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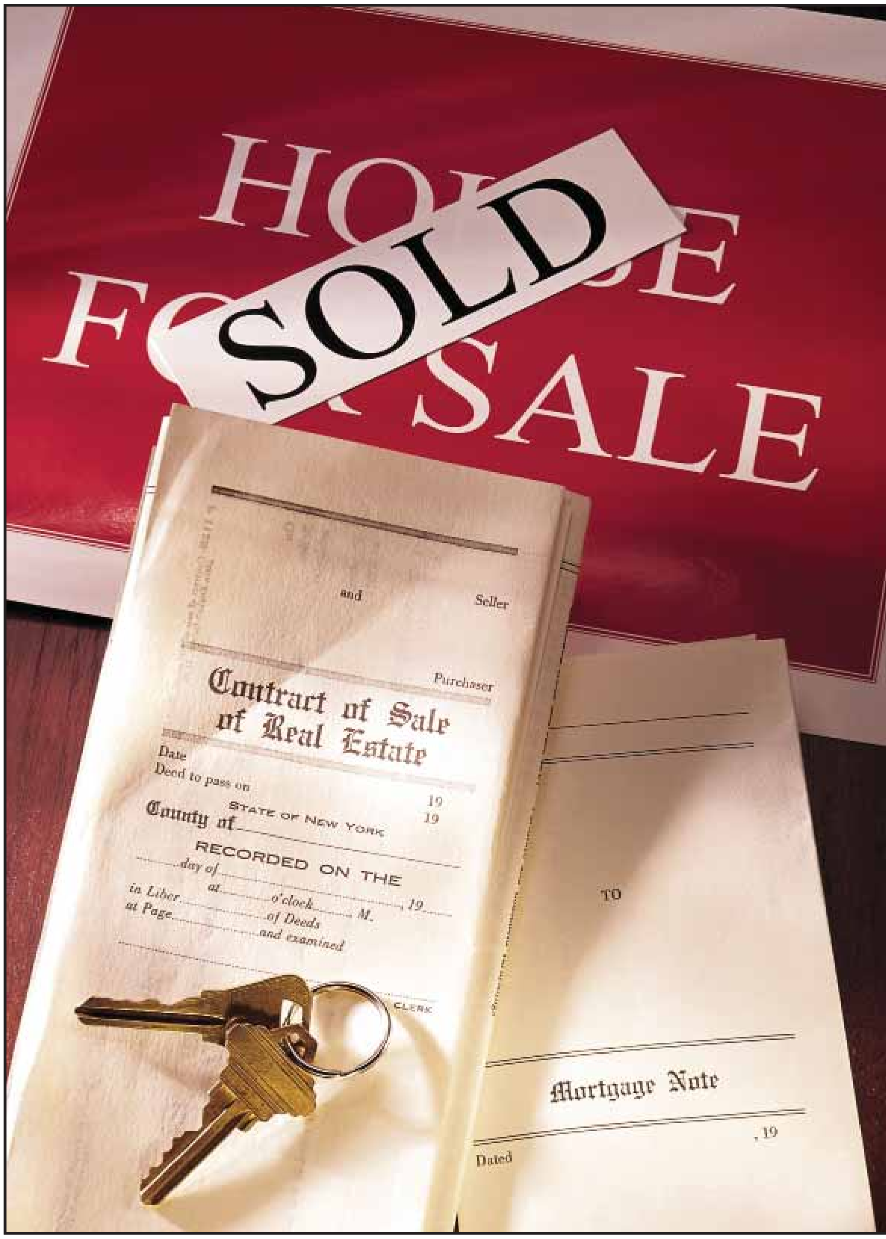

Inside

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Real Estate Transactions—Residential Property*

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Message from the Section Chair

I hope this message finds you all well and that you were able to enjoy some time off this summer. Our summer meeting in Ellicottville at the Holiday Valley Resort was a great success with beautiful weather, a quality CLE program, and fantastic company! I hope you can join us at the NYSBA Annual Meeting at the Hilton New York in New York City in January for another amazing CLE program. Our next summer meeting is going to be held in July at Crystal Springs Resort in Sussex County, New Jersey. More details to follow.

The Section has been very busy continuing to prepare and present numerous CLE programs throughout the state, following and commenting on proposed legislation and with projects like NYSBA President Vincent E. Doyle III's Section Diversity Challenge. Our Diversity Team of Harry Meyer, David Berkey, Mindy Stern and Marvin Bagwell is working hard on developing and executing our Diversity Plan. If you are interested in helping or have any ideas, we'd love to hear them!

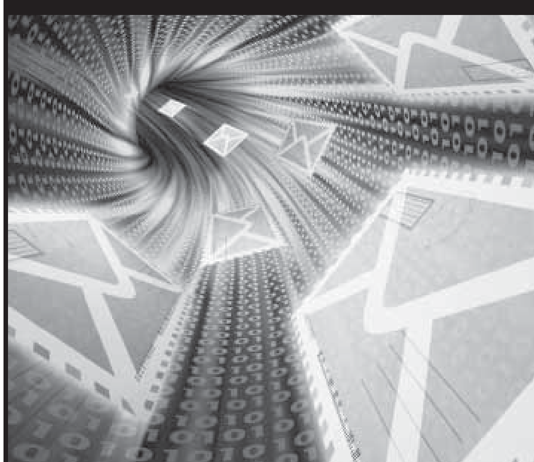
Thanks, in part, to our task force, among many other parties, electronic recording is becoming a reality. Follow the developments on the Section's blog. We are also finally seeing the end of the carbon form RP 5217 Real Property Transfer Report. The New York State Department of Taxation and Finance's Office of Real Property Services has announced the introduction of a new online Real Property Transfer Report, which is intended to eventually replace the paper version of this form. The counties of **Cortland, Essex, Orange, Onondaga and Tompkins** will be participating in a pilot project for the use of the online form. For the time being, each county will accept both the carbon form and the electronic version, but eventually each will phase out the original carbon.

Our thoughts are with our members affected by the flooding from Irene and subsequent rains—I hope that everyone is safe and that the damage suffered, if any, was minimal. As I type this I am preparing to travel to New York for our Executive Committee meeting on the 10th Anniversary of the attacks of September 11th and I am simultaneously receiving numerous emails from some Executive Committee members regarding further flooding in the Albany / Schenectady area and the Southern Tier / Binghamton area. These events certainly put life into perspective. As attorneys, I think we are by nature hard working, dedicated people, often to our own detriment. May you work hard, enjoy what you do, find success and have a fun and fulfilling personal life. Balance is the key.

Again, my "door" is always open. Should you have suggestions, comments or questions, please do not hesitate to contact me at hrogers@davidsonfink.com or at 585-546-6448.

Heather C.M. Rogers

Request for Articles



If you have written an article and would like to have it considered for publication in the *N.Y. Real Property Law Journal*, please send it to one of the Co-Editors listed on page 38 of this *Journal*.

Articles should be submitted in electronic document format (pdfs are NOT acceptable) and include biographical information.

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Why Is the Interstate Land Sales Act a Thorn in My Side?

By Vincent Di Lorenzo

In March 2011, the Second Circuit issued an opinion that restricted the possibilities available to developers of condominium or cooperative housing to claim exemption from the Interstate Land Sales Full Disclosure Act (ILSA).[1] The court's decision, in *Bodansky v. Fifth on the Park Condo, LLC*,[2] settled a difference of opinion in the lower courts regarding a developer's ability to avoid the requirements and remedies provided in the Act by piggybacking the exemptions contained in the Act. *Bodansky* involved a condominium development containing 160 residential units. The plaintiffs had signed contracts for purchase of units from June 2007 to May 2008 and were provided the offering plan filed under New York's Martin Act.[3] The developer did not, however, file a statement of record with the Department of Housing and Urban Development (HUD) and did not provide plaintiffs with the property report required under ILSA. As of September 10, 2009, the developer had signed contracts to sell 90 units, and on that date received a temporary certificate of occupancy. Plaintiffs attempted to rescind their contracts due to the developer's failure to comply with the requirements imposed by ILSA. The developer claimed it was exempt by piggybacking two exemptions contained in the Act: (a) an exemption for sale of less than 100 lots, applicable to the first 90 lots sold, and (b) an exemption for sale of "improved" lots applicable to all remaining condominium units sold after it obtained a temporary certificate of occupancy. The district court ruled in favor of the developer, allowing it to piggyback these two exemptions contained in the Act.[4]

The federal district court decisions in New York had reached conflicting conclusions when addressing the issue of piggybacking of exemptions. One line of authority, which included the lower court's decision in *Bodansky*,[5] allowed piggybacking of exemptions by concluding that nothing in the statute requires that the determination of the developer's eligibility for the 100-lot exemption must be determined at the time of the sale of any particular lot.[6] Another line of authority had effectively prevented piggybacking by concluding that the availability of an exemption from ILSA is determined at the time each purchaser signs their purchase agreement.[7] Thus, combining the 100-lot exemption with other exemptions would be allowed only if at the time of execution of a purchaser's sales contract fewer than 100 non-exempt lots were being offered for sale in a subdivision pursuant to a common promotional plan.

The Second Circuit's Decision

ILSA recognizes the possibility that the 100-lot exemption, contained in § 1702 (b), will be combined with one or more of the exemptions contained in § 1702 (a).[8] However the issue presented in the lower courts and to the Second Circuit was one of timing. The issue was whether the exemption for *all* units in the subdivision could be perfected later in time, and thus the exemptions could be piggybacked, or must be perfected at the time a purchase agreement is signed for any unit.

The *Bodansky* case is the first Circuit Court decision in New York that has interpreted the requirements and exemptions contained in ILSA. The Second Circuit acknowledged that ILSA did allow a sponsor to combine the 100-lot exemption with the exemptions contained in 15 U.S.C. § 1702(a), including the improved lot exemption.[9] However, it ruled that availability of exemption from the Act is determined at the time the contract to purchase any particular unit is signed.[10] The court relied on the terms of the statute to reach this conclusion. In part it relied on the terms of the statutory provision that grants purchasers a right to revoke. As the court explained:

> The revocation right under Section 1703(c) runs for 2 years from the date of contract signing. The possibility of revocation would be of limited value to purchasers if they had to wait an indefinite length of time to learn whether they could revoke. We do not believe that Congress enacted this consumer protection statute intending that when the statute was violated a diligent injured party could not timely invoke the statute's remedies. Rather, the text of ILSA suggests that a purchaser would be able to determine, *on the date of contract signing*, whether she could revoke her contract because the 100—lot exemption did not apply.[11]

The Second Circuit therefore vacated the district court's judgment and remanded the case. Of course, at the time plaintiffs had signed their contracts 160 lots were being offered for sale, and none of the lots were exempt under the improved lot exemption. Therefore, the development was not exempt at that time.[12]

ILSA's Requirements and Remedies

ILSA applies to sales of "lots."[13] It is well settled that the term "lot" includes offerings of condominium units, and it likely includes offerings of cooperative housing units as well.[14] It is also settled that while the Act's requirements apply to a "sale or lease,"[15] for purposes of ILSA a sale takes place at the time the purchaser signs the contract.[16]

The Act imposes three requirements: (a) developers must file a statement of record with HUD;[17] (b) developers must provide a property report to all purchasers before they sign any contract;[18] and (c) contracts for the sale of lots must contain certain terms and be in a particular form.[19] This last requirement has three components: (a) a contract must be in a form acceptable for recording, and contain a description of the lot which makes the lot clearly identifiable; (b) the seller must be contractually obligated to provide the purchaser with written notice of any default and must allow a right to cure within twenty days after receipt of such notice; and (c) in the event of a contractual breach by the purchaser which allows retention of the down payment by the seller, the seller's right must be limited to retention of no more than 15 percent of the purchase price.[20]

In recent years the New York courts have witnessed a fair number of lawsuits in which purchasers of units attempted to revoke their contracts based on the developer's failure to comply with one or more of the Act's requirements. This right to revoke a contract of sale due to the developer's failure to comply with ILSA's disclosure requirements is expressly granted in the Act. It provides:

> In the case of any contract or agreement for the sale… or a lot for which a property report is required by this chapter and the property report has not been given to the purchaser…in advance of his or her signing such contract or agreement, such contract or agreement may be revoked at the option of the purchaser or lessee within two years from the date of such signing, and such contract or agreement shall clearly provide this right.[21]

The right to revoke is also expressly granted in the event of seller's failure to comply with the required contractual terms discussed above.[22]

In *Bodansky*, the developer's acts of noncompliance were its failure to file a statement of record and provide a property report prior to execution of plaintiffs' contracts of sale.[23] In another recent decision in the Southern District of New York, the developer's act of noncompliance was a failure to comply with ILSA's contractual requirements.[24] In that case the plaintiffs had received a property report as required by ILSA. However, the purchase agreement was not in recordable form, it did not provide for notice or opportunity to cure in the event of purchaser's default, and it provided for a down payment of 20 percent of the purchase price, in stages, and a right to retain that down payment in the event of purchaser's default. The district court's opinion granted plaintiffs' motion for summary judgment in its action to enforce their right to revoke the contract of sale. The court's opinion was based on the conclusion that the contract did not comply with ILSA's requirements. Specifically, it was not in recordable form primarily because it was not acknowledged. The court also noted, however, that the description of the unit in the contract was not in a form capable of being recorded and the contract expressly stated that it may not be recorded by the purchaser.[25]

Exemptions under the Act

A developer that has failed to comply with one or more of the requirements of ILSA often attempts to avail itself of the exemptions contained in the Act. There are two sets of exemptions. Full exemptions relieve developers from all of the Act's requirements, prohibitions and remedies, including the prohibitions against fraudulent conduct. The list of full exemptions includes: (a) sale of lots in a subdivision containing less than 25 lots; (b) sale of "improved" land; and (c) sale of land under a "contract obligating the seller" to erect a building within a period of two years.[26] Partial exemptions relieve developers of the obligation to file a statement of record and provide purchasers with a property report, but not the Act's prohibition against fraudulent conduct or other requirements. The list of partial exemptions includes the sale of lots in a subdivision containing fewer than 100 lots "which are not exempt under" section 1702 (a).[27]

Thus, prior to the Second Circuit's decision in *Bodansky*, the line of authority that permitted developers to piggyback exemptions by combining the 100-lot exemption with the improved land exemption or another exemption in § 1702 (a) excused far more developers from the need to comply with ILSA. As a result, it allowed fewer purchasers to invoke the Act's rescission remedy. The Second Circuit's decision has the effect of granting a right of rescission to a greater number of purchasers. The federal district court's decision in *Bacolitsas* would expand the number of potential purchasers that could claim the rescission remedy even further since most contracts for sale of condominium or cooperative units are not in recordable form. That decision is being appealed.

"I've Already Provided Extensive Disclosures"

Developers of condominium or cooperative units in New York who become subject to ILSA's requirements and remedies are often befuddled by their predicament. They claim that they have complied with all the filing and disclosure requirements of the Martin Act, which are more extensive than ILSA. Therefore, arguably, purchasers have been adequately protected in their need for reliable information prior to making a decision to purchase.

Congress addressed the issue of possibly duplicative federal and state disclosure requirements. However, the Act's provisions do not serve to excuse developers of New York condominiums and cooperatives from the need to comply with ILSA based on compliance with the Martin Act.

ILSA allows for substitution of state disclosure materials for the statement of record and property report required under ILSA.[28] However, a state must be "certified." In order for certification to occur there must be a finding that (a) state laws require disclosure of information which is at least substantially equivalent to that required to be disclosed under ILSA, (b) the state's administration of its laws provides, to the maximum extent practicable, that the information required to be disclosed is accurate, and (c) state laws, taken as a whole, provide sufficient protection for purchasers.[29] These requirements could be easily satisfied with respect to New York's Martin Act and the administration of the Act by the New York Attorney General's office. However, there is one additional requirement for certification. ILSA also provides:

> Any State requesting certification must agree to accept a property report covering land located in another certified State but offered for sale or lease in the State requesting certification if the property report has been approved by the other certified State. Such property report shall be the only property report required by the State with respect to the sale or lease of such land.[30]

New York State disclosure requirements have not been certified due to this final requirement. The court in *Bodansky* was sympathetic to the developer's claims that it would be subject to two sets of disclosure requirements—state and federal—that substantially overlap without providing additional protection for purchasers. However, the court concluded that concern had to be addressed by Congress.[31]

Conclusion

The Second Circuit's decision in the *Bodansky* case has limited the situations in which developers can claim exemption from ILSA by forbidding piggybacking of exemptions. As a result, in situations where the developer has not complied with ILSA's registration and disclosure requirements, more condominium unit purchasers can revoke their contracts pursuant to ILSA. That right is extended to an even greater number of purchasers under the lower court's decision in *Bacolitsas*. We await the outcome of appellate review of that decision to assess how large a group of purchasers can now seek revocation of their contracts.

Endnotes

1. 15 U.S.C. §§ 1701-1720 (2011).
2. 635 F.3d 75 (2d Cir. 2011).
3. N.Y. Gen. Bus. Law § 352-e (McKinney 2009).
4. *Bodansky*, 635 F.3d at 77-79.
5. 732 F. Supp. 2d 281 (S.D.N.Y. 2010), *vacated*, 635 F.3d 75 (2d Cir. 2011).
6. *See Bodansky*, F. Supp. 2d at 287-88; *see also* Romero v. Borden E. River Realty LLC, No. 09-CV-655, 2010 WL 5758981 (E.D.N.Y. Mar. 11, 2010) (explaining that Congress included timing requirements in other exemptions under § 1702 (b) but none in the 100-lot exemption); Pasquino v. Lev Parkview Developers, LLC, No. 09 Civ. 4255 (LMM) (S.D.N.Y. Dec. 8, 2010) (explaining that plaintiffs' motion for summary judgment denied substantially for the reasons set forth in the district court opinion in *Bodansky*).
7. *See* Griffith v. Steiner Williamsburg, LLC, 760 F. Supp. 2d 345, 356–58 (S.D.N.Y. 2010) (discussing other federal and state court decisions in other states that have drawn the same conclusion); *see also* Nu-Chan, LLC v. 20 Pine St. LLC, No. 09 Civ. 00477 (PAC), 2010 WL 3825734, at *3 (S.D.N.Y. Sep. 30, 2010); Tencza v. Tag Ct. Square, LLC, No.10 Civ. 3752 (RJH), 2011 WL 3610582, at *3 (S.D.N.Y. Aug. 12, 2011).
8. 15 U.S.C. § 1702 (b)(1) (authorizing exemptions for sale of lots in a subdivision containing fewer than one hundred lots which are not exempt under subsection (a)).
9. *See Bodansky*, 635 F.3d at 81.
10. *See id.* at 83-87.
11. *Id.* at 83 (emphasis added).
12. *Id.*
13. 15 U.S.C. § 1703.
14. *E.g.* Winter v. Hollingsworth Props., Inc., 777 F.2d 1444, 1448 (11th Cir. 1985) (and cases cited therein); Cruz v. Leviev Fulton Club, LLC, 711 F. Supp. 2d 329, 331 (S.D.N.Y. 2010) (and cases cited therein) (referring to sale of condominium units). *See also* 24 C.F.R. § 1710.1 (West 2011) (defining "lot" as any division, unit or undivided interest in land if the interest includes the right to exclusive use of a specific portion of the land).
15. 15 U.S.C. § 1702 (a).
16. *E.g., Winter*, 777 F.2d at 1449; Markowitz v. Ne. Land Co., 906 F.2d 100, 104 (3d Cir. 1990).
17. 15 U.S.C. §§ 1703(a)(1)(A), 1704-1706.
18. 15 U.S.C. §§ 1703(a)(1)(B), 1707.
19. 15 U.S.C. § 1703(d) (providing for a right to revoke if the contractual requirements are not satisfied).
20. *Id.*
21. *Id.* § 1703(c).
22. *See id.* § 1703(d).
23. *See* Bodansky v. Fifth on the Park Condo, LLC, 635 F.3d 75, 81 (2d Cir. 2011) (indicating that ILSA "requires developers to submit a 'statement of record' to HUD…before selling…any nonexempt lot," and that "it is unlawful 'to sell…any lot'" without providing a printed property report to the purchaser prior to signing of a contract).
24. Bacolitsas v. 86th & 3rd Owner, LLC, No. 09 Civ. 7158 (PKS), 2010 WL 3734008, at *7 (S.D.N.Y. Sept. 21, 2010).
25. *See id.* at *5-8.
26. 15 U.S.C. § 1702(a).
27. *Id.* § 1702(b).
28. *Id.* § 1708(b).
29. *Id.* §§ 1708(a)(1)-(2).
30. *Id.* § 1708(a)(3).
31. *See* Bodansky v. Fifth on the Park Condo, LLC, 635 F.3d 75, 86 (2d Cir. 2011).

Vincent Di Lorenzo is professor of law at St. John's University and author of *New York Condominium and Cooperative Law* (West).

The Practitioner's Guide to Residential Real Estate Transactions: The Joint Bar Association Residential Real Estate Contract

By John G. Hall and Thomas J. Hall[1]

Part I: Introduction

The purpose of this series of articles will be to familiarize practitioners with the basic principles of residential real estate practice. These articles will first examine the real estate contract and then examine various forms of deeds and collateral documents such as the real property transfer tax returns and other ancillary documents that must accompany a deed for recording. The title report and title policy and their appropriate endorsements will be examined in the future as will be the basic principles of mortgage financing.

The initial articles will deal with the specific provisions of the residential real property contract. The contract that will be analyzed is the one currently prepared and approved by the Real Property Section of the New York State Bar Association, New York State Land Title Association, the Committee on Real Property Law of the Association of the Bar of the City of New York and the Committee of Real Property Law of the New York County Lawyers Association (the "Joint Bar Contract"). Although other form contracts are currently utilized by some practitioners, particularly the New York Board of Title Underwriters contract,[2] the Joint Bar Contract contains virtually everything that is in the New York Board of Title Underwriters contract. Frequently practitioners had enhanced the New York Board of Title Underwriters contract by utilizing their own riders to that contract. Most provisions that you would see in such a rider are now incorporated in the Joint Bar Contract. Nevertheless, as is the case with virtually every form contract, there are provisions in the Joint Bar Contract that are frequently subject to some disagreement among practitioners. In particular the provisions dealing with the mortgage contingency clause and the escrow provision for the down payment are often heavily negotiated. In subsequent installments of this series, the differences of opinion among practitioners as to these and other provisions of the Joint Bar Contract will be discussed.

Part II: Disclaimers

Turning to the Joint Bar Contract itself, the first area of examination should be the disclaimers at the top of page 1 of the contract. The first disclaimer states:

> **WARNING: NO REPRESENTATION IS MADE THAT THIS FORM OF CONTRACT FOR THE SALE AND PURCHASE OF REAL ESTATE COMPLIES WITH SECTION 5-702 OF THE GENERAL OBLIGATIONS LAW ("PLAIN LANGUAGE").**

Generally, this disclaimer of the plain English law is not of much significance especially in downstate New York. The reason for this is that Section 5-702 of the General Obligations Law[3] only applies to contracts of $50,000 or less, where the subject of the transaction is primarily for personal, family or household purposes. As we are all aware, it is extremely rare that there is an improved piece of property sold for less than $50,000.00. In any event, the Joint Bar Contract has made an attempt to provide that its provisions are in plain English and are appropriately divided by captions as required by the statute. More importantly, the provisions of the General Obligations Law provide that a violation of the plain English language provisions should not be subject to any action for rescission or to render the contract void or voidable. A violation of the provision shall not constitute a defense in any action to enforce the agreement or for breach of the agreement. Finally, the penalty for violation of its provisions is limited to actual damages sustained plus the sum of $50.00. It would seem that it would be a Herculean task to prove "actual damages" for failure to use "plain English," especially when the parties have been represented by counsel in the negotiation and execution of the contract.

The next disclaimer at the top of the contract deals with provisions of Section 5-1311 of General Obligations Law:[4]

> **NOTE: FIRE AND CASUALTY LOSSES AND CONDEMNATION.**
>
> This contract form does not provide for what happens in the event of fire, or other casualty loss or condemnation before the title closing. Unless different provision is made in this contract Section 5-1311 of the General Obligations Law will apply. One part of that law makes a Purchaser responsible for fire and casualty loss upon taking possession of the Premises before the title closing.

This provision is of significantly more importance than the plain language provision. Section 5-1311 of the General Obligations Law, subdivision (b) makes a Purchaser who takes possession of the subject premises, prior to closing, responsible for any fire and casualty loss that occurs on the premises. Whether or not there is a recovery from any fire insurance company would depend on whether or not the Purchaser in possession had insurance on the property (assuming he had an insurable interest)[5] or whether the terms of the Seller's policy provides that the coverage would continue to cover even though the Seller is out of possession. It is therefore clear that permitting the Purchaser to take possession prior to closing without providing adequate insurance coverage for the premises could have very serious consequences. The Seller should be sure that his insurance will not be voided by the Buyer taking possession.

Contract of Sale made as of 20
BETWEEN

Address:

Social Security Number / Fed. I.D. No(s):
hereinafter called "Seller" and

Address:
Social Security Number / Fed. I.D. No(s):
hereinafter called "Purchaser"

This portion of the contract which designates the parties to the contract, on initial observation, seems to be relatively simple. Nevertheless, it is an area fraught with danger for the practitioner. When specifying parties to a contract, especially if they are corporations, partnerships, limited liability companies or other entities, the precise names must be specified exactly. For example, "ABC Building Corp." is a different legal entity than "ABC Building Corporation." The correct names of New York corporations and LLCs can be easily verified by going to the Department of State's website.[6] In addition, the failure to specify proper addresses can create subsequent problems. Utilizing Post Office Box 222 or in care of John Smith, Esq. are areas that lead to trouble in the event of litigation. For instance, in the event of a subsequent lawsuit, a party to a contract may not be able to locate the other party to the contract for purposes of service. In addition, where a party is an entity, it should specify its state of formation. For instance, "Ajax Corporation, a New York corporation," or "Beta Company LLC, a Delaware limited liability company" or whatever else may be the status. Again, these simple things are important in the event there has to be subsequent service in a resulting lawsuit. Moreover, if a party's name is incorrect on the contract, it will often lead to endless headaches throughout the transaction as other parties involved, such as mortgage lenders and title companies, will look to the contract to prepare documents, run credit reports, perform various searches (*e.g,* bankruptcy searches, judgment searches). Getting the names precisely correct in the contract can therefore avoid nuisances like having to re-run searches or crossing out and initialing changes on a voluminous stack of paper at the closing table.

Frequently contracts are made by "ABC Company" to the Purchasers with no indication of what type of entity "ABC Company" is. It could be a partnership, or perhaps a foreign corporation such as a New Jersey Corporation.

New York practitioners of course realize that "ABC Company" could not be a New York corporation because of the provisions of Business Corporation Law Section 301(a)(1).[7]

Another frequent error in designating the parties to a contract is the utilization of a trust as a grantor or a grantee. A trust cannot hold title.[8] Title can only be held by a trustee. Therefore, a sale from the John Smith Living Trust or a purchase by the Mary Brown Family Trust would be ineffective in transferring title. Where a trust is involved, title resides in the trustee, so a deed would therefore have to be made by "Thomas Trustee as trustee of the John Smith Living Trust." Before preparing the contract, the trust agreement should be examined to be sure that the property is alienable and the trustee or trustees signing have the authority to do so.[9]

Other areas of concern in specifying parties would include designations such as "Alfred Allamerican as Agent for Peter Principal" or "Nathan Numb as Nominee."[10] Also, it is important to determine that the Seller is not an incompetent. The contract is void if made by an adjudicated incompetent.[11] If the contract is made by an unadjudicated incompetent the contract is voidable.[12] Whether void or voidable the contract cannot be set aside against a bona fide Purchaser for value without notice.[13]

If a contract is made by an infant it is not void but merely voidable.[14] It may be avoided by the infant within ten years or until three years after reaching his or her majority, whichever is later[15] even against a bona-fide Purchaser for value.[16]

If the contract of sale is for all or substantially all of the corporation's assets or is not made in the ordinary course of the corporation's business, shareholder approval is necessary.[17] If a conveyance is made in the ordinary course of business, only board of director approval is necessary and a recital in the Deed that the "conveyance is made in the ordinary course of business of the Seller" will protect the Purchaser.[18]

If the Seller is a religious corporation, the contract should be made subject to the approval of the Supreme Court, as a court order approving the contract will be required in order to convey title.[19] If the corporation is a type B or C corporation under the Not For Profit Corporation Law, and the sale is of all or substantially all of the corporation's assets, Supreme Court approval is required.[20] If a type A or D Not For Profit Corporation, no court approval is required unless required by another statute.[21]

Care should be taken to be cognizant of the "Entity Concept" of partnership property. If title is in the name of the "ABC Partnership" a conveyance by "A, B and C Copartners of the ABC Partnership" will be deficient.[22]

Contracts by fiduciaries should specify the authority, for example:

"John Smith as attorney in fact for Mary Jones" or

"Frank Faithful as Executor of the Estate of Daniel L. Dead"

The utilization of post office boxes for addresses should be avoided. The County Clerk will not record an instrument without a street address on it.[23] Consequently when a deed is later prepared from a contract with post office box addresses the attorneys are only creating trouble for themselves and the title insurer.

The informational portion of the contract also utilizes an "as of" date which allows the parties to agree that the contract is effective as of a date other than the actual signing date.

Part III: Premises

> **1. Premises.** Seller shall sell and convey and Purchaser shall purchase the property, together with all buildings and improvements thereon (collectively the "Premises"), more fully described on a separate page marked "Schedule A," annexed hereto and made a part hereof and also known as:
>
> Street Address:
>
> Tax Map Designation:
>
> Together with Seller's ownership and rights, if any, to land lying in the bed of any street or highway, opened or proposed, adjoining the Premises to the center line thereof, including any right of Seller to any unpaid award by reason of any taking by condemnation and/or for any damage to the Premises by reason of change of grade of any street or highway. Seller shall deliver at no additional cost to Purchaser, at Closing (as hereinafter defined), or thereafter, on demand, any documents that Purchaser may reasonably require for the conveyance of such title and the assignment and collection of such award or damages.

Paragraph 1 of the Joint Bar Contract in its initial sentence contains the Seller's agreement to sell and the Purchaser's agreement to purchase the property. The question then arises as to what constitutes the property. Clearly the property would include all of the real estate described in the description annexed to the Contract. However, the standard contract goes beyond that and states that the sale is "together with all buildings and improvements thereon (collectively 'the premises')." As lawyers the first question we would ask ourselves is why does the standard contract not use the word "fixtures" but instead uses the words "buildings and improvements." Clearly, any building permanently attached to the premises would be a fixture and would be conveyed together with the real estate to which it is permanently affixed. The term "improvements" includes more than fixtures.[24] Improvements could conceivably cover some of the items set forth in the personal property clause which is paragraph 2 of the form contract. Determining what constitutes fixtures was explored at great length in the Appellate Division (Second Department) in the case of *Sigrol Realty Corp. v. Valcich.*[25] In that case the issue was whether or not certain bungalows situated on real property were fixtures. The bungalows were not permanently affixed and were movable. The Appellate Division, Second Department stated that whether chattels annexed to realty remain personalty or become realty is determined by classifying those chattels into three different classifications. The Court stated:

> (1) Some chattels such as gas ranges because of their character as movables remain personalty after their annexation regardless of any agreement between the chattel owner and the land owner…. (2) Other chattels such as brick, stone and plaster placed in the walls of the building become realty after annexation regardless of any agreement to the contrary between the chattel owner and the land owner. Such personal property does not retain its character as such if it is annexed to the realty in such manner as to become an integral part of the realty and be movable without practically destroying the personal property or if all or a part of it be essential to the support of the structure to which it is attached…(3) Still other chattels after attachment continue to be personalty or become realty in accordance with the agreement between the title owner and the land owner….

The court in the *Sigrol* case determined that the bungalows in question fell into category (3) and retained their classification as personalty. It is therefore evident that the inclusion of the word "improvements" in the standard form should be an integral part of the contract, certainly from the Purchaser's point of view.

Paragraph 1 in referring to the premises states as "more fully described on a separate page marked 'Schedule A' annexed hereto and made part hereof and also known as:

Street Address:

Tax Map Designation:"

Both the Seller's attorney and the Buyer's attorney should take great efforts to insure that there is an annexed Schedule A to the contract of sale. A street address description alone could lead to great difficulties between the parties. For instance, assume that the property consists of two tax lots but the premises 62 Broadway exists only on one of the two tax lots. Clearly an issue could develop as to whether the Seller intended to sell both tax lots or only intended to sell the tax lot and building designated as 62 Broadway.

It should also be kept in mind that tax map descriptions change and are frequently inaccurate. Therefore relying on a tax map description could also create great difficulties between the Buyer and the Seller especially where the tax map and the record description are not the same.

For instance, assume that the tax map is five feet wider than the actual described property. Certainly an issue would develop as to whether or not the Purchaser would be entitled to reject title or procure damages.

Schedule A attached to the contract should be prepared from the

Seller's existing deed and/or title policy. Of course, Seller's counsel should be sure that Seller intends to sell everything described. If he only intends to sell half of what is described, obviously the description from the prior deed cannot be utilized.

Basically, there are three types of descriptions: (1) A metes and bounds description which describes the property by monumentation, courses and distances. Of all the descriptions, assuming it has been properly prepared from an accurate survey, it is the most accurate and the one that preferably should be used. (2) The second type of description is a description of lots on a filed map. These descriptions have historically been very accurate and frequently utilized in conveyancing. However, in recent years certain County Clerks will no longer take a description with only lots on a filed map. They insist that the filed map description be followed with a metes and bounds description or at a minimum, a diagram of the tax lot. When a metes and bounds description follows lots on a filed map description, the succeeding metes and bounds description can either be preceded by a preamble providing "said premises being bounded and described as follows" or "said premises being *more particularly* (emphasis added) bounded and described as follows." If it is the first and there is a discrepancy between the filed map lots and the metes and bounds description, the filed map lot description will prevail. If the second is utilized and there is a discrepancy between the metes and bounds description and the filed map description, the metes and bounds description will prevail.

Although properties can also be described by a tax block and lot, the attorneys involved should be aware that tax blocks and lots are not always the same and could have changed by virtue of an apportionment between the time of the acquisition of the original deed and the proposed contract. Also, they should be aware that frequently tax lots do not coincide with the metes and bounds description. Therefore, a tax block and lot description is not a preferable way to prepare a contract or convey.

The courts have also held that a description describing the premises as "being known as and by street number" will not cure a defective description.[26]

It is good practice to add after the description a same premises clause[27] which usually is set forth in the following form:

> Being the same premises described in and conveyed to the sellers (to be changed to the grantors in the deed) by deed dated ______ and recorded in the office of the Clerk of the County of ____________ in Reel ____ Page _____.[28]

A same premises clause can cure a description which standing along would not be sufficient to convey the entire lot.[29] A same premises clause can also clear certain questions of identity. For instance, if title is acquired by John R. Smith and Mary J. Smith but is conveyed by John Smith and Mary Smith no question of identity need be raised if the deed conveyed includes the same premises clause. The same premises clause is also helpful in having abstracters be able to complete their chain of title more efficiently. However, care should be taken not just to copy the prior same premises clause because the grantor and grantee in the prior clause would be different as would be the recording information. A new same premises clause should be prepared for each subsequent transaction. As previously set forth it is essential that the same premises that were acquired are being conveyed. If you only intended to convey part of the property acquired, the same premises clause should read: "being part of the same premises acquired," etc.[30]

Street widenings or acquisitions of property for street purposes can radically change the prior description. If a piece of property fronting on a street is 100 feet deep but the street is widened to 10 feet by 10 feet, the property to be described would no longer be 100 feet, it would be 90 feet. If the description runs 100 feet from the widened street line, the effect will be that the Seller or grantor has no valid title to the rear 10 feet of the property. Similarly, if the description begins from an intersection and the intersecting street has been widened 10 feet, if the original distance was 150 feet from the corner, the widening would result in the premises being conveyed only being 140 feet from the corner. So care should be taken if the attorney is aware of any street widenings.

An integral part of paragraph 1 of the standard contract contains what is known as a streets rights clause. That clause states, "together with Seller's ownership and rights, *if any*, (emphasis added) to land lying in the bed of any street or highway, opened or proposed, adjoining the Premises to the center line thereof…." Although the Seller does not have to convey good title to the Purchaser to the street he has to give the Purchaser whatever title he has. If title is in the City of New York, the Seller is not obligated to deliver title to the street to the Purchaser. This clause is extremely important and should never be removed from the contract. In the event the street is later condemned, the owner would acquire any condemnation award that would be payable as a result of the condemnation. If there were no streets rights clause, the owner would not be entitled to any condemnation award which conceivably could be payable to a prior owner. There have been instances where vacant land has been sold and the streets rights clause has been crossed out of the contract. In those cases the purchaser would be obligated to accept a deed without the clause. Where the particular street has not been legally opened and the purchaser wishes to hook into an existing sewer lying in the bed of such privately owned street he may very well need the consent of his grantor which might come at a steep per house price. This might even ocucr if the grantor did not reserve rights to the street. In those cases, without a streets rights clause the Purchaser would not have a right to hook into any existing sewer or sewers lying in the bed of this privately owned street without procuring the consent of the owner. That consent of the owner might conceivably come at a very expensive price.

The balance of the streets rights clause provides that the sale includes any condemnation award that may be forthcoming by either an acquisition of title to the street or by raising or lowering the grade of the street. It also provides that the Seller shall deliver at no additional cost to the Purchaser such documents as the Purchaser may require to collect the condemnation award. It should be kept in mind in the City of New York that there are many instances where title has come through the City of New York in which instances the City of New York has put a covenant in its deeds limiting future condemnation awards to $1.00. Obviously in those cases there would be no award for the acquisition of the street or change of grade. Occasionally builders in order to build on an unmapped street execute forms known as change of grade waivers, which are recorded in the chain of title and run with the land. In these case if the street is raised or lowered when finally mapped, the owner would not be entitled to damage for change of grade because they were waived. Where a street is raised, leaving the property below grade, there is always danger from flooding.[31]

The first sentence of Personal Property clause sets forth that the sale includes "all fixtures and articles of personal property now attached or appurtenant to the premises, *unless specifically excluded below*." The end of the personal property clause in the form then excludes "furniture and household furnishings." The question then becomes what is meant by the phrase "attached or appurtenant to the premises"? Although there is case law on the topic, the question of whether a particular item is "appurtenant" is a question of fact to be decided by taking into consideration all relevant facts and circumstances.[32] Clearly, this is not a sufficiently certain standard for practicing attorneys to rely upon. Any attorney who has been involved in an otherwise smooth closing that deteriorated into an acrimonious affair over whether the washing machine was or was not intended to be included in the sale will concur that the "question of fact" analysis is unworkable in a transaction.

Fortunately, the third sentence of the personal property clause provides some further guidance on what items are considered "attached or appurtenant to the property" by stating "they include but are not limited to" a whole laundry list of items ranging from obvious items such as plumbing and heating fixtures to less significant items such as switch plates, weather vanes and window boxes. Clearly then, it is important for the Seller's attorney to include only those items which the Seller intends to sell to the Buyer and specifically exclude anything that would otherwise be considered "attached or appurtenant to the property" if the Seller does not intend to sell a particular item as part of the transaction. Conversely, the Buyer's attorney will want to be sure that everything the Buyer understands to be included in the sale is specifically set forth as items included in the "laundry list" of items which are "attached or appurtenant to the property."

Although the personal property clause is seemingly a simple matter, there is no substitute for each attorney carefully reviewing the accuracy of the clause with his or her client. At the time the contract is being negotiated, clients will frequently laugh at the question of whether, for example, the weather vane is included in the sale. When they get to the closing and a dispute occurs over whether a refrigerator should have been removed, they are no longer laughing; they are looking to their attorney as to how this could have happened.[33] Proper draftsmanship eliminates these "simple" problems.

It should also be noted that the significance and detail of the personal property clause will also vary depending on the type of property being sold. For example, an extremely detailed schedule of personal property would be expected if a hotel or multi-unit apartment building is being sold. Similarly, any contract for the sale of commercial property should prompt both attorneys to think carefully and consult with their respective clients as to the personal property to be included which, depending on the type of commercial use, could be a significant matter.

Another issue to be considered by the attorneys is the "warranty of title" to the personal property which the Seller gives to the Purchaser. The second sentence of the personal property clause provides that the "Seller represents and warrants that at closing, [the personal property]

Part IV: Personal Property

2. Personal Property. This sale also includes all fixtures and articles of personal property now attached or appurtenant to the Premises, unless specifically excluded below. Seller represents and warrants that at Closing they will be paid for and owned by Seller, free and clear of all liens and encumbrances, except any existing mortgage to which this sale may be subject. They include, but are not limited to, plumbing, heating, lighting and cooking fixtures, chandeliers, bathroom and kitchen cabinets and counters, mantels, door mirrors, switch plates and door hardware, venetian blinds, window treatments, shades, screens, awnings, storm windows, storm doors, window boxes, mail box, TV aerials, weather vane, flagpole, pumps, shrubbery, fencing, outdoor statuary, tool shed, dishwasher, washing machine, clothes dryer, garbage disposal unit, range, oven, built-in microwave oven, refrigerator, freezer, air conditioning equipment and installations, wall to wall carpeting and built-ins not excluded below (*strike out inapplicable items*).

Excluded from this sale are furniture and household furnishings

will be paid for and owned by Seller, free and clear of all liens….” While this warranty is frequently not a concern because a Seller has usually purchased the personalty prior to entering into the contract, such is not always the case. For example, if a tenant has recently vacated an apartment in a two family home and left behind furniture, a refrigerator, an air conditioning unit, etc., the Seller does not have title to those items, which may be subject to a claim of ownership by the tenant that has vacated. Similarly, if a Seller acquired title through a Referee's Deed in Foreclosure and personal property was simply left at the premises, the Seller would not have title to that property. Whenever there is doubt as to the Seller's ownership of personal property, the "warranty of title" in the personal property clause should be deleted. The contract should be modified to provide that while the Seller will not remove the items of personal property, the Seller makes no representation or warranty as to the ownership thereof.

Although the issue rarely arises, counsel should be aware that the sale of personal property can result in liability for sales tax.[34] Although the obligation to pay any sales tax falls on the Purchaser, the Seller is typically required to collect it and, if the Seller fails to do so, the Seller may be liable for the tax. Therefore, if a particular transaction involves personal property that is significant, Seller's counsel may want to apportion a portion of the Purchase Price to personal property, collect and pay the sales tax to the taxing authority.[35]

Paragraph 3 of the Contract sets forth the basic financial terms of the transaction including the full purchase price, the amount of the contract deposit,[36] the amount of the existing mortgage which will remain on the property after the closing (i.e. the amount of mortgage the Buyer has agreed to take "subject to"),[37] the amount of any purchase money mortgage from Purchaser to Seller[38] and the balance due at closing.[39]

As an initial matter, counsel should be sure that the total of the figures in paragraphs 3(a) through 3(d) equals the total purchase price set forth in the beginning of Paragraph 3. In addition, it should be noted that in most residential transactions, the Purchaser will be applying for financing to a third party lender. The amount of that financing (the Mortgage contingency amount) ***is not*** set forth as a separate item in paragraph 3.[40] The mortgage contingency amount is set forth in paragraph 6 of the contract.

Paragraph 3(a) provides that the contract downpayment or deposit is to be paid "on signing of this contract by Purchaser's *good* check payable to the Escrowee...subject to collection." Although a certified or bank check is not required for the downpayment, the check provided must be "good." If the Purchaser's check is dishonored for any reason, the Purchaser has defaulted under the contract. In such event the Seller may sue on the check and is entitled to recover the amount of the check regardless of whether the Seller has suffered any damages caused by Purchaser's breach. This is so because the Purchaser would not otherwise be able to default on the contract without forfeiting the deposit as liquidated damages.[41]

The payment of the downpayment pursuant to the contract gives the Purchaser an equitable lien on the Seller's interest in the real property.[42] As a result, if the Seller defaults under the contract, one of the Purchaser's remedies is to foreclose the so-called vendee's lien.[43] Paragraph 24 of the contract acknowledges the existence of the vendee's lien, provides that the amount of the lien includes, in addition to the deposit, the reasonable expenses of examination of title and any survey and survey inspection charges, and further provides that the lien terminates after the Purchaser's default.

Paragraph 3(a) contemplates that the downpayment will be held by an Escrow Agent in accordance with the Escrow provision set forth in Paragraph 6 of the Contract. Customarily, the Escrow Agent is the Seller's Attorney. Placing the downpayment in escrow (as opposed to releasing it to the Seller) has the obvious advantage of safeguarding the money between the contract and closing. Utilizing an Attorney Escrow Agent has the further advantage of providing the parties with the benefits of the Lawyers Fund for Client Protection in the rare event that the Escrow Agent defalcates.[44] Although the downpayment is typically placed into an IOLA attorney trust account, the Seller's attorney should be aware of his or her obligation to place the contract deposit into an interest-bearing account for the benefit of the parties in the appropriate circumstances.[45]

Finally, the Seller's attorney should be mindful of the issue of whether the FDIC insurance applicable to the escrow deposit is sufficient.[46] In one recent case,[47] contract escrow deposits for one client totaling $2,730,000.00 were placed into the Seller's Attorney Trust Account. Between the contract and closing,

3. Purchase Price. The purchase price is $500,000.00 payable as follows:

(a) on the signing of this contract, by Purchaser's good check payable to the Escrowee (as hereinafter defined), subject to collection, the receipt or which is hereby acknowledged, to be held in escrow pursuant to paragraph 6 of this contract (the "Downpayment"):	**$50,000.00**
(b) by allowance for the principal amount unpaid on the existing mortgage on the date hereof, payment of which Purchaser shall assume by joinder in the deed:	**$100,000.00**
(c) by a purchase money note and mortgage from Purchaser to Seller:	**$200,000.00**
(d) balance at Closing in accordance with paragraph 7:	**$150,000.00**

the depositary bank failed. The Seller only recovered approximately one third of the escrow deposit from the FDIC insurance and the liquidation of the Bank. The Seller's Attorney / Escrow Agent was sued by his client for malpractice, who alleged, inter alia, that it was negligent for the attorney to place a large contract deposit into a small bank without taking any further steps to safeguard the deposit. The Supreme Court, New York County, denied the motion to dismiss plaintiff's complaint, holding that the plaintiff had stated a cause of action for malpractice.[48] Although the Appellate Division reversed the lower court and ultimately held that the Attorney did not commit malpractice, caution and prudence may nevertheless dictate that a large escrow deposit be split among a number of financial institutions to obtain adequate FDIC insurance.

Paragraph 3(b) describes that portion of the purchase price which will be credited to the Purchaser for accepting title subject to the lien of an existing mortgage on the property. In our example above, this would mean that the Seller has an existing mortgage with a $100,000.00 balance. Rather than pay off the mortgage at the closing, the title is transferred to the Purchaser subject to the lien of this mortgage. Since the Purchaser is accepting the title already encumbered with $100,000.00 of mortgage debt, the Purchaser gets credited for this amount toward the total purchase price. The reasons for transferring title subject to an existing mortgage lien are many, but would include: (a) favorable loan terms, such as a below-market interest rate; (b) savings in mortgage tax; and (c) savings in transfer tax (by utilizing the continuing lien deduction).

If the Seller is personally obligated to pay the mortgage debt, transferring the title subject to the lien of the mortgage carries some risk to the Seller. If the mortgage is not paid by the new owners, the Seller can still be sued on the Note or his guaranty for the full amount of the debt or the Seller could be liable for a deficiency judgment if the mortgage is foreclosed and the equity in the property is insufficient to satisfy the debt. Some protection from these risks is afforded to the Seller if the Purchaser does agree to assume payment of the debt as set forth in paragraph 3(b). Upon the Purchaser's assumption of the debt, the Purchaser becomes personally liable and the Seller's status is changed from direct obligor to surety. Thereafter, if the Purchaser and mortgagee enter into a material modification of the mortgage terms, without the Seller's knowledge or consent, the Seller can be discharged entirely from liability.[49]

If the parties agree that the Purchaser is to assume the mortgage debt as set forth in paragraph 3(b) of the contract, the following provision should be put into the deed:

> Subject to a mortgage held by XYZ Lender dated June 2, 2003 recorded June 5, 2003 in Reel 12345 Page 678 in the original principal amount of $135,000.00 upon which there is now unpaid the principal sum of $100,000.00 with interest from May 1, 2005 which the Grantees herein assume and agree to pay in accordance with the terms of said mortgage and the Note secured thereby.

Once this provision is inserted into the Deed, the *Grantees* (in addition to the Grantors) should sign the Deed in order to make the assumption language explicitly binding on the Grantees.

All of this being said, transferring title subject to an existing mortgage occurs infrequently, especially in residential real estate transactions. Most residential real estate mortgages are held by institutional lenders. These mortgages invariably are not assumable because of "due on transfer" provision contained in those mortgages. Therefore, a Purchaser is not likely to accept title subject to an existing mortgage which will then be immediately in default because the due on transfer provision has been violated. However, counsel should be aware that, in certain narrow instances, due on transfer provisions may not be enforced by institutional lenders against certain transferees under the Federal Garn-St. Germain Act.[50] Therefore, the advantages of selling subject to a mortgage may still be available for certain transactions, such as certain intra-family transfers and pursuant to a divorce.

Paragraph 3(c) is to be utilized if the Seller will be "taking back" a mortgage from the Purchaser as part of the purchase price. The contract form provides that the terms and provisions of the purchase money mortgage are further described in Paragraph 5. The preferable approach would be to prepare the exact form of Note and Mortgage to be signed by the Purchaser at closing and attach it to the contract along with a provision stating that the agreed-upon forms are attached to the contract.

Preparing the purchase money note and mortgage at the time of the contract forces the parties and their attorneys to focus in on the terms of the loan documents right up front and prevents disputes about clauses to be included at the time of closing. For example, many knowledgeable attorneys are surprised to learn that the "standard form" NYBTU Mortgage does *not* include a provision which allows the mortgagee to collect legal fees in a foreclosure action. If the Seller desires to add such a provision when the mortgage is drafted for the closing, the Buyer may object that such a provision is not contained in the "standard form" and therefore was not within the agreement of the parties. The Seller will undoubtedly argue that such a provision is entirely customary because most lender's mortgages contain such a provision. By focusing on the terms of the loan documents early in the transaction, unresolved issues are not left "hanging" and unpleasant surprises and disputes can be avoided.

Paragraph 3(d) simply provides that the balance of the purchase price (after giving the Buyer credit for (a) the downpayment, (b) the principal balance of any mortgage liens being taken "subject to" and (c) the amount of purchase money mortgage) must be paid at closing. The acceptable types of funds are set forth in Paragraph 7 of the contract. The issues that arise with the types of payment (permitted and unpermitted) will be discussed later in the context of Paragraph 7.

Part V: Existing Mortgage

> **4. Existing Mortgage. (Delete if inapplicable) If this sale is subject to an existing mortgage as indicated in paragraph 3(b) above:**
>
> (a) The Premises shall be conveyed subject to the continuing lien of the existing mortgage, which is presently payable, with interest at the rate of percent per annum, in monthly installments of $ which include principal, interest and escrow amounts, if any, and with any balance of principal being due and payable on
>
> (b) To the extent that any required payments are made on the existing mortgage between the date hereof and Closing which reduce the unpaid principal amount thereof below the amount shown in paragraph 3(b), then the balance of the price payable at Closing under paragraph 3(d) shall be increased by the amount of the payments of principal. Seller represents and warrants that the amount shown in paragraph 3(b) is substantially correct and agrees that only payments required by the existing mortgage will be made between the date hereof and Closing.
>
> (c) If there is a mortgagee escrow account, Seller shall assign it to Purchaser, if it can be assigned, and in that case Purchaser shall pay the amount in the escrow account to Seller at Closing.
>
> (d) Seller shall deliver to Purchaser at Closing a certificate dated not more than 30 days before Closing signed by the holder of the existing mortgage, in form for recording, certifying the amount of the unpaid principal, the date to which interest has been paid and the amounts, if any, claimed to be unpaid for principal and interest, itemizing the same. Seller shall pay the fees for recording such certificate. If the holder of the existing mortgage is a bank or other institution as defined in Section 274-a of the Real Property Law it may, instead of the certificate, furnish a letter signed by a duly authorized officer, employee or agent, dated not more than 30 days before Closing, containing the same information.
>
> (e) Seller represents and warrants that (i) Seller has delivered to Purchaser true and complete copies of the existing mortgage, the note secured thereby and any extensions and modifications thereof, (ii) the existing mortgage is not now, and at the time of Closing will not be, in default, and (iii) the existing mortgage does not contain any provision that permits the holder of the mortgage to require its immediate payment in full or to change any other term thereof by reason of the sale or conveyance of the Premises.

Paragraph 4 of the Joint Bar Association Contract does not deal with the particulars of the Purchaser obtaining a new mortgage but deals with the Purchaser taking over a mortgage that presently exists on the property. It could be a mortgage either made by the Seller or for that matter a prior owner. The usual reason for doing this is either to save the Buyer mortgage tax and / or closing costs. As an incidental matter it may also save the Seller transfer taxes.[51]

To fully understand the mechanics of such a transaction, the difference between taking title "subject to" a mortgage and taking title "subject to and assuming" a mortgage must be understood. The relationship of "Due on Sale" or "Due on Transfer" provisions in the underlying mortgage must also be considered.[52]

As we are all aware the mortgage subjects the real property to the lien of the mortgage debt and the mortgage note subjects the borrower to *personal* liability for the mortgage debt. If there is a $500,000.00 mortgage transaction and at a foreclosure sale the property can be sold for only $400,000.00, the lender (assuming the balance of $500,000.00 had not amortized down) would in all likelihood be able to procure a deficiency judgment[53] for $100,000.00. This judgment could be collected by levying on the borrower's salary, bank account, boat, etc.

If there was no default and a Buyer were to take "Subject To" the $500,000.00 mortgage referred to above, and did not execute an assumption agreement (which conceivably could be in the form of a consolidation, extension and modification agreement ("CEMA"),[54] only the property would be at risk for the debt. The Purchaser would not have any personal liability. Personal liability would remain with the original borrower, *i.e.*, the Seller.

However, if the Buyer takes title "Subject to and Assuming" a mortgage he not only subjects the property to the mortgage debt but could be personally liable for any deficiency judgment.

If the deficiency could not be collected from the assuming Purchaser, the original obligor (Seller or Seller's predecessor mortgagor) would be liable for any remaining deficiency.[55]

Normally in the absence of an assumption agreement the mechanism for a party to assume an existing mortgage would be for the closing deed to provide:

> Subject to and assuming a first mortgage held by Bountiful Bank in the amount of $400,000 and recorded in Reel 1421 Page 706 in the (Insert County) County Clerk's Office.[56]

The *Purchaser* in addition to the Seller would sign the deed indicating his assent to assume the indebtedness.

The Purchaser could also become personally liable for the debt by signing an assumption agreement or as previously stated a consolidation, extension and modification agreement in which he or she agrees to pay the total consolidated debt.

If the transaction is merely subject to the existing mortgage the Purchaser need not sign anything. The deed would merely contain the language set forth above without the words "and assuming."

In either event "Subject To" or "Subject To and Assuming," the Purchaser must be wary that the mortgage does not contain a "Due on Sale" or "Due on Transfer" provision. These provisions are inserted by lenders to protect them from Purchasers assuming a mortgage with a below-market interest rate and have been held valid.[57]

The Purchaser can frequently protect himself or herself by conditioning the transaction upon getting the lender's approval which would normally come with an agreement to raise the interest rate to a market rate.

Subparagraph 4(a) above is relatively simple and is merely for the purpose of setting forth the existing terms of the mortgage to be taken "Subject To" or "Assumed." Nevertheless, it cannot be ignored. Care should be taken to make sure that the loan would be fully amortized and not a "balloon loan."[58]

Subparagraph 4(b) must be read in conjunction with paragraph 3 of the contract, the purchase price provision. Assume the purchase price provisions provides as follows:

> **3. Purchase Price. The purchase price is** **$800,000.00**
>
> payable as follows:
>
> (a) on the signing of this contract, by Purchaser's good check payable to the Escrowee (as hereinafter defined), subject to collection, the receipt or which is hereby acknowledged, to be held in escrow pursuant to paragraph 6 of this contract (the "Downpayment"): **$80,000.00**
>
> (b) by allowance for the principal amount unpaid on the existing mortgage on the date hereof, payment of which Purchaser shall assume by joinder in the deed: **$420,000.00**
>
> (c) by a purchase money note and mortgage from Purchaser to Seller: **-0-**
>
> (d) balance at Closing in accordance with paragraph 7: **$300,000.00**

You will note that the mortgage referred to in paragraph 3(b) (the purchase price provision) is to be assumed. If the Purchaser wished the transaction to only be "subject to" the mortgage, the words "payment of which Purchaser shall assume by joinder in the deed" should be stricken out.

Assume also that between the signing of the contract and closing, the mortgage is reduced by amortization from $420,000 to $400,000. Paragraph 4(b) above requires the Buyer to increase the amount of cash to be paid at closing from $300,000 to $320,000.

However, if the Seller made a voluntary prepayment of $100,000, for example, the Purchaser would not be required to increase the cash balance.[59] Of course, what any prudent practitioner should do is append a copy of the note, mortgage and any modifications thereof to the contract, after reviewing them for stepped up or balloon payments, etc.

Subsection 4(c) provides that if there is an existing escrow for taxes etc., the Seller shall assign it to the Buyer if permitted by the lender. The Purchaser would then reimburse the Seller for the escrow amount at closing. This assignment is normally done in letter form.

Subsection 4(d) deals with what is known as a mortgagees or lienors estopppel certificate. as opposed to a mortgagor's estoppel.[60] The mortgagee's (lienors) estoppel certificate certifies the unpaid principal balance, the date to which payments are made, and an itemization of unpaid payments of principal and interest, if any. If the lender is a bank or similar institution, this may be done by letter as provided for in Real Property Law § 274(a).[61] Many banks attempt to protect themselves from errors by including a statement in the payoff letter that an error in the payoff letter will not create an estoppel against the bank.[62]

Subparagraph 4(e) is a protective measure for the Buyer. It reminds him to review the note, mortgage and extensions and modifications thereof. They are best appended to the contract. It further represents that the existing mortgage is not in default nor will it be at closing. The Purchaser's attorney must be aware that if there is an acceleration of the total unpaid principal as a result of a payment default, it cannot be undone without the lender's consent.[63] Finally, it provides that the existing mortgage will not become due and payable by reason of the sale or conveyance of the premises. It also provides that no other change of any term can be made by reason of the transfer. Usually this would be the interest rate or perhaps in the case of an adjustable rate mortgage, the margin or the index. Nevertheless, even if the mortgage contains such a clause, it can be waived by the lender and the lender most likely would do so if the mortgage is brought up to a market rate either by consolidation or modification.

The provisions of paragraph 4 of the standard contract do not relate to a new mortgage to be obtained by the Buyer. Such a mortgage is governed by paragraph 8 of the standard contract. Paragraph 4 deals with existing mortgages that are either taken subject to or assumed. Similarly, neither paragraph 3(b) or 3 (c) of the contract deal with new mortgages. The amount of a new mortgage does not appear anywhere in paragraph 3(d), the balance due at closing of which it constitutes either all or a part thereof. Thus, if in the example above, the Buyer would be procuring a new $180,000 mortgage the proceeds thereof would constitute part of the $300,000.00 balance due at closing.

Part VI: Purchase Money Mortgage

> **5. Purchase Money Mortgage.** (*Delete if inapplicable*) If there is to be a purchase money mortgage as indicated in paragraph 3(c) above:
>
> (a) The purchase money note and mortgage shall be drawn by the attorney for Seller in the form attached or, if not, in the standard form adopted by the New York State Land Title Association. Purchaser shall pay at Closing the mortgage recording tax, recording fees and the attorney's fees in the amount of $ for its preparation.
>
> (b) The purchase money note and mortgage shall also provide that it is subject and subordinate to the lien of the existing mortgage and any extensions, modifications, replacements or consolidations of the existing mortgage, provided that (i) the interest rate thereof shall not be greater than ___ percent per annum and the total debt service thereunder shall not be greater than _____ $____ per annum, and (ii) if the principal amount thereof shall exceed the amount of principal owing and unpaid on the existing mortgage at the time of placing such new mortgage or consolidated mortgage, the excess be paid to the holder of such purchase money mortgage in reduction of the principal thereof. The purchase money mortgage shall also provide that such payment to the holder thereof shall not alter or affect the regular installments, if any, of principal payable thereunder and that the holder thereof will, on demand and without charge therefor, execute, acknowledge and deliver any agreement or agreements further to effectuate such subordination.

Paragraph 5 of the Joint Bar Association Contract deals with the terms of a true take back purchase money mortgage.[64]

It is clear that if the terms of the mortgage and note are left until the time of closing, that much consternation can be created. This is why the contract envisions that copies of the proposed note and mortgage be attached to the contract as exhibits.

In the absence of those forms being attached, the contract provides that the forms of the New York State Land Title Association be utilized. However, care should be taken by the Seller in utilizing these forms because they usually lack clauses that are important to the Seller.

For instance, there is no clause for allowing attorneys' fees. There is no clause for imposing a late charge nor is there a due on transfer provision. Also, a well-drafted mortgage will usually require the mortgagor to provide to the mortgagee proof of payment of real estate taxes and water and sewer charges, if any.

From the Purchaser's point of view the note and mortgage do not provide for prepayment without penalty. In New York, without such a provision the mortgagee is entitled to interest to maturity.[65]

The standard contract provides that the Purchaser will pay the mortgage tax and recording fees. The Purchaser will also pay the Seller's attorney for the preparation of the purchase money note and mortgage in an amount specified in the contract. Since the Seller's attorney is not charging his or her own client for this fee, it is important that the amount be put in the contract to avoid a dispute at the closing as to what the reasonable value of the Seller's attorney's fee would be.

Subsection (b) of paragraph 5 describes what the results will be if the purchase money mortgage is a second mortgage and changes are made by the borrower in the terms of the existing first mortgage during the life of the second mortgage.

Clearly if the owner agreed to an increase in the interest rate or a shortening of the term, the payments on the first mortgage would be increased. This may have the effect of jeopardizing the second mortgage if the mortgagor is subsequently unable to keep up with the payments on the first mortgage. Subsection (b) therefore seeks to set the ground rules for permitting the mortgagor to modify the first mortgage. They are as follows:

1. **"The interest rate shall not be greater than __ percent per annum."** Assume the existing first mortgage has a rate of 6%. It is negotiable with the Seller / second mortgagee as to what percentage would be permissible on a modification of the 6% mortgage. The Seller might feel that only 5% would be permissible in order to make his or her investment in the second mortgage safer.

   However, it is more likely that the Seller would hold the 6% note or even more likely go to a higher rate if the second mortgage is being paid down out of the refinanced mortgage. It should be kept in mind that second mortgages are frequently for a shorter period such as one to three years whereas a refinanced first may be of benefit to its owner / second mortgagor because it may have a 15-year or more payout.

2. **"…the total debt service thereunder shall not be more than $_____ per annum."** This provision is to protect the second mortgagee from the owner refinancing the first mortgage and increasing the annual payment of principal and interest (debt service) on both the first and second mortgage (total debt service) above a specified amount.

   If agreed upon it could be an annual amount greater or less than the total initial debt service.

3. If the refinancing of the first mortgage increases the amount of the first mortgage, the excess shall be paid to the second mortgagee in reduction of the principal of the second mortgage.

4. The payment of the amount in reduction of the second mortgage shall not alter the amount and schedule of payments thereunder.

If these conditions are met, the Seller / mortgagee of the second mortgage agrees on demand and without charge to execute an agreement to subordinate the second mortgage to the modified first mortgage.

Part VII: Down Payment in Escrow

6. Downpayment in Escrow. (a) Seller's attorney ("Escrowee") shall hold the Downpayment in escrow in a segregated bank account at

until Closing or sooner termination of this contract and shall pay over or apply the Downpayment in accordance with the terms of this paragraph. Escrowee shall hold the Downpayment in a(n) **NON-** interest-bearing account for the benefit of the parties. If interest is held for the benefit of the parties, it shall be paid to the party entitled to the Downpayment and the party receiving the interest shall pay any income taxes thereon. If interest is not held for the benefit of the parties, the Downpayment shall be placed in an IOLA account or as otherwise permitted or required by law. The Social Security or Federal Identification numbers of the parties shall be furnished to Escrowee upon request. At Closing, the Downpayment shall be paid by Escrowee to Seller. If for any reason Closing does not occur and either party gives Notice (as defined in paragraph 25) to Escrowee demanding payment of the Downpayment, Escrowee shall give prompt Notice to the other party of such demand. If Escrowee does not receive Notice of objection from such other party to the proposed payment within 10 business days after the giving of such Notice, Escrowee is hereby authorized and directed to make such payment. If Escrowee does receive such Notice of objection within such 10 day period or if for any other reason Escrowee in good faith shall elect not to make such payment, Escrowee shall continue to hold such amount until otherwise directed by Notice from the parties to this contract or a final, non-appealable judgment, order or decree of a court. However, Escrowee shall have the right at any time to deposit the Downpayment and the interest thereon with the clerk of a court in the county in which the Premises are located and shall give Notice of such deposit to Seller and Purchaser. Upon such deposit or other disbursement in accordance with the terms of this paragraph, Escrowee shall be relieved and discharged of all further obligations and responsibilities hereunder.

(b) The parties acknowledge that Escrowee is acting solely as a stakeholder at their request and for their convenience and that Escrowee shall not be liable to either party for any act or omission on its part unless taken or suffered in bad faith or in willful disregard of this contract or involving gross negligence on the part of Escrowee. Seller and Purchaser jointly and severally (with right of contribution) agree to defend (by attorneys selected by Escrowee), indemnify and hold Escrowee harmless from and against all costs, claims and expenses (including reasonable attorneys' fees) incurred in connection with the performance of Escrowee's duties hereunder, except with respect to actions or omissions taken or suffered by Escrowee in bad faith or in willful disregard of this contract or involving gross negligence on the part of Escrowee.

(c) Escrowee may act or refrain from acting in respect of any matter referred to herein in full reliance upon and with the advice of counsel which may be selected by it (including any member of its firm) and shall be fully protected in so acting or refraining from action upon the advice of such counsel.

(d) Escrowee acknowledges receipt of the Downpayment by check subject to collection and Escrowee's agreement to the provisions of this paragraph by signing in the place indicated on the signature page of this contract.

(e) Escrowee or any member of its firm shall be permitted to act as counsel for Seller in any dispute as to the disbursement of the Downpayment or any other dispute between the parties whether or not Escrowee is in possession of the Downpayment and continues to act as Escrowee.

(f) The party whose attorney is Escrowee shall be liable for loss of the Downpayment.

In the usual contract of sale there is no legal obligation for the Seller to provide that a contract downpayment be held in escrow.[66] However, any prudent Purchaser's attorney would make sure that such a provision is included in order to protect their client in the event that the sale does not close. For instance, what happens when the sale price is $300,000.00 and the total amount of mortgage and other liens is $350,000.000, or when an errant Purchaser's spouse leaves town with the remaining funds required for purchase? In these, and a myriad of other circumstances which threaten a successful closing, if the downpayment is turned over to the Seller, without the protection of an escrow agreement, it is possible that the Purchaser would never receive his or her money back.

In the vast majority of circumstances, the Seller's attorney would be the escrowee. An attorney must keep the deposit in a depository institution within the State of New York.[67] However, the Codes, Rules and Regulations of the State of New York provides that an out-of-state institution may be used, "provided [that], …such banking institution complied with such Part 1300 of this Title,[68] and the lawyer has obtained the prior written approval of the person to whom such funds belong which specifies the name and address of the office or branch of the banking institution where such funds are to be maintained."[69]

The General Business Law requires that the name of the depositary bank and the escrow agent be specified in the contract.[70]

The account should be denominated an "Attorney Special Account," "Attorney Trust Account" or "Attorney Escrow Account."[71]

Generally, if the money is put in a non-interest bearing account, it should be an IOLA account.[72] If the money is put in an interest-bearing account, the attorney escrowee will be obligated to file a 1099.[73]

If the attorney receives a cash deposit of $10,000.00 or more, the attorney must comply with the Internal Revenue's currency regulations and file Internal Revenue Form 8300.[74]

In the case of very large deposits, the attorney should consider depositing the funds in more than one banking institution because of limitations in FDIC deposit insurance.[75]

Turning to the contractual provision itself, it is difficult to opine on what is meant by the phrase "segregated bank account." If it is intended to mean an *attorney trust account* the contract should be explicit in delineating it as such. If it is intended to mean a *separate attorney trust account for the particular transaction*, the contract should be explicit in this meaning. This is one provision of the contract that should be remedied at the time of the contract's next revision.

If the purpose of the language is to include non-attorney escrowees, the Purchaser's lawyer should be careful especially downstate.[76] Funds held in escrow by attorneys are protected by the Lawyer's Fund for Client Protection of the State of New York.[77] Funds held by non-attorney escrow agents, such as real estate brokers, are not protected by the Fund.

The standard contract provides that the down payment will be held in escrow until closing or "sooner termination of this contract." "Sooner termination of the contract" could be the result of various circumstances, including, breach by either Seller or Buyer, or Buyer's failure to be approved for a mortgage in accordance with a mortgage contingency.

The second sentence of paragraph "6" requires that the word "NON" be inserted before the words "interest-bearing account" if the account is to be held without interest.

The third sentence of paragraph "6" provides that if the downpayment is placed in an interest-bearing account that the interest will follow the downpayment. If the transaction closes, the interest will be paid to the Seller. If the downpayment is returned to the Buyer, the interest will likewise be paid to the Buyer. The escrow agent should be sure to obtain the social security number of the party who receives the interest in order that the appropriate form 1099 can be generated.

> Where the downpayment is very large, the parties sometimes negotiate a split of the interest.

The fourth sentence of paragraph "6" provides that if the money is not held in an interest-bearing account "for the benefit of the parties" it will be deposited in an IOLA account or "as otherwise permitted or required by law."

The fifth sentence provides that the social security numbers of the parties will be provided to the escrowee "upon request."

The sixth sentence provides that at closing, the downpayment will be paid to the Sellers.

The seventh through eleventh sentences of subparagraph (a) set out the proper procedure for determining the fate of downpayment in the event of a dispute. It is fraught with danger for the busy or less than diligent attorney. These provisions state that if for any reason closing does not occur, either party to the transaction can give notice to the escrow agent demanding payment. The escrow agent is then obligated to give prompt notice of the demand to the other party to the transaction. If the other party does not object within ten business days, the escrow agent is "authorized and *directed* (emphasis added) to make such payment [to the demanding party]." In these circumstances, it thus appears that the escrow agent cannot, in his or her own discretion, refuse to make payment. It is therefore evident that an attorney receiving notice of demand for the payment should immediately notify his or her client and follow up on the transaction.

If the escrow agent *receives* an objection to payment within ten business days, he or she shall continue to hold the money in escrow until otherwise directed by notice from the parties to the contract or by a final non-appealable judgment, order or decree of court.

The escrow agent could, however, opt to deposit the funds with the clerk of the county in which the property is located and give notice thereof to the Seller and Buyer. The escrow agent thereupon shall be relieved of all further liability.

Subparagraph (b) of paragraph "6" exonerates the escrow agent from any liability except if his or her actions were taken in bad faith, in willful disregard of the contract provisions or were grossly negligent. Both Seller and Buyer jointly and severally agree to indemnify the escrow agent against all costs and expenses including reasonable attorneys' fees except where the escrow agent acted in bad faith, in willful disregard of the contract provisions or was grossly negligent.

Subparagraph (c) of paragraph "6" states that the escrowee may act or refrain from acting on the advice of counsel, including a member of its firm. In such a case, the escrowee would be "fully protected." What is meant by "fully protected" has not been determined by the courts yet, but it seems that at a minimum that the escrowee's action would have had to have been taken in good faith**.**

Subparagraph (d) provides that the downpayment check is accepted by the escrowee "subject to collection." Thus if the check bounces, the Purchaser is in default of the contract.[78] Subparagraph (d) also requires that the escrow agent to sign the contract in its capacity as escrowee.

Subparagraph (e) permits the escrow agent or any member of his firm to act as counsel for Seller in any dispute between the parties or in regards to the downpayment. One would hope that this would constitute a waiver of the attorney-client privilege but the contract does not specifically say it does.

Subparagraph (f) provides that if the escrowee runs off with the money it is the escrowee's clients' problem.

Endnotes

1. Copyright, September 1, 2004, by John G. Hall and Thomas J. Hall. John G. Hall and Thomas J. Hall are partners in the Staten Island Law Firm of Hall & Hall, LLP. John G. Hall is a past Chair of the Real Property Law Section of the New York State Bar Association. Thomas J. Hall is co-chair of the Richmond County Bar Association Real Estate Committee and a member of the Executive Committee of the Business Law Section of the New York State Bar Association.
2. The New York Board of Title Underwriters (NYBTU) is no longer in existence. However, some practitioners continue to use NYBTU forms.
3. In relevant part, N.Y. Gen. Obl. Law § 5-702 (McKinney 2001) states:

   a. Every written agreement entered into after November first nineteen hundred seventy-eight…to which a consumer is a party and the money, property or service which is the subject of the transaction is primarily for personal, family or household purposes must be:

   1. Written in a clear and coherent manner using words with common and every day meanings;

   2. Appropriately divided and captioned by its various sections.

   Any creditor, Seller or lessor who fails to comply with this subdivision shall be liable to a consumer who is a party to a written agreement governed by this subdivision in an amount equal to any actual damages sustained plus a penalty of fifty dollars…No action under this subdivision may be brought after both parties to the agreement have fully performed their obligation under such agreement, nor shall any creditor, Seller or lessor who attempts in good faith to comply with this subdivision be liable for such penalties…It also shall not apply to agreements involving amounts in excess of fifty thousand dollars nor prohibit the use of words or phrases or forms of agreement required by state or federal law, rule or regulation or by a governmental instrumentality.

   b. A violation of the provisions of subdivision a of this section shall not render any such agreement void or voidable nor shall it constitute:

   1. A defense to any action or proceeding to enforce such agreement; or

   2. A defense to any action or proceeding for breach of such agreement.
4. N.Y. G.O.L. § 5-1311 provides:

   1. Any contract for the purchase and sale or exchange of realty shall be interpreted, unless the contract expressly provides otherwise, as including an agreement that the parties shall have the following rights and duties:

   a. When neither the legal title nor the possession of the subject matter of the contract has been transferred to the Purchaser: (1) if all or a material part thereof is destroyed without fault of the Purchaser or is taken by eminent domain, the vendor cannot enforce the contract, and the Purchaser is entitled to recover any portion of the price that he has paid; but nothing herein contained shall be deemed to deprive the vendor of any right to recover damages against the Purchaser for any breach of contract by the Purchaser prior to the destruction or taking; (2) if an immaterial part thereof is destroyed without fault of the Purchaser or is taken by eminent domain, neither the vendor nor the Purchaser is thereby deprived of the right to enforce the contract; but there shall be, to the extent of the destruction or taking, an abatement of the purchase price.

   b. When either the legal title or the possession of the subject matter of the contract has been transferred to the Purchaser, if all or any part thereof is destroyed without fault of the vendor or is taken by eminent domain, the Purchaser is not thereby relieved from a duty to pay the price, nor is he thereby entitled to recover any portion thereof that he has paid; but nothing herein contained shall be deemed to deprive the Purchaser of any right to recover damages against the vendor for any breach of contract by the vendor prior to the destruction or taking….

5. *See* DeWitt v. Agricultural Ins. Co., 157 N.Y. 353 (1898).

6. *See* N.Y. Dep't of State, Division of Corp., State Records & UCC, http://www.dos.ny.gov/corps/bus_entity_search.html.

7. N.Y. Bus. Corp. Law § 301(a)(1) (McKinney 2003 & Supp. 2011) provides:

   > ...the name of a domestic or foreign corporation...shall contain the word "corporation," "incorporated" or "limited," or an abbreviation of such words; or, in the case of a foreign corporation, it shall, for use in this state, add at the end of its name one of such words or an abbreviation thereof.

8. *See* N.Y. Est. Powers & Trusts Law § 7-2.1(a) (McKinney 2001); *but see id.* § 7-2.1(c) (making an exception for trusts with transferable certificates, trusts for employees and trusts for self-employed individuals and others).

9. *See id.* § 7-2.1(c)(1).

10. *See* N.Y. Gen. Obl. Law. § 5-703(1) (stating that a contract for the sale of realty by an agent is void unless the agent's authority is in writing). It is preferable that the authority be by a duly *recorded* power of attorney which can be revoked only by a duly *recorded* revocation. *See* N.Y. Real Prop. Law § 326 (McKinney 2006). This obviates any claims that the authority was revoked prior to contract execution.

11. *See* Fitzhugh v. Wilcox, 12 Barb. 235 (Sup. Ct. N.Y. County 1851).

12. *See* Ortelere v. Teachers Ret. Bd. of New York, 25 N.Y.2d 196, 250 N.E.2d 460 (1969); *see also* Verstandig v. Schlaffer, 296 N.Y. 62, 70 N.E.2d 15 (1946); Finch v. Goldstein, 245 N.Y. 300, 157 N.E. 146 (1927).

13. *See* Goldberg v. McCord, 251 N.Y. 28, 166 N.E. 793 (1929); *In re* Lebovici, 171 Misc.2d 604, 655 N.Y.S.2d 305 (Sup. Ct. Queens County 1997).

14. *See* Stephenson v. Naumann, 195 N.Y.S. 768 (Sup. Ct. Kings County 1922), *aff'd*, 204 A.D. 891, 197 N.Y.S. 951 (2d Dep't 1922).

15. *See* N.Y. C.P.L.R. § 212 (McKinney 2011); *Id.* § 208.

16. *See* Oneida County Savings v. Saunders, 179 A.D. 282, 166 N.Y.S. 280 (4th Dep't 1917); *see also* Wyatt v. Lortscher, 217 A.D. 224, 216 N.Y.S. 571 (4th Dep't 1926); Icovino v. Haymes, 191 Misc. 311, 77 N.Y.S.2d 316 (N.Y.C. Mun. Ct. Richmond County 1948).

17. *See* N.Y. Bus. Corp. Law § 909(a).

18. *See id.* § 909(b).

19. *See* N.Y. Religious Corp. Law § 12(1) (McKinney 1990 & Supp. 2011).

20. *See* N.Y. Not-For-Profit Corp. Law § 510(a)(3) (McKinney 2005 & Supp. 2011).

21. *See id; see also id.* § 201 (defining type A, B, C and D corporations).

22. *See* N.Y. Partnership Law § 12(3) (McKinney 2006) (requiring that title acquired in a partnership name can be conveyed only in the partnership name). It is entirely conceivable that the partnership could consist of more partners than the "name" partners A, B and C. It is also essential to examine the partnership agreement and any amendments thereof. After all, the partnership agreement may provide that only Partner "D" can execute a contract for the sale of real estate.

23. *See* N.Y. Real Prop. Law § 333(1-a).

24. *See* Monroe Savings Bank v. First Nat'l Bank of Waterloo, 50 A.D.2d 314, 377 N.Y.S.2d 827 (4th Dep't 1976).

25. 12 A.D.2d 430, 212 N.Y.S.2d 224 (2nd Dep't 1961), *aff'd,* 11 N.Y.2d 668 (1962).

26. Fitzpatrick v. Sweeny, 56 Hun 159 (Sup. Ct. Gen. T. 1st Dep't 1890), *aff'd*, 121 N.Y. 707 (1890).

27. For the type of trouble which can arise in a faulty same premises clause, *see* Pillmore v. Walsworth, 166 A.D. 557, 152 N.Y.S. 344 (4th Dep't 1915), *aff'd*, 232 N.Y. 591, 134 N.E. 584 (1922), holding that only the grantors' fractional interest was conveyed.

28. In the State of New York recordings usually are made in the office of the respective county clerk where the property is situated. However, in four counties of the City of New York, deeds are recorded in the office of the New York City Register for (New York, Kings, Queens or the Bronx). The County of Richmond, which is part of the City of New York, does not have a City Register's Office and recordings are made in the Richmond County Clerk's Office. In all other counties of the State, recordings are made in the office of the County Clerk.

29. *See* Growen Realty Corp. v. Levy, 143 Misc. 797, 256 N.Y.S. 729 (N.Y. Mun. Ct. Manhattan County 1932); *see also* Wessel v. Cramer, 56 A.D. 30, 67 N.Y.S. 425 (1st Dep't 1900).

30. Although the case of *Thayer v. Finton* holds that the described premises would be enlarged by the defective same premises clause, there has been much litigation on the point. 63 Sickels 395, 108 N.Y. 394 (1888).

31. For an in-depth discussion of descriptions, the reader should consult the New York State Bar Association publication entitled "Real Estate Titles."

32. Mastrangelo v. Manning, 17 A.D.3d 326, 793 N.Y.S.2d 94 (2d Dep't 2005); Zlinkoff v. Bonis, 171 N.Y.S. 228 (Sup. Ct. App. T. 1st Dep't 1918).

33. Some items which are not set forth in the form contract that frequently need to be addressed include: ceiling fan(s), gas grill(s), outdoor pool and pool equipment, burglar alarm system and television satellite dish or antenna.

34. *See* N.Y.C.R.R. tit. 20, ch. IV, § 527.1.

35. *See* Question # 13 on RP-5217, which must accompany all deeds upon filing with the Recording Officer.

36. *See* Paragraph 3(a).

37. *See* Paragraph 3(b).

38. *See* Paragraph 3(c).

39. *See* Paragraph 3(d).

40. The Mortgage contingency amount is included in the figure set forth in Paragraph 3(d). For example, a $400,000.00 sale with a 10% deposit and 80% financing will show a contract deposit in Paragraph 3(a) of $40,000.00 and the balance due at closing in Paragraph (3)d as $360,000.00 (even though the mortgage contingency amount is $320,000.00).

41. *See* Palmer v. Golden, 127 Misc. 487, 216 N.Y.S. 509 (Sup. Ct. Saratoga County 1926), *aff'd*, 221 A.D. 360, 223 N.Y.S. 897 (3rd Dep't 1927); Raubitschek v. Blank, 35 Sickels 478, 80 N.Y. 478 (1880); Smith v. Treuthart, 130 Misc. 394, 223 N.Y.S. 481 (Sup. Ct. Monroe County 1927).

42. *See* Crossland Savings, FSB v. Foxwood & Southern Co., 202 A.D.2d 544, 609 N.Y.S.2d 282 (2d Dep't 1994).

43. *See* Elterman v. Hyman, 192 N.Y. 113, 84 N.E. 937 (1908).

44. The Lawyers Fund for Client Protection is funded entirely by practicing attorneys and provides a mechanism for clients to be made whole in the event their attorney diverts escrow money. *See* N.Y.C.R.R. tit. 22, ch. VII. § 7200.13 (2011) (limiting a payment of awards to not exceed $300,000, not to include attorney's fees and out of pocket expenses, while additional taxes, interest, late charges and similar penalties as the direct result of attorney misappropriation may be included at the discretion of the trustees); *see also* N.Y.C.R.R. tit. 22, ch. VII, § 7200.8(d) (excluding from coverage damages resulting from attorney negligence, malpractice or neglect and losses arising from financial transactions with an attorney not within the attorney-client relationship).

45. *See generally* N.Y. Judiciary Law § 497(4) (McKinney 2005); N.Y.C.R.R. tit. 20, ch. LXIX, §7000.10. Although the attorney generally has discretion to determine whether a separate interest bearing escrow account is appropriate, the IOLA regulations provide that if the escrow deposit is expected to earn less than $150.00 in interest, given the size of the deposit and the length of time it is expected to be held, then such a deposit is presumed to be appropriate for an IOLA account.

46. Presently, as a result of the Dodd-Frank Wall Street Reform and Consumer

Protection Act, the Federal Deposit Insurance Act was amended to include Attorney IOLA accounts within the definition of a "non-interest bearing transaction account." *See* 12 U.S.C. § 1821(a)(1)(B)(iii)(II); *see also* 12 C.F.R. 330.16. As a result, deposits into an IOLA account currently enjoy an unlimited amount of FDIC insurance protection. Escrow deposits placed into a non-IOLA account would have the benefit of FDIC insurance up to $250,000.00. 12 C.F.R. Part 330 (generally providing FDIC insurance of up to $250,000.00 per account). The temporary unlimited deposit insurance coverage for IOLA deposits will sunset on December 31, 2012.

47. *See* Bazinet v. Kluge, 14 A.D.3d 324, 788 N.Y.S.2d 77 (1st Dep't. 2005).

48. *See* Bazinet v. Kluge, 196 Misc. 2d 231, 764 N.Y.S.2d 320 (Sup. Ct. N.Y. County 2003).

49. *See* Calvo v. Davies, 28 Sickels 211, 73 N.Y. 211 (1878); *see also* Jones v. Gelles, 125 A.D.2d 794, 509 N.Y.S.2d 900 (3d Dep't 1986).

50. 12 U.S.C. § 1701j-3(d) (1983). Examples from the statute of exempt transfers or dispositions include:

> With respect to a real property loan secured by a lien on residential real property containing less than five dwelling units, including a lien on the stock allocated to a dwelling unit in a cooperative housing corporation, or on a residential manufactured home, a lender may not exercise its option pursuant to a due-on-sale clause upon—
>
> * * *
>
> (3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;
>
> * * *
>
> (5) a transfer to a relative resulting from the death of a borrower;
>
> (6) a transfer where the spouse or children of the borrower become an owner of the property;
>
> (7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;
>
> (8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or
>
> (9) any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.

51. *See*, e.g., N.Y. Tax Law § 1402(a) (McKinney 2008) (regarding the continuing lien deduction on state transfer tax); *see also* the N.Y.C. Real Prop. Transfer Tax for the convoluted rules relating to the N.Y.C. continuing lien deduction.

52. *See* Stith v. Hudson City Savings, 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. Broome County 1970) (upholding such provisions). Under these circumstances, no prepayment charges may be made if the property is a 1 to 6 family owner occupied residence. *See* N.Y. Real Prop. Law § 254-a.

53. *See* N.Y. Real Prop. Acts. § 1371 (McKinney 2006).

54. "CEMA" is an acronym for the document known as a "Consolidation, Extension and Modification Agreement." The Agreement can perform any one or more of three functions: (1) it can *consolidate* one or more mortgages; (2) it can *extend* the term of one or more mortgages; (3) it can *modify* the provisions of one or more mortgages, such as changing the interest rate, prepayment charges, late charges or a myriad of other terms.

For example, suppose there were three mortgages encumbering a property as follows:

Mortgage A—$200,000.00 Balance, Interest Rate 9%, Maturity Date 2/1/2010

Mortgage B—$300,000.00 Balance, Interest Rate 7½%, Maturity Date 8/1/2015

Mortgage C—$100,000.00 Balance, Interest Rate 6%, Maturity Date 11/1/2020

The Agreement could consolidate all three mortgages to form one of $600,000.00. It could extend the term of all to mature on 12/1/2025 and modify the interest on all three as consolidated to 7%.

55. *See* Calvo v. Davies, 28 Sickels 211, 73 N.Y. 211 (1878).

56. N.Y. Gen. Oblig. Law §5-705 provides as follows:

> No grantee of real property shall be liable upon any indebtedness secured by a mortgage hereon executed prior to the time of the conveyance of the real property to the grantee, nor shall he be liable for any deficiency that may remain upon the foreclosure and sale, unless such grantee shall simultaneously with the conveyance to him of such real property execute and acknowledge, before an officer authorized to take acknowledgments of deeds, a statement in writing stating in substance that such grantee assumes and agrees to pay such mortgage debt and giving the specific amount of the debt assumed.

In New York, Bronx, Kings and Queens Counties the recital would not be for the County Clerk's Office but for the New York City Register's Office for that County.

57. Stith v. Hudson City Savings, 63 Misc.2d 863, 313 N.Y.S.2d 804 (Sup. Ct. Broome County 1970). Subsequent to *Stith* the enactment of the Garn–St. German Depository Institutions Act in 1982 denied enforcement to any state statutes which attempted to prohibit due on sale or due on transfer clauses. See 12 U.S.C. § 1701J-3. It should be noted however, that in subsection (d) that the following nine exclusions to the law are listed for 5 dwelling units or less. They are as follows:

> (d) Exemption of specified transfers or dispositions
>
> With respect to a real property loan secured by a lien on residential real property containing less than five dwelling units, including a lien on the stock allocated to a dwelling unit in a cooperative housing corporation, or on a residential manufactured home, a lender may not exercise its option pursuant to a due-on-sale clause upon–
>
> (1) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;
>
> (2) the creation of a purchase money security interest for household appliances;
>
> (3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;
>
> (4) the granting of a leasehold interest of three years or less not containing an option to purchase;
>
> (5) a transfer to a relative resulting from the death of a borrower;
>
> (6) a transfer where the spouse or children of the borrower become an owner of the property;
>
> (7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse does not relate to a transfer of rights of occupancy in the property; or

(8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.

58. A balloon loan is one where the principal balance becomes due before the loan is fully amortized. Thus a loan for five years on a 30-year payout could have as a final payment a large principal balance become due at the end of five years even though the payments for those five years would have been based upon and the same as those for a 30-year mortgage which would fully amortize.

59. What would happen under these circumstances is an interesting query. Would the Seller have to extend a second mortgage under the same terms as the assumed first mortgage? Most likely the problem would be resolved by negotiation.

60. A mortgagor's estoppel certificate is usually required by a lender when it is about to assign its mortgage and the assignee requires the lender to procure a certificate stating that there are no offsets or defenses to the loan, what the unpaid principal balance is, the date to which payments are current and the interest rate.

61. N.Y. Real Prop. Law § 274-a provides:

> §274-a. Certificate of principal amount unpaid on mortgages of real property
>
> 1. The holder of a mortgage upon real property shall execute and deliver to the owner of the real property upon which such mortgage is a lien a written instrument setting forth the amount of the principal of said mortgage remaining unpaid, the date to which interest has been paid, and the amounts, if any, claimed to be unpaid upon said mortgage for principal and interest, itemizing the same, provided, however, that prior written demand by registered or certified mail has been made upon the holder of such mortgage by such owner of the real property and that such owner of the real property shall have executed and delivered to another a written contract to convey, or shall have received a written commitment to make a mortgage loan upon, the real property or an interest therein. The written instrument hereinbefore required of the holder of the mortgage shall be a certificate duly executed and acknowledged in the same manner as required by law to entitle a conveyance of real property to be recorded, except that a bank, savings bank, private banker, trust company, savings and loan association or any other banking organization, as defined in the banking law, a national bank or trust company or any other federally-chartered or federally-regulated savings and loan association or other banking institution and an insurance company duly organized or licensed to do business in this state under the insurance law of this state and the state of New York, or an agency thereof and a political subdivision of the state of New York or an agency thereof may, in lieu of the said certificate, furnish a letter signed by a duly authorized officer, or employee or agent, containing the information required to be set forth in such certificate. An owner of real property who shall have complied with the foregoing requirements and who shall not have received the written instrument from the holder of the mortgage thereon within twenty days after such compliance shall be entitled to petition a court of competent jurisdiction for an order requiring such holder of the mortgage to comply with this section.

62. There do not appear to be any reported cases dealing with the validity of such a provision.

63. *See* Graf v. Hope Bldg. Corp. 254 N.Y. 1, 171 N.E. 884 (1930).

64. The term purchase money mortgage as used in this paragraph means a mortgage taken back by the Seller from the Buyer. Although where a third party (such as a bank) lends money to a Buyer for the purpose of purchasing real property, that mortgage is referred to as a purchase money mortgage, that is not the type of purchase money mortgage referred to here. This paragraph refers to a "take back" purchase money mortgage. The true purchase money mortgage is exempt from any claims of usury. *See* Mandelino v. Fribourg, 23 N.Y.2d 145, 242 N.E.2d 823 (1968).

65. *See* Troncone v. Canelli, 147 A.D.2d 633, 538 N.Y.S.2d 39 (1989).

66. There is such a requirement where the Seller is a builder of new homes. N.Y. Lien Law § 71-a(3)(a)-(e) provides:

> (a) The initial advance pursuant to a contract of sale which by its terms provides for or is incidental to a contract providing for the construction on the subject real property of residential condominium unit or any structure designed solely for residential occupancy of not more than two families living separately, on property to be purchased shall, at the vendee's option, be deposited within five business days thereafter by the recipient in an interest bearing escrow account in a bank, trust company, savings bank, state or federal savings and loan association, located in this state. Such deposit, together with the interest accumulated thereon, shall remain the property of the vendee except as otherwise provided herein. The recipient shall advise the vendee in writing of the name of the depository where the funds have been placed within ten business days after such deposit has been made.
>
> (b) In lieu of making the deposit of such moneys in an escrow account as provided in paragraph (a) of this subdivision, the recipient may post with the vendee a bond or contract of indemnity….
>
> * * *
>
> (d) Such advance shall be retained in the escrow account… until the trust is terminated (i) by the recipient's performance of the terms of the contract of sale, or (ii) by default of the vendee excusing the recipient's performance of the terms of the contract of sale, or (iii) by release or discharge of the recipient's liability to fund such advance to the vendee, or (iv) upon transfer of the real property to the vendee.
>
> (e) Every contract of sale which by its terms provides for or is incidental to a contract providing for the construction on the subject real property of a residential condominium unit or a structure designed solely for the residential occupancy by not more than two families living apart, shall contain a statement advising the vendee of the provisions of this subdivision. Such statement shall be printed in bold type which is at least two points larger than any other printing contained thereon and shall read as follows:
>
> "YOU, AS THE PURCHASER OF THIS RESIDENCE, MAY REQUIRE THE RECIPIENT OR CONTRACTOR TO

DEPOSIT THE INITIAL ADVANCE MADE BY YOU IN AN ESCROW ACCOUNT. IN LIEU OF SUCH DEPOSIT, THE RECIPIENT OR CONTRACTOR MAY POST A BOND OR CONTRACT OF INDEMNITY WITH YOU GUARANTEEING THE RETURN OF SUCH A SERVICE."

67. *See* N.Y.C.R.R. tit. 22 § 1200.00, *amended by* N.Y. Rules of Professional Conduct, Rule 1-15.

68. *See* N.Y.C.R.R. tit. 22, ch.7, § 1300 (governing the reporting regulations for dishonored checks). Attorney escrow accounts, both in New York and out of State, may only be maintained in banks "which have agreed to provide dishonored check reports…." N.Y.C.R.R. tit. 22, ch. 7, § 1300.1(a). Reports are to be filed with the Lawyers' Fund for Client Protection "whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason." *See* N.Y.C.R.R. tit. 22, ch. 7 § 1300.1(c).

69. *See* N.Y.C.R.R. tit. 22 § 1200.00, *amended by* N.Y. Rules of Professional Conduct, Rule 1-15.

70. *See* N.Y Gen. Bus. Law § 778-a(2). In the case of condominiums, the required information includes the name of the account and the bank address. *See* N.Y.C.R.R. tit. 13, ch.2, § 23.3(q)(2)(ii).

71. *See* N.Y.C.R.R. tit. 22 § 1200.00, *amended by* N.Y. Rules of Professional Conduct, Rule 1-15. IOLA accounts should also include the acronym "IOLA." *See also* N.Y.C.R.R. tit. 21, ch. LXIX, § 7000.9(a).

72. N.Y. Gen. Bus. Law § 778-a(4) states that an attorney may place funds in a non-interest bearing account, including those authorized by N.Y. Jud. Law § 497, which describes "Interest on Lawyer Accounts," commonly referred to as "IOLA" accounts. The interest gathered on these unsegregated accounts goes into the IOLA fund, established by the New York State legislature in 1983. Revenue collected by the fund is to be distributed "as grants and contracts to not-for-profit tax-exempt entities for the purpose of delivering civil legal services to groups currently underserved by legal services, such as the elderly and the disabled, and the enhancement of civil legal services to the poor through innovative and cost-effective means, such as volunteer lawyer programs and support training services." N.Y. State Fin. Law § 97-v(3)(a).

The Judiciary Law states that lawyers should place only "qualified funds" in IOLA accounts, describing those funds as "moneys received by an attorney in a fiduciary capacity from a client or beneficial owner and which, in the judgment of the attorney, are too small in amount or are reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or beneficial owner." N.Y. Jud. Law § 497(2); *see also* N.Y.C.R.R. tit. 21, ch. LXIX, § 7000.2(e). However, N.Y Jud. Law § 497(5) provides: "[n]o attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds."

Indeed, courts have generally found that even when lawyers place large deposits in IOLA accounts for a substantial amount of time, they will not be liable for damages. But, exceptions to the safe harbor in N.Y. Jud. Law § 497(5) have not been definitively ruled out. In Takayama v. Schaefer, 240 A.D.2d 21, 669 N.Y.S.2d 656 (2d Dep't 1998) the court found the plaintiff-Purchaser was not entitled to recovery where the attorney-escrow agent placed a $12,000.00 down payment in his IOLA account and retained it there while dispute over the Purchaser's inability to obtain a mortgage was being resolved. However, the court stated that such a finding did not mean "that there are no circumstances under which an attorney may be held responsible or that the safe-harbor provision of Judiciary Law § 497(5) has no limits." *Id.* at 25-26, 669 N.Y.S.2d at 659-60. In Mann v. Skidmore, 2 Misc. 3d 50, 51, 774 N.Y.S.2d 252, 252 (2d Dep't 2003) the court held fast to the safe harbor provision finding that the plaintiffs were not entitled to recover where the attorney placed $84,613.92 in proceeds in an IOLA account for approximately a year and a half, finding that the "plaintiffs failed to establish that defendant lacked good faith either in depositing the funds at issue in a non-interest-bearing attorney IOLA account in the first instance, or in failing to transfer the funds at some later time." Note, however, that this case dealt with the deposit of sale proceeds rather than a down payment.

In Bazinet v. Kluge, 196 Misc. 2d 231, 764 N.Y.S.2d 320 (Sup. Ct. N.Y. County 2003) (*supra* note 75), the court found circumstances which it believed warranted an exception to N.Y Jud. Law § 497(5), stating that plaintiffs had a cause of action for lost interest where the attorney placed two down payments, both exceeding one million dollars, in an IOLA account. The court found that since each downpayment would have generated over $1,000.00 in interest per month, they could not be considered "qualified funds." *Id.* at 236-37, 764 N.Y.S.2d at 324-25. The strength of this decision is questionable, however, since it also relies on the Nassau County court's determination in Mann v. Skidmore (noted in above paragraph), which has since been reversed by the Second Department in the opinion discussed above.

73. *See* 26 C.F.R. § 1.6045-4. 26 C.F.R. § 1.6045-4(a) stipulates that with some exceptions, a "reporting person must make an information return in respect to a real estate transaction and…must furnish a statement to the transferor." "Reporting person" is defined in 26 C.F.R. § 1.6045-4(e)(3) as one of the following:

> Under subsection (i), reporting person is defined as the person listed as the settlement agent in the Uniform Settlement Statement prescribed under the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. § 2601 et seq. Although not explicit, this agent should be the person who performs "settlement services" as defined in 12 U.S.C. § 2602 [RESPA], namely "any service provided in connection with a real estate settlement, including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate broker, the origination of a federally related mortgage loan…and the handling of the processing, and closing of settlement." If the Uniform Settlement Statement is not used, or does not name a settlement agent, subsection (ii) provides that the reporting person shall be "the person responsible for closing the transaction," that is "the person who prepares a closing statement presented to the transferor and transferee at, or in connection with, the closing of the real estate transaction." Closing statement is defined as any "written document that identifies the transferor and transferee, reasonably identifies the transferred real estate, and describes the manner in which the proceeds payable to the transferor are to be (or were) disbursed at, or in connection with, the closing." When no closing statement is used or conversely, when there is no closing statement, subsection (iii) describes the reporting person is the "first listed of the persons that participate in the transaction as–
>
> (A) The attorney for the transferee who is present at the

occasion of the delivery of either the transferee's note or a significant portion of the cash proceeds to the transferor, or who prepares or reviews the preparation of the document(s) transferring legal or equitable ownership of the real estate;

(B) The attorney for the transferor who is present at the occasion of the delivery of either the transferee's note or a significant portion of the cash proceeds to the transferor, or who prepares or reviews the preparation of the document(s) transferring legal or equitable ownership of the real estate; or

(C) The disbursing title or escrow company that is most significant in terms of gross proceeds disbursed. If more than one attorney would be the person responsible for closing the transaction under the preceding sentence, the person among such attorneys who is considered responsible for closing the transaction under this paragraph (e)(3)(iii) is the person whose involvement in the transaction is most significant."

The 1099 usually must be mailed to the recipient of the interest by January 31st of the year following the calendar year in which the interest is paid. At closing arrangements should be made with a service provider who will undertake to file the 1099 as required by law. These services generally charge a small fee in the neighborhood of $10.00–$15.00 for the service.

74. *See* 26 U.S.C. § 6050I.

75. *See* Bazinet v. Kluge, 14 A.D.3d 324, 788 N.Y.S.2d 77 (1st Dep't 2005). In *Bazinet*, the attorney placed two separate down payments, both exceeding one million dollars, in an IOLA account maintained by his firm in a small New York branch of the Connecticut Bank of Commerce [the "CBC"]. The CBC was closed and the attorney's client sued, alleging malpractice and stating that the attorney should have deposited the funds in a way in which they would have been fully covered by FDIC insurance. The First Department found in favor of the attorney, stating, "There is no allegation that [the attorney] violated any statute or regulation, much less that he breached the escrow provisions of the contracts. There is no requirement imposed by law that an attorney-escrow agent place escrow funds in an account fully insured by the FDIC (*see* N.Y. Gen Bus. § 778-a) and there are no allegations that [the attorney] knew that the CBC was in danger of closing." *Id.* at 325, 788 N.Y.S.2d at 78. Following this logic, the Court found that the proximate cause of the loss was not the actions of the attorney, but rather the "unforeseen demise" of the CBC. *Id.*

The American Bar Association, however, has found this holding "questionable," stating: "The attorney should have advised his client of the risk that small banks are more likely to fail than large banks and that he could take other steps to reduce the risk of loss." American Bar Association, Prob. & Prop. Magazine, Keeping Current–Property: Cases (Sept./Oct. 2005), http://qa.americanbar.org/publications/probate_property_magazine_home/probate_2005_index.html.

In addition, the result might differ under varying factual circumstances. In *Bazinet*, the court did not comment on the effect of the deposit being in a New York branch of an out-of-state bank; however, a court might find that the attorney would have been aware that the bank was in danger of closing if it was a New York State Bank.

76. In downstate New York, down payments are typically large sums such as 10% of the purchase price. In upstate New York the amount may be much less such as $1,000.00 and held by the real estate broker.

77. N.Y.C.R.R tit. 22, ch. VII, § 7200; The Lawyer's Fund for Client Protection of the State of New York, Annual Report of the Board of Trustees for the Calendar Year 2006, at *3, http://www.nylawfund.org/ar.html (stating "Losses reimbursed by the Fund include…escrow deposits in real property transactions…."). If an Attorney-Escrow Agent defalcates with the Escrow Fund, the Lawyer's Fund for Client Protection of the State of New York will reimburse the injured party up to a maximum amount of $300,000.00. *See* N.Y.C.R.R. tit. 22, ch. VII, § 7200.13(a).

78. *See* Daimon v. Fridman, 6 A.D.3d 426, 773 N.Y.S.2d 441 (2d Dep't 2004); *see also* Rawcliffe v. Aguayo, 108 Misc. 2d 1027, 438 N.Y.S.2d 697 (Sup. Ct. Kings County 1981).

(paid advertisement)

When Purchasing a Newly Constructed Condominium Unit, Let the Buyer Beware

By Jeffrey R. Metz and Adam Leitman Bailey

The real estate crisis has hit home for thousands of buyers of newly constructed properties.[1] Negligently built homes with serious construction problems have forced homeowners to look for a real estate superhero to come to the rescue. Many builders have simply run out of money and hide behind shell corporations. Lawsuits are more expensive than ever and the Attorney General lacks the resources to be a viable alternative. The offices of the District Attorneys have flirted with making arrests and have convened more than one grand jury. Still, no arrests have been made to date. Even when suits succeed, the victory can prove empty. This office sued a developer and obtained a twenty million dollar judgment on behalf of its client. However, the developer claimed that he was a worker at a bakery and was poverty stricken. Given this situation, and the lack of assistance from the legislature or governmental agencies, condominium boards or unit owners have been forced to sue the vendors: the contractors, architects, engineers and HVAC designers. But recently, the Court of Appeals rendered a decision which shuns these victims and narrows the opportunity for much needed relief. This article will discuss the present state of the law.

Negligent Misrepresentation

Professionals such as accountants,[2] lawyers,[3] and engineering consultants[4] can be found liable to third parties for the acts they have performed for their clients. However, "before a party may recover in tort for pecuniary loss sustained as a result of another's negligent misrepresentations there must be a showing that there is either actual privity of contract between the parties or a relationship so close as to approach that of privity."[5]

The Court of Appeals utilizes a three-prong test to determine whether there is the functional equivalent of privity necessary to impose liability due to a negligent misrepresentation made by a professional. The factors to consider are:

> Awareness that the reports were to be used for a particular purpose or purposes; (2) reliance by a known party or parties in furtherance of that purpose; and (3) some conduct by the defendants linking them to the party or parties and evincing defendant's understanding of their reliance.[6]

The facts of a given case will determine whether the functional equivalent of privity exists between a plaintiff and the third party. On one end of the spectrum is *Credit Alliance v. Arthur Anderson & Co.*[7] There, the plaintiff-lenders provided financing to third parties for the purchase of capital equipment. One such company regularly required and was provided with financing. In 1978, the lender, as a condition to extending additional major financing to the borrower, required an examination of the borrower's audited financial statement. The borrower provided the lender with a financial statement "For the Years Ended December 31, 1977 and 1976." The statement had been prepared by the defendant-accountants in the discharge of their routine responsibilities to the borrower. Based upon this statement, the borrower received a credit extension.[8]

In 1979, as a pre-condition to further financing, the lender required examination of another financial statement. The statement "For the Years Ended February 28, 1979 and December 31, 1977" that the accountants had continued to prepare in the discharge of their routine responsibilities to the borrower, was furnished to the lender.[9]

The borrower filed for bankruptcy in 1980 and in 1981 the lender sued the accountants for the losses it suffered on its outstanding loans. The plaintiffs claimed that the defendant-accountants knew, should have known, or were on notice that the audited financial statements were being utilized by the borrower to induce companies such as plaintiffs to make credit available to the borrower. Plaintiffs further alleged that defendant-accountants knew, should have known, or were on notice that the audited statements were being shown to plaintiffs for such a purpose.[10]

Although both the lower court and the Appellate Division found that the lender's complaint set forth a cause of action for negligent misrepresentation, the Court of Appeals reversed, holding that the plaintiffs failed to set forth "either a relationship of contractual privity with [the defendant-accountants] or a relationship sufficiently intimate to be equated with privity."[11]

Employing the three-prong test, the Court of Appeals found that the complaint lacked an adequate allegation of either a particular purpose for the reports' preparation or the prerequisite conduct on the part of the accountants. Despite allegations that the borrower sought to induce plaintiff-lenders to extend credit, no claim was made that defendant-accountants were employed to prepare the reports with that particular purpose in mind. There was also no allegation that defendant-accountants had any direct dealing with plaintiffs, had specifically agreed with borrower to prepare the report for plaintiffs' use or agreed to provide plaintiffs with a copy of such reports. There was, "simply no allegation of any word or action on the part of [defendant-accountants] directed to plaintiffs, or anything contained in [defendant-accountants'] retainer agreement with borrower which provided the necessary link between them."[12]

On the other end of the spectrum is *Ossining Union Free School Dist. v. Anderson LaRocca Anderson*.[13] There, Plaintiff, a school district, began a structural evaluation of its buildings and entered into an agreement with co-defendant Anderson, an architectural firm. Under the agreement, Anderson was authorized to retain consultants, as Anderson did by retaining co-defendants Thune and Geiger as engineering consultants to assist in the evaluation project. The school board did not have a contract with either of the retained engineering consultants.[14]

Thune and Geiger tested the concrete throughout the building and both issued reports detailing serious weaknesses. As a result of the report, plaintiffs closed the annex and obtained other facilities to house the students at a substantial expense. Subsequently, plaintiff school district hired a third independent engineer to check the results, and that engineer advised plaintiff that the high school annex was constructed with a different concrete than that reported by co-defendant Thune and Geiger, and the building was, in fact, structurally sound.[15]

Plaintiff then commenced an action alleging, *inter alia*, negligence and malpractice against all three defendants. Defendants Thune and Geiger moved for dismissal, contending that absent contractual privity, claims against them could not be sustained. The Supreme Court granted the dismissal, and the Appellate Division affirmed, holding that while generally recovery is not granted to a third person arising from negligent representation without a contractual relationship, a narrow exception applies to accountants who "may be held liable to noncontractual parties who rely to their detriment on negligently prepared financial reports."[16]

The Court of Appeals reversed finding that liability may be imposed upon professionals other than accounts and therefore, despite being under contract with co-defendant Anderson only, Thune and Geiger undertook their work with the knowledge that it was for the school board and that the school board would be relying on their finding.[17] Thus, "defendants were aware –indeed, could not possibly have failed to be aware – that the substance of the reports they furnished would be transmitted to and relied upon by the school district. Plaintiff asserts that that was the very purpose of defendants' engagement."[18] On these facts, liability was imposed.

These cases illustrate the difference between actions taken by professionals in the course of their general duties to their clients which adversely affect a third-party, and the actions of professionals that are hired by a client for a specific purpose which adversely affects another. So how does this apply to the scenario posed above?

Sykes v. Cosentini

As the recently decided case of *Sykes v. Cosentini*[19] instructs, the consumer is pretty much out of luck. There, Plaintiffs sued a mechanical engineering company alleging that it had negligently misrepresented in the Condominium Offering Plan the capabilities of the HVAC system it designed for the use in the Plaintiffs' unit. The unit was actually too small and it never sufficiently heated in the winter or cooled in the summer.[20]

Plaintiffs' complaint alleged that these statements could be attributed to the engineering firm; that it was negligent in making them; that the statements were false; and, that the Plaintiffs relied upon them in purchasing the unit.[21]

The Court of Appeals, in an opinion authored by Justice Smith, found that the complaint failed to state a cause of action against the engineering firm. Relying upon the three-prong *Credit Alliance* test, Justice Smith found that the "[p]laintiffs have not sufficiently alleged that they were a 'known party or parties,' as *Credit Alliance* requires."[22] This, notwithstanding that the engineering firm "obviously knew in general that prospective purchasers of apartments would rely upon the offering plan."[23] Accordingly to the Court, because the engineering firm "did not know the identity of the specific nonprivity party who would be relying, the complaint falls short of satisfying the *Credit Alliance* test."[24]

Obviously, when a purchaser goes to contract in the pre-construction phase of the building of a new luxury condominium, the purchaser sees only a spot on a map or a hole in the ground. Without any ability to see the unit to be constructed, the purchaser is completely reliant upon the promises made by the developer and its engineering team. And, in this economic atmosphere where many development companies are mere shells and often not around to honor their obligations, without key sources of recovery for promises not kept, the purchaser is especially vulnerable.

So does the purchaser have any recourse? The answer appears to be: only when an engineering professional makes a Certification in the Offering Plan for the benefit of prospective purchasers.

Purchaser as the Third Party Beneficiary

For more than one hundred and fifty years, the law of the state has been that a third party may sue as a beneficiary on a contract made for his benefit.[25] But "[g]enerally it has been held that the ordinary construction contract—i.e., one which does not expressly state that the intention of the contracting parties to benefit a third party—does not give third parties who contract with the promisee the right to enforce the latter's contract with another."[26] This is because "[s]uch third parties are generally considered mere incidental beneficiaries."[27] These principles were illustrated in a motion court decision.

Bridge Street Homeowners Ass'n v. Brick Condominium Developers, LLC

In *Bridge Street*,[28] several purchasers of units in a newly constructed building brought suit, inter alia, against the architect who executed an Engineer's Certificate in the Offering Plan pursuant to which the plaintiffs purchased their units. The complaint reflected what occurs all too often: only after moving in did the plaintiffs discover numerous defects in design and construction. The cost of remediation was high: in excess of eighteen million dollars.[29]

But unlike in *Sykes*, *supra*, the Architect in *Bridge Street* certified in the Offering Plan "for the benefit of all persons to whom this offer is made," that:

> Upon due diligence and investigation of the facts, inspection of the property and review of the Offering Plan, the Offering Plan was complete and truthful and did "not contain any fraud, deception, concealment suppression" or "contain any representation or statement which is false, where we: (a) know the truth; (b) with reasonable effort could have known the truth; (c) made no reasonable effort to ascertain the truth; or (d) did not have knowledge concerning the representations or statements made.[30]

Thus, the plaintiffs argued that although the architect rendered its services under the contract it made with the Sponsor, such services "were expressly for their benefit, entitling them to recover against Weiss for his malpractice in performance or for breach of that contract as third party beneficiaries." The court agreed and denied the architect's motion to dismiss these causes of action.[31]

Conclusion

Purchasers need to carefully review Offering Plans to determine whether relief may be available against the engineering team in a newly constructed condominium.

In light of *Sykes*, claims of negligent misrepresentation will not survive a motion to dismiss unless the purchaser will be able to establish that he or she was a known party. Third party intended beneficiary claims will likely fare no better unless there is a certification made by a professional and the certificate contains the proper language that it is for the benefit of the persons to whom the offer is made. So even though the purchase of a luxury condominium may be involved, the old adage "buyer beware" still applies. Instead of victims having to look for a super hero to fix everything, the State Legislature needs to step in and pass laws that start protecting homeowners in newly constructed homes. First, the developer must be required to keep a reserve fund whereby money is retained after the building has been sold to cover possible problems. Second, an additional amount should be retained and only released after an engineer certifies that the building has a clean bill of health. Third, the owners of the units must control the condominium board as soon as 50 percent of the units have been sold or within two years so they can control the affairs of the buildings.

Endnotes

1. *See* Adam Leitman Bailey & John M. Desiderio, *Navigating Buyers and Developers Through New Construction Deals*, N.Y. L.J., May 3, 2010, at 4.
2. *See, e.g.*, Credit Alliance Corp. v. Arthur Anderson & Co., 65 N.Y.2d 536, 551, 483 N.E.2d 110, 118, 493 N.Y.S.2d 435, 443 (1986).
3. *See, e.g.*, Prudential Ins. Co. of Am. v. Dewey, Ballantine, Bushby, Palmer & Wood, 80 N.Y.2d 377, 381-82, 605 N.E.2d 318, 320, 590 N.Y.S.2d 831, 833 (1992).
4. *See, e.g.*, Ossining Union Free School Dist. v. Anderson LaRocca Anderson, 73 N.Y.2d 417, 424, 539 N.E.2d 91, 94, 541 N.Y.S.2d 335, 338 (1989).
5. *Prudential Ins. Co.*, 80 N.Y.2d at 382, 605 N.E.2d at 320, 590 N.Y.S.2d at 833.
6. *Ossining*, 73 N.Y.2d at 425, 539 N.E.2d at 95, 541 N.Y.S.2d at 339 (citing *Credit Alliance*, 65 N.Y.2d at 551, 483 N.E.2d at 118, 493 N.Y.S.2d at 443).
7. 65 N.Y.2d 536, 483 N.E.2d 110, 493 N.Y.S.2d 435, (1986).
8. *See id.* at 541, 483 N.E.2d at 111, 493 N.Y.S.2d at 436.
9. *See id.* at 541-42, 483 N.E.2d at 111, 493 N.Y.S.2d at 436 (relying on accountant's statements, plaintiff provided additional financing to the borrower).
10. *See id.* at 542, 483 N.E.2d at 112, 493 N.Y.S.2d at 437 (alleging further that the accountant knew or recklessly disregarded facts which indicated that the 1977 and 1979 statements were misleading).
11. *Id.* at 543, 483 N.E.2d at 112, 493 N.Y.S.2d at 437.
12. *Id.* at 553–54, 483 N.E.2d at 119, 493 N.Y.S.2d at 444-45.
13. 73 N.Y.2d 417, 539 N.E.2d 91, 541 N.Y.S.2d 335 (1989).
14. *See id.* at 419–20, 539 N.E.2d at 92, 541 N.Y.S.2d at 336.
15. *See id.* at 420, 539 N.E.2d at 92, 541 N.Y.S.2d at 336.
16. *Id.* at 421, 539 N.E.2d at 92, 541 N.Y.S.2d at 336.
17. *See id.* at 425-26, 539 N.E.2d at 95-96, 541 N.Y.S.2d at 339-40.
18. Ossining Union Free School Dist. v. Anderson LaRocca Anderson, 73 N.Y.2d 417, 425, 539 N.E.2d 91, 95, 541 N.Y.S.2d 335, 339 (1989).
19. 15 N.Y.3d 370, 938 N.E.2d 325, 912 N.Y.S.2d 172 (2010).
20. *See id.* at 372, 938 N.E.2d at 326, 912 N.Y.S.2d at 173.
21. *See id.*
22. *Id.* at 373, 938 N.E.2d at 326, 912 N.Y.S.2d at 173.
23. *Id.*, 938 N.E.2d at 326, 912 N.Y.S.2d at 173.
24. *Id.* at 374, 938 N.E.2d at 327, 912 N.Y.S.2d at 174.
25. *See* Lawrence v. Fox, 20 N.Y. 268, 271 (1859) (stating that the law was first announced in 1806).
26. Port Chester Elec. Constr. Corp. v. Atlas, 40 N.Y.2d 652, 656, 357 N.E.2d 983, 986, 389 N.Y.S.2d 327, 330 (1976).
27. *Id.*
28. Bridge St. Homeowners Ass'n v. Brick Condo. Developers, 18 Misc. 3d 1128(A), 856 N.Y.S.2d 496, 2008 N.Y. Slip Op 50221(U) (Sup. Ct. Kings County 2008).
29. *See id.* at *2.
30. *See id.*
31. *Id.* at *3-4.

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Notary's Responsibility to Verify Identity of Person Presenting Document

By Michael J. Siris

In this age of "identity theft" and eponymous, bogus "42 Street Identifications,"[1] it is not uncommon for an imposter to present himself to a notary for the purpose of acknowledging[2] a document, which is subsequently used to transfer property (a power of attorney is a perfect example). Indeed, a notary can be part of the scam, knowing full well that the person is an imposter. A completely innocent purchaser for value who purchases real property will be in for a rude awakening when he learns that his rights to his new purchase are trumped, of course, by the rights of the real owner because a forgery cannot convey good title absent exceptional equitable circumstances. With the imposter sipping Margaritas in the Bahamas and having made off with the funds from the scam, the innocent purchaser (or his title insurer) is often left holding the proverbial bag unless the notary was guilty of some misconduct that was a proximate cause of the loss.

Oddly, while New York has a fairly robust and lengthy history of actions holding notaries accountable in such or similar situations, the cases offer little guidance with respect to what steps a notary should take to verify someone's identity. Moreover, New York does not have any regulations setting forth any specific standard, leaving a notary to ponder whether the person appearing before him has presented "satisfactory evidence" of his identity.[3]

Statutory or Common Law

First, a look at the underpinnings for any claim against a notary is in order. New York has had for many years a statute (now Executive Law Section 135) which provides that "[f]or any misconduct[4] by a notary public in the performance of any of his powers such notary public shall be liable to the parties injured for all damages sustained by them."[5] Many New York claims against a notary have been based on this statute.[6]

On the other hand, it is also clear that there exists a non-statutory cause of action against a notary whose negligence (or fraud) is a proximate cause of another's loss.[7] To be on the safe side, a practitioner seeking indemnity from a potentially liable notary should include a statutory cause of action (based on Executive Law Section 135) and a common law cause of action in fraud, negligence, or both (depending on the facts of the case).

Holding Notaries Accountable

In New York there are several cases that have either held a notary responsible in situations such as the one set forth above, or have indicated that such a claim is viable.

Independence Leasing Corporation v. Aquino[8] is frequently cited for the proposition that "misconduct" in Section 135 need not be intentional as the notary had attempted to argue. In *Aquino*, Nicholas Aquino impersonated and forged his father James' name on a car lease acknowledged by Roger Kemblas.[9] After the father was sued and successfully defended the action, he cross-claimed against the notary and his employer. Precisely what the notary did do, or did not do, to verify the imposter's identity is not clear as the lower court merely said that the notary "did not obtain proper identification [from the imposter son]."[10] In any event, the City Court of Buffalo (the lower court) concluded that the plaintiff (the leasing company) could not recover from the notary under Section 135 because "misconduct of a notary in a civil case is confined to intentional, fraudulent or willful acts [which had not been proven]."[11]

On appeal, however, the county court traced the history of Executive Law Section 135 back to 1870,[12] reversed and reinstated the leasing company's claim against the notary and the bank, holding that "negligence has long been within the compass of misconduct by the notary."[13]

With respect to the father's cross claim, the Erie County Court (effectively the appellate court) focused only on whether the Buffalo City Court properly held that the cross claim "alleging negligence [was] not barred by the [s]tatute of [l]imitations as it was in the main lawsuit."[14] On this point, the county court concluded that the claim sounded in "implied contract rather than negligence" and, thus, was subject to a six-year statute of limitations, which did not run until the father had actually suffered his loss (which was within the statute of limitations).[15]

The county court did not discuss whether the cross claim could have been based on a violation of Section 135 (and, indeed, there is no reason why it could not have been). In any event, just as the lower court gave us little insight into precisely what steps the notary took (or did not take) to verify the imposter's purported identity, there is scant discussion in the county court as well.

Another case often cited is *Plemmenou v. Anninos*[16] although, again, this case gives us little guidance as to what steps a notary must take. In *Plemmenou* all we know is that, as part of a scheme engineered by the plaintiff's husband, the defendant notary acknowledged a power of attorney at a time when the plaintiff was in Greece.[17] The court did not discuss whether the person presenting the power of attorney had any sort of identification indicating that she was the plaintiff.

Instead, the focus in *Plemmenou* was simply whether the plaintiff could spell out a claim against the notary for misconduct. In the lower court, the notary, citing *Rastelli v. Gassman*,[18] successfully advanced an overly literal reading of Section 135 and argued that the plaintiff could not make out a claim under the statute because the plaintiff had not relied on the false acknowledgment. Quite rightly, the Appellate Division rejected that argument, pointing out that "the whole point of [the plaintiff's] former husband's scheme was to keep her unaware of it [and, if defendant's argument was accepted], [s]he could never prove reliance on the notary's alleged misconduct because, by the very design of the plan, she was not meant to know of it."[19]

While this opinion certainly put to rest any attempt to prevent the unwitting victim from seeking relief from the notary under the statute, the opinion offers scant guidance with respect to what a notary must do to be held liable (or not liable).

Likewise, more recent cases against notaries offer little clues as to the standard a notary must follow with respect to verifying someone's identity.

In *RLI Insurance Company v. Athan Contracting Corporation*,[20] a surety brought an action against a contracting company, its principals, and a notary (Harvey Pincus) who, it was alleged, may have "improperly notarized a signature" of Demetrious Rexines as that of Athanasios Koukoulis who should have signed the document.[21] While citing *Maloney v. State*[22] and recognizing that a cause of action under Section 135 may exist against a notary, there is no discussion of what, if anything, the notary did to verify the identity of the person who signed. In any event, the claim against the notary was dismissed because it was held that the alleged victim (Mr. Koukoulis) had ratified the "indemnity" agreement he claimed he had not signed.[23]

Edwards v. Rockaway Storage Inc.[24] involved an attempt to impose a somewhat unique standard of care upon a notary who acknowledged a power of attorney presented by someone who had actually passed into the great beyond—a rather remarkable feat indeed. The imposter presented what appeared to be a standard-issue New York State driver's license but which was actually phony. The defendant (the innocent purchaser for value) impleaded the notary who happened to work for Century 21 (which obviously was solvent).

On the notary's motion to dismiss the third-party complaint, the defendant / good faith purchaser for value argued that: (1) the notary should have maintained a copy of the actual license presented, which he did not; and, (2) the notary should have—for a nominal fee—checked, in real time, the New York State Department of Motor Vehicles' (DMV) website which would authenticate whether a given driver's license number was legitimate (the license number on the identification card would not have been authenticated by the website).

Instead, the notary produced a logbook, which contained the bogus driver's license number. While the court was not "inclined to adopt" the position that the notary should have checked the DMV website (or maintained a photocopy of the actual license), the court denied the notary's motion because he "failed in his duty to administer an oath…prior to witnessing the execution [of the power of attorney]."[25] However, by implication, the court effectively held that the notary's failure to make a photocopy of the driver's license presented (as opposed to simply keeping a logbook with the license number in such book) was sufficient care on the notary's part.

Conclusion

While it is clear that an action against a notary is certainly alive and well in New York, there is very little judicial or other guidance on the standard of care a notary must follow in ascertaining the identity of a person appearing before him.

For sure, a notary who is actually complicit with an imposter should be a target of any victim (or its title insurer) of a forgery perpetrated by an imposter. But what of the notary who is merely negligent—a notary who, for example, asks for and receives from the imposter two forms of government-issued photo identifications which appear to be legitimate, and makes copies of such identifications for his records? Should that notary be given a pass when the imposter—again off in the Bahamas—is exposed for what he is?

Despite the existence of some informal standard (such as two forms of photo identification), each case must be judged on its own—there do not yet appear to be any hard and fast rules. For instance and as an extreme example, someone who presents himself to a notary—particularly one who is charging for his services—with even five forms of photo identifications but wearing prison fatigues would hardly be someone whose signature a notary should be in a rush to acknowledge.

Conversely, someone who presents himself, with only one form of photo identification, to a law office notary who is not charging a fee is clearly a more eligible candidate for an acknowledgment. Because the courts in New York have so far been quiet with respect to a standard, a creative[26] attorney is free to chart his own course here in an attempt to secure reimbursement for a swindled client. In any case, the careful practitioner whose client has been cheated in a scam based on a document presented by an imposter to a notary needs to carefully examine the facts and circumstances under which the notary provided his acknowledgment.

Endnotes

1. *See generally* John D. Perovich, *Liability of Notary Public or his Bond for Negligence in Performance of Duties*, 44 A.L.R.3d 555 (1972) (containing an excellent national summary of the law on notarial liability, updated weekly with relevant case law).
2. *See generally* Elizabeth Williams, 1 N.Y. Jur. 2d *Acknowledgments* § 1 (2011) (defining "acknowledgment" as "a form for authenticating instruments conveying property or otherwise conferring rights. It is a public declaration by the person executing the instrument that the act evidenced thereby is his or her act and deed [although the notary does not have to actually witness the signature]." (internal citations omitted)); *See id.* § 37 (clarifying that an "acknowledgment" should not be confused with a notary's notarization (of an affidavit), or a verification of a pleading). In any event, in order to take advantage of New York's "Recording Act" (N.Y. Real Prop. Law § 291 (McKinney 2006)), a "conveyance" of real property (as defined in N.Y. Real Prop. Law § 290(3)) must be acknowledged.

3. N.Y. Real Prop. Law §303 provides: "An acknowledgment must not be taken by any officer unless he knows or has satisfactory evidence, that the person making it is the person described in and who executed such instrument."

   What exactly is "satisfactory evidence" is not clear from the cases as discussed above. A cursory check of some of the various notarial organizations indicates that some recommend that a notary who does not know the person insist on at least one form of government-issued photo identification. In addition, although its provenance is unclear, a definition of "satisfactory evidence of identity" appears in an Administrative Law Tribunal opinion, in which the Administrative Law Judge stated that it: [M]eans identification of an individual based on: (1) current documents issued by a governmental agency with the individual's photograph and signature, or (2) *at least two, current documents issued by an institution, business entity, or federal or state government with at least the individual's signature*; or (3) the oath or affirmation of a credible person who is personally known to the notary public and who personally knows the individual (emphasis added). Div. of Licensing Servs. v. Del Guidice, 763 D.O.S. 1 (2001) (Dept. of State), http://www.dos.state.ny.us/ooah/decisions/non_indexed/DELGUIDI.htm (last visited September 3, 2011).

   In other words, one government-issued document with a photo or two non-photo identifications issued by a private institution or government with signatures thereon would be considered "satisfactory evidence" at least under this particular definition.
4. The exact definition of "misconduct" in regards to Section 135 has been the subject of judicial debate. *See* Independence Leasing Corp. v. Aquino, 133 Misc. 2d 564, 506 N.Y.S.2d 1003 (Erie Co. Ct. 1986) [hereinafter *Independence Leasing Corp. III*] (stating that "misconduct" is not defined in Section 135). Worth reading is Justice Ira Warshawsky's erudite discussion in International Equine Acquisitions Holdings Inc. v. Moshell, 2009 N.Y. Slip Op 31247(U) (Sup. Ct. Nassau Co. 2009) (granting the unopposed motion for summary judgment against notary defendant who "falsely" notarized signatures).
5. N.Y. Exec. Law § 135 (McKinney 2010).
6. *See, e.g.*, *Independence Leasing Corp. III*, 133 Misc. 2d 564, 506 N.Y.S.2d 1003.
7. *See, e.g.*, *Maloney v. Stone*, 195 A.D.2d 1065, 601 N.Y.S.2d 731 (4th Dep't 1993).
8. 133 Misc.2d 564, 506 N.Y.S.2d 1003 (Erie Co. Ct. 1986). There are actually three Independence Leasing Corp. reported decisions as this citation was preceded by 111 Misc. 2d 1039, 445 N.Y.S.2d 893 (Buffalo City Ct. 1981), and 125 Misc. 2d 620, 480 N.Y.S.2d 274 (Buffalo City Ct. 1984). Interestingly, in the N.Y. Pattern Jury Instructions for "Negligent Misrepresentation," *Independence Leasing Corp. III* is one of the cases cited for the charge. *See* PJI 2:230 (2011), WL NY PJI 2:230.
9. Often, a notary may not have sufficient resources to justify a claim against him. Here, not only was the notary sued, but so was his employer. *See Independence Leasing Corp. III*, 133 Misc. 2d 564, 506 N.Y.S.2d 1003.
10. Independence Leasing Corp. v. Aquino, 125 Misc. 2d 620, 621, 480 N.Y.S.2d 274, 274 (Buffalo City Ct. 1984) [hereinafter *Independence Leasing Corp. II*].
11. *Id.* at 621, 480 N.Y.S.2d at 274.
12. Indeed, in its scholarly discussion the Court cites Commercial Bank of Kentucky v. Varnum, 3 Lans. 86 (N.Y. Sup. Gen. T. 1st Dep't 1870), *rev'd on other grounds*, 49 N.Y. 269 (1872), which involved a predecessor statute, 3 R.S., 5th ed., 474, section 37 (formerly 2 R.S. 1st ed., part III, ch. III, title II, section 48). *Independence Leasing Corp. III*, 133 Misc.2d at 568, 506 N.Y.S.2d at 1006. Interestingly, the Court quotes (then) Justice Cardozo (sitting in the First Department), who held that "[w]hatever may be said of the right of the plaintiff to maintain this action independent of the statute…there can be no doubt of their right to sue the defendant under the [statute] upon the ground of official misconduct." *Id.* (quoting *Varnum*, 3 Lans. at 105).
13. *Independence Leasing Corp. III*, 133 Misc. 2d at 569, 506 N.Y.S.2d at 1006.
14. *Id.* at 571, 506 N.Y.S.2d at 1008.
15. *Id.* at 572, 506 N.Y.S.2d at 1008.
16. 12 A.D.3d 657, 785 N.Y.S.2d 120 (2d Dep't 2004). A very recent citation to *Plemmenou* occurred in Wells Fargo Bank, N.A. v. Sherwood, 82 A.D.3d 758, 917 N.Y.S.2d 910 (2d Dep't 2011) (upholding the denial of a notary's claim to dismiss the claim under Section 135 of the Executive Law). We do not know what steps the notary took, or did not take, with respect to identifying the alleged imposter, but the plaintiff claimed that the notary was "without requisite knowledge as to the true identity of the signator…." *Id.*
17. *Plemmenou*, 12 A.D.3d at 657, 785 N.Y.S.2d at 120.
18. 231 A.D.2d 507, 647 N.Y.S.2d 253 (2d Dep't 1996). The confusion created by *Rastelli* (but clarified in *Plemmenou*) emanates from this statement: "There is no cause of action for notarial misconduct absent injury and there can be no injury unless a plaintiff can demonstrate that he or she relied to his or her detriment on the alleged misconduct…." *Rastelli*, 231 A.D.2d at 508, 647 N.Y.S.2d at 255. While some of the defendant-lenders in the case made their loan before the alleged notarial misconduct (with respect to a deed they claim they had not signed), other lenders made their loan after the alleged notarial misconduct. Hence, the third party complaint against the notary (Goodman) was sustained as to such lenders. However, there is, again, no indication of whether the persons who presented themselves to Goodman had any form of identification. *See Rastelli*, 231 A.D.2d 507, 647 N.Y.S.2d 253.
19. *Plemmenou*, 12 A.D.3d at 658, 785 N.Y.S.2d at 120.
20. 667 F. Supp. 2d 229 (E.D.N.Y. 2009).
21. *Id.* at 233.
22. 195 A.D.2d 1065, 601 N.Y.S.2d 731 (4th Dep't 1993). *Maloney* involved a claim by beneficiaries of securities that their signatures were forged on written authorizations that resulted in the pledging thereof. As is relevant to this discussion, the beneficiaries obtained summary judgment on their claim against the notary (Fagan). Again, there is no indication of the basis of the claim against the notary (statutory or common law), let alone any indication of whether or not the authorizations were presented by imposters to the notary. *See id.*
23. *RLI Ins. Co.*, 667 F. Supp. 2d. at 237.
24. 30 Misc. 3d 1215(A), 924 N.Y.S.2d 308, 2008 N.Y. Slip Op 52724(U) (Sup. Ct. Queens Co. 2008).
25. *Id.* at *2. Actually, an acknowledgment may not necessarily require the administration of an oath because, as noted above, an acknowledgment requires that a certain person known to the notary (or properly identified in some fashion) appeared before the notary and "acknowledged" to the notary that he (the person) had signed the document in question. *See supra* notes 2-3.
26. Although the plaintiff lost on a motion for summary judgment, one creative attorney attempted to argue that a notary who kept his notary stamp in the top unlocked drawer of his desk should be held responsible for someone who filched the stamp to assist in a scam. *See Dizazzo v. Capital Gains Inc.*, 2009 NY Slip Op 32186(U) (Sup. Ct. Nassau Co. 2009).

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Bergman on Mortgage Foreclosures: More Strictness on the 90-Day Notice

By Bruce J. Bergman

From the proverbial time immemorial, there was no requirement of statute or case law that acceleration of the mortgage balance required any notice or warning from the mortgage holder. The widely employed FannieMae/FreddieMac uniform instruments necessitate a 30-day notice to cure as a condition precedent, but that was a matter of contract. By now, lenders, servicers and their counsel are familiar with the mandate of RPAPL §1304 that a 90-day notice must be sent by the lender or servicer as a prerequisite to foreclosure of a home loan. This began in 2008 applying solely to subprime, non-traditional or high-cost home loans. As of February, 2010, this was extended to all home loans.

A recent case joins others and underscores yet again the dismaying strictness in court interpretations of the 90-day notice requirement for New York home loan foreclosures. [*GMAC Mortgage LLC v. Munoz*, 28 Misc.3d 1235 (A), 2010 WL 3583992 (N.Y. Sup.)] (We observe dismay from the viewpoint of lenders; borrowers will be heartened.)

Regarding the action in question, the borrower had defaulted in the spring of 2006 and there was apparently no issue whatsoever about that. The foreclosure was begun in January of 2010, and the mandated settlement conference was held in April, 2010. (So the borrower knew full well that he was in default.) Nothing came of the conference and no issues were raised which might have impeded the progress of the foreclosure. Then the plaintiff applied to have a referee appointed (to thereafter compute and then seek judgment of foreclosure and sale).

But the court denied the application for the referee's appointment and that is the heart of the matter. The plaintiff had identified the loan as non-traditional, thereby requiring the 90-day notice. The complaint appropriately pleaded that the notice had been sent and the time had expired. The court, however, viewed that statement (in a complaint verified by the attorney) as insufficient demonstration that the notice was sent. What the court ruled to be required was evidentiary proof, including an affidavit from one with personal knowledge of compliance as to the type size and content requirements of the notice, together with an affidavit of proper service of the notice by registered or certified mail and by first class mail to the last known address of the borrower. Such proof not having accompanied the application for the order of reference, it was denied.

That the 90-day notice is of any genuine help to a borrower or leads to reinstatements of mortgages, or generally aids the foreclosure process, has never been demonstrated. Because the law requires it, however, then removes debate as to the utility of such notice, it needs to be sent. Here, though, the borrower made no objection about the notice—there was no claim that it was not sent or not received. That the borrower was in default was also manifest. The court nonetheless required as a new prerequisite for the action to proceed absolute proof of compliance with the statutory requirements. A statement in the complaint that it was accomplished was found wanting.

While there is no suggestion here that this court's punctilious demand is irrational, it is another example of the unrelenting burdens of paper work imposed as prerequisites to the progress of a mortgage foreclosure action. Lenders will be bogged down. Defaulting borrowers will be afforded yet more time. Were the borrower here to have denied receipt of the notice, then of course the foreclosing plaintiff would have been compelled to prove compliance. In the absence of that, however, one can question the need for all the extra tasks (which leads to delay and expense).

While this becomes philosophical, that these burdens continue remains a fact, and that this sort of thing would emerge was predictable upon passage of the statute requiring the notice. Lenders have apparently accepted it with equanimity, although this is another sign that mortgage foreclosures in New York—already the lengthiest in the nation—will become ever more difficult and ever more time consuming.

Mr. Bergman is the author of the three-volume treatise, *Bergman on New York Mortgage Foreclosures*, LexisNexis Matthew Bender (rev. 2009) and is a member of Berkman, Henoch, Peterson & Peddy, P.C., Garden City, New York. He is also a member of the USFN and the American College of Real Estate Lawyers and a Fellow of the American College of Mortgage Attorneys.

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Student Case Comment:

Aames Funding Corporation v. Houston: Emergency Stay Granted Pending Determination of Defendant's HAMP Modification Application

By Constantine Kalogiannis

On June 28, 20011, the Appellate Division, Second Department held, in *Aames Funding Corporation v. Houston*, that once plaintiff's loan servicer (America's Servicing Company, hereinafter ASC) "participated in the HAMP program and accepted appellant's application for loan modification under the HAMP program," it should "not have scheduled a foreclosure sale while the appellant's loan application was pending."[1]

Almost five years before the court's opinion, in August 2006, a judgment of foreclosure and sale was entered against defendant and in favor of plaintiff.[2] Defendant appealed the order, challenging plaintiff's standing to foreclose.[3] The Appellate Division, Second Department concluded that the defendant failed to produce evidentiary proof sufficient to warrant a trial on his defenses, and thus the court granted plaintiff's motion for summary judgment.[4]

In December 2009, ASC notified the defendant that he might be eligible for the federal Home Affordable Mortgage Program (HAMP).[5] Defendant submitted an application to ASC for a loan modification. In a letter dated April 30, 2010, ASC notified defendant that the loan modification application was "currently under review by [ASC's] Loss Mitigation Department."[6] Defendant subsequently sent ASC, on July 2, 2010 and August 5, 2010, additional documents requested for the pending application for a loan modification. In spite of the pending modification application, plaintiff published a notice of a foreclosure sale scheduled for August 26, 2010.[7]

On August 23, 2010, defendant moved for an emergency stay of the foreclosure sale pending a determination on his application for a residential mortgage modification pursuant to HAMP.[8] Defendant argued that language contained in U.S. Treasury Supplemental Directive 10-02 afforded him relief. In relevant part, the Directive stated: "[a] servicer may not refer any loan to foreclosure or conduct a scheduled foreclosure sale unless and until…[t]he borrower is evaluated for HAMP and is determined to be ineligible for the program."[9] Plaintiff countered, stating that the *Making Home Affordable Program Handbook* superseded the Supplemental Directive.[10] On October 21, 2010, the Supreme Court vacated all stays and allowed the plaintiff to proceed with the foreclosure sale.[11]

On appeal, the Second Department reversed, stating that "[u]nder the circumstances, the plaintiff should not have scheduled a foreclosure sale while the…loan modification application [pursuant to HAMP] was pending."[12] The *Making Home Affordable Program Handbook* in force at the time of the appeal contained the same language as Directive 10–2: "[a] servicer may not refer any loan to foreclosure or conduct a scheduled foreclosure sale *unless and until*...[t]he borrower is evaluated for HAMP and is determined to be ineligible for the program [emphasis added]."[13]

This decision by the Appellate Division provides some respite to those who are pursuing a HAMP residential loan modification. As long as the HAMP modification application is still pending, the *Making Home Affordable Program Handbook* bars a loan servicer from referring any loan to foreclosure or conducting a scheduled foreclosure sale until ineligibility is determined.[14]

Endnotes

1. 85 A.D.3d 1070, 1070-71, 926 N.Y.S.2d 639, 639-40 (2d Dep't 2011).
2. *Id.* at 1070, 926 N.Y.S.2d at 639.
3. Aames Funding Corp. v. Houston, 44 A.D.3d 692, 843 N.Y.S.2d 660 (2d Dep't 2007).
4. *Id.* at 693, 843 N.Y.S.2d at 661.
5. *Aames Funding Corp.*, 85 A.D.3d at 1070, 926 N.Y.S.2d at 639.
6. *Id.* at 1071, 926 N.Y.S.2d at 640.
7. *See id.*
8. *See id.*
9. *Id.* at 1070-71, 926 N.Y.S.2d at 639.
10. *Id.* at 1071, 926 N.Y.S.2d at 640.
11. *See id.*
12. *Id.*
13. *Id.*
14. *See* Making Home Affordable Program Handbook (page 62), *available at* https://www.hmpadmin.com/portal/news/docs/.../hampupdate120210.pdf.

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Student Case Comment:
Bank of New York v. Silverberg: The Second Department Deals Another Blow to MERS

By Yuliya Viola

On June 7, 2011, the Appellate Division, Second Department, ruled in *Bank of New York v. Silverberg*[1] that Mortgage Electronic Registration Systems, Inc. ("MERS") was "without authority to assign the power to foreclose" to Bank of New York, as trustee, because it was "never the lawful holder or assignee of the notes described and identified in [the defendants'] consolidation agreement."[2] Acknowledging that MERS holds about 60 million mortgage loans in the United States, Justice Leventhal stressed that the court is "mindful of the impact that this decision may have on the mortgage industry in New York, and perhaps the nation."[3] However, Justice Leventhal emphasized that "the law must not yield to expediency and the convenience of lending institutions."[4] "Proper procedures must be followed to ensure the reliability of the chain of ownership, to secure the dependable transfer of property, and to assure the enforcement of the rules that govern real property."[5]

In *Silverberg,* defendants, Mr. and Ms. Silverberg, obtained two loans from Countrywide secured by residential real property. The promissory notes executed were payable to Countrywide, but MERS was referred to as the mortgagee for the purpose of recording.[6] Subsequently, defendants executed a consolidation agreement. According to the consolidation agreement, Countrywide was the lender and the note holder, while MERS was acting only as lender's nominee. MERS was not assigned the promissory notes secured by the two mortgages.[7] MERS assigned the consolidation agreement to the Bank of New York, as a trustee for holders of mortgage pass-through certificates.[8] Upon defendants' default on the consolidation agreement, Bank of New York commenced a mortgage foreclosure action. Defendants moved to dismiss the complaint for lack of standing. The Supreme Court denied defendants' motion, concluding that plaintiff was the owner of both the mortgages and the promissory notes under the consolidation agreement because MERS, as lender's nominee, assigned the mortgages as part of the consolidation agreement to plaintiff.[9] On appeal, defendants contended that plaintiff failed to establish a chain of ownership to the notes and mortgages, from Countrywide to the plaintiff, at the time it commenced the foreclosure action. Defendants asserted that neither MERS nor Countrywide had assigned the underlying notes, and properly transferred the mortgages,[10] to plaintiff.[11] The Second Department reversed the lower court decision "[b]ecause MERS was never the lawful holder or assignee of the notes described and identified in the consolidation agreement…."[12] To have standing in a mortgage foreclosure action, a plaintiff must show that it is the holder and assignee of both the notes and mortgages at the time the action was commenced.[13] To transfer the obligation, either a written assignment or the physical delivery of the underlying note prior to commencement of a foreclosure action is sufficient.[14] However, the notes were never assigned to MERS, they were never physically delivered to MERS, and the consolidation agreement did not specifically give MERS the right to assign the underlying notes. Bank of New York did not acquire the power to foreclose because it merely stepped into the shoes of MERS. The court distinguished the earlier decision in *Mortgage Elec. Registration Sys., Inc. v. Coakley,* since in that case the lender had transferred and tendered the promissory note to MERS before commencement of the foreclosure action.[15]

The *Silverberg* decision has an important effect on the manner in which foreclosures are handled when MERS is a party, because it enforces the requirement that the party commencing the foreclosure action must be the holder or assignee of both the note and mortgage at the time the foreclosure action is commenced.

Endnotes

1. 86 A.D.3d 274, 926 N.Y.S.2d 532, 2011 N.Y. Slip Op 05002 (2d Dep't 2011). The Official Appellate Division Reporter (86 A.D.3d 274) will not be cited in subsequent endnotes because pin citations are not available at this time.
2. *Silverberg*, 926 N.Y.S.2d at 539, N.Y. Slip Op 050002 at *5.
3. *Id.*, NY Slip Op at *6.
4. *Id.*
5. *Id.* at 539-40, N.Y. Slip Op 050002 at *6.
6. *Id.* at 533-34, N.Y. Slip Op 050002 at *1.
7. *Silverberg*, 926 N.Y.S.2d at 534, N.Y. Slip Op 050002 at *2.
8. *Id.* (noting that the assignment of the consolidation agreement to the Bank of New York gave the holders of mortgage pass-through certificates a right to receive payments on the loan).
9. *Id.* at 535, N.Y. Slip Op 050002 at *2.
10. *Id.* Defendants contended that mortgages were never properly assigned to plaintiff because MERS, as nominee for Countrywide, did not have power to transfer the mortgages. Defendants also argued that "the mortgages…were bifurcated, rendering the mortgages unenforceable and foreclosure impossible." *Id.*
11. *Id.*
12. *Id.* at 539, N.Y. Slip Op 050002 at *5.
13. *Silverberg*, 926 N.Y.S.2d at 537, N.Y. Slip Op 050002 at *4 (citing *U.S. Bank, N.A. v. Collymore,* 68 A.D.3d 752, 753, 890 N.Y.S.2d 578, 580 (2d Dep't 2009)).
14. *Silverberg*, 926 N.Y.S.2d at 538, N.Y. Slip Op 050002 at *4 (citing *Collymore,* 68 A.D.3d at 754, 890 N.Y.S.2d at 580).
15. *Silverberg*, 926 N.Y.S.2d at 539, N.Y. Slip Op 050002 at *5.

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