breach of contract or negligence) P lost

****Fleischer v. Morreale,*** 11 Misc. 3d 1004, 810 N.Y.S.2d 624 (Supreme Court, Suffolk County 2006) (Hackeling, J.) (01/31/06) (where PCDS disclaimed defects, *purchasers recovered costs* to repair roof and basement flooding, but not for security system purchasers knew was inoperable) P WON on two defects, lost on one

Short v. Valone, Index No. 2005-SC-21753 (Rochester City Court 2006) (Miller, J.) (04/18/06) (purchaser was aware of condition of roof and *did not justifiably rely* on PCDS) P lost

****Calvente v. Levy,*** 13 Misc. 3d 38, 816 N.Y.S.2d 828 (Supreme Court App. Term 2d Dept. 2006) (Rudolph, P.J.) (04/27/06) (Orange County) (*purchaser entitled to actual damages* for seller's willful failure to disclose prior basement flooding problem in PCDS) P WON

****Adrien v. Estate of Peter Zurita,*** 29 A.D.3d 498, 814 N.Y.S.2d 709 (2d Dept. 2006) (Florio, J.P.) (05/02/06) (Orange County) (where PCDS disclosed tenants, purchaser *could not justifiably rely* on seller's attorney's expressions of opinion on future outcome of holdover proceeding) P lost

Conanan v. Oliveri, 12 Misc. 3d 1161A, 2006 N.Y. Misc. LEXIS 1292 (Supreme Court Richmond County 2005) (Gigante, J.) (05/26/06) (second action by plaintiff against same defendant for "active concealment" of termite infestation and damage barred by res judicata) P lost

P won: 3 (two by Hackeling, J., Suffolk County and one by Rudolph, J., Orange County)
P lost: 10

PCDS Delivery in PCDA Cases

PCDS Delivered**:** *Malach* (Richmond); *Korik* (Richmond); *Conanan* (Richmond); *Gabberty* (Nassau); *Renkas* (Monroe); *Fleischer* (Suffolk); *Short* (Monroe); *Calvente* (Orange); *Adrien* (Orange). 9 cases

PCDS Not Delivered: *Bishop* (Suffolk); *Delano* (Suffolk); *Goldman* (Richmond) (not required for condo). 3 cases

For a discussion of earlier cases, see Holtzschue, "*Caveat Emptor* Ain't What It Used to Be: New Developments, Trends and Practice Tips," 25 *N.Y. Real Prop. L.J.* 3 (Winter 1997).

Reasons Why the Purchasers LOST the PCDA Cases:

(1) *The Seller was not shown to have actual knowledge of the defect: Malach* (swimming pool); *Conanan* (termites; purchaser did not read PCDS before signing contract); *Goldman* (cut in air conditioning pipe). 3 cases

(2) *Purchasers failed to show justifiable reliance*: *Gabberty* (purchasers on notice as to basement seepage by seller's failure to answer PCDS questions); *Renkas* (purchasers did not fully use opportunity to inspect basement); *Fleischer* (purchasers knew security system was inoperable); *Short* (purchaser aware of condition of roof); *Adrien* (purchasers could not justifiably rely on seller's opinion as to future outcome of holdover proceeding). 5 cases

(3) *Seller's opt-out did not vitiate fraud action based on PCDS, but since no representations, there was no fraud: Bishop* (damage to floors).

(4) *Purchasers did not show their attorney should have discovered the violation: Korik* (patio permit violation).

Reasons Why the Purchasers WON PCDA Cases:

(1) *Purchasers showed the sellers had actual knowledge of the defect*: *Delano* (actual concealment using dummy heating vents); *Fleischer* (roof leaks and basement flooding); *Calvente* (sellers willfully failed to disclose prior basement flooding problem). 3 cases

Conditions Complained of in PCDA Cases:

(1) basement flooding: *Gabberty*; *Renkas*; *Fleischer* (P won); *Calvente* (P won). 4 cases

(2) roof condition: *Fleischer* (P won); *Short*. 2 cases

(3) swimming pool defect: *Malach* (no PCDS question)

(4) patio built without permit: *Korik* (no PCDS question)

(5) air conditioning pipe leaks: *Goldman*

(6) termite infestation and damage: *Conanan*

(7) damage to floors: *Bishop*

(8) dummy heating vents: *Delano* (P won)

(9) security system: *Fleischer*

(10) outcome of holdover proceedings: *Adrien*

Recent PCDA Cases: Court/Winner/Judge/Case **08/16/06**

	Seller	**Purchaser**	**Judge**	**Case**
Appellate Courts				
1st Dept.				
2d Dept.	1	1 (App. Term)	Rudolph/Florio	*Calvente/ Adrien*
3d Dept.				
4th Dept.				
Supreme Courts				
Richmond	2		Gigante	*Conanan*; *Conanan*
Nassau	1		Roberto	*Gabberty*
Suffolk		1	Hackeling	*Fleischer*
Monroe	1		Stander	*Renkas*
Civil/District/City Courts				
Richmond	3		Straniere	*Malach*; *Korik*; *Gallo*
Nassau				
Suffolk	1	1	Hackeling	*Bishop*; *Delano*
Monroe	1	_	Miller	*Short*
Totals	**10**	**3**		

Judges in PCDA Cases:

Straniere (Civil Court Richmond): *Malach*, *Korik*, *Goldman*

Gigante (Supreme Court Richmond): *Conanan*; *Conanan*

Roberto (Supreme Court Nassau): *Gabberty*

Hackeling (District and Supreme Court Suffolk): *Bishop*; *Delano*; *Fleischer*

Stander (Supreme Court Monroe): *Renkas*

Miller (City Court Rochester): *Short*

Rudolph (Supreme Court App. Term 2d Dept.): *Calvente*

Florio (2d Dept.): *Adrien*

Restrictions on Sale of Condominium Units

By Vincent Di Lorenzo

Introduction

During the last decade condominium developments have become increasingly popular in the State of New York. One of the advantages to condominium ownership that is often touted is that condominiums are subject to fewer restrictions on sale. Implied in the statement is an assumption that the law would not permit controls as restrictive as exist in many cooperative developments. Curiously, however, there is very little case law supporting this assumption.

In May 2005, the First Department, in *Demchick v. 90 East End Avenue Condominium*,[1] considered the validity of a condominium by-law that restricted the sale of all studio apartments to the owners of the larger units in the condominium. The Appellate Division has addressed the issue of permissible resale restrictions in condominium developments on only two occasions. In 1986 the First Department addressed the issue in the *Anderson* case[2] and then last year it addressed it in the *Demchick* case. The *Anderson* case decided the narrow question of whether a condominium association's right of first refusal, in the form of a right to match a bona fide third party offer within 30 days after notification by the owner, was an unreasonable restraint on alienation or violated the statutory rule against perpetuities for remote vesting. The First Department sustained the preemptive right in question because, inter alia, this form of restriction did not unreasonably restrict the unit owner's right to alienate. The decision did not address what additional restrictions might be imposed. Almost twenty years later the Appellate Division considered that question in the *Demchick* case.

In *Demchick* the condominium contained 43 units, 38 of which were large, expensive multi-bedroom units and 5 of which were small, inexpensive studios. The unit owners, through an amendment of the by-laws, restricted sales of all studio units to existing owners of multi-bedroom units or to outside purchasers of such larger units in the condominium. Such restriction was not in the offering plan or original by-laws of the condominium. It was later adopted by a vote of the majority of unit owners. Plaintiff sought to set aside the restriction claiming it was an unreasonable restraint on alienation. The lower court concluded that the restriction was unreasonable, but the First Department reversed. In a very brief opinion, the appellate court explained that (a) the purpose of the restriction—to preserve the character of the condominium—was reasonable, and (b) the duration of the restriction was not unlimited.[3] In drawing the latter conclusion the court explained that the restriction can be modified or removed at any time by a duly called meeting of unit owners.

This article explores the justification for the court's determination in *Demchick.* The conclusion drawn is that the court did not properly apply the common law doctrine prohibiting unreasonable restraints on alienation. This article also examines the protection that the doctrine prohibiting unreasonable restraints affords owners of condominium units who purchase in the expectation that the doctrine will protect them against the type of restrictions that are common in cooperative apartment developments. The conclusion drawn is that such expectation is unjustified.

Unreasonable Restraints on Alienation—Analysis of the Common Law Doctrine

The New York Court of Appeals has repeatedly stated that the common law rule prohibiting unreasonable restraints on alienation requires a case-by-case analysis that measures reasonableness based on the price, duration and purpose of the restriction.[4] This standard employs a weighing process in which a restriction's adverse impact on alienability is assessed and then weighed against the purpose behind the restriction. Under such a standard one could view the court's conclusion in *Demchick* as a valid conclusion. However, a close analysis of the decision reveals that the court misconstrued the governing law in reaching its conclusion.

Immediate concern regarding the reasonableness of the court's balancing of interests is generated by a reading of the Court of Appeals' decision in *Allen v. Biltmore Tissue Corporation*.[5] In that case the court stated: ". . . if the by-law under consideration were to be construed as rendering the sale of the stock impossible to anyone except to the corporation at whatever price it wished to pay, we would, of course, strike it down as illegal."[6] This was dictum in the case but it serves to signal the court's view of such a restriction. The restriction the court describes is similar to the restriction considered in *Demchick*. In *Demchick* sale of the studio units was made impossible to anyone except the other 38 owners of larger units, or a future purchaser of both a large unit and a studio, and no requirement was imposed to ensure payment of market value or some other "fair" price. Given this limited pool of potential purchasers, any purchaser could effectively dictate the price—i.e., decide what price the purchaser wished to pay. Yet, the court in *Demchick* concluded this was not an unreasonable restraint on alienation without any discussion of the reasonableness of the price term. Presented below is a more detailed discussion of the parts of the common law doctrine prohibiting unreasonable restraints on alienation—namely, the time and price terms of the restriction and the limit on class of potential purchasers.

Duration of Restriction

Earlier case law has concluded that restrictions that are unlimited in duration are suspect.[7] In *Demchick* the court concluded that the restriction only appeared to be unlimited on its face. However, it could be modified or removed at any time by a vote of the unit owners and, in that sense, was not unlimited in duration. The court cites the Massachusetts decision in *Franklin v. Spadafora*, and the Florida decision in *Metropolitan Dade County v. Sunlink Corp*., as persuasive authority to support this conclusion.[8]

Demchick is misconstruing the governing legal standard. The New York Court of Appeals has repeatedly stated that when it examines the duration of a restriction under the common law rule regarding restraints on alienation, as opposed to the rule against perpetuities, it does not examine how long a restriction on any sale might be in force. Instead it examines the time limit imposed on a party's right to restrict each particular sale. As the court explained in *Wildenstein & Co. Inc. v. Wallis*:

> The rule condemns "not a restriction on transfer, a provision merely postponing sale during the option period, but an effective prohibition against transferability itself" (Allen v. Biltmore Tissue Corp., *supra*, at 542, 161 N.Y.S.2d 418, 141 N.E.2d 812 [emphasis in original]). Thus, the reasonableness of Wildenstein's rights is determined by considering the 30-day period during which it could exercise its preemptive rights and the six month period of its exclusive consignment right, not the remotely potential perpetual quality of those rights.[9]

The same approach was used by the court in *Metropolitan Transportation Authority v. Bruken Realty Corporation.*[10]

Naturally, in some cases all sales or other transfers are prohibited during the entire period of the restriction. In that case, the time of the restriction on each particular sale is identical to the time for which the restriction is imposed. In *Wildenstein & Co. v. Wallis*, for example, there was an exclusive consignment for a six-month interval. The time limit of the exclusive right was equivalent to the time any other consignment was prohibited.[11] However, when transfers are permitted but a restriction is imposed on each future, proposed transfer then the courts have considered the reasonableness of the duration of the restriction in each, particular attempted transfer.[12]

Turning to issue of the reasonableness of a time limit for restrictions in each particular sale, in *Wildenstein* the court found the 90-day and six-month periods to be reasonable in part because they were typical in the art world. In fact, the six month exclusive consignment right was unusually short for the art world. Therefore, the *Demchick* court should have examined how long a period of time the owners of the 38 large units are given to decide whether to purchase a studio when its owner wishes to sell. The by-law in that case contained no time limit during which the particular, proposed sale could be embraced by one of the 38 eligible unit owners. Moreover, if the court had examined the duration of the restriction from this viewpoint it would have confronted evidence that restrictions on sales of condominium units, which are typically in the form of a right of first refusal, are imposed for fixed, relatively short time periods, e.g., 30-60 days. In other words, the duration of this restriction was highly unusual in the condominium world.

Even assuming the court in *Demchick* was correct in analyzing the duration of the restriction with reference to its total length of existence, its conclusion that the restriction was not unlimited as to time is subject to criticism. The court reasoned a restriction containing no maximum time limit is, in fact, not unlimited in duration because it can be amended. The out-of-state cases it cites do support this conclusion,[13] and the New York case law has never addressed it explicitly. However, the actual disposition of the cases decided in New York suggest this is not an acceptable approach. Restrictions on transfer of real estate are either imposed by a will or imposed by a contract—e.g., a lease, an option agreement, a deed in which the transfer restriction is a part of the bargain. Any contractual restriction has the potential to be modified. Applying the *Demchick* court's reasoning no restriction that is contractual needs to contain a time limit.

Reasonable Price

The price to be paid by the holder of a right to restrict sales to third parties is a second factor the courts consider in making an overall determination regarding the reasonableness of restraint on alienation. The court in *Demchick* never discussed this factor. In *Demchick* there was no mechanism in place to ensure the studios were purchased at fair market value or at some other price determined to be a fair price.

The court in *Metropolitan Transportation Authority* cautioned against restrictions that lead to prices that are less than market prices. It noted:

> Reasonableness also depends on price, for the method by which the price is set can be critical in determining whether a preemptive right unlawfully restrains transfers. When the holder has a right to purchase at a fixed price, or at a price less than that offered in the market, it is likely to involve a sacrifice by the owner if he wishes to transfer the property, thus becoming a far more serious interference with alienability.[14]

The typical mechanism for arriving at a fair price in a condominium context is through a right at first refusal in the form of a right to match a bona fide third-party offer. However, if there are no third party offers, then a fair price could be established by an independent third party[15] (appraisal) or by arbitration.[16]

In *Demchick*, it is highly unlikely there would be more than one offer, and no bona fide "open market" offer since the studio unit could not be sold apart from a simultaneous ownership interest in a larger unit. Yet no mechanism was adopted to ensure payment of a fair price, as has been suggested in decisions of the Court of Appeals.

Reasonableness of price to be paid is, of course, one factor to consider in judging the overall reasonableness of a particular restraint on alienation. However, a restriction that does not seek to ensure payment of a fair price is suspect.

Limits on Potential Purchasers

A final factor that assists in determining if a restriction is unreasonable is the size of the class of potential purchasers. The smaller the size, the greater the adverse effect on the owner's ability to alienate. This was never considered by the court in the *Demchick* decision. As noted earlier in the *Allen* case, the Court of Appeals opined that if the class of potential purchasers was limited to the corporation itself then it was suspect.[17]

Numerous decisions in New York have determined a restriction on sale to be an unreasonable restraint based solely on an excessive limitation on potential purchasers. In extreme cases, the limits that have been struck down limited transfer or consent to a transfer to one person.[18] They have also been struck down in cases limiting transfer to a larger group, such as any family member.[19] In all of these cases the courts determined that restriction was repugnant to the fee estate.[20]

In more recent times, restrictions on sale have not always been deemed to be repugnant to the fee estate but only unenforceable if unreasonable. Yet these earlier decisions confirm that unduly restricting the class of potential purchasers renders the restriction suspect. In *Demchick* the number of potential purchasers was a bit larger than in the reported cases. Nonetheless, the potential class of purchasers was severely limited, and a significant adverse impact on power to alienate could be expected.

The Weighing Process—Inherent Uncertainty in the Doctrine

The facts in *Demchick* suggest that the conclusion should have been drawn that the adverse impact on the ability of unit owners of studios to sell at a fair price would be substantial. One might also opine that this adverse effect overcomes the weight to be given to the purpose behind the restriction. As a result, the restriction should have been found to be an unreasonable restraint on alienation. The lower court drew this conclusion, and the unit owner was confident that this conclusion would not be upset on appeal. The unit owner was so confident that he directed his attorney not to file any papers in opposition to the appeal.

However, the difficulty in predicting an outcome when applying a test that employs a weighing process is that when a restriction does serve a permissible purpose, such as the one in *Demchick*, then the outcome is never certain. On appeal, the purpose of the restriction in *Demchick* was identified as "preserv(ing) the character of the Condominium."[21] The condominium association's brief explained it was concerned that permitting sale of the studio apartments alone to outsiders ". . . would alter the exclusive character of the Condominium [and] could create a more transient, and less family-oriented atmosphere in the Condominium."[22] As discussed above, the court in *Demchick* did not fully consider the adverse impact of the restriction in question. Nonetheless, if it had, the court could still have concluded that it found the purpose to be served important enough to outweigh the adverse impact on alienability.

This is the inherent uncertainty generated by attempting to apply the common law prohibition against unreasonable restraints on alienation to particular restrictions that might be imposed in a condominium development. The outcome depends on a weighing process. This is an inherently subjective determination since it involves a comparison of two nonquantitative assessments. This subjectivity renders predictions about permissible and impermissible restrictions problematic.

The *Allen* decision discussed above, in which the court criticized a preemptive right to repurchase corporate shares if it could be exercised at whatever price the corporation wished to pay, actually illustrates the uncertainty in predicting outcomes of challenges to validity of restrictions on sale. In *Allen,* the court also stated that more than a disparity between an option price and current value must be demonstrated to render a restriction invalid.[23] In *Allen,* shareholders in a close corporation had the preemptive right to purchase shares of other shareholders at the original purchase price of the stock. The court upheld the restriction. It noted that shares of a close corporation have no easily ascertainable value and therefore the price to be paid can be set by appraisal or can be set by some other method such as book value. It was willing to tolerate either approach, unlike its decision in *Metropolitan Transportation Authority*, because the court equated a close corporation to a partnership. The "partners" were seeking to veto the admission of new participants in their venture—a reasonable purpose in the court's view. The court then decided that the purpose behind the restriction outweighed any adverse effect on alienability, despite the limit on price.[24]

A condominium, especially one containing 43 units, could be analogized to a close corporation or partnership, and then the analysis of the reasonableness of the restraint can shift from a focus on price to a focus on purpose. As a result, in condominium developments the individual unit owners might be allowed to impose many restrictions—other than a right to match a bona fide third party offer—when they serve the purpose of limiting the identity or character of new members in the "partnership" that is the condominium development.[25]

Conclusion

The restrictions that courts will sustain on sales of condominium units is an issue that few appellate courts have addressed in New York. The First Department's decision in *Demchick v. 90 East End Avenue Condominium* suggests that the assumption that only a right to match a bona fide third party offer would be sustained is open to question. The case has also highlighted that the common law doctrine prohibiting unreasonable restraints on alienation generates uncertainty rather than a degree of certainty in making predictions regarding a court's view of the validity of particular restrictions on sale of condominium units. Any such prediction is unreliable, as the parties discovered in the *Demchick* litigation.

Endnotes

1. 18 A.D.3d 383, 796 N.Y.S.2d 62 (2005).
2. *Anderson v. 50 East 72nd Street Condominium*, 119 A.D.2d 73, 505 N.Y.S.2d 101 (1st Dep't 1986).
3. *Id*. at 63.
4. *Wildenstein & Co., Inc. v. Wallis*, 79 N.Y.2d 641, 648, 584 N.Y.S.2d 753, 757 (1992); *Metropolitan Transportation Authority v. Bruken Realty Corporation*, 67 N.Y.2d 156, 162, 501 N.Y.S.2d 306, 308 (1986).
5. 2 N.Y.2d 534, 161 N.Y.S.2d 418 (1957).
6. *Id*. at 542.
7. *See Jarecki, Lam, Omath* and *Inwood* decisions, which involved restrictions with no limit as to time, *infra* note 11.
8. *Franklin v. Spadafora*, 447 N.E.2d 1244 (Mass. 1983); *Metropolitan Dade County v. Sunlink Corporation*, 652 So.2d 551, 1993 Fla. App. Lexis 1283 (3d Dist., February 2, 1993), rehearing en banc of earlier decision reported at 1992 Fla. App. Lexis 547 (January 28, 1992) (adopting Judge Jorgenson's dissent to the panel opinion as the opinion of the en banc court).
9. *Id*. at 651-2.
10. 67 N.Y.2d 156, 167 (the reasonableness of Delbay's preemptive right must be determined not by considering the 99-year term, but by considering the 90-day period during which the right could be exercised after the MTA decided to sell); *see also Anderson v. 50 East 72nd Street Condominium*, 505 N.Y.S.2d 101, 104 (1st Dep't 1986) (the duration of the restraint is not measured by the life of preemptive right, but rather by the period during which the right can be exercised once the owner decides to sell).
11. Similar examples involve options to buy, that therefore prohibit any other sales, agreements to lease that vest rights in a particular party, or agreements prohibiting partition. *Jarecki v. Shung Moo Louie*, 95 N.Y.2d 665, 722 N.Y.S.2d 784 (2001) (an option to purchase a cooperative apartment contained in a sublease of the unit); *Lam v. Chi Kei LI*, 222 A.D.2d 290, 635 N.Y.S.2d 26 (1st Dep't 1995) (option to purchase granted to the plaintiff); *Lam Omath Holding Company, Inc. v. City of New York*, 149 A.D.2d 179, 545 N.Y.S.2d 557 (1st Dep't 1989) (agreement to lease premises conditioned on rezoning of the parcel); *Geoffrey v. Schmidt*, 279 A.D. 912, 110 N.Y.S.2d 576 (2d Dep't 1952).
12. *See, e.g.*, *Wildenstein & Co. Inc. v. Wallis*, 79 N.Y.2d 641, 584 N.Y.S.2d 753 (1992) (right of first refusal to purchase for a 30-day period); *Bessen v. Glatt*, 170 A.D.2d 924, 566 N.Y.S.2d 750 (3d Dep't 1991) (either co-owner may offer to sell their interest to the other with the nonselling party granted 45 days to refuse to purchase); *Inwood Park Apartment, Inc. v. Coinmach Industries Co*., 6 Misc. 3d 246, 783 N.Y.S.2d 453 (Sup. Ct., New York Co. 2004) (right of first refusal to meet any bona fide offer to lease the laundry room).
13. The Supreme Judicial Court of Massachusetts later limited the reasoning of the *Franklin* case "to the particular facts of that case." *Certified Corp. v. GTE Products Corporation*, 392 Mass. 821, 825, 467 N.E.2d 1336, 1339 (1984). Presumably this meant it was limited to a condominium context.
14. 67 N.Y.2d at 167 (citations omitted).
15. *See e.g. Wildenstein*, 79 N.Y.2d at 652 (if parties cannot agree on a reasonable price the agreement requires that the price be set by a major international auction house representative).
16. *Metropolitan Transportation*, 67 N.Y.2d at 168.
17. *Allen*, *supra* note 5. In the *Allen* case, other stockholders of the close corporation had the first opportunity to purchase any stockholders shares if he wished to sell them for a period of 60 days. Thereafter, if the option was not exercised they could be sold to third-parties.
18. *In re Josephine Jeromos*, 9 Misc. 2d 294, 166 N.Y.S.2d 959 (Sup. Ct., Erie Co. 1957) (devise to son of testatrix with the condition he can dispose of the parcel only to his daughter); *Steffan v. Steffan*, 135 Misc. 568, 239 N.Y.S. 155 (Sup. Ct., Erie Co. 1930) (devise to two brothers and neither could force a sale without the consent of the other).
19. *Livingston v. New York, O. & W. Ry. Co.*, 193 A.D. 523, 184 N.Y.S. 665 (3d Dep't 1920) (devise requiring farm to remain in the family); *Hacker v. Hacker*, 153 A.D. 270, 138 N.Y.S 194 (2d Dep't 1912) (estate must remain in the Hacker family); *In re Tallman*, 131 Misc. 863, 229 N.Y.S. 308 (Sup. Ct., Clinton Co. 1928) (title to real estate shall never pass from the family name of Tallman). *Contra, In re Cianciulli*, 10 Misc. 2d 418, 168 N.Y.S.2d 251 (Sur. Ct., Nassau Co. 1957) (involving right to purchase at the prevailing market price).
20. *See DePeyster v. Michael*, 6 N.Y. 467, 493 (1852) (involving a prohibition on sale unless a share of the proceeds was paid to the original owner).
21. *Demchick, supra* note 1, at 63.
22. T. James Bryan, *Cp-Op and Condo Difference in the Right to Sell or Lease a Unit*, New York Law Journal, August 16, 2005, at 4.
23. *Allen v. Biltmore Tissue Corporation*, 2 N.Y.2d 534, 543, 161 N.Y.S.2d 418, 424 (1957).
24. In fairness, the court in *Allen* also noted that (1) the time period of the preemptive right was limited to 90 days and if not exercised the stock could be sold to outsiders, and (2) as to price, typically there is no easily ascertainable market value for the shares of a closely held corporate enterprise. Thus the facts in the *Demchick* case could be distinguished.
25. This issue was explored in Vincent DiLorenzo, *Restraints on Alienation in a Condominium Context: An Evaluation and Theory for Decision Making*, 24 Real Property, Probate and Trust Journal, 403, 432 (1989).

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The subject of the following article is of great interest to the real estate bar. We invite additional comments from those with differing views as well as those supporting the position taken.—Eds.

Title Insurance Agent Licensing Law Controlled Business Restrictions Should Not Apply to Attorneys Who Provide Title Insurance to Clients

By William P. Johnson

All across the State of New York, attorneys involved in real estate transactions act as title agents for their clients. Many of these attorneys do not provide title insurance other than for their clients. A bill being considered in the New York State Assembly and Senate would change this practice (Assembly Bill No. A11979 and Senate Bill No. S8132). The original proponent of the bill, the New York State Land Title Association (NYSLTA), argues that preventing attorneys from providing title insurance to their own clients is consistent with New York State Bar Association Ethics Opinions which already prohibit attorneys from doing so. This understanding of the ethics opinions is incorrect. Moreover, promoting this incorrect position, if successful, would result in eliminating most private practice attorneys from the title agent role and leave nearly all the title insurance business to the underwriters and non-law firm agencies.

The bill's purpose is to license and regulate title insurance agents. Many of the bill's provisions seek to repair problems in the title insurance industry involving both attorney and non-attorney title agents. These reforms include creating educational requirements for non-attorney title insurance agents and preventing title insurance premiums from being shared where core title insurance work is not performed (unearned kickbacks and referral fees). The bill also restricts a title insurance premium from being shared between a title insurance agency and an affiliated referral source unless the agency has multiple and significant other sources of title insurance business besides the referral source. Under the bill's definitions, an attorney who operates a title agency as an adjunct to his or her law practice would be deemed an "originator" of the title insurance order and the attorney also would be a "title insurance agent."

> *. . . NYSLTA argues that preventing attorneys from providing title insurance to their own clients is consistent with [NYSBA] Ethics Opinions which already prohibit attorneys from doing so. This understanding of the ethics opinions is incorrect.*

With these classifications, the controlled business provisions of the bill would apply, including the requirement that an originator not have a financial interest in the agent unless that attorney's title insurance agency also has significant and multiple sources of title insurance business. Effectively, this provision prevents an attorney from having a financial interest in the attorney's own ability to be paid for writing title insurance if the only source of the title insurance business is the law firm's own clients.

This prohibition is contrary to the traditional function of attorneys preparing title opinions on behalf of their clients. In recent decades, throughout much of New York State, title insurance issued by attorneys has become an attorney's title opinion backed up by the financial strength, legal defense capacity and continuity through time of a title insurance company. Attorneys representing parties in real estate transactions typically have the obligation to make sure title to the real property is good and issuing title insurance is a modern way of doing so.

An argument that New York State Bar Association Ethics Opinions prohibit an attorney from writing title insurance for his or her own client is based on a misreading of those opinions. New York State Bar Association Ethics Opinion No. 621, together with Opinions 576 and 595, which it builds upon, allows an attorney to represent a party and act as title insurance agent as part of his/her law practice as long as certain requirements regarding potential conflicts of interest, disclosure and segmented billing are satisfied. However, Opinion No. 621 concludes that an attorney may not refer a title insurance order to a title agency if it is a separate business entity in which the attorney has a financial interest. This conclusion is based on the conflict between the business interests of the separate agency and the client's interests. That opinion explains that a separate title agency is like a real estate brokerage or life insurance agency owned by an attorney to which an attorney is prohibited from referring clients.

In arguing that an attorney's dual role as title agent and lawyer is prohibited, possibly, the NYSLTA relies on New York State Bar Association Ethics Opinion No. 753. That opinion sets forth and summarizes standards for attorneys referring business to mortgage brokerages and title abstract companies in which an attorney has a financial interest. It is significant to note that Opinion 753 does not address the issue of an attorney in an individual capacity serving as both attorney and title agent.

The NYSLTA's position that the title insurance agent licensing bill's impact of prohibiting attorneys from writing title insurance for only their own clients wrongly argues that the prohibition is consistent with New York State Bar Association Ethics Opinions. Opinion 621 allows attorneys to provide title insurance to their clients as long as certain ethical considerations are satisfied. Moreover, if enacted with this prohibition in place, the bill would harm real estate clients by eliminating their choice to have their own attorney examine title and issue title insurance. It would also hinder consumers from receiving reduced total expenses because of economy of scale. Simply stated, real estate attorneys will need to charge their clients a higher fee to cover their title related work if they do not receive a portion of the title insurance premium. Since the client pays the same title insurance no matter who shares in it, the combined amounts of the title insurance premium and attorney's fees are likely to cost clients more money under the licensing bill. The language of the bill should be amended to remove attorneys' own clients from its controlled business provisions and allow attorneys to continue providing title insurance for their own clients. While there may be problems in the title insurance industry which should be reformed by a title insurance agency licensing law, the practice of attorneys providing a modern and financially backed version of a title opinion through title insurance is a practice which should be encouraged rather than outlawed.

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RLUIPA and Land Use Regulations

By Joel H. Sachs

A. What Is RLUIPA?

The guarantees of the Free Exercise and the Equal Protection Clauses of the United States Constitution have always been a factor in the considerations of religious land use applications. However, in 2000, the Federal Government sought to more specifically limit local regulation of religious uses through the adoption of the Religious Land Use and Institutionalized Persons Act 42 U.S.C. §§ 2000cc - 2000cc-5 ("RLUIPA"). RLUIPA has two (2) primary components—a land use provision and an institutionalized persons provision. Through the land use provision, Congress sought to protect religious land uses from discriminatory governmental practices used to exclude or otherwise limit the location of churches, synagogues and religious uses in municipalities throughout the United States. *See Midrash Sephardi, Inc. v. Town of Surfside*, 366 F.3d 1214, 1237 (11th Cir. 2004), *rehearing en banc denied*, 116 Fed. Appx. 254 (11th Cir. July 13, 2004), *cert. denied*, 543 U.S. 1146 (2005).

Section 2000cc of RLUIPA prohibits governments from imposing or implementing land use regulations in a manner that imposes a *substantial burden* on the religious exercise of a person or institution unless the land use regulation is *in furtherance of a compelling governmental interest and is the least restrictive means of furthering that compelling governmental interest. See* 42 U.S.C. § 2000cc(a)(1). This section of RLUIPA also prohibits governments from imposing or implementing a land use regulation: (1) in a manner that treats a religious assembly or institution on less than equal terms with a nonreligious assembly or institution, (2) that totally excludes religious assemblies from a jurisdiction or (3) that unreasonably limits religious assemblies, institutions or structures within a jurisdiction. *See* 42 U.S.C. § 2000cc(b).

RLUIPA has the potential to impact virtually any governmental decision implementing zoning and land use regulations. Religious exercise is broadly defined in the statute to include ". . . any exercise of religion, whether or not compelled by, or central to, a system of religious belief" [42 U.S.C. § 2000cc-5(7) (A)] and the "use . . . , building, or conversion of real property for the purpose of religious exercise shall be considered to be religious exercise of the person or entity that uses or intends to use the property for that purpose" [42 U.S.C. § 2000-cc-5(7)(B)]. Zoning variances, site plan approval and special permits are among the areas of regulation which most frequently create a forum for a claim of RLUIPA violations. If a violation is found, RLUIPA entitles the claimant to "appropriate relief," which can consist of injunctive relief and/or monetary damages. In addition, 42 U.S.C. § 1988(b) permits courts, in their discretion, to award attorney fees to a party who prevails under RLUIPA. The strict standard imposed by RLUIPA on government entities coupled with the potential to pay damages as well as the attorney fees of both sides have led many local governments to settle RLUIPA claims prior to a Judicial Decision.

Through the land use provision, Congress sought to protect religious land uses from discriminatory governmental practices used to exclude or otherwise limit the location of churches, synagogues and religious uses in municipalities throughout the United States.

To avoid violations of RLUIPA, local zoning ordinances must be drafted in a manner that does not discriminate against religious exercise. In order to do that, municipalities must, among other things, be certain that permitting requirements do not single out religious institutions and practices and that such permitting requirements are related in some way to the potential impacts of the use. Moreover, the municipal boards, commissions and agencies which implement and interpret zoning ordinances and other land use regulations must be sensitive to the potential for a RLUIPA claim that the zoning ordinance has been implemented in a manner which discriminates against religious exercise.

As a result, religious land use applications require careful attention by local governments. The record should be carefully developed with respect to any adverse impacts the use is expected to have. For example, one town recently denied a special permit to a Buddhist Temple citing the impacts of on-street parking and potential noise. Yet, on-street parking is permitted in the area and most significantly the primary purpose of the temple was silent meditation. The case was settled with the granting of the special permit and the payment of attorneys' fees by the town.

Further, if any conditions are placed upon a religious use, they should be narrowly drawn to address only specific adverse impacts associated with the use that have been documented in the reviewing agency's record. These conditions might establish the hours of operation, the maximum number of individuals that may gather at any one time, the maximum square footage of any proposed building, the means of ingress and egress from the site, the amount of off-street parking, etc. In formulating the conditions, the boards, commissions and agencies need to be cognizant of the purposes of the facility and sensitive to the beliefs of the religion before it. For instance, if a particular religion has applied to expand its facilities and one of its tenets is that its congregants should gather at 7:00 a.m. to pray, it would not be reasonable to limit the hours of operation of the facility to 9:00 a.m. to 5:00 p.m.

B. Is RLUIPA Constitutional?

In reaction to *Employment Division, Department of Human Resources v. Smith*, 494 U.S. 872 (1990), Congress passed RLUIPA to reestablish the strict scrutiny test articulated by the United States Supreme Court in *Sherbert v. Verner*, 374 U.S. 398 (1963), and *Wisconsin v. Yoder*, 406 U.S. 205 (1972), for all laws that were challenged as violative of the Free Exercise Clause. Under this test a violation of the Free Exercise Clause is found if a law imposes a substantial burden on religious exercise and the government cannot show a compelling interest to justify that burden. In *Smith*, the Supreme Court exempted many laws from this test by holding that (1) "valid and neutral laws of general applicability" that have an incidental effect of burdening religion are evaluated using rational basis scrutiny and (2) strict scrutiny applies if the action combines a Free Exercise claim with another constitutional claim or if the challenged law is not neutral and generally applicable (in other words it is targeted at religion).

RLUIPA is Congress' second attempt to reestablish the strict scrutiny test for Free Exercise claims. Its first attempt was the Religious Freedom Restoration Act ("RFRA"), 42 U.S.C. §§ 2000bb to 2000bb-4 (originally enacted in 1993). However, in *City of Boerne v. Flores*, 521 U.S. 507 (1997), the U.S. Supreme Court declared RFRA unconstitutional as it applies to the states because it was beyond the enforcement powers granted to Congress in section five of the Fourteenth Amendment. Thereafter, Congress passed RLUIPA pursuant to its authority under the Commerce Clause, the Spending Clause and section five of the Fourteenth Amendment.

To date, the Supreme Court has not addressed the facial constitutionality of the land use provision of RLUIPA (42 U.S.C. § 2000cc) but it has upheld the facial constitutionality of the institutionalized persons provision of RLUIPA (42 U.S.C. §§ 2000cc-1) (*See Cutter v. Wilkinson*, 544 U.S. 709 (2005)). The Eleventh Circuit has upheld the land use provisions of RLUIPA as a valid exercise of Congress' power under section five of the Fourteenth Amendment, as not violative of the Tenth Amendment, and as not violative of the Establishment Clause. *See Midrash Sephardi, Inc.*, 366 F.3d at 1236-1243 (11th Cir. 2004). In contrast, a District Court in California has held that RLUIPA is unconstitutional when applied in individual land use assessment cases because Congress exceeded its enforcement power under section five of the Fourteenth Amendment. *Elsinore Christian Ctr. v. City of Lake Elsinore*, 291 F.Supp.2d 1083, 1096-1102 (C.D. Cal. 2003). As the *Elsinore* court noted, however, at least three other district courts have ruled that RLUIPA is valid and constitutional in this respect. *See Cottonwood Christian Ctr. v. Cypress Redevelopment Agency*, 218 F.Supp.2d 1203, 1221 (C.D. Cal. 2002); *Hale O Kaula Church v. Maui Planning Comm'n*, 229 F.Supp.2d 1056, 1072 (D.C. Haw. 2002); *Freedom Baptist Church of Delaware County v. Township of Middletown*, 204 F.Supp.2d 857, 868 (E.D. Pa. 2002).

Although there is no definitive ruling on the constitutionality of the land use portion of RLUIPA, the vast majority of cases that have addressed its constitutionality have upheld it.

Moreover, these same district courts also found that RLUIPA is a valid exercise of Congress' Commerce Clause power. *See Cottonwood*, 218 F.Supp.2d at 1220-21; *Hale O Kaula Church*, 229 F.Supp.2d at 1071-72; *Freedom Baptist Church*, 204 F.Supp.2d at 867. The *Elsinore* court disagreed and held the Commerce Clause authority an inappropriate basis for RLUIPA's enactment because, in its view, in RLUIPA, Congress exceeds this authority by attempting to regulate the way states regulate private parties. *See Elsinore*, 291 F.Supp.2d at 1102-1104. Since *Elsinore*, two courts in the Southern District of New York also have concluded that RLUIPA is valid under the Commerce Clause. *See Fortress Bible Church v. Feiner*, 2004 WL 1179307 at *3 (S.D.N.Y. March 29, 2004); *Westchester Day Sch. v. Village of Mamaroneck*, 280 F.Supp.2d 230 (S.D.N.Y. 2003), *vacated and remanded on other grounds*, 386 F.3d 183 (2d Cir. 2004).

Although there is no definitive ruling on the constitutionality of the land use portion of RLUIPA, the vast majority of cases that have addressed its constitutionality have upheld it.

C. Implementing RLUIPA—Burdens of Proof

As noted above, to trigger the strict scrutiny review mandated by RLUIPA, at least one of the following must be established: (1) the burden is imposed in a program or activity that receives federal financial assistance; (2) the burden affects, or removal of that burden would affect, interstate commerce or commerce with foreign nations; or (3) the burden is imposed in "the implementation of a land use regulation or system of land use regulations under which a government makes . . . individualized assessments of the proposed uses for the property involved." 42 U.S.C. § 2000cc(a)(A)-(C). The labor, material and financial transactions inherent in the construction of a church have been found to affect interstate commerce and thereby trigger the application of RLUIPA. *See Cottonwood Christian Ctr.*, 218 F.Supp.2d at 1221. Similarly, the proposed improvements to a religious school were found to affect interstate commerce because the school employs one out-of-state teacher, the school educates out-of-state students, and the improvements include the construction of a hall. *Westchester Day Sch. v. Village of Mamaroneck*, 417 F.Supp.2d 477, 541 (S.D.N.Y. 2006). The consideration of a special use permit has been held to constitute an individualized assessment in the implementation of a land use regulation. *Id*. at 542; *Living Water Church of God v. Charter Township of Meridian*, 384 F.Supp.2d 1123, 1134 (W.D. Mich. 2005).

Once a plaintiff has triggered RLUIPA, a *prima facie* case that RLUIPA has been violated must be established by presenting evidence that the land use regulation in question: (1) imposes a substantial burden; (2) on the 'religious exercise;' (3) of a person, institution or assembly." 42 U.S.C. § 2000cc(a)(1); *Westchester Day Sch. v. Village of Mamaroneck*, 417 F.Supp.2d 477, 540. To be protected a religious belief need not be acceptable, logical, consistent or comprehensible to others—it need only be sincerely held and, in the individual's own scheme of things, religious. *Fifth Ave. Presbyterian Church v. New York City*, 293 F.3d 570, 574 (2d Cir. 2002).

RLUIPA does not define what constitutes a "substantial burden." For a burden on religion to be substantial, the government regulation must compel action or inaction with respect to a sincerely held belief—merely inconveniencing the religious institution or the adherent's action is not sufficient. *Grace United Methodist Church v. City of Cheyenne*, 235 F.Supp.2d 1186 (D. Wyo. 2002), *aff'd*, 427 F.3d 775 (10th Cir. 2005); *See also Henderson v. Kennedy*, 265 F.3d 1072, 1074 (D.C. Cir. 2001) (prohibiting the sale of T-shirts on the National Mall was not a substantial burden on the plaintiffs' religious exercise because the T-shirts could have been given away free at that location or sold on other nearby streets). A substantial burden on religion has also been expressed as "foregoing or modifying the practice of one's religion because of governmental interference or fear of punishment by the government." *Murphy v. Zoning Comm'n of the Town of New Milford*, 148 F.Supp.2d 173, 189 (D. Conn. 2001), *vacated and remanded*, 402 F.3d 342 (2d Cir. 2005).

The Second Circuit has cautioned that "rejection of a submitted plan, while leaving open the possibility of approval of a resubmission with modifications designed to address the cited problems, is less likely to constitute a 'substantial burden' than definitive rejection of the same plan." *Westchester Day Sch. v. Village of Mamaroneck*, 386 F.3d 183, 188 (2d Cir. 2004). However, the Second Circuit has recognized that in some circumstances even though a denial of a specific proposal indicates a willingness to consider revisions, it may be found to be a substantial burden where the stated willingness to consider revisions is disingenuous, or the suggested revisions impose so great an economic burden as to make amendment unworkable or where the change demanded constitutes a burden on religious exercise. *Id.* at 188 n.3.

Not all courts recognize the willingness to approve a smaller structure as preventing the finding that a substantial burden has been imposed. *See Living Water Church of God*, 384 F.Supp.2d at 1128-29 (refusal of church's request for new construction, which included classrooms, a gymnasium, a sanctuary, day care rooms, office and meetings rooms, constituted a substantial burden even though the planning commission stated a willingness to permit smaller structures since they were insufficient to fulfill the church's needs); *Sts. Constantine and Helen Greek Orthodox Church, Inc. v. City of New Berlin*, 396 F.3d 895, 901 (7th Cir. 2005) (denial of rezoning application was a substantial burden even though the plaintiff church could have searched for other parcels of land to develop or filed subsequent applications with the city because there would have been delay, uncertainty and expense—the burden does not have to be insurmountable to be substantial).

Other courts also have recognized the denial of an application as imposing a substantial burden on the exercise of religion. *See Guru Nanak Sikh Society of Yuba City v. County of Sutter*, 326 F.Supp.2d 1140, 1150 (E.D. Cal. 2003); *Cottonwood Christian Ctr*., 218 F.Supp.2d 1203, 1226 (C.D. Cal 2002) (religious exercise was substantially burdened by the denial of a permit to build a new church when the church's current location was too small to accommodate its membership); *DiLaura v. Ann Arbor Charter Township*, 30 Fed. Appx. 501, 509 (6th Cir. Feb. 25, 2002) (unpublished) (denial of a zoning variance to allow a donated house to be used as a religious retreat was a substantial burden under RLUIPA).

If a plaintiff establishes a *prima facie* showing under RLUIPA, the burden shifts to the local government to demonstrate that the land use regulation furthers a *compelling governmental interest* and that the land use regulation is the *least restrictive means* of furthering that compelling interest. 42 U.S.C. § 2000cc(a)(1)(A)-(B); *Westchester Day Sch*., 417 F.Supp.2d at 540. Significantly, the federal district court for the District of Connecticut has found that local governments have a compelling interest in enforcing their zoning regulations and ensuring the safety of residential neighborhoods through traffic regulations. *See Murphy*, 148 F.Supp.2d at 190, *vacated and remanded on other grounds*, 402 F.3d 342 (2d Cir. 2005).

D. Notable Cases Applying RLUIPA in the Second Circuit

1. *Westchester Day Sch. v. Village of Mamaroneck*

For over fifty years, Westchester Day School ("WDS") has operated as an Orthodox Jewish day school in a residential neighborhood in the Village of Mamaroneck, Westchester County, New York. The school offers a coeducational curriculum of secular and Judaic studies, daily prayer and observance of Jewish practices and customs. In October 2001, WDS sought a modification of the special use permit under which it operates to allow construction of an additional school building as well as renovations and improvements to the existing facilities. The plan provided for 25 additional classrooms and a multipurpose room in the new building and the rededication of 13 existing classrooms for use as library space, computer rooms and administrative offices. The modifications were intended to modernize classrooms; reduce class size; provide space for music, art and computer rooms; provide a library and study center dedicated to Jewish scholarship; and provide a new chapel. The Mamaroneck ZBA initially issued a "negative declaration" under SEQRA. After the manifestation of neighborhood opposition, the ZBA rescinded the negative declaration.

WDS sued the Village of Mamaroneck, its ZBA and several individuals in federal court alleging the rescission of the negative declaration was unlawful. The District Court granted the partial summary judgment motion of WDS, finding the rescission violated SEQRA and the application proceeded to the special permit phase. *See Westchester Day Sch. v. Village of Mamaroneck*, 236 F.Supp.2d 349 (S.D.N.Y. 2002). Ultimately, the modification of the special permit was denied by the ZBA for among other reasons: the potential for increased intensity of use due to increased enrollment at WDS; traffic concerns relating to increased volume and the effect on nearby intersections; and insufficient parking. WDS amended its complaint to challenge the lawfulness of the denial and moved for partial summary judgment. The District Court granted summary judgment in favor of WDS directing the ZBA to grant immediate and unconditional approval of WDS's application. *See Westchester Day Sch. v. Village of Mamaroneck*, 280 F.Supp.2d 230 (S.D.N.Y. 2003). Defendants appealed.

The Second Circuit vacated the District Court's grant of summary judgment and remanded. The Second Circuit found the District Court had made several findings essential to its decision about which a factfinder could reasonably disagree on the record before it. In overturning the District Court, the Second Circuit took pains to emphasize that the ZBA's resolution stated "this denial exclusively addresses the future expansion of the school and its accessory uses . . . *as they relate to this application* (emphasis added by the Second Circuit)." *Westchester Day Sch. v. Village of Mamaroneck,* 386 F.3d 183, 187 (2d Cir. 2004). The Second Circuit read this phrase as the ZBA indicating it was leaving open the possibility that a modification of the proposal coupled with the submission of data found to be lacking in the application before the court would result in approval. The Second Circuit went on to state the following:

> Rejection of a submitted plan, while leaving open the possibility of a approval of a resubmission with modifications designed to address the cited problems is less likely to constitute a "substantial burden" than definitive rejection of the same plan, ruling out the possibility of approval of a modified proposal. . . . [However,] denial of the precise proposal submitted may be found to be a "substantial burden," notwithstanding a board's protestations of willingness to consider revisions—for example, where the board's stated willingness is disingenuous, or cure of the problems noted by the board would impose so great an economic burden as to make amendment unworkable, or where the change demanded would itself constitute a burden on religious exercise.

Westchester Day Sch., 386 F.3d at 188.

The Second Circuit also cautioned the District Court that it may be applying RLUIPA too expansively when it reasoned that any improvement or enlargement proposed by a religious school to its secular education and accessory facilities would be immune from regulation or rejection by a ZBA so long as the proposed improvement would enhance the overall experience of students. The Second Circuit believes under this interpretation of RLUIPA, if a religious school and a secular school submit identical applications to enlarge their gymnasiums to a ZBA, the ZBA would be free to reject the application of the secular school but not that of the religious school if the gym would improve the experience of the students in the religious school. Thus, the Second Circuit fears this interpretation causes RLUIPA to go "beyond the proper function of protecting the free exercise of religion into the constitutionally impermissible zone of entwining government with religion in a manner that prefers religion over irreligion and confers special benefits on it." *Id*. at 189-190.

On remand, there was a nonjury trial at the Federal Courthouse in White Plains that resulted in a finding that the ZBA's denial of WDS' application violated RLUIPA and was arbitrary and capricious under New York law. *See Westchester Day Sch. v. Village of Mamaroneck*, 417 F.Supp.2d 477 (S.D.N.Y. 2006). The District Court issued a mandatory injunction ordering the ZBA to approve the application. In reaching its decision, the District Court noted that the classrooms would be used for both secular and religious instruction; that it was inappropriate to bifurcate WDS' curriculum and consider the religious and secular components in isolation because the school would not exist at all without its religious mission; and that parents pay tuition to the school because they know in addition to receiving a good general education the students will be inculcated in the tenets, traditions and rituals of the Orthodox Jewish faith.

The District Court also found that, prior to WDS' application, it had been hampered by a woefully inadequate physical plant, which had contributed to a steady decline in enrollment, which threatened the survival of WDS. Cognizant of the Second Circuit's decision, the District Court also took pains to make factual findings that the ZBA's decision on the application was final and that it, in fact, had failed to respond to a proposal by WDS to reduce the size of the new building proposed. The District Court made further findings of fact that the permit denial was not the least restrictive means of addressing the interests asserted by the ZBA. Among other things, the District Court noted that the ZBA's own consultants had forwarded to the ZBA a draft resolution approving the application subject to conditions including an enrollment cap and a traffic management plan.

2. *Murphy v. Town of New Milford*

Since 1994, the Plaintiffs in this action have hosted Sunday afternoon prayer group meetings in their single-family home located on a cul-de-sac lined with six other single-family homes. They assert that their Christian beliefs require them to hold these meetings and that, due to the health of one of the Plaintiffs, their home is the only acceptable location for such meetings. The number of people attending the meetings has varied, ranging from ten to sixty. In November 2000, the Town's Zoning Enforcement Officer sent Plaintiffs a letter advising them that their meetings violated zoning regulations. Two days later a lawsuit was commenced. Thereafter, in December 2000, the Zoning Enforcement Officer issued a cease and desist order, under which Plaintiffs were directed to discontinue meetings consisting of more than 25 participants, and to cease using their backyard as a parking lot. Plaintiffs sought injunctive relief, contending that the zoning regulations, as applied, violated their rights under RLUIPA. The District Court enjoined the enforcement of the cease and desist order. *See Murphy v. Town of New Milford*, 148 F.Supp.2d 173 (D.Conn. July 5, 2001); *see also Murphy v. Town of New Milford*, 289 F.Supp.2d 87 (D.Conn. 2003), *vacated*, 402 F.3d 342 (2d Cir. 2005).

On appeal, the Second Circuit vacated the injunction and remanded with a direction to dismiss the action, without prejudice, as unripe for judicial review. *See Murphy v. Town of New Milford*, 402 F.3d 342 (2d Cir. 2005). In reaching this determination, the Second Circuit held RLUIPA plaintiffs must obtain a final, definitive decision from the entity charged with implementing the challenged land use regulation(s) as long as an immediate injury will not result and the additional administrative remedies will further define their alleged injuries. The cease and desist order did not inflict an immediate injury because (1) fines and imprisonment could not be imposed unless and until an enforcement proceeding was brought in which the zoning violation(s) were proven and the trial court exercised its discretion to impose penalty(s) for the violation(s) and (2) the order could have been stayed by appealing it to the New Milford ZBA. Moreover, a variance may have been obtained from the ZBA by showing a literal enforcement of the zoning regulation would work an unusual hardship. The Second Circuit held that without such an appeal, the court cannot know what use of the property would be permitted by the Town and, therefore, can not address the many constitutional issues raised by the parties.

3. *Faith Temple Church v. Town of Brighton*

Faith Temple Church v. Town of Brighton, 405 F.Supp.2d 250 (W.D.N.Y. 2005). The town's eminent domain proceedings do not constitute "land use regulation" for purposes of RLUIPA.

4. *Fortress Bible Church v. Feiner*

Fortress Bible Church v. Feiner, 03 Civ. 4235 (S.D.N.Y. White Plains, May 4, 2006, Judge Robinson, presiding): This action was commenced against the Town of Greenburgh and Town Supervisor Paul Feiner. After extensive discovery, the Town moved for summary judgment. The following facts were established for purposes of the motion:

(1) on or about March 16, 1998, the Church purchased a 6.53 acre parcel of real property situated in the Town of Greenburgh, Westchester County, New York for the purpose of constructing a new church facility (that would include a school) thereon;

(2) the zoning of the property permitted the construction of a church and school as-of-right; and

(3) to construct the proposed building, Fortress Bible Church needed:

  (a) site plan approval from the Town Board,

  (b) a waiver from the Town Board of the requirement to construct landscaped parking islands and

  (c) a variance from the ZBA from the side yard set back requirement to permit the building to be located farther away from the adjacent single family homes and closer to the Sprain Brook Parkway, a major six lane regional highway;

(4) to obtain these approvals, the Church had to undergo the environmental review required by SEQRA;

(5) on November 24, 1998, the Church submitted a site

plan application to the Town of Greenburgh, which described the project as "construction of one building to house a church, school and sanctuary";

(6) the single building and 106 parking spaces were to be located on 1.45 acres of the 6.53 acre site;

(7) on January 17, 2000, the Church submitted a revised site plan and other documents, including among other things a comprehensive traffic study;

(8) Defendants issued a positive declaration under SEQRA on June 19, 2000;

(9) the FEIS for the project was accepted as complete on December 1, 2003;

(10) Defendants state they denied the Church's application due to the traffic problems posed by the location and proposed scale of the project; and

(11) in its SEQRA Findings Statement, the Town Board determined the project did not sufficiently minimize or avoid adverse environmental impacts.

In opposition to the summary judgment motion, the Church asserted that it has outgrown its current facilities, and that its lack of adequate space substantially burdened its religious activities. The Church also alleged that the Defendants had engaged in a continuing course of conduct intended to discourage, delay and ultimately prevent the Church from developing its new property.

The District Court denied the motion with respect to the Church's RLUIPA claims. The court found, among other things, that the Church had presented evidence that the Town's conduct in denying the Church's land use application imposed a substantial burden on the Church's religious exercise. This evidence, which was essentially unchallenged by the Town, was sufficient to withstand summary judgment. The District Court also found triable issues of fact as to whether the Town's denial of the Church's application was based upon compelling governmental reasons. In reaching this determination, the court noted the following:

(1) The Town failed to show that traffic concerns presented a compelling governmental reason to deny the Church's application. For instance, the New York State Department of Transportation granted conceptual approval for the Church's proposed entrance onto the improvements to Dobbs Ferry Road. In addition, the Town had recently granted two other land use applications that would increase vehicular activity in the vicinity of the Church's property. In doing so, the Town accepted traffic calculations that *included* the additional traffic counts that would be generated by the Church's completed development of its property. Finally, the court reiterated the Second Circuit's recent observation in *Westchester Day:* "[C]ase reports do not reveal any case in which a court has found traffic concerns compelling." *Id.*, 386 F.3d at 191.

(2) The Town failed to rebut the Church's evidence that its project complies with the Town Code's parking requirements.

(3) The Town failed to show that internal traffic circulation on the site posed a problem, as a consultant for the Town had stated that vehicular circulation on the site could be adequately controlled.

(4) The Town's recently adopted steep slope ordinance may not apply to the Church's property, and the Town had found during its SEQRA review that the Church's proposed erosion controls were adequate.

The case was scheduled to proceed to a bench trial beginning on October 11, 2006.

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Legislative Committee Report

By S.H. Spencer Compton

2006 was an active year for legislation affecting real property in the state of New York. The Real Property Law Section's Legislative Committee, co-chaired by Spencer Compton, Gary Litke and, recently, our new upstate Co-Chair Kathleen Lynch, devoted significant attention to the following matters:

1. Technical Corrections Act (S7012, A10672)

During its March trip to Albany, members of the Legislative Committee persuaded Senator DeFrancisco to sponsor the Committee's maiden legislative effort, the Technical Corrections Act, drafted by Karl Holtzschue and Spencer Compton, which corrected erroneous section numberings and misused words in certain statutes. The Act was passed by the Senate and the Assembly, then signed into law by Governor Pataki this past June. On deck for 2007, a bill to eliminate the requirement that a separate assignment of leases and rents be recorded with every mortgage. Our task force, led by Joshua Stein, is hard at work on an initial draft of this proposed bill.

2. Home Equity Theft Prevention Act (A10057, S6824)

Despite the Real Property Law Section's vigorous opposition, led by Steve Baum, the Home Equity Theft Prevention Act was enacted. The Act, introduced in response to the alarming rise in home equity theft across New York State, requires written disclosure to homeowners regarding the terms of a title transfer that occurs when a home is in foreclosure, and provides the right to cancel the deal within five days of signing the contract. It prohibits making false statements with intent to defraud the homeowner and provides for a consumer education notice to be sent to all homeowners in foreclosure warning them about such scams. The legislation establishes civil and criminal penalties for violating the law. The Act, which requires mortgage lenders to include with their foreclosure notices contact information for various state agencies printed in English and Spanish on colored paper, was strongly supported by the American Association of Retired People. Although various members of the Legislative Committee participated in conference calls expressing their concern that legitimate loan foreclosures could be snarled in useless litigation over the Act's well-intentioned but obtuse and unclear provisions, the clout of AARP prevailed in the legislature and the bill was enacted.

3. Broker Commission Escrow Bill (S193-A, A3395-A)

The New York State Association of Realtors proposed an amendment to Real Property Law Section 294-b. The bill provided for an escrow account for the broker's compensation from the proceeds of a conveyance involving residential property if the broker had previously recorded an affidavit of entitlement with a copy of the written brokerage agreement and did not receive compensation at or prior to deed delivery. In a groundbreaking display of cooperation with the brokerage community, the Section worked with NYSAR to agree on the text of the proposed bill and the Section submitted a legislative report in support. Inexplicably (to date), after the bill was passed by both the Assembly and the Senate, it was vetoed by the Governor.

4. Title Agency Licensing Bill (S8132, A11979)

The New York State Land Title Association has proposed a bill requiring the licensing of title insurance agents. The Real Property Law Section has appointed a task force led by Lawrence Wolk and is opposing the bill's passage because it effectively would prohibit attorneys from acting as title insurance agents for their clients. The Section also has other concerns:

- Does the bill promote the unlicensed practice of law?
- Why doesn't the bill require audits, which would easily disclose kickbacks that are already prohibited by the Insurance Law?
- Why does the bill not limit up-charges or control them when there is a rate manual to follow for premiums and which uncontrolled up-charges are believed to be the source of illegal kickbacks?
- Does the bill limit competition and discourage operation at a higher quality level by the elimination of attorneys who have an obligation to produce and deliver the best service available to their clients?

The Section deplores the practice of kickbacks or unearned fees and/or the payment of referral fees when the referring party performs little or no services. The Section does believe that licensing would be beneficial to the industry, but does not believe that attorneys should be prohibited from providing title insurance for their own clients. We anticipate that this bill will continue to work its way through the legislative process in 2007. The Section will continue to oppose it as written. Stay tuned.

5. LLC Publication Act (S6831A, A10399)

The bill makes technical and clarifying amendments to Chapter 767 of the Laws of New York, which shortened the publication period required upon formation of a limited liability company in New York, prescribed how the LLC may publish notices and required the LLC to disclose its top ten members, with an exception for hedge funds. If the LLC failed to publish within 120 days of formation, the state would suspend the LLC's authority to do business.

The "clarifying" bill initially proposed to amend Chapter 767 imposed substantial and unnecessary burdens on business with no significant benefits to the public. It contemplated undoing the only improvement that Chapter 767 made (the shorter publication period) and further provided that *if the LLC failed to comply with the publication requirement within 120 days of formation, then every member of the LLC would become personally liable for all obligations of the LLC*.

Joshua Stein published a scathing commentary on the existing LLC publication requirement and the proposed amendment in the Spring 2006 *N.Y. Real Property Law Journal* and authored the Section's legislative report in opposition to the proposed bill. The Legislative Committee appointed a task force chaired by Gregg Pressman. After numerous conference calls and other consensus building efforts, Gregg's task force was able to cause the elimination of two of the more offensive provisions: the requirement that an LLC disclose its top ten members, and the personal liability penalty for failure to comply. The Section believes that requiring LLC's to publish notice of formation serves no interest but providing funding for the newspaper publishing industry, which vigorously promoted the bill. The Act was passed by the Assembly and the Senate and signed by the Governor this summer. The Section plans to promote the repeal of the LLC Publication Act in the months to come.

If you wish to learn more, the texts of the bills referenced above may be accessed on the RPLS section of the NYSBA website. (The direct web address is: http://www.nysba.org/statewatch/SBA_RPLS.HTM).

S.H. Spencer Compton is Co-Chair of the Legislative Committee of the Real Property Law Section of the New York State Bar Association. He is Senior Vice-President and Special Counsel at First American Title Insurance Company of New York.

The Deficit Reduction Act of 2005 and Its Effect Upon Transfers of Assets and Real Property for Long Term Care Planning Purposes

By Anthony J. Enea

As attorneys we regularly advise our clients as to the merits of transferring their homes for estate, gift and income tax planning purposes. Rarely is long term care planning the primary focus of most real property transfers. However, failing to do such long term planning in connection with transfers of interests in real estate after the enactment of the Deficit Reduction Act of 2005 ("DRA") would be shortsighted and perhaps dangerous, especially when dealing with clients who are over the age of 65 years.

On December 18, 2005, the U.S. Senate, in a vote of 51-50 with Vice President Dick Cheney casting the deciding vote, passed the DRA. As a result of some differences in the Senate and House versions, the legislation was sent back to the House of Representatives for a final vote. On February 1, 2006, the House of Representatives approved the DRA by a vote of 216 to 214. On February 8, 2006, President Bush signed the legislation into law. The DRA will affect all non-exempt transfers of assets (gifts and uncompensated transfers that create periods of ineligibility for Medicaid) made on or after February 8, 2006. Exempt transfers such as inter-spousal transfers, transfers to a blind or disabled child, a caretaker child exempt transfer, and a transfer to a sibling with an equity interest are not affected by the DRA. Pursuant to the DRA, the States were given a specified period of time within which to adopt the provisions of the legislation or enact enabling legislation if determined to be necessary. On July 20, 2006, the New York State Department of Health issued Administrative Transmittal #06 OMM/ADM-5, which implemented the provisions of the DRA in New York, effective August 1, 2006.

Rarely is long term care planning the primary focus of most real property transfers. However, failing to do such long term planning . . . after the enactment of the . . . DRA would be shortsighted and perhaps dangerous, especially when dealing with clients who are over the age of 65 years.

The DRA affects Medicaid eligibility and the transfer of asset rules in three (3) significant ways:

1. Creation of a sixty (60) month look-back period for all transfers of assets (60 month period immediately preceding the date an institutionalized individual is both institutionalized and has applied for Medicaid) irrespective of whether they are outright transfers or transfers to certain trusts. Under the prior law there was a sixty (60) month look-back period for transfers to trusts (i.e., Irrevocable Income Only Trust) and a thirty-six (36) month look-back for all other transfers.

2. The penalty period (period of disqualification for Medicaid) created by a non-exempt transfer of assets will commence on the *later of* (a) the month following the month in which the transfer is made (as under prior law), or (b) the date on which an individual is both receiving institutional level of care (i.e., is in a nursing home or receiving care at home under the Lombardi program or other waivered program) and whose application for Medicaid would be approved, but for the imposition of a penalty period at that time for a non-exempt transfer made.

Thus, under the DRA, the penalty period for a non-exempt transfer of assets made within the sixty (60) month look-back period will commence when the applicant has $4,150 or less, is receiving an institutional level of care (in a nursing home or under a waivered long term home health care program), has applied to Medicaid for assistance, and the application would be approved but for the penalty period imposed. This is the most onerous measure contained in the new legislation. For example, if a Westchester County applicant made a non-exempt transfer of $300,000 of assets on May 15, 2006, this would create an approximately thirty-five (35) month period of ineligibility commencing on June 1, 2006 ($300,000 ÷ $8,724 the Westchester County monthly regional nursing home rate). However, pursuant to the provisions of the DRA, if said individual were to apply for Medicaid for an institutional level of care within the five (5) year look-back period, the ineligibility period for the above stated transfer would not commence until the applicant had $4,150 or less of savings, had applied to Medicaid for an institutional level of assistance, and the application would be approved, but for the penalty period imposed by the transfer.

It should be noted that, pursuant to the provisions of the DRA, and as under prior law, no penalty period is imposed for transfers made by an applicant requesting non-waivered community Medicaid (homecare Medicaid).

3. An applicant's Homestead (house, condo, co-op) with equity above $500,000 will render an applicant ineligible for Medicaid. This provision does not apply if a spouse, child under the age of 21, or a blind or disabled child resides in the house.

   Each state was given the ability to increase the amount of permitted home equity to an amount not in excess of $750,000. New York has opted for the $750,000 amount. Additionally, homeowners will have the ability to reduce their equity through a reverse mortgage or home equity loan. There is also an exemption from this home equity provision for an applicant who has a spouse, minor, blind or disabled child living at home.

   Some of the other significant changes contained in the DRA with respect to Medicaid are: (a) annuities will be required to name the state as a remainder beneficiary, and annuities that have a balloon payment will be considered a countable asset; (b) multiple transfers in more than one month must be aggregated; (c) the "income first" rule (community spouse's income shortfall must be made up from income of spouse in institution) will be mandatory in all states (already required in New York) (see *In re Golf*, 91 N.Y.2d 656, 674 N.Y.S.2d 600 (1998); (d) penalty periods will be imposed for partial months (rounding down will no longer be permitted); (e) partnership long term care insurance policies will be permitted in additional states other than the four presently permitted, which include New York.

How Will the DRA Affect the Planning Options Available to Preserve Assets and Real Property?

The most dramatic impact the DRA will have is upon those individuals who are facing an immediate long term care crisis and have failed to do any prior long term care planning. The single person with a small nest egg and/or a house who requires immediate nursing home care will be most severely impacted by the DRA. A married couple will still have the option of utilizing spousal refusal in New York. The DRA has effectively eliminated what was known as "Rules of Halves Planning," wherein one could give away on the eve of going into a nursing home approximately half of his or her assets, and the remaining half would be sufficient to pay the nursing home bill during the ineligibility period created by the transfer. However, there are still a number of planning options available in the crisis planning scenario, for example, the use of an actuarially sound private annuity or promissory note within the context of a partial gift/partial sale of assets, purchase of a life estate in the home of another and the use of a personal service contract. These are all options available and being considered as crisis planning vehicles.

Clearly, the best scenario is still one where the long term care planning has been implemented at least five years prior to the long term care crisis occurring. The DRA is built to exact punishment on the procrastinator; those who sufficiently plan in advance to avoid needing Medicaid within the five (5) year look-back period will fare best.

Even before the DRA was enacted, the decision to transfer the primary residence raised a number of important issues and concerns for both the attorney and client (for example; gift taxes, potential capital gains tax consequences and, of course, the transfer's impact on the Medicaid eligibility of the senior). However, once the decision is made to transfer the primary residence to someone other than a spouse, for Medicaid planning purposes, there have been, in my opinion, predominantly three planning options available:

The DRA is built to exact punishment on the procrastinator; those who sufficiently plan in advance to avoid needing Medicaid within the five (5) year look-back period will fare best.

(a) Outright Transfer of the Residence Without the Reservation of a Life Estate

Perhaps the least desirable option available, as the transferee of the property will receive the transferor's original cost basis in the property (original purchase price/value upon receipt plus capital improvements), and the outright transfer is a completed gift subject to gift taxes. For Medicaid eligibility purposes and pursuant to the DRA, the outright transfer of the residence would be subject to a five (5) year look-back period, and if the transfer of the residence was made within the look-back period, the ineligibility period created would not commence until the individual enters the nursing home and has applied for Medicaid, and would otherwise be eligible but for the transfer.

Additionally, from a tax perspective the use of an outright transfer of the residence results in the transferor losing the Internal Revenue Code ("IRC") § 121(a) principal residence exclusion for capital gains of $250,000 (single person) or $500,000 (married couple). However, if the transferee owns and resides in the premises for two out of the five preceding years, he or she will be able to use said principal residence exclusion. Any Veteran's, STAR and Senior Citizen's Exemptions are also lost by an outright transfer. It is necessary to obtain a fair market value appraisal of the premises gifted for purposes of calculating the federal gift tax credit ($1,000,000 per person) utilized by the transfer.

(b) Transfer of the Residence with the Reservation of a Life Estate

Under prior law and from purely a Medicaid planning perspective relevant to the length of the ineligibility period created by a non-exempt transfer, this option had some important advantages. Because the retained life estate is given a value by Medicaid, which is subtracted from the overall fair market value of the premises at the time of transfer, the period of ineligibility for Medicaid could, depending on the age of the transferor, be significantly reduced. It was possible to create a period of ineligibility for Medicaid that was often less than 36 months. This was a distinct advantage over the use of a deed without the reservation of a life estate and a transfer to an Irrevocable Income Only Trust, wherein no reduction in the value of the fair market value of the assets transferred is permitted for purposes of calculating the period of ineligibility. However, the DRA has significantly reduced the effectiveness of this option. Although the period of ineligibility created by an outright transfer of real property with a reservation of a life estate would not be longer than 36 months, pursuant to the DRA, if the transfer was made within the look-back period (60 months), the period of ineligibility would not commence until the applicant is receiving institutional care in a nursing home or under a waivered long term home health care program (Lombardi program) and was otherwise eligible for Medicaid, but for the transfer made (i.e., has no more than $4,150). Thus, under the DRA a transfer with a retained life estate would create a lengthy period of ineligibility if the application for Medicaid were made within the look-back period.

Pursuant to § 2036(a) of the IRC, the transfer of a residence with a retained life estate permits the transferee of the residence to receive a full step up in his or her cost basis in the premises upon the death of the transferor, to its fair market value on the transferor's date of death. This occurs because the residence is includible in the gross taxable estate of the transferor upon his or her demise. This, of course, presumes the existence of an estate tax upon the death of the transferor. A "*life estate*" pursuant to *§ 2036(a) of the IRC* is the possession or enjoyment of, or a right to the income from, the property or the right either alone or in conjunction with another to designate the persons who shall posses or enjoy the property or income thereof. (Sample language for a life estate is attached.)

The most significant problem in utilizing a deed with the reservation of a life estate results if the premises are sold during the lifetime of the transferor. A sale during the transferor's lifetime will result in (a) a loss of the step up in cost basis, thus, subjecting the transferee to a capital gains tax on the sale with respect to the value of the remainder interest being sold (difference between transferor's original cost basis, including capital improvements, and the sale price), and (b) pursuant to Medicaid rules the life tenant is entitled to a portion of the proceeds of sale based on the value of his or her life estate. This portion of the proceeds could be significant and will be considered an available resource for Medicaid eligibility purposes, thus impacting the transferor's eligibility for Medicaid or being an asset against which Medicaid may have a lien. The existence of the possibility that the premises may be sold prior to the death of the transferor(s) poses a significant detrimental risk that needs to be explored in great detail with the client.

If, for tax planning purposes, it is prudent to make the gift an "incomplete gift," the reservation of a limited testamentary power of appointment to the Grantor should be considered. (Sample language for a limited testamentary power of appointment is attached.)

It should be remembered that *§ 2702 of the IRC* values the transfer of the remainder interest to a family member at its full value without any discount for the life estate retained.

Retention of a life estate falls within one of the exceptions of *§ 2702*.

If the transfer does not fall within *§ 2702 of the IRC*, or if one of the available exceptions applies (e.g., treated as a transfer in trust to or for the benefit of), calculation of the life estate is performed pursuant to *IRC § 7520*, and the tables for the month in issue need to be consulted to determine the correct tax value of the remainder interest.

Pursuant to *IRC § 2702*, if the homestead is transferred to a non-family member the use of a traditional life estate will result in a completed gift of the remainder interest. It should also be remembered that the gift of a future interest (remainder or reversionary interest) is not subject to the annual exclusion of $12,000 per donee for the year 2006.

(c) Transfer to an Irrevocable Income Only Trust a/k/a ("Medicaid Qualifying Trust")

As a result of the enactment of the DRA, and from a purely Medicaid planning perspective, the use of the Irrevocable Income Only Trust a/k/a "Medicaid Qualifying Trust" may be the most logical option. As previously explained, irrespective of the fair market value of the residence transferred to the Trust, one will not want to apply for Medicaid within the five year look-back period in order to avoid the harsh penalties contained in the DRA for transfers made within the look-back period. However, the properly drafted Irrevocable Income Only Trust will allow the residence to be sold during the lifetime of the transferor with little or no capital gains tax consequences, as it is possible to utilize the transferor's personal residence exclusion of up to $500,000 if married, and $250,000 if single, by reserving in the trust instrument the power to the Grantor(s) in a non-fiduciary capacity and without the approval and consent of a fiduciary, to reacquire all or any part of the trust corpus by substituting property in the trust with property of equivalent value. The Grantor(s) will be considered the owner for income tax purposes. *See IRC § 675(4)*. Additionally, the transfer to the Trust can be structured to allow the transferee to receive the premises with a stepped up cost basis upon the death of the transferor, through the reservation of a life income interest (life estate) to the Grantor. *§ 2036(a) of the IRC*.

While the lengthy Medicaid ineligibility period must be appropriately considered, however, the tax advantages and the continued flexibility of being able to sell the premises during the transferor's lifetime without income tax consequences, in my opinion, makes the Irrevocable Income Only Trust an ideal option in most circumstances. Additionally, the Grantor/Creator of the trust can give the trustees the power to invade the principal of the trust for his or her adult issue, thus creating greater flexibility and access to trust principal, if desired.

The transfer of the residence to the Irrevocable Income Only Trust is a taxable gift of a future interest, no annual exclusion available. Full value of premises reported on gift tax return. If the value is over $1,000,000, gift taxes are due. If a limited power of appointment is retained, the gift to the trust is incomplete (*Treasury Reg. 25.2511-2(b)* and no gift tax return is required.

As a result of the life income interest retained by the Grantor, on the death of the Grantor of the Trust, the date of death value of all assets in the trust will be included in the Grantor's taxable estate pursuant to *§ 2036(a) of the IRC*. Inclusion in Grantor's estate will result in a full step up in basis for all trust assets pursuant to *§ 1014(e) of the IRC*, assuming an estate tax is still in existence at the time of the Grantor's demise.

Conclusion

The new law more than anything else severely punishes those who neglect to plan for their long term care. Whether it be the transfer of assets to an Irrevocable Income Only Trust, the use of a deed with a life estate or the purchase of long term care insurance, it is clear that through advance planning one can limit the extent of his or her exposure to the costs of long term care.

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Sample Limited Power of Appointment

"Grantor reserves the power to appoint the remainder and/or Grantor's life estate in the premises to any one or more of the issue of the Grantor, siblings of the Grantor, or issue of the Grantor's siblings, or the spouses or surviving spouses of any of the foregoing persons, with the term "issue" being deemed to include persons who have been adopted according to law or born out of wedlock. This power shall be exercisable or may be relinquished during the Grantor's lifetime by a deed executed to the Grantee(s) herein or to others who are members of the class of appointees set forth herein, making express reference to this power and recorded in the County Clerk's Office where this deed is recorded, prior to the Grantor's death. This power shall not be exercisable to a Will. No exercise of this power shall be deemed to release the Grantor's life estate unless such a release is explicitly made in a deed. The exercise of this power shall exhaust it, and unless the power is specifically released in such a deed, the deed recorded last shall control as to any ambiguities or inconsistencies. This power can not be exercised in favor of Grantor, Grantor's estate or Creditors of Grantor." Release and termination of the limited power of appointment "completes" the gift and requires the filing of a gift tax return for the full fair market value of the property (sale price).

Sample Life Estate

"SUBJECT TO AND RESERVING UNTO the party of the first part, ______________________, an estate in and to said premises during her lifetime such that the party of the first part reserves the right to the use and possession of the premises during her lifetime. The party of the first part shall pay for all maintenance and repairs, water and sewer charges, insurance charges and taxes related to the premises. The party of the first part reserves any and all real estate tax exemptions available to her including, but not limited to the STAR, Senior Citizens' or Veterans' exemption."

NYC Tax Appeals Tribunal Applies Lower Transfer Tax Rate Schedule to Uncombined Condominium Units to Be Used as Single Residence

By Joel E. Miller

An article by Yosi (Joe) Benlevi in the Fall issue of this *Journal* discussed the application of the New York City real property transfer tax where two or more residential condominium units are conveyed by a single grantor to a single grantee. As there reported, a serious issue arises because there are two significantly different rate schedules that apply to conveyances by deed. In the crucial words of the statute, the lower rate schedule applies only to "conveyances of one, two or three-family houses and individual residential condominium units,"[1] with the higher rate schedule applying to "all other conveyances."[2]

Clearly, the lower rate schedule applies to the everyday conveyance of a single residential condominium unit. What is not clear is whether or not the lower rate schedule also applies where two or more of such units are conveyed by the same grantor to the same grantee.

With but the single exception about to be described, the New York City Department of Finance (the "Finance Department") has always maintained that the lower rate schedule cannot be used where more than one unit is involved. The exception was that the Finance Department allowed the lower rate schedule to be used where both of the following were true: (i) the two or more units were intended to be used as a single residence, and (ii) they had already been "physically combined" prior to the conveyances. As stated in an advisory memorandum issued by the Finance Department in 2000:

> The Department will not treat a transfer of adjacent . . . residential condominium units *that have been physically combined into a single residence* as [being subject to the higher rate schedule].[3]

Lest there be any doubt, the Finance Department went on to stress that the exception that it had created required a pre-conveyance actual physical combination, saying:

> The fact that two or more units . . . will be combined following the transfer will not be sufficient to permit the transaction to be treated as a transfer of . . . an individual residential condominium unit taxable at the lower rates.[4]

A grantor who found himself within the Finance Department's two-pronged rule obviously had no reason to complain. However, it must be said that the Finance Department's position simply does not square with the statute, which refers to "condominium units," not "residences." If, as the Finance Department says, the higher rate schedule applies where two or more separate condominium units are involved, it should be equally applicable where two or more physically combined condominium units are involved. Either there are two or more condominium units or there are not, regardless of the physical situation and the grantee's intention. Despite that, the Finance Department continued to contend that, in all other situations, a grantor of more than one condominium unit to the same grantee could not use the lower rate schedule.

As reported in the Benlevi article, three cases thereafter were presented in which the Finance Department's exception did not apply.[5] In each of them, more than one condominium unit was involved but, although the condominium units were intended to be used as a single residence (thus satisfying the first prong of the Finance Department's two-prong test), they had not been physically combined.[6] In all three cases, the taxpayer won at the administrative law judge ("ALJ") level. In each case, the ALJ based his or her decision on the following two distinct alternative grounds:

- Because the statute is phrased in the plural—referring to "individual residential condominium units" rather than to "an individual residential condominium unit"—the lower rate schedule applies regardless of how many condominium units are involved and without regard to whether or not they are intended to be used as a single residence.
- All of the condominium units involved were intended to be used as a single residence, and neither a pre-conveyance physical combination nor even an intent to combine in the future is necessary.

As the Benlevi article indicated was expected to happen, the Finance Department appealed all three decisions to the New York City Tax Appeals Tribunal (the "City Tribunal"). Although the City Tribunal had obviously not yet ruled when that article was written, it has since done so—and the taxpayers were again victorious.[7] Significantly, though, the City Tribunal based its affirmances solely on the second ground stated above—i.e., that it was enough if all the condominium units involved were intended to be used as a single residence, the lack of physical combination being of no consequence.

As in the case of the Finance Department's two-prong rule, the City Tribunal's single-prong it's-enough-if-a-single-residence-is-intended rule does not comport with the statutory language. It appears that, rather than focusing on the statute, the City Tribunal reached its decisions by accepting the main thrust of the Finance Department's rule but significantly modified it by eliminating the physical combination requirement. In any event, the City Tribunal's rule is clear enough, and it will be welcomed by all who come within it.

But what of the grantor whose grantee does not intend to use all of the condominium units as a single residence? Under the first of the ALJ alternative rulings, such a grantor would win. However, the City Tribunal pointedly refrained from endorsing that ground, saying in part:

> While we find that the [transfers involved were not] the sale of multiple residential condominium units, we decline to adopt the [ALJ's] conclusion that no sale of multiple residential condominium units from the same seller to the same buyer could ever be subject to the Higher Tax Rate Schedule. Under the facts in the matter at bar it is not necessary for us to address that issue at this time and, thus, we decline to do so. For this reason, we need not address whether, or the extent to which, the Appellate Division's decision in *Emerson Unitrust v. Commissioner of Finance of the City of New York*, 16 A.D.3d 201 (1st Dept. 2005) and the New York State Tax Appeals Tribunal's decision in *Lamparelli Construction Company, Inc.*, DTA No. 819886, May 25, 2006, require the Higher Rate Schedule to apply to a sale of multiple residential condominium units, cooperative apartments or one, two or three-family houses.

We are accordingly left with uncertainty as to what will happen in multiple-conveyance-but-not-intended-to-be-a-single-residence cases. Not having been specifically overruled on their first ground, will the City ALJs stick to their guns on that point? Will the Appellate Division and State Tax Appeals Tribunal decisions referred to in the last-quoted passage cause them to alter their view? We shall have to wait and see.

Endnotes

1. NYC Admin. Code § 11-2102.a(9)(i). The lower rate schedule provides for a rate of 1% where the consideration is $500,000 or less and 1.425% where the consideration is more than $500,000.
2. NYC Admin. Code § 11-2102.a(9)(ii). The higher rate schedule provides for a rate of 1.425% where the consideration is $500,000 or less and 2.625% where the consideration is more than $500,000.
3. *Real Property Transfer Tax on Bulk Sales of Cooperative Apartments and Residential Condominium Units*, Finance Memorandum 00-6 (June 19, 2000). See also FLR 054831-021 (June 9, 2005); FLR 994756-021 (undated); FLR 034801-021 (May 23, 2003); FLR 004761-021 (Aug. 23, 2000); and FLR 984736-021 (Mar. 23, 1999).
4. *Id.*
5. *In re David Gruber*, TAT(H) 03-07 (RP), TAT(H) 03-08 (RP), TAT(H) 03-09 (RP) (May 5, 2005); *In re Daniel and Shiela Rosenblum*, TAT(H) 01-31 (RP) (Nov. 9, 2004); *In re Cambridge Leasing Corp.*, TAT(H) 03-11 (RP) (Sept. 28, 2004).
6. In some cases, that would never occur, as, for example, if one of the condominium units was a so-called "maid's room" on a different floor or a storage space elsewhere in the building.
7. *In re David Gruber*, TAT (E) 03-07 (RP), TAT (E) 03-08 (RP), TAT (E) 03-09 (RP) (Sep. 12, 2006); *In re Daniel and Shiela Rosenblum*, TAT (E) 01-31 (RP) (Sep. 12, 2006); *In re Cambridge Leasing Corp.*, TAT (E) 03-11 (RP) (Sept. 12, 2006).

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Bergman on Mortgage Foreclosures:
New Roadblock in New York Evictions After Foreclosure

By Bruce J. Bergman

This is a point that occurs to us often—something we fervently believe. (Mortgage servicers, of course, agree with us heartily.) Post-foreclosure evictions should be less laden with difficulty than "usual" evictions. After all, the eviction after foreclosure is not a matter of lease interpretation or when or whether rent was paid, or whether lease terms have been breached or whether a Yellowstone proceeding is applicable. It is simply a situation where persons who have no right to occupy the now foreclosed premises are remaining in possession. In common parlance, they are hanging around when they don't belong there.

That being so, most unwelcome are further complications to slow up the process of a foreclosure sale purchaser (such as the foreclosing lender or servicer) proceeding to obtain physical possession of the property just purchased. But a recent case does indeed present such an impediment by ruling that the attorney for the foreclosure sale purchaser can*not* sign the required notice to quit. [*Washington Mutual Home Loans v. Calderon,* N.Y.L.J., Sept. 25, 2002, at 23, col. 3 (Owens Co., Civ. Ct., Housing Part, Katz, J.)]

Here's what this means to mortgage lenders and servicers in practical terms. Although there are two methods to prosecute evictions after foreclosure in New York [*see* RPAPL § 713(5) and RPAPL § 221], there are some places (particularly New York City) where the method may best be pursued in landlord and tenant court. That approach requires as a prerequisite the service of a ten-day notice to quit to the parties who are holding over at the foreclosed premises.

In turn, *someone* has to sign the notice to quit and typically and traditionally it was the owner's attorney (most often the foreclosing plaintiff's attorney) who would sign that notice to quit. It is apparent that first sending each notice to quit to a mortgage servicer to sign and return has the potential to add days or even weeks to the process of the eviction.

Traditionally, case law seemed to say that where the attorney for the party prosecuting the eviction was the same attorney who handled the foreclosure, then there was no surprise for the holdovers and there was no confusion about who was bringing the action and that was the key consideration. Thus, that attorney could sign the notice. The new case, however, says it isn't so and that absent some explanatory authority in writing—and attached to the notice to quit—the signature of the attorney on the notice to quit is insufficient so that any eviction based upon that notice to quit must fail.

Although this is a decision at a lower court level (housing part of civil court) it is published and is out there for other judges and the world to see. It suggests strongly that there is peril in an attorney signing the post-foreclosure notice to quit. The ready solution would be to obtain a limited power of attorney from each mortgage servicer and to annex it to each notice to quit. This would appear to eliminate the danger presented by this unfortunate new case.

Mr. Bergman, author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures* (Matthew Bender & Co., Inc., rev. 2004), is a partner with Berkman, Henoch, Peterson & Peddy, P.C., Garden City, NY; an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course; and a special lecturer on law at Hofstra Law School. He is also a member of the USFN and the American College of Real Estate Lawyers.

Case Note

Calvagno v. Bisbal, 430 F. Supp. 2d 95 (E.D.N.Y. May 2006)

This case concerns whether a buyer of property at a foreclosure auction, who had notice that the property was the subject of a predatory lending scheme, was a bona fide purchaser. A bona fide purchaser would know there was clear title to the property, and would not expect there to be claims against her title. The original owners, who were defrauded out of their home, used the Real Estate Settlement Procedures Act (12 U.S.C. § 2601) (RESPA) to obtain, in Federal Court, a temporary restraining order and preliminary injunction against an eviction proceeding in State Court. The Court had to determine first if it had jurisdiction, and second, whether an injunction was warranted.

Facts

The plaintiffs are Carol and Anthony Calvagno, who live in a house in Suffolk County that has been in their family for three generations. They claim to have been defrauded out of title to their house by certain of the defendants in an apparent predatory lending scheme. The defendants fraudulently induced the Calvagnos to transfer title to the property to other defendants, who then took out a mortgage on the property and began to charge the Calvagnos rent, saying they would be able to repurchase the house after two years of timely rent payments. The defendants, however, never forwarded any of the Calvagnos' rent payments to the mortgagee and the bank foreclosed.

The Suffolk County District Attorney prosecuted the defendants for fraud. The defendants had pled guilty and were awaiting sentencing at the time this case was decided. The Calvagnos alleged that, as a condition of the guilty plea, the house was supposed to have been deeded back to them, but the bank's efforts to sell the house at a foreclosure auction prevented that from happening; they also assert that the district attorney told them they would receive money restitution from the defendants, but never did.

Another defendant, Deborah Bisbal, purchased the property at the foreclosure auction, even though she was told by the Calvagnos about the fraud. She subsequently brought eviction proceedings against the Calvagnos in Suffolk County District Court.

Discussion

Jurisdiction

The Court determined that RESPA provided a basis for federal question jurisdiction. Section 2614 authorizes an action to be brought in federal court for violations of RESPA's provisions.

Preliminary Injunction

In order to be granted a preliminary injunction, according to the Second Circuit, a plaintiff must show: (1) irreparable harm; and (2) either (a) a likelihood of success on the merits, or (b) sufficiently serious questions going to the merits, and a balance of hardships tipping decidedly in the plaintiff's favor. The Court easily found that the Calvagnos would suffer irreparable harm by being evicted from their home.

The Court then noted the allegations of widespread fraud by the convicted mortgage brokers, and also by the bank and others who were involved in the transaction. The Court also noted possible violations of federal law under RESPA. Although it was clear that the defendants could assert the affirmative defense of the statute of limitations, the Court said the defense might be subject to estoppel or equitable tolling. Finally, the Court stated that the defendant, Bisbal, although not a party to the fraudulent transactions, was alleged to have been informed of the fraud and that she might not be a bona fide purchaser of the property. In a dispute over title, a bona fide purchaser would be protected against a claim by the true owner.

Outcome

The Court found that the plaintiffs were entitled to a preliminary injunction to halt their eviction, subject to the following: First, plaintiffs must post a security bond to cover costs and/or damages that might be incurred by the defendant. Second, the Court found it unfair that the Calvagnos had made no mortgage payments and had paid no taxes for several years while still living in the house, and ordered them to post a bond of $50,000; they also had to pay rent to Bisbal of $2,000 per month. Finally, the Calvagnos were directed to file a complaint in this action. If the Calvagnos did not comply with all the above conditions, the Court would permit Bisbal to make a motion to vacate the injunction. The preliminary injunction is to remain in effect until disposition of the case on its merits.

Susan Israel

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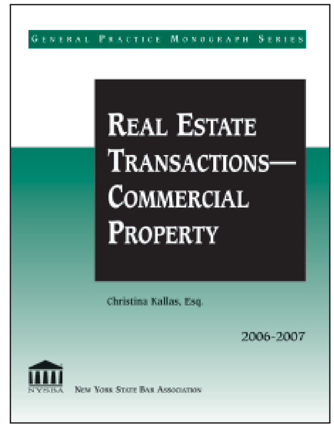

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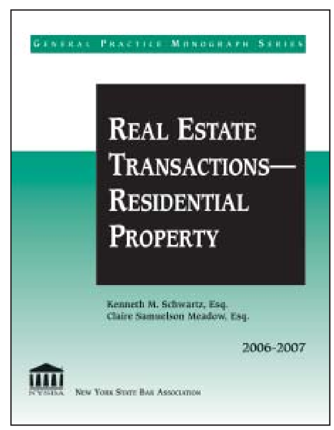

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