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Message from the Outgoing Chair

In August 2015 I wrote my first column. It seems too soon to be writing my last as Chair of the Section. As one of our esteemed former Chairs, Karl Holtzschue, warned me late last summer, before you think about it your term is over. He was right.

Thanks to you all, especially the Executive Committee members, and most especially my fellow officers, Mindy Stern, Trish Watkins, Tom Hall and Spencer Compton, for making my job so easy and enjoyable. Thanks, too, to the three prior Chairs I had the pleasure of serving with in the officers group, Dave Berkey, Steve Alden and Ben Weinstock. These are the people who provided the lessons on how to serve the Section. For what I did right, I thank them. For anything you found deficient, blame my inability to follow their example

The Real Property Law Section remains one of the strongest in the New York State Bar Association, second in size only to the Trusts and Estates Law Section. This success can only be attributed to the great work being done by our various committees. It is the committees, each focused on a particular area of practice, which enable our Section to thrive. The benefit to our members is the information provided by our committees, aiding our members in their individual practices. This is what keeps the Section active and growing.

A special note of thanks to our District Representatives. This group has continued to spread the word about the benefits of Section membership throughout the State. District Representatives have taken the lead in serving members in their districts and helping the Section grow.

In my first column I set forth some modest goals for the year. It is time for the report card.

- Our membership has remained stable in spite of a slight decline in overall bar membership
- While we have continued to enjoy increased participation at the leadership level by women and the addition of some less senior members, our efforts with respect to racial diversity have been less successful. Mindy, the challenge remains.
- Our CLE programs, particularly at our summer and annual meetings, continue to provide somewhat of a potpourri, trying to provide information of value for members throughout the state with divergent interests.
- Attendance at our regularly scheduled CLE programs remains strong.
- Our bylaws have been reviewed and revised as needed.
- The Section continues to have a meaningful presence at the State level through the active participation of our delegates to the State House of Delegates, Sam Tilton, Steve Alden, Michele Wildgrube and Joe Walsh, and the HOD liaison to the Section, Ira Goldenberg.

Among the significant accomplishments this past year, the following stand out:

- Increased presence of the Section through attendance by individual members at various law school functions—efforts led by Ariel Weinstock, Shelby Green, Dave Berkey and Harry Meyer.
- Review and revision of committee descriptions and goals led by Nancy Connery and our District Representatives.
- Revision of our bylaws led by Karl Holtzschue and his task force.
- Formation of a task force led by Joel Sachs to address the continuing blight of Zombie Houses throughout New York State.
- Record attendance at our 2015 Summer meeting at Bristol Harbor Resort, Vermont, led by Mindy Stern.

I realize the risk of singling out the accomplishments above. For those whose efforts I have overlooked, please accept my apology.

The Section is thriving. I have every confidence that it will continue to thrive and reach new heights in the capable hands of Mindy, Trish, Tom, Spencer and our newest officer, Jerry Antetomaso. We are in good hands.

Thanks again to all who have participated this year and made me look good. Take advantage of what the Section continues to offer. There is plenty to choose from.

One final expression of gratitude is in order. Without the help of Amy Jasiewicz at the State Bar Office, this ship would certainly have run aground numerous times. Thanks, Amy.

Thanks for letting me serve.

Best to all.

Leon T. Sawyko

Message from the Incoming Chair

So what's your passion? Whether you just graduated from law school, or have been practicing for years, we all gravitated to real property law for a reason. What is yours?

Do you want to:

- Protect landmarked buildings?
- Eliminate the scourge of "zombie" houses from neighborhoods to make them safer and preserve property values?
- Help a client buy or sell a trophy building? Or represent the lender providing the financing?
- Convince the legislature to adopt rational laws affecting property owners and occupants, or to correct an injustice?
- Help a not-for-profit with a mission you support get or keep a real property tax exemption?
- Reduce real estate's carbon footprint through "green" measures?
- Work to support the housing needs of New Yorkers by improving mortgage foreclosure practices, addressing homelessness, or promoting affordable housing?
- Organize community service projects?
- Select law school scholarship recipients?
- Negotiate a newsworthy office, retail or restaurant lease?
- Help a coop or condo deal with the Air B&B phenomenon?
- Create or update forms to make it more efficient to do what you love?
- Improve how our Section uses technology to connect with its members?

Whatever your personal interest in all things real estate, you will find a place in the Real Property Law Section to fulfill it. Our Section has a collective passion—we strive to serve our clients and the public with the highest moral and ethical standards, to achieve excellence, to be relevant, and to find meaning in our work.

Our Committees Chairs and members come from every part of the State. They develop their missions and goals through collective consensus. If you join us, you will have the unique opportunity to network and collaborate with fellow dirt lawyers at all stages of their careers—ranging from the most seasoned, accomplished members of our profession, to those just starting out—to select projects and develop programs for the coming year. Our Section consistently is one of the largest in the Association, but the warmth and collegiality of our members and leadership make it feel much more intimate—like collaborating with good friends who nurture you and encourage you to be your best, both personally and professionally.

It is humbling to reflect upon all of the talented, dedicated and accomplished predecessors in this position. I am honored and privileged to be embarking on this year-long journey with you. Please join us to make the coming year the best ever for the Real Property Law Section. We need you!

Mindy H. Stern

Fraud in Sale of Condominium Units: ILSA as the Basis for Recovery

By Vincent Di Lorenzo

On September 26, 2014, Public Law 113-167 was signed by President Obama exempting condominium sales from the registration and disclosure requirement of the Interstate Land Sales Full Disclosure Act (ILSA).[1] The 2014 amendment does not exempt condominium sales from the antifraud prohibitions contained in ILSA.[2] Private parties bringing actions against real estate developers based on the fraudulent acts or practices of a developer often allege common law fraud, violation of N.Y. General Business Law § 349 which prohibits deceptive acts or practices in the conduct of any business, contract claims based on express warranties, or claims based on statutory warranties. Each of these claims has limitations or requirements that may prevent a successful action. What is often ignored is a possible action based on ILSA's antifraud provisions. This article explores the availability of a private action under ILSA based on allegations of fraud and the required elements of such a cause of action.

ILSA's Antifraud Prohibitions

As an initial matter, it is well settled that sales of condominium units are subject to ILSA. The statute applies to the sale or lease of any "lot."[3] However, courts have embraced the viewpoint of the Department of Housing and Urban Development (HUD) that condominium sales are within the reach of the statute.[4]

ILSA's antifraud prohibitions are twofold: one related to disclosures required under the statute, and the other imposing a broader prohibition. Thus the statute makes it unlawful for any developer or agent to make use of any means or instruments of communication in interstate commerce or the mail to sell or lease any lot "where any part of the statement of record or the property report contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein pursuant to sections 1704 through 1707…."[5] The 2014 amendment to ILSA exempts condominium sales from these disclosure requirements. Thus, future sales would not be subject to this initial statutory antifraud prohibition that is tied to disclosure requirements. However, sales occurring prior to the effective date of the 2014 amendment remain subject to this initial prohibition, which extends to both material misrepresentations and to material omissions.

The second, broader antifraud prohibition in ISLA makes it unlawful for any developer or agent, with respect to the sale or lease of any lot:

(A) to employ any device, scheme or artifice to defraud;

(B) to obtain money or property by means of any untrue statement of a material fact, or any omission to state a material fact… with respect to any information pertinent to the lot or subdivision;

(C) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon a purchaser….[6]

This second antifraud prohibition applies to sales or offers made both before and after the effective date of the 2014 amendment.

Authorizations for Private Actions and Remedies

A private action is expressly authorized for any violation of section 1703(a) of the statute, which includes both of its antifraud prohibitions. The action is authorized for any purchaser or lessee against a developer or agent.[7] The relief authorized is damages, specific performance or such other relief as the court deems fair, just and equitable.[8] In addition, interest, court costs and reasonable amounts for attorneys' fees are authorized.[9] This is in addition to enforcement actions that may be brought by the Consumer Financial Protection Bureau,[10] including actions imposing civil money penalties for "knowing" violations of ILSA.[11]

Explored below are following issues: (a) who can bring a private action alleging fraud, (b) who can be held liable for the alleged fraudulent activity, and (c) what are the required elements of an action alleging fraudulent activity in violation of the ILSA?

Proper Parties

A private action may be maintained by a "purchaser or lessee" if a sale or lease was made in violation of section 1703(a).[12] This language suggests that private actions can be maintained only by actual purchasers or lessees. However, the Act's definition of "purchaser" is broader. The term encompasses "an actual or prospective purchaser or lessee of any lot…."[13] The antifraud prohibition in section 1703(a)(1) extends to displaying or delivering "to *prospective* purchasers… material which is inconsistent with information required to be disclosed in the property report…."[14] In addition the antifraud prohibitions in section 1703(a)(2) apply to "the sale or lease, or *offer to sell* or lease…any lot…."[15]

An issue that has been addressed by the courts is the right of subsequent owners to maintain an action against the developer. In *Gibbes v. Rose Hill Plantation Development Co.*,[16] the federal district court ruled that one of the plaintiffs, Gibbes, had no cause of action under the ILSA because Gibbes had purchased the lot from an earlier lot owner and not from the developer or developer's agent. The action brought in the *Gibbes* case involved an allegation that the developer failed to implement promises made verbally and through the property report. The court ruled that "private causes of action under ILSA are limited to persons who directly purchase their property from a developer or a developer's agent."[17]

Similarly, the North Carolina Court of Appeals, in *Konopisos v. Phillips*, concluded that the Act's protections do not extend to the purchasers' assignees.[18] The case in question did not involve allegations of fraud. It involved plaintiffs' claim that they could cancel the purchase agreement because the developer did not file a statement of record or provide a property report. The initial purchasers had assigned all rights in and to the contract of sale, including all rights of action, to the plaintiffs. Despite the broad language contained in the assignment in question, the court concluded the assignee had no cause of action under the Act. The court reasoned that the Act was designed to protect only the purchaser and not the assignee, who has never dealt with the seller (developer). The Act's definition of protected "purchaser(s)" harmonizes with the overall purpose of the Act, namely to ensure disclosure of all material facts to buyers from the developer of the site.[19]

A conclusion at odds with the *Gibbes* decision was drawn by the federal district court in New York in *Board of Managers of the Mason Fisk Condominium v. 72 Berry Street, LLC*.[20] The case did not directly address the right of a subsequent owner to maintain an action. Rather it involved the ability of a condominium association, as assignee, to bring a claim on behalf of unit purchasers. In the course of its opinion the court concluded that the *Gibbes* decision would eviscerate the doctrine of assignee standing that is well established in the Second Circuit.[21] Ultimately the court denied standing to the association because the assignment in question did not explicitly transfer fraud claims under ILSA, and because proving the claims in the complaint would require the participation of each individual purchaser.

As to defendants that may be named in an action, ILSA targets "any developer or agent" that engaged in the fraudulent activity in question.[22] "Developer" is defined as any person who directly or indirectly sells or leases, or offers to sell or lease, or advertises for sale or lease any lots.[23] The Act's definition identifies the actor who may be held liable, but also further defines the activity targeted—namely fraud in connection with any sale or lease, any offer to sell or lease, or any advertisement for sale or lease of any lot.

The Fourth Circuit, in *Total Realty Management LLC v. R. A. North Development*, explored if a defendant must be a direct party to a sale to be held liable for violations of ILSA's antifraud prohibitions. The court noted the difference in the statutory basis for liability contained in section 1703(a)(1) of the Act and section 1703(a)(2) of the Act. Section 1703(a)(1) targets developers who "sell or lease any lot." This limits liability to actual sellers of the property in question. However, section 1703(a)(2) does not contain this limitation. The court concluded that the terms of the statute and its legislative history do not support limiting liability under section 1703(a)(2) to sellers.[24] In the *Total Realty* case the court allowed a claim for violations of ILSA to be brought not only against the entity selling the lots in question. It also allowed plaintiff to bring an action to hold independently liable the entity that participated in sales and marketing efforts.

The term "agent" is defined as any person who represents, or acts for or on behalf of any developer.[25] However, specifically excluded is any attorney "whose representation of another person consists solely of rendering legal services."[26] In *Rolo v. City Investing Company Liquidating Trust*,[27] the court had distinguished liability of an attorney as agent of the developer from possible liability for aiding and abetting fraud. It concluded that the exclusion of an attorney of law in the definition of "agent" in section 1701(6) is a bar to primary liability only, and not to secondary liability.[28]

Elements of a Cause of Action

The various prohibitions against fraud apply when any developer or agent, directly or indirectly, makes use of any means or instruments of transportation or communication in interstate commerce, or of the mails.[29] For example, the antifraud provisions of the ILSA formed the basis of a private action alleging fraud in *Board of Managers of Park Slope Views Condominium v. Park Slope Views, LLC*.[30] In that case the plaintiffs alleged defendants failed to build the condominium in accordance with representations made in the purchase agreement, marketing materials and offering plan. Instead the property was allegedly built in a defective and unworkmanlike manner and in violation of the New York City Building Code. The court denied defendants' motion to dismiss. It noted that the antifraud provisions of the ILSA applied because the defendants used e-mail and the internet to disseminate marketing materials and the offering plan.

To maintain a private action alleging fraud, plaintiff must allege and prove a prohibited activity. When the property is subject to all of ILSA's requirements, including registration and disclosure requirements, the prohibited activity includes (a) making untrue statements of material facts or omitting material facts in any statement of record or property report, and (b) displaying or delivering advertising and promotional material inconsistent with the information required to be disclosed by the Act. These are sometimes referred to as section 1703(a)(1) actions. When the cause of action is not based upon the Act's registration and disclosure requirements, the prohibited activity encompasses (a) employing any device, scheme or artifice to defraud, (b) obtaining money or property by means of an untrue statement of material fact or omission of a material fact, and (c) engaging in any transaction, practice or course of business that operates as a fraud or deceit on a purchaser. These are sometimes referred to as section 1703(a)(2) actions.

Courts have confirmed that proof of scienter is not required for a successful action. Purchasers are not required to prove that defendants had an intent to deceive or defraud.[31] In reaching this conclusion courts have relied on the explicit terms of the provisions in ILSA imposing liability, and have drawn parallels to various sections of the federal securities laws. For example, in *Husted v. Amrep Corporation*, the court noted that section 1709(a) of ILSA, which authorizes civil actions by purchasers, is modeled on section 11 of the Securities Act of 1933, 15 U.S.C. § 771. Intent to deceive or defraud is not an element of a cause of action under section 11. In addition, among the claims that may be brought under section 1709 is a claim alleging a lot was sold by means of a property report that contained an untrue statement or omission of a material fact in violation of section 1703(a)(1) of the Act. Intent to deceive or defraud is not a requirement imposed by the express terms of the Act. Rather, once a statement is proven to be material, liability is imposed.[32]

Similarly, in *Ackmann v. Merchants Mortgage & Trust Corporation* the action brought alleged a violation of section 1703(a)(2), namely a transaction, practice or course of business that operates as a fraud or deceit upon a purchaser. The court noted the language of this subsection is identical to section 17(a)(3) of the Securities Act of 1933, and the U.S. Supreme Court has concluded proof of scienter is not required for liability under section 17(a)(3). The court in *Ackmann* ruled that the plain meaning of section 1703(a)(2) of ILSA focuses upon, and imposes liability based upon the conduct of the developer, and not the culpability of the developer.[33]

What is unsettled is whether proof of reliance is a required element for recovery. The overwhelming majority of reported cases have concluded that proof of reliance is not necessary in a private action alleging fraud under the ILSA. However, courts have separately considered actions brought under section 1703(a)(1) and actions brought under section 1703(a)(2). The former prohibits misrepresentations and omissions of material facts in a statement of record or property report. The latter is the broader prohibition against fraud. The reported cases also differentiate actions brought under section 1703(a)(2)(B) and actions brought under section 1703(a)(2)(A) or (C).

One of the earliest cases considering the necessity of proving reliance is *Bryan v. Amrep Corporation*.[34] With respect to liability based on misrepresentations or omissions in the statement of record, *i.e.*, a section 1703(a)(1) claim, the court concluded that "a plaintiff is not required to prove that each purchaser relied in some way on the omission or misrepresentation but only that a material misrepresentation or omission existed in the statement of record at the time the property was sold."[35] However, with respect to a claim under section 1703(a)(2), the court concluded that "reliance is an element of a section 1703(a)(2) claim based on misrepresentations, at least under section 1703(a)(2)(B)…."[36] This conclusion was drawn at a time when section 1703(a)(2)(B) explicitly required proof of reliance. Moreover, the court noted that reliance was not required when the claim was based on a material omission, as opposed to a misrepresentation.[37]

In 1979 Congress amended the ILSA and removed the explicit requirement of reliance contained in section 1703(a)(2)(B). The House Report and House Conference Report discussing the 1979 amendments noted that section 1703(a)(2)(B) remains a prohibition against fraud but "the purchaser's actual reliance would no longer have to be an element of proof."[38] Subsequent case law has addressed the issue of reliance in actions brought under both sections 1703(a)(1) and 1703(a)(2).

Cases brought under section 1703(a)(1) have uniformly concluded that proof of reliance is not necessary. The court's decision in *Burns v. Duplin Development, Inc.*,[39] illustrates the courts' reasoning. In that case the court examined the reported case law and the terms of the Act before drawing the conclusion that reliance is not a requirement. First, it noted the current text of the Act makes no reference to reliance. Second, it explained that section 1703(a)(1)(C) has its origins in section 12(a)(2) of the Securities Act of 1933, which the courts have concluded does not require proof of reliance.[40]

As noted above, prior to the 1979 amendments to the Act some courts had concluded reliance was not required for violations of section 1703(a)(2)(A) and (C). After the amendments the court in *Disandro v. Makahuena Corporation*,[41] drew an analogy between the Hawaiian Horizontal Property Act and ILSA. It relied on the statements contained in the Congressional reports accompanying the 1979 amendments to ILSA to opine that proof of reliance was not necessary under *any* of the prohibitions against fraud contained in section 1703(a).[42]

However, not all courts have concluded that reliance is not an element of recovery. The distinction drawn by some courts is between an action brought under section 1703(a)(1) (fraud based on the content of the statement of record or property report) and an action brought under section 1703(a)(2) (other fraudulent acts or practices). In *Dongelewicz v. First Eastern Bank*,[43] the court differentiated the two statutory bases for liability. It concluded that the prohibitions in section 1703(a)(2) are general prohibitions against fraud, and "establishing fraud requires proof of detrimental reliance…."[44] The court did not otherwise justify or explain its conclusion. The same conclusion was drawn by the court in *Ivar v. Elk River Partners, LLC*.[45] In both of these decisions the court required proof of reliance for claims brought under section 1703(a)(2).

Similarly, in *Taplett v. TRG Oasis (Tower Two), Ltd., LP*,[46] the court ruled that proof of reliance was required in any action alleging violation of section 1703(a)(2). The court considered the 1979 amendments to the Act and the Congressional reports that discussed the reliance requirement. However, it also noted the Congressional reports stated the amendments were designed to conform more closely to the language found in the securities laws.[47] Based on this general statement in the Congressional reports, rather than the specific discussion of the reliance requirement, the court then reasoned that section 1703(a)(2) more closely resembles Rule 10b-5 and section 17(a), as opposed to section 1703(a)(1) which resembles section 12(a)(2) of the federal securities laws. Given this similarity the court thought it inappropriate to interpret the ILSA provisions any differently. Thus, proof of reliance was required.

A different conclusion was drawn in *Gibbes v. Rose Hill Plantation*.[48] In that case the court concluded that plaintiff need not show reliance in order to prove a violation of the general prohibitions against fraud in section 1703(a)(2)(A) or (C). However, with respect to violations of section 1703(a)(2)(B), which prohibits untrue statements or omissions of material facts, plaintiff need not show reliance to maintain an action based on an omission, but may be required to show reliance to maintain an action for an affirmative misrepresentation.

The court in *Gibbes* did not explain the reason for its conclusion. The court cited the earlier decision of the federal district in Montana in *Prebil v. Pinehurst, Incorporated*. However, in *Prebil* the court actually opined that it was highly questionable that reliance is required under the Act.[49]

Gibbes then also cited the courts' decisions in *Bryan v. Amrep* and *Gilbert v. Wood Marketing, Inc*.,[50] without noting that both decisions were handed down before the 1979 amendment to ILSA which removed the explicit requirement of reliance contained in the earlier version of section 1703(a)(2)(B) of the Act.

Turning to the essence of the action, the prohibited activity will often consist of either a misrepresentation or omission of a material fact. Expressions of opinion or puffery regarding the qualities of an offering are not actionable. However, if a statement assigns a *specific* quality to an offering that it does not possess, the seller has transcended the limits of puffery and may be held liable for making a false representation.[51] In the *Gentry* case the statements made were that the condominiums "(1) are a luxury development; (2) are extraordinary; (3) blend tropical charm with contemporary elegance; (4) combine materials and finishes of exceptional quality with timeless craftsmanship; (5) provide spacious patios from which to enjoy glorious sunrises over the water, and (6) that Altman Development Corporation consistently delivers products and services of the highest caliber to clients and residents…."[52] The court concluded these statements were statements of opinion and general characterizations that constitute puffery.

A distinct issue raised in *Solomon v. Pendaries Properties, Inc*.[53] is whether mere subsequent nonperformance of promises made by a developer supports a cause of action under section 1703 of the Act. The court ruled there is no cause of action for representations of future occurrences that the developer in good faith intended, at the time of sale, to carry out.[54] In the *Solomon* case the developer represented it would build certain amenities which were not in fact built. The evidence indicated that failure to complete the promised facilities was due to economic problems incurred by the developer years after the plaintiffs' purchase.

The standard for materiality for violations of the ILSA is borrowed from the standard employed for violations of the federal securities laws. Namely, a misrepresentation or omission is material if a reasonable purchaser might have considered that statement or omission important in making a decision to purchase.[55] In the *Paquin* case the court concluded that failure to disclose that the parent corporation of the corporation that owned the developer had filed for bankruptcy was not an omission of a material fact. The court reasoned that the several corporations in question were separate legal entities, that the property report repeatedly warned that the success of the venture depended on satisfactory sale of lots and the ability to secure financing, and that there was no evidence that the developer held itself out as relying on the bankrupt corporation's financial assistance.

Price v. Owens-Illinois Development Corporation[56] is also useful in considering the issue of materiality. In that case the developer's broker represented that mobile homes were not allowed in the subdivision based on the terms of restrictive covenants. However, the purchaser was not told the restrictive covenants could be later amended to allow mobile homes. In fact, they were later amended to allow mobile homes. The court initially noted that the omission was material. It explained that "whether or not mobile homes are allowed in an area can have a significant effect on property values, and a reasonable investor would no doubt consider that fact important in making a decision."[57] However, the court then noted that an action under section 1703(a)(1) requires an untrue statement of a material fact or an omission of a material fact "required to be stated pursuant to sections 1704 through 1707 of this title."[58] In the *Price* case the court concluded that disclosure of a reservation of the right to amend restrictive covenants that have been recorded was not a required disclosure under the statute.

The sources of actionable misrepresentations or omissions of material facts, when not found in the statement of record or property report, are varied. Actions have been based on misrepresentations made in promotional dinners and tours,[59] in sales and marketing materials distributed at presentations,[60] in sales brochures and oral statements made at presentations,[61] and in advertisements.[62]

Section 1703(a)(2) also prohibits activities beyond misrepresentations and omissions of material facts, namely it prohibits any "device, scheme or artifice to defraud,"[63] as well as "any transaction, practice or course of business" that would operate as a fraud or deceit on a purchaser.[64] It was these prohibitions that formed the bases for the action in *Ivar v. Elk River Partners, LLC*.[65] In that case defendants sought to convince purchasers that the lots they were purchasing were worth substantially more than they in fact were. They accomplished this by publicly recording the pre-incentive prices in prior sales rather than the lower, actual sales prices, and intentionally withholding property appraisals. This activity was viewed as the scheme to defraud or the practice that operated as a fraud, in violation of section 1703(a)(2).

Exemptions and Statute of Limitations

A cause of action based on ILSA's antifraud prohibitions may be a desirable alternative for a private plaintiff due to ILSA's express authorization of private actions, the broad scope of fraudulent acts and practices prohibited, and the statute's less demanding elements for recovery. However, the Act contains exemptions from its antifraud prohibitions. Among exempt real estate developments are: (a) sale of lots in a subdivision containing less than 25 lots (units), (b) sale of any improved land, and (c) sale of land under a contract obligating the seller to erect a building within two years.[66]

ILSA contains a statute of limitations applicable to private actions.[67] The limitations period is three years. However, an action based on a misrepresentation or omission in the statement of record or property report (i.e. section 1703(a)(1)) must be brought within three years of the date the contract for sale or lease of the lot was signed.[68] Actions based on fraudulent acts and practices targeted under the ILSA in section 1703(a)(2) must be brought within three years of discovery of the violation or "after discovery should have been made by the exercise of reasonable diligence."[69]

Conclusion

ILSA can serve as an effective means by which a condominium unit purchaser can maintain an action against a developer based on allegations of fraud. In contrast to some state statutory prohibitions against fraud, ILSA expressly authorizes private actions. In contrast to state common law actions, ILSA's prohibitions extend to both misrepresentations and omissions. In addition, its prohibitions encompass a broad range of fraudulent activity beyond disclosure obligations. Finally, to maintain an action, proof of scienter is not required, and in the view of most courts neither is reliance.

Endnotes

1. 15 U.S.C. §§ 1701-1720. The 2014 amendment to ILSA takes effect 180 days after enactment. Pub. L. No. 113-167, § 2.
2. The amendment is to section 1702(b) of ILSA which provides an exemption from the "the provisions requiring registration and disclosure (as specified in section 1703(a)(1) and sections 1704 through 1707 of this title)…." 15 U.S.C. § 1702(b).
3. 15 U.S.C. § 1703(a).
4. *E.g.*, Berlin v. Renaissance Rental Partners, 723 F.3d 119, 123-24 (2d Cir. 2013); Winter v. Hollingsworth Properties, 777 F.2d 1444, 1448 (11th Cir. 1985). The Dodd-Frank Act transferred responsibility for administering ILSA to the Consumer Financial Protection Bureau. The Bureau's definition of the term "lot" is found at 12 C.F.R. 1010.1(b), and is identical to HUD's definition. 24 C.F.R.1710-1(b).
5. 15.U.S.C. § 1703(a)(1)(C).
6. *Id.* § 1703(a)(2).
7. *Id.* § 1709(a).
8. *Id.*.
9. *Id.* § 1709(c).
10. *Id.* §§ 1714, 1701(1).
11. *Id.* § 1717a.
12. *Id.* § 1709(a).
13. *Id.* § 1701(10).
14. *Id.* § 1703(a)(1)(D).
15. *Id.* § 1703(a)(2).
16. 794 F. Supp. 1327 (D.S.C. 1992).
17. 794 F. Supp. at 1333-34. *Compare with* Trotta v. Lighthouse Point Land Co., LLC, 551 F. Supp. 2d 1359, 1366 (S.D. Fla. 2008), *aff'd on other grounds*, 319 Fed. Appx. 803 (11th Cir. 2009) (purchaser, a limited liability company, was essentially the alter ego of the assignee, and therefore the plaintiff has standing. The assignee did deal with the developer as the original purchaser, albeit through a limited liability company rather than as an individual).
18. 226 S.E.2d 522, 524 (Ct. App. N.C. 1976).
19. *Id.*
20. 801 F. Supp. 2d 30, 37-38 (E.D.N.Y. 2011).
21. *Id.*
22. 15 U.S.C. § 1703(a).
23. *Id.* § 1701(5).
24. 706 F.3d 245, 252 (4th Cir. 2013).
25. 15 U.S.C. § 1701(6).
26. *Id.* § 1701(6).
27. 845 F. Supp. 182 (D.N.J. 1994) (the court decided, however, that the claim was time barred), *aff'd on other grounds*, 155 F.3d 644 (3d Cir. 1998).
28. *Id.* at 222.
29. 15 U.S.C. § 1703(a).
30. 39 Misc. 3d 1221A, 972 N.Y.S.2d 142, 2013 NY Slip Op. 50689U (N.Y. Sup. Ct. Kings County 2013).
31. *See* Husted v. Amrep Corp., 429 F. Supp. 298, 310-11 (S.D.N.Y. 1977); Burns v. Duplin Land Devel., Inc., 621 F. Supp. 2d 292, 306 (E.D.N.C. 2009) (court rejects seller's claim that mistake or inadvertent omission in a property report is not actionable, because text of the statute does not mention scienter and the remedial intent of Congress counsels against judicially implying scienter); Hester v. Hidden Valley Lakes, Inc., 495 F. Supp. 48, 53-54 (N.D. Miss. 1980); Ackmann v. Merchants Mortgage & Trust Corp., 645 P.2d 7, 16-17 (Colo. 1982) (court discusses suggestion in the Tenth Circuit decision in *Solomon v. Pendaries Properties* that intent is required, but concludes it is mere dicta).

32. *Husted*, 429 F. Supp. at 310-11; *Hester*, 495 F. Supp. at 53-54 (court notes section 1709 closely parallels section 12 of the Securities Act of 1933).

33. 645 P.2d at 16. The court also noted the legislative history of ILSA reinforces the conclusion that a scienter requirement was not contemplated.

34. 429 F. Supp. 313 (S.D.N.Y. 1977).

35. *Id.* at 317 (discussing former section 1709(a) of the Act).

36. *Id.* at 319.

37. *Id.* at 320. *See also* Gilbert v. Woods Mktg, Inc., 454 F. Supp. 745, 748-49 (D. Minn. 1978) (section 1703(a)(2)(B) expressly provides that reliance is an element, but presumably plaintiffs may establish a case under sections 1703(a)(2)(A) and (C) without proof of reliance, so long as the principal alleged fraud is a failure to disclose).

38. H.R. Rep. No. 96-154, at 34-35, reprinted in 1979 U.S.C.C.A.N. 2317, 2350-51; H.R. Conf. Rep. No. 96-706, at 83, reprinted in 1979 U.S.C.C.A.N. 2402, 2442 (discussing Public Law 96-153).

39. 621 F. Supp. 2d 292, 303-06 (E.D.N.C. 2009).

40. *See* Paniaguas v. Aldon Cos., Inc., 2005 WL 1983859 (N.D. Ind. 2005); Gibbes v. Rose Hill Plantation Dev. Co., 794 F. Supp. 1327, 1334 (D.S.C. 1992); DiSandro v. Makahuena Corp., 588 F. Supp. 889, 895 (D. Haw. 1984); Hester v. Hidden Valley Lakes, Inc., 495 F. Supp. 48, 53-54 (N.D. Miss. 1980). *Cf.* Lukenas v. Bryce's Mountain Resort, Inc., 538 F.2d 594, 596 n.11 (4th Cir. 1976) ("[w]hether 'reliance' is essential to [an action for material misrepresentations or omissions in the property report] is subject to some doubt.").

41. 588 F. Supp. 889 (D. Haw. 1984).

42. *Id.* at 895.

43. 80 F. Supp. 2d 339 (M.D. Pa. 1999).

44. *Id.* at 348.

45. 705 F. Supp. 2d 1220, 1236-37 (D. Colo. 2010).

46. 755 F. Supp. 2d 1197 (M.D. Fla. 2009).

47. *Id.* at 1202.

48. 794 F. Supp. 1327, 1336 (D.S.C. 1992).

49. Prebil v. Pinehurst, Inc., 638 F. Supp. 1314, 1317 (D. Mont. 1986).

50. 794 F. Supp. at 1336, n.22.

51. Gentry v. Harborage Cottages-Stuart, LLP, 602 F. Supp. 2d 1239, 1252 (S.D. Fla. 2009), *aff'd in part*, 654 F.3d 1247 (11th Cir. 2011).

52. *Gentry*, 602 F. Supp. 2d at 1252-53.

53. 623 F.2d 602 (10th Cir. 1980).

54. *Id.* at 604.

55. Paquin v. Four Seasons of Tennessee, Inc., 519 F.2d 1105, 1109 (5th Cir. 1975). *Cf.* Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma, 96 S. Ct. 2430, 2434 (1976) (the Act is based on the full disclosure provisions and philosophy of the Securities Act of 1933).

56. 646 F. Supp. 314 (M.D. Ga. 1986).

57. *Id.* at 316.

58. 15 U.S.C. § 1703(a)(1)(C).

59. *U.S. v. Amrep Corp.*, 560 F.2d 539 (2d Cir. 1977).

60. Total Realty Mgmt., LLC v. R.A. North Dev., 706 F.3d 245, 249 (4th Cir. 2012).

61. Gilbert v. Woods Mktg., Inc., 454 F. Supp. 745, 750 (D. Minn. 1978).

62. Dongelewicz v. First Eastern Bank, 80 F. Supp. 2d 339, 348 (M.D. Pa. 1999).

63. 15 U.S.C. § 1703(a)(2)(A) (2012).

64. 15 U.S.C. § 1703(a)(2)(C).

65. 705 F. Supp. 2d 1220, 1237 (D. Col. 2010).

66. 15 U.S.C. § 1702(a)(1)-(2). These exemptions are discussed in detail in Di Lorenzo, New York Condominium and Cooperative Law § 2:0 (West).

67. 15 U.S.C. § 1711.

68. 15 U.S.C. § 1711(a)(1). Courts have rejected claims that the statute of limitations should commence on the date of the actual sale of the lot in question. *E.g.*, Yeomans v. Le Triomphe P'ship, 884 F.2d 847, 848-9 (5th Cir. 1989); Cook v. Deltona Corp., 753 F.2d 1552, 1561-62 (11th Cir. 1985); Aldrich v. McCulloch Props., Inc., 627 F.2d 1036, 1043-44 (10th Cir. 1980).

69. 15 U.S.C. § 1711(a)(2).

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Absent Sublease Recognition Agreement, the Rejection of a Prime Lease in a Bankruptcy Case Leaves a Sublessee Largely Out in the Cold

By Marc D. Rosenberg and Daniel N. Zinman

As a recent decision by Bankruptcy Judge Robert Drain of the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") in the *A&P* bankruptcy case highlights,[1] sublessees are largely powerless to remain in possession of the subleased premises when the sublessor rejects its primary lease in the sublessor's bankruptcy case, at least in the absence of a sublease recognition agreement between the sublessee and the primary lessor.

Background

When A&P, a longtime supermarket operator, commenced its second bankruptcy case in approximately five years, it did so with the goal of winding down its business and liquidating its assets. It simply could not profitably operate as a supermarket chain any longer. Among its most valuable assets were hundreds of real property leases for properties on which A&P operated its supermarkets. A&P's primary secured lenders agreed to fund A&P's orderly liquidation, provided that it was conducted in accordance with strict sale related milestones reflected in the parties' financing agreements. Promptly after filing for bankruptcy, the Bankruptcy Court granted A&P permission to conduct a sale process for its real estate leases designed to monetize the value of such assets.[2]

One of the leases subject to the sale process (the "Supermarket Lease") covered a property located in New York City that had an initial term expiring in 2024, with renewal options totaling nearly another 24 years.[3] A&P had previously subleased about 9% of the property to a third party (the "Supermarket Sublease") for five years, plus renewals for an additional 8.5 years. After conducting a thorough sale process, A&P decided to reject the Supermarket Lease pursuant to an agreement with the primary lessor (the "Landlord").[4]

Typically, if the rent provided for under a lease is above market, no one would bid on the lease and the lessee would reject the lease, leaving the lessor with an unsecured claim for breach of the lease.[5] If the rent due under the lease is below market, however, the lessee could assume and assign the lease to a third party for value. Here, the Landlord was sufficiently concerned with the possibility that a third party might pay value to acquire the Supermarket Lease that the Landlord agreed to pay A&P to reject the Supermarket Lease in consideration for two payments: $10.5 million after entry of a final order approving the lease rejection and an additional $10.5 million (minus any litigation costs incurred in connection with any eviction action) after the sublessee under the Supermarket Sublease (the "Sublessee") had surrendered or been dispossessed of the property.[6]

A&P filed a motion seeking the Bankruptcy Court's approval of its decision to reject the Supermarket Lease. To approve a debtor's decision to reject an unexpired lease, bankruptcy courts typically apply a "business judgment" test—similar to a state law "business judgment" standard of review of corporate decision making—but one in which the court is quite deferential to the views of the major stakeholders in the bankruptcy case.[7] Here, only the Sublessee objected to the motion. Given the support of the other stakeholders in the case and the fact that the Landlord's bid represented the only bid A&P received for the Supermarket Lease, the Bankruptcy Court readily agreed that A&P exercised good business judgment in rejecting the Supermarket Lease in exchange for the payments from the Landlord. The more difficult questions facing the court concerned the Sublessee's post-rejection possessory rights. The Sublessee made a series of arguments in support of its contention that it had the right to continue to possess the subleased premises, notwithstanding A&P's rejection of the prime lease.

The Voluntary Surrender Doctrine

First, the Sublessee relied upon New York's voluntary surrender doctrine, which is a fact-based common law exception to the general rule that a sublease does not survive the termination of the prime lease. The voluntary surrender doctrine applies to protect the sublease where the landlord and the tenant agree to the voluntary surrender of the prime lease[8] and is intended to prevent the landlord and prime lessee from colluding to deprive the subtenant of its rights under the sublease. The doctrine does not protect the sublease, however, from the termination of the prime lease because of the prime lessee's breach.[9]

One example of the application of the voluntary surrender doctrine is the seminal case of *Eten v. Lyster*,[10] in which a landlord paid a tenant to surrender his lease and vacate the premises and then sued the sublessee for possession. The New York Court of Appeals ruled that although the "expiration of the term of the [prime] lease in any of the ways provided for" in the prime lease (*e.g.*, expiration of the term or a breach of lease by the lessee) would have ended the sublease, the prime lease came to an end because of the surrender of the lease by the prime lessee.[11] Accordingly, the subtenant was entitled to continued possession and the prime lessor became the immediate landlord of the subtenant under the same terms and conditions as the sublease.[12]

In the A&P case, the Sublessee argued that the agreement between the Landlord and A&P to reject the Supermarket Lease in exchange for a monetary consideration from the Landlord was effectively the same as the voluntary surrender in *Eten v. Lyster* and its progeny. Despite the fact that both A&P and the Sublessee requested that the Bankruptcy Court issue a binding ruling on the application of the voluntary surrender doctrine, the Bankruptcy Court ruled that it was precluded from doing so under the decision of the United States Court of Appeals for the Second Circuit in *Orion Pictures*.[13] In *Orion*, the Second Circuit held that a motion to reject a lease under section 365 of the Bankruptcy Code is a summary proceeding, under which there is no prolonged discovery or lengthy trial with respect to disputed factual issues. Given those limitations, the Bankruptcy Court refused to issue a binding ruling on whether the voluntary surrender doctrine applies in the context of a section 365 lease rejection motion, leaving the issue to be resolved in state court between the primary Landlord and the Sublessee.

The Bankruptcy Court did express a non-binding view of the merits, however. Given that one-half of the consideration payable by the Landlord to A&P was contingent upon removal of the Sublessee from the premises, the Bankruptcy Court considered the likelihood of the Landlord's success on the issue in order to rule on whether A&P was exercising good business judgment in agreeing to the Landlord's terms.[14]

The Bankruptcy Court ruled that A&P did exercise good judgment in this regard, concluding that it believed that a state court would likely rule that the voluntary surrender doctrine is not triggered by a lease rejection pursuant to section 365 of the Bankruptcy Code. The Bankruptcy Court believed that the rejection was not "voluntary" given that A&P was pursuing an expedited liquidation strategy and that A&P, after a thorough marketing process, agreed to accept valuable consideration from the Landlord to reject a lease. Also, a rejection of the contract under section 365 amounts to a breach of the lease, not a termination.[15] If other courts follow the Bankruptcy Court's views on the application of the voluntary surrender doctrine, absent actual collusion between the prime lessor and prime lessee, a sublessee would not be able to use the voluntary surrender doctrine to protect its sublease in the event of a rejection of the primary lease by the primary lessee.

The Application of Section 365(h)(1)(A)(ii) to the Sublessee

In the alternative, the Sublessee argued that section 365(h) of the Bankruptcy Code protected its possessory rights. Section 365(h) contains statutory protections for lessees where lessors reject their leases in bankruptcy. Under section 365(h)(1)(A)(ii), if a debtor rejects an unexpired lease of real property in which the debtor is the lessor, then:

> if the term of such lease has commenced, the lessee may retain its rights *under such lease* (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable bankruptcy law.[16]

Thus, if a debtor-lessor rejects a lease, the lessee may elect to remain in possession of the subleased premises for the balance of the term plus any renewals, with rent due at the contractual rate.

The Sublessee argued that A&P's rejection of the primary lease amounted to the rejection of the Supermarket Sublease, granting the Sublessee the right to remain for the balance of the Supermarket Sublease plus any renewals under section 365(h)(1)(A)(ii). The Bankruptcy Court disagreed. When A&P rejected the primary lease, it was obligated to surrender the premises to the Landlord pursuant to section 365(d)(4). Interpreting section 365(h)(1)(A)(ii) such that the Sublessee was entitled to remain in possession of the subleased premises for the balance of the Sublease's term (plus renewals) would cause a conflict with the requirement of the primary lessee—A&P—to surrender the entire premises immediately. The Sublessee could hardly stay in the subleased premises after A&P had surrendered the premises to the Landlord.[17]

The Bankruptcy Court made one additional point in this regard. Recall that section 365(h)(1)(A)(ii) states that the lessee may retain its rights "under such lease." Thus, the Subtenant is limited to retaining its rights under its Sublease. Subject to a favorable state court ruling on the voluntary surrender doctrine, the Bankruptcy Court ruled that the Sublessee no longer had any rights once A&P surrendered the premises to the Landlord. Although, as noted above, a rejection of the lease pursuant to section 365 is a breach of the lease, not a termination, the Bankruptcy Court nevertheless held that the requirement that A&P surrender the premises "is tantamount to termination as far as the subtenant's rights" under the Sublessee.[18] Once A&P rejected the Supermarket Lease and surrendered the premises, the Subtenant no longer had any meaningful right to possession from A&P. According to the Court, "a proper reading of section 365(h)(1)(A)(ii)'s reference to the [Sublessee's] rights 'under such [sub] lease' and section 365(d)(4)'s surrender requirement show that section 365(h) does not give the subtenant a meaningful election to remain in its former subtenancy when the debtor has rejected the overlease first or simultaneously with the sublease."[19] The Sublessee retained the right to seek relief against the Landlord in state court, but given the Bankruptcy Court's views concerning application of the voluntary surrender doctrine to the facts presented, the Sublessee's prospects do not seem overly bright.

Sublessee's Rights Under Section 363(e)

The Sublessee also attempted to invoke the Bankruptcy Code's protections for holders of property interests when a debtor sells property, arguing that A&P's rejection of the Supermarket Lease should be properly characterized as a sale. Under section 363 of the Bankruptcy Code, a debtor in possession, such as A&P, can seek to sell its property free and clear of all interests. That right, however, is subject to a number of restrictions, including section 363(e), which requires that the court "prohibit or condition such use, sale or lease as is necessary to provide adequate protection" of a third party's interest in the property being sold, used, or leased.

As the Bankruptcy Court pointed out, however, nowhere did A&P describe its lease rejection motion as a "sale," nor did A&P seek relief under section 363 of the Bankruptcy Code. Thus, the Bankruptcy Court could have ruled that there was no sale and ended its discussion of this issue. The Bankruptcy Court chose, however, to address this issue to the extent that the A&P could be said to have "sold" the Supermarket Lease to the Landlord.

In so doing, the Bankruptcy Court distinguished the case before it—in which the debtor was proposing to reject a lease—from a situation where the primary lessor of real property is the debtor and is seeking to sell the underlying real property free and clear of the lessee's interest in the real property. In the latter case, there is a split of authority as to whether a debtor can sell real property free and clear of a lease without affording the lessee the protections of section 365(h);[20] however, that was not the situation here. To the extent that anything was being "sold," according to the Court, it was the Supermarket Lease, not the underlying real property. In contrast, the Bankruptcy Court held that the Sublessee's property interest was in the Sublease and the real estate subleased pursuant to it. A&P was not "selling" that property, nor was it using or leasing it. Instead, A&P was rejecting the lease. Accordingly, the Bankruptcy Court held that the sublessee had no interest in property entitled to adequate protection.

Conclusion

As the foregoing discussion makes clear, a sublessee is unlikely to be able to remain in possession of the subleased premises if the sublessor rejects the primary lease in its bankruptcy case. To the extent possible, a sublessee, in negotiating a sublease, should require a sublease recognition agreement with the primary landlord whereby the primary landlord agrees to recognize the sublease if the primary lease is rejected or otherwise breached by the tenant / sublandlord under circumstances not caused by the subtenant.[21]

Endnotes

1. *In re The Great Atl. & Pac. Tea Co., Inc.*, 544 B.R. 43 (Bankr. S.D.N.Y. 2016).
2. *See id.* at 47-48. In a chapter 11 bankruptcy case, a debtor may, subject to the bankruptcy court's approval, reject, assume, or assume and assign an unexpired lease. The purpose of giving a debtor such rights is to permit the debtor "to use valuable property of the estate and to 'renounce title to and abandon burdensome property.'" *In re Orion Pictures Corp.*, 4 F.3d 1095, 1098 (2d Cir. 1993). Ultimately, the decision whether to reject, assume, or assume and assign an unexpired lease is a matter of the debtor's business judgment, subject to court approval.
3. *Id.* at 45.
4. *Id.* at 48.
5. *See* 11 U.S.C. § 502(b)(6) (2012). Usually, lessor receives a poor recovery on such a claim, as the claim often will receive payment from the debtor's bankruptcy estate of only cents on a dollar of claim. In addition, the amount of the claim itself is capped by section 502(b)(6) of the Bankruptcy Code, which disallows claims arising from the rejection of real property leases to the extent the claim exceeds:

    (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—(i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed or the lessee surrendered, the leased property; plus

    (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.
6. *The Great Atl.*, 544 B.R. at 48.
7. *See id.* at 48-49. Usually, a debtor's major stakeholders are the debtor's creditors. Here, A&P's agreement with the Landlord had the support of both the debtor's secured creditors and its official committee of unsecured creditors (which represents the interests of all unsecured creditors).
8. Goldcrest Transp., Ltd. v. Across Am. Leasing Corp., 298 A.D.2d 494, 495, 748 N.Y.S.2d 411, 413 (2nd Dep't 2002).
9. *The Great Atl.*, 544 B.R. at 51.
10. 60 N.Y. 252 (1875).
11. *Id.* at 258-59.

12. *Id.* at 259.

13. *In re Orion Pictures Corp.*, 4 F.3d 1095 (2d Cir. 1993).

14. Another recent decision in the United States Bankruptcy Court for the Southern District of New York took a similar approach, citing to Judge Drain's decision in A&P. In *In re Sabine Oil & Gas Corp.*, No. 15-11835, 2016 WL 890299, *4 (Bankr. S.D.N.Y. Mar. 8, 2016), Judge Chapman, in allowing the debtor to reject certain pipeline and gas gathering agreements, refused to issue a binding ruling on the non-debtor parties' argument that the contractual covenants ran with the land (and thus would survive the debtor's rejection of the contract), but did examine the issue in the context of determining whether the debtor was exercising good business judgment in determining to reject the agreements.

15. *See In re Lavigne*, 114 F.3d 379, 386-87 (2d Cir. 1997).

16. 11 U.S.C. § 365(h)(1)(A)(ii) (emphasis added).

17. *The Great Atl.*, 544 B.R. at 52-53.

18. *Id.* at 53.

19. *Id.*

20. *Compare In re Patriot Place, Ltd.*, 486 B.R. 773 (Bankr. W.D. Tex.) (holding that real property cannot be sold pursuant to section 363 free and clear of a lessee's interest under section 365(h) *with Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (B.A.P. 7th Cir. 2003) (holding that a debtor can sell real property free and clear of leases, without necessarily giving the lessees the protections they have under section 365). *See also Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696 (Bankr. S.D.N.Y. 2014) (holding that a debtor can sell real property free and clear of leases, but the lessee's interest in the property must receive adequate protection under section 363(e)). A discussion of this issue is beyond the scope of this article.

21. Although the sublease between A&P and the Subtenant granted the Subtenant a right to terminate if it failed to receive a recognition agreement from the primary landlord within 60 days of the sublease's effective date, no such agreement was entered into between the parties and the condition was deemed waived.

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The Evolving Use of License Agreements in Real Estate-Related Transactions

By S.H. Spencer Compton and Diane Schottenstein

A 1917 *Yale Law Review* article described license agreements as "Chameleon-hued,"[1] a reference to their versatility and adaptability to so many circumstances. In today's fast paced economy, in addition to their traditional applications, license agreements create the parties' sometimes subtle temporary relationships, rights and obligations in shared work space environments, pop-up stores and even artisanal food halls curated by celebrity chefs. The use of a license agreement may also reflect a landlord's desire to avoid the increasingly burdensome framework inherent in the landlord / tenant relationship. Owners and users of real estate need to understand the many potential applications of a license agreement.

Traditionally, licenses agreements have been used to provide rights to install and maintain communication towers and antennae, display signs, run concession stands at sporting events and other venues, gain access during construction, and use parking spaces and storage areas.

For over a century, license agreements have been used to document the concept of a shop within a shop. For example, in a department store cosmetics section, many or all of the brands will display their products in close proximity to those of other brands, yet each brand retailer is a separate and distinct business operation. The respective rights and obligations of the store owner and the licensee are memorialized in a license agreement. This is also the case with designer shops in stores such as Bloomingdales, Saks Fifth Avenue or Macy's. The designer will sell its products pursuant to a license agreement, and the department store will have the right to terminate the license if, for example, the licensee's branding is no longer compatible with that of the store or if certain sales targets are not met. Often the licensee will invest large sums to fixture and fit out its designated area to capitalize on its exposure in the department store and the department store will want them to remain as long as both parties are profiting from the relationship.

How is a license different from a lease or an easement? According to *Freidman on Leases*, "a lease is a conveyance of exclusive possession of a specific property for a term less than that of the grantor usually in consideration of the payment of rent, which vests an estate in the grantee."[2] Generally, a lease provides for an exclusive right to use the space for a set period of time. Considerable legislation and case law in each state now define the obligations of a landlord and tenant created by a lease arrangement. In contrast, Friedman goes on to explain that a license merely makes permissible acts on the land of another that would otherwise lack permission. Critical elements of a license are: (i) that it is terminable at will; and (ii) it does not grant the licensee an estate in the land.[3]

In determining whether an agreement is a lease, a license or an easement, courts will also consider whether the granted use is non-exclusive, whether the owner retains certain controls over the property, and whether the owner provides services essential to the licensee for the use of the property.[4] A license is distinguishable from an easement which, like a license, permits the use of the owner's property or restricts the owner from certain uses of it property; however, unlike a license, an easement transfers to the easement holder an interest that encumbers the property and affects title. Easements are classified as *appurtenant* to the property in which event they either benefit the holder and are transferable with the transfer of the property or they are *personal* to the holder of the easement in which event they do not run with the land. Unless otherwise specified, an easement is presumed to be permanent and non-exclusive, and is generally transferable.

A property owner may prefer a license over a lease because it is easier to remove a licensee than to remove a tenant. With a lease, there can be an expensive, litigious and highly technical gauntlet of legal process to remove a tenant. While the eviction winds its way through court, the landlord can face cumbersome delays, lost income, large tax expenses, lost opportunities to obtain a new responsible tenant, and burdensome legal fees. Even if a lease specifically states that a landlord may use self-help, it is a risky proposition. Section 853 of the New York Real Property Actions and Proceedings Law provides that if a tenant is ejected from real property by force or other unlawful means, the tenant may recover treble damages from the landlord and may be restored to the property if ejected before the end of the lease term.[5]

By contrast, it is well settled that a licensor may revoke a license "at will" and can use "self-help" to remove a defaulting licensee, thus foregoing the arduous gauntlet required to regain possession of leased property. Under a license, the licensee has no estate in the property and has no right to possession. Unless expressly contradicted in the license agreement, common law principles generally apply and the licensor has the absolute right to use peaceable self-help to remove a licensee from a licensed premises. However, even though it is easier to remove a licensee than it is to remove a tenant, certain laws apply. New York Real Property Actions and Proceedings Law Section 713, which generally relates to summary holdover proceedings where no landlord-tenant relationship exists, applies to an action against a licensee if the license has expired or been revoked and would therefore require the sending of a ten day notice to quit.[6]

Where the distinction between a license and a lease becomes blurred, there can be uncertainty as to how a court might characterize the license agreement despite how it is labeled. Besides the title of the document, a court will look at the elements of the agreement and the equities of the situation in its decision making. In *American Jewish Theatre Inc. v. Roundabout Theatre*, the Appellate Division, First Department wrote, "what defines the proprietary relationship between the parties is not its characterization or the technical language used in the instrument but rather the manifest intention of the parties. The nature of the transfer of absolute control and possession is what differentiates a lease from a license or any other arrangement dealing with property rights. Whereas a license connotes use or occupancy of the grantor's premises, a lease grants exclusive possession of designated space to a tenant subject to rights specifically reserved by the lessor. The former is cancellable at will without cause."[7] Here, the plaintiff theatre company brought an action for injunctive relief that could only be afforded to a tenant in the context of a rental dispute. Because the plaintiff had a six-month fixed right to use the space that was not revocable at will, the court found that, even though the agreement between the parties was labeled a license, the relationship was a leasehold one.

In a more recent case, *Nextel of N.Y. v. Time Management Corp.*, the Supreme Court, Appellate Division Second Department, found that a rooftop cellular agreement was a lease, not a license, because the agreement contained provisions typical of a lease and conferred rights well beyond those of a holder of a license or a temporary privilege.[8]

Further, it seems the courts will look at the equities of a situation to come to its decision. In *Blenheim LLC v. Il Posto LLC*, the Civil Court of the City of New York, New York County found that a provision in a lease giving a restaurant a license revocable at will to use a vault space could not be revoked at will.[9] The Court concluded on the facts of the case that the landlord knew that the tenant needed the vault for its compressors, hot water heaters and elevator machine equipment and, as such, the use of the vault space was necessary and essential for the use of the space as a restaurant and was therefore appurtenant to the lease between the parties and thus irrevocable.[10] Accordingly, where a license is viewed as coupled with an interest or where there is reliance on the license, a court might equitably rule that there should be greater protections for the user.

Most recently, in February 2014, in *Union Square Park Cmty. Coal, Inc. v. New York City Department of Parks and Recreation*, the New York Court of Appeals affirmed an Appellate Court decision that found that a fifteen-year agreement between the N.Y. Department of Parks and Recreation and a restaurant was a license and not a lease.[11] Here, even though the document was entitled "License," it had a fifteen-year term and a payment structure that resembled a lease. Although in this case the use of the indoor pavilion was exclusive, the outdoor space was available to non-restaurant patrons except in certain designated areas where liquor was served. In addition, in the agreement the Department of Parks and Recreation retained the right to terminate the relationship at will on twenty-five (25) day written notice as long as its reasons were not arbitrary or capricious.

In examining the distinction between a license and a lease, the New York Court of Appeals stated:

> A document is a lease if it grants not merely a revocable right to be exercised over the grantor's land without possessing any interest therein but the exclusive right to use and occupy the land. It is the conveyance of 'absolute control and possession of the property at an agreed rental which differentiates a lease from other arrangements dealing with property rights' (Feder v. Caliguira, 8 N.Y.2d 400, 404 [1960]). A license, on the other hand, is a revocable privilege given 'to one, without interest in the lands of another, to do one or more acts of a temporary nature on the lands. (Trustees of Town of Southampton v. Jessup, 162 N.Y. 122, 126 [1900]; see also Lordi v. County of Nassau, 20 A.D.2d 658, 659 [2d Dept 1964] aff'd without op. 14 N.Y.2d 699 [1964] ['Generally, contracts permitting a party to render services within an enterprise conducted on premises owned or operated by another, who has supervisory power over the method of rendition of the services, are construed as licenses.']. That a writing refers to itself as a license or lease is not determinative; rather the true nature of the transaction must be gleaned from the rights and obligations set forth therein. Finally, a broad termination clause reserving to the grantor "the right to cancel whenever it decides in good faith to do so" is strongly indicative of a license as opposed to a lease (Miller, 15 N.Y.2d at 38).[12]

Although its analysis of the law was not so novel, the *Union Square* decision may indicate a critical turning point since it underscores the willingness of the Court of Appeals to find a license rather than a lease, even though: (i) the term was fifteen years, (ii) the user was required to invest $700,000 in capital investments that were not refundable upon termination, (iii) the annual fees were substantial starting at $350,000 and increasing to $400,000 or more if percentage rent was greater, and (iv) the owner was required not to be arbitrary and capricious in exercising its at-will termination right. Further, in deciding *Union Square*, the Court of Appeals ignored its earlier precedent in *Miller v. City of New York* where, under similar facts, it found that an agreement by New York City's Parks Commissioner allowing a private corporation to use a golf-driving range was a lease not a license.[13]

As the referenced cases indicate, there can be benefits to characterizing an agreement as a license agreement rather than a lease, but the instrument must be drafted carefully and, *caveat emptor*: the title of the agreement may not be dispositive. Courts seem apt to find a document is: (i) a lease, if it is for an exclusive use for a set period of time; and (ii) a license, if it for a non-exclusive use which is terminable at will. Further, there may be an element of equity, which influences the courts' decision. Skilled real estate lawyers will assess which form of agreement—license or lease—will best serve their respective clients' needs.

Since one indicia of a license is a broad licensor termination right, a licensee may resist its use where a significant financial commitment is needed to prepare the space for its use. However, licensors are increasingly using creative financing arrangements whereby they agree to return an unamortized portion of the licensee's installation investment upon termination to encourage the use of a license rather than a lease. Licensors are agreeing to these provisions where they want the flexibility of an absolute right to terminate the license for any reason (such as the ability to pursue a development deal).

What developing trends lend themselves to license agreement arrangements?

Traditionally, "pop up" stores have been used for seasonal Halloween or Christmas outlets and designer sample sales. However, today, social media has made it easier and less expensive than ever to advertise the availability of pop up space. Web sites such as thestorefront.com connect property owners who have short term retail space to rent with artists, brands and boutiques in need of temporary quarters, something in the nature of airbnb. Lately, national brands and known entities have been using "pop up" spaces: Kate Spade opened one to launch a new line, Kanye West had a pop up space at 355 Bowery in New York City to sell tickets, hats and bags in connection with a concert tour, and tech giants Google and Microsoft have opened temporary locations to capitalize on the holiday rush. These pop up stores provide a landlord income while it seeks a more permanent tenant, waits for longer term rents to rise, or, perhaps, works through a zoning change. Pop up tenants can add positive visibility or buzz to a location, increasing its desirability.

When entering into a license agreement for a pop up store, a property owner should be careful not to hinder its pursuit of a more profitable long term tenant or, in a mall setting, violate existing tenants' exclusive uses or other rights. Likewise, the owner should keep in mind that a pop up occupant may not be as vested in the location as a tenant with a lease and may be less concerned with running a quality operation or being a good neighbor. In all events, liability insurance should be in place because accidents can happen even if the pop up use is only for a few days.

License agreements provide an attractive flexible short term use option for a specific limited purpose whereby a retailer can experiment with a location or create a splash in a heavily trafficked area that it could not afford otherwise. Because there is typically not a large fit out investment, users are agreeable to the licensor's right to terminate at will upon notice. In fact, in certain circumstances, there might not even be a grant of a specific space to the user. For example, in a retail context, the pop up space can be integrated into another non–exclusive use such as where an art gallery agrees to place a certain number of pictures on its walls or a cigar vendor has the right to have a concession stand at a hotel.

Another growing use of license agreements is in shared space situations. With the popularity of temporary work arrangements, a user may not even be devised a specific work space and could have non-exclusive rights to use a conference room, reception area, and available secretarial services (for an extra fee). The user need not make a long term commitment to the space nor invest in outfitting an office since it typically comes furnished. The owner gets optimal use of its space and the ability to charge for a la carte services. Depending on the facts and circumstances, these arrangements may be appropriately characterized (and documented) as licenses. Where the occupant does not have exclusive use of a particular office space for a set period and the agreement is terminable upon thirty days' notice, it seems unlikely the transaction would run awry of any court-imposed license / lease distinction.

Food halls are increasingly popular today, in particular those where a celebrity chef "curates" a food court. For example, it has been reported that Anthony Bourdain is opening Bourdain Market at Pier 58 on the Hudson River by the Meatpacking District.[14] The build-out may include a Singapore-style open area hawker market with moveable stalls selling a variety of inexpensive foods surrounded by a communal eating space. In a food hall, the curator sells different vendors the right to use a designated portion of the space. The curator typically retains the right to change the vendor mix (upon reasonable notice) and the food vendor gets profits and positive exposure without investing in fixturing and promoting a traditional restaurant. Again, since occupancy can be terminated at will after notice and the use is not exclusive, a license agreement seems to be the right legal vehicle.

We live in a fast-changing world where information is exchanged via social media at hyper-speed and flexible short term associations are increasingly important. Like a chameleon in the jungle, the license agreement is an often overlooked instrument that can be adapted to a myriad of different transaction types to create win / win situations for the parties.

Disclaimer: Nothing contained in this article is to be considered as the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. This article is intended for educational and informational purposes only. The views and opinions expressed in this article are solely those of the authors, and do not necessarily reflect the views, opinions, or policies of one of the author's employer, First American Title Insurance Company.

Endnotes

1. Wesley Newcomb Hohfeld, *Faulty Analysis in Easement and License Cases,* 27 Yale L.J. 66, 92 (1917).
2. Patrick A. Randolph & Milton R. Friedman, *Friedman on Leases*, 37-1 (5th ed. 2004), https: / / discover.pli.edu / Browse / Title?start=0&rows=10&fq=~2B~title_id~3A282B~660~29~&facet=true&qt=legal_natural.
3. *Id.* at 37-1, 37-3.
4. *Shearin v. Back on Track Grp., Inc.*, 46 Misc.3d 910, 914, 916, 997 N.Y.S.2d 227, 230, 232 (Civ. Ct. Kings Cnty. 2014) (citing Fed'n of Orgs., Inc. v. Bauer, 6 Misc.3d 10, 12, 788 N.Y.S.2d 806, 808 (App. Term 2004)).
5. *See* N.Y. Real Prop. Acts. Law § 853 (McKinney 1981).
6. *See* N.Y. Real Prop. Acts. Law § 713 (McKinney 2010).
7. *American Jewish Theatre, Inc. v. Roundabout Theatre Co., Inc.*, 203 A.D.2d 155, 156, 610 N.Y.S. 2d 256, 257 (1st Dep't 1994).
8. *See Nextel of New York, Inc. v. Time Mgmt. Corp.*, 297 A.D.2d 282, 283, 746 N.Y.S.2d 169, 171 (2d Dep't 2002).
9. *See Blenheim LLC v. Il Posto LLC,* 14 Misc.3d 735, 742, 827 N.Y.S.2d 620, 626 (2006).
10. *See id.*
11. *Union Square Park Cmty. Coal., Inc. v. New York City Dep't of Parks and Recreation*, 22 N.Y.3d 648, 656-57, 985 N.Y.S.2d 422, 427 (2014).
12. *Id.*
13. *Miller v. City of New York*, 15 N.Y.2d 34, 37, 255 N.Y.S.2d 78, 80 (1964).
14. Faith Hope Consolo, Douglas Elliman Real Estate, *The Faithful Shopper: All Hail the Food Halls*, Huffington Post (Jan. 15, 2016), http: / / www.huffingtonpost.com / faith-hope-consolo / faithful-shopper-all-hail_b_8962134.html.

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The Most Significant Title and Foreclosure Cases of the Past Year

By Adam Leitman Bailey and Dov Treiman

Since one author, Adam Leitman Bailey, started practicing law 20 years ago, when a terrible court decision without any basis in law would arrive, we would be thankful that the Court of Appeals was in session and had the final word. Those days are gone; today's Court of Appeals makes policy-based decisions rather than relying on precedent, and the law even, as demonstrated below, overturns two hundred years of precedence. This pattern has continued this year. In this article we analyze two decisions by the Court of Appeals and one by the U.S. Supreme Court.

In *Faison v. Lewis*,[1] the Court of Appeals rocked the stability in the transfer of title by eliminating the statute of limitations from one entire category of cases. In *Flushing Savings Bank v. Bitar*,[2] the court explained the rules for determining the proper deficiency judgment amount and appraisal requirements. In *Jesinoski v. Countrywide Home Loans*,[3] the U.S. Supreme Court got into the act with a unanimous decision that will also negatively affect the stability of residential real estate transfers and lending.

Faison v. Lewis

In *Faison*, the court in a 4-3 decision, over a stirring dissent with the better arguments, ruled that when bringing a suit to invalidate a mortgage because of a forgery in the chain of title, there is no statute of limitations.[4] This is part of a family of cases coming down from the Court of Appeals over the last several decades depriving the very concept of statute of limitations of the certainty it held a generation ago.[5]

In *Faison*, the plaintiff sought to set aside a mortgage based on a purportedly forged deed. The bank defended on the basis that more than six years had passed since the issuance of the deed, more than two years since the plaintiff had discovered the purported forgery.[6] While opponents of *Faison* have focused on the fact that the statute of limitations was disregarded on the mere allegation of a forgery, it is common in litigation for procedural questions to be so wrapped up in the facts of the case that carts frequently appear to precede horses. However, the real problem with *Faison* is not why the statute of limitations was disregarded, but rather that it was at all.

The majority of the court makes the rather weak-kneed argument as follows:

> Having failed to persuade based on our case law, the defendant argues that a statute of limitations is necessary to protect the sanctity of real property titles. However, Section 213(8) contains a two-year discovery rule, which potentially extends the life of a claim years beyond the six-year statutory term. As a consequence, land titles already are subject to challenge, based on a forged deed, far into the future.[7]

The referenced CPLR section, namely, 213(8) reads:

> an action based upon fraud; the time within which the action must be commenced shall be the greater of six years from the date the cause of action accrued or two years from the time the plaintiff or the person under whom the plaintiff claims discovered the fraud, or could with reasonable diligence have discovered it.[8]

Thus, 213(8) has two standards for fraud limitations period: six years from commission of the fraud or two years from its discovery. The court is arguing that this latter period is both so vague and potentially so long that the effective limitations period is already very long and the court is therefore doing no harm by changing it from very long to infinite.

This argument is absurd on its face. When the Legislature defines something in terms that may be difficult to ascertain under some sets of facts, that does not mean that there is no harm done in removing any definition at all. And, whether there is harm or not, it is for the Legislature to define not only the duration of statutes of limitations, but also what triggers them, not the courts. The courts should, generally speaking, be in the business of interpreting statutes, not abolishing them.

The basis of the court's decision is that forgery confers no rights and therefore sets no demarcation point for the invocation of rights. While the court cites to many cases that say that forgery confers no rights, the "therefore" is unsupported in the case law and the dissent is quick to point this logical flaw out.[9]

The real problem with *Faison* is that by completely abolishing the statute of limitations, it also completely abolishes the stability of title that comes with defined periods of time when titles can be challenged. While some of that is intrinsic in title law, such as adjudications over the ancient rights of Native Americans, by and large the bedrock of our real property system is that these rights are stable and challenges to them rare. In *Faison*, the court disregards this principle.

Flushing Savings v. Bitar

In *Bitar*, the court unanimously ruled that in seeking a deficiency judgment above the fair market value of foreclosed-upon premises, the foreclosing plaintiff does not have to get the application right in the first instance.[10] A defective application is subject to correction. However, the correction that is called for is a detailed factual analysis of how to arrive at the fair market value of the foreclosed-upon premises.

Two things are noteworthy in the history of this case, both of them appearing in the footnotes of the decision. The first is that the Attorney General of the State of New York submitted an amicus brief opposing the bank's positions.[11] The court unanimously rejected the Attorney General's point of view. Had the Attorney General prevailed, the bank would have had a tight deadline to get its application for a deficiency judgment right and only one chance to get it right. The court, in its decision, allows for one correction, but carefully footnotes, "We express no opinion as to what steps a court may take in the event the lender, having been given an additional opportunity to submit the necessary and relevant proof, nonetheless submits inadequate proof in the second instance."[12]

The flaw in the application was simply that it was bulk produced without any genuine individualized study of the circumstances of the case. The court rejected the application for a deficiency judgment as being "unsubstantiated" and demanded that any such application contain some level of detail of factual data to back up the affiant's contentions, without the court setting forth what those details need be. It left that to the discretion of individual judges and we can well imagine that actual practice of the judges will vary widely by department and even more widely by the proclivities of the individual judges hearing these applications.

Until *Bitar*, the concern for the mechanical processing of foreclosure matters was largely limited to the initial phases of foreclosure procedure.[13] With *Bitar*, we now see the court focusing on the later stages of foreclosure procedure: the actual sale and the ensuing procedures until the foreclosure has reached its very last phase. *Bitar* is therefore important not merely for its rule that the application for a deficiency judgment must be handcrafted by legal counsel, but rather as a signal that all areas of mortgage foreclosure procedure[14] will now be expected to be handcrafted rather than bulk processed.

Now where the party that was plaintiff in the foreclosure action was also the successful bidder at the foreclosure auction, the application for a deficiency judgment must include detailed analyses of how the appraiser arrived at the appraised value of the property. This will certainly include things like the sales price of other comparable properties geographically close or otherwise relevant to the distressed property. Where sales are not available, presumably assessments can be used and appropriate mathematical formulae can be applied to derive an estimate of market value from the assessed value, at least where the assessment is relatively recent.

Jesinoski v. Countrywide

With *Jesinoski* being a unanimous decision of the U.S. Supreme Court, and one knowing the immense diversity of philosophy on that court, one is naturally led to wonder why the unanimity. This is all the more true because it is a Scalia opinion, a short one at that, and there are no concurrences, certainly no dissents. We have to believe that the answer lies in the confluence that the decision presents between the strict constructionist point of view one normally finds with the five conservative justices of the then-current court and the pro-consumer view one finds with the four liberal justices. These two viewpoints, trumping all other considerations, must then have led to all nine of them agreeing.

The question before the court was simple: Under the Truth in Lending Act (TILA), must one, within three years of the making of the loan, commence an action to rescind a home loan on the basis of failure to conform to the disclosure requirements of the act or does it suffice to send a mere letter to the bank disaffirming the loan? The court ruled that it was enough to send a mere letter within the three-year period, mere indeed, not necessarily certified mail or any other formal requirements.[15] Justice Antonin Scalia writes, "Although §1635(f) tells us *when* the right to rescind must be exercised, it says nothing about *how* that right is exercised."[16] Indeed, since the statute under consideration says, "shall have the right to rescind…by notifying the creditor, in accordance with regulations of the board, of his intention to do so," under Scalia's interpretation, there appears to be no particular need that the "notifying" even be in writing.[17]

Now, what Scalia has going for himself in this is the actual wording of the statute and readers of this *Journal* are most likely well aware that legislation is both routinely and notoriously (to us) sloppily written. So, where the statute says "notifying" and does not say "commencing suit," it is a reasonable interpretation that Congress intended the "notifying" to be a predicate to suit rather than a statute of limitations for the suit itself.[18] However, *Jesinoski* does not regard it as a predicate to suit, but rather as an alternative to suit.

Perhaps Congress really did intend that one could either write a letter or bring a suit, but if so, it was an unusually naïve moment for Congress as any socially aware person would understand that the bank is not going to sit idly by in being told its mortgage was invalid, and there is going to be a suit, even if it is the bank commencing it in the form of a declaratory judgment action, rather than the mortgagor being the commencing party.

However, Congress could have decided that the moment of rescission was to be a mere layperson's non-technical letter or even a telephone call. But, if that is the case, the law is radical indeed. The virtue of commencing lawsuits is that they are public records, depending on the local practice either immediately where in New York they are commenced with the filing of a complaint or soon to be in jurisdictions where commencement is achieved through the service of process.

They are thus easy for anyone seeking to know the current financial structure of a piece of real property to research. Contrast that with private correspondence, telephone calls, or emails, where even the person initiating the contact may often have no record of the communication, much less a public record, and the validity of the mortgage becomes a matter not of public record for what can be a rather long time.

The effect of this decision, therefore, is to shut down or at least increase the risks in the rather lively trade in mortgages that may have been partly responsible for the Great Recession of 2008, but in a greatly restricted sense continue to have a value in our legal system. After all, a private person who holds a mortgage on a piece of property may wish to sell the mortgage in order to realize some of the cash inherent in the deal immediately, rather than over what is typically a 30-year period, a period that may even exceed that person's life expectancy. However, where a mere phone call can invalidate the mortgage that is being sold, it is no longer a marketable instrument. Thus, there is an anti-consumer consequence to *Jesinoski* as well.

Post-*Jesinoski*, the very least the proposed assignee of a mortgage is going to want from the holder of the underlying note is an affidavit that there have been no communications of any kind to the assignor purporting to disavow the note. However, the assignee should also be examining the documentation that the mortgagor received at the time of the origination of the loan, especially if fewer than three years prior to the assignment, to ensure that the documentation is to the satisfaction of the assignee in compliance with the TILA, and that may well necessitate some highly focused inquiries.

The answer the Supreme Court would no doubt give to that observation is that the answer is for Congress to amend the statute so as to remove these undesirable effects. Both the *Faison* and *Jesinoski* decisions necessitate state and federal legislative intervention to restate the law in the former case, and to codify reliable notice requirements for the latter. Until and whether the Legislature and Congress act, the stability of some title transfers and whether lenders will continue to lend and title companies insure, remain endangered.

Endnotes

1. 25 N.Y.3d 220, 32 N.E.3d 400, 10 N.Y.S.3d 185 (2015).
2. 25 N.Y.3d 307, 33 N.E.3d 1282, 12 N.Y.S.3d 12 (2015).
3. 135 S. Ct. 790, 190 L. Ed. 2d 650 (2015).
4. *Faison*, 25 N.Y.3d at 226, 32 N.E.3d at 404, 10 N.Y.S.3d at 189.
5. *Id.* at 227, 32 N.E.3d at 404, 10 N.Y.S.3d at 189. ("[T]his is the prevailing approach in other jurisdictions"); *see also, e.g.*, Moore v. Smith–Snagg, 793 So. 2d 1000, 1001 (Fla. Dist. Ct. App., 5th Dist. 2001), Wright v. Blocker, 198 So. 88, 90-91, 144 Fla. 428, 432–436 (1940).
6. *Faison*, 25 N.Y.3d at 223-24, 32 N.E.3d 402, 10 N.Y.S.3d at 187.
7. *Id.* at 229, 32 N.E.3d at 406, 10 N.Y.S.3d at 191.
8. N.Y. C.P.L.R. § 213(8) (McKinney 2016).
9. *See Faison*, 25 N.Y.3d at 233, 32 N.E.3d at 409, 10 N.Y.S.3d at 194 (Lippman, J., dissenting) ("While a deed *proved* to have been a forgery cannot operate to affect ownership rights, this does not compel the result that the opportunity to challenge such conveyance is without limit.") (no emphasis added).
10. *See Bitar*, 25 N.Y.3d at 314, 33 N.E.3d at 1286, 12 N.Y.S.3d at 16 (2015) (stating that although "FSB failed to meet its burden in the initial application," the "Supreme Court should have permitted FSB to submit additional proof establishing fair market value.").
11. *Id.* at 314 n.1, 33 N.E.3d at 1287 n.1, 12 N.Y.S.3d at 17 n.1.
12. *Id.* at 314 n.2, 33 N.E.3d at 1287 n.2, 12 N.Y.S.3d at 17 n.2.
13. Evergreen Bank v. D & P Justin's, Inc. 152 A.D.2d 898, 899, 544 N.Y.S.2d 244, 245 (3d Dep't 1989) (adopting a contested fair market value as determined by appraisal without a hearing).
14. This includes judgment foreclosure, condominium common charge foreclosure, and anything else that borrows mortgage foreclosure procedure.
15. *Jesinoski*, 135 S. Ct. 790, 793 (2015).
16. *Id.* at 792 (no emphasis added).
17. *Id.* (citing 15 U.S.C. § 1635 (2012)).
18. 15 U.S.C. § 1635 (2012).

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Bergman on Mortgage Foreclosures

Election of Remedies—OK to Foreclose Even Though Suing on Note!

By Bruce J. Bergman

The title of this column merits a usually hokey examination point because a principle which has been a source of much confusion (although we opine that it is established) is pointedly clarified in a recent case—on appeal: *VNB New York Corp. v. Paskesz*, 131 A.D.3d 1235, 18 N.Y.S.3d 68 (2d Dept. 2015).

To be candid, most mortgage lenders and servicers do not enter the byzantine world of election of remedies (known in other states as the one action rule). When there is a mortgage default, they will foreclose the mortgage. In rare instances—and there are good reasons for it—the lender will sue on the note. Examples of apt occasions to pursue on the note include: the mortgage has been extinguished by a senior mortgage or a tax lien foreclosure; or, the borrower or mortgagor personally liable for the debt have deep pockets and the foreclosure presents hurdles. But attempting to do so both at the same time is only rarely an issue.

Such does not mean, however, that the necessity for dual actions never occurs or is unimportant. While typically the arena of commercial cases or more sophisticated or unusual situations, the fact is that proceeding on two tracks can be helpful and meaningful. The problem, though, has been the notion that it is either one or the other; you can't do both. At least such is the prevailing wisdom. But it is not necessarily so, as the cited case illuminates.

This admittedly difficult subject is best approached by noting three aspects of New York statute which affect the subject and then lead to a conclusion. The first is the overall edict (RPAPL §1301) that the holder of a note and mortgage is empowered to proceed at law to recover on the note, *or* proceed in equity to foreclose the mortgage—but must elect only one of these alternative remedies and cannot do both. That is the general proposition which suggests to most that the choice must indeed be one or the other.

Next is the section [RPAPL §1301(1)] addressing that action at law, the suit on the note, which provides that when a plaintiff obtains a final judgment in an action for any part of the mortgage debt, there is then a prohibition against commencing or maintaining a foreclosure action, *unless* an execution on that judgment has been returned fully or partially unsatisfied.

Then consult the reverse provision [RPAPL §1301(3)] which on the other hand bars a party from commencing an action at law—for example, a suit on the note—to recover any part of the mortgage debt while a mortgage foreclosure action is pending but has not itself reached final judgment—at least without leave of the court to do so.

Here, in the new case, the mortgage holder had begun an action for replevin (among other things) and later commenced a foreclosure action. Because the action at law was initiated first, that means the section dealing with a money judgment controls (not the section about starting a foreclosure first) and underscores that because no final judgment had been entered in the replevin action, there was no preclusion of an action to foreclose the mortgage.

This clearly confirms what the statute says. If you sue on the note but don't arrive at a judgment, you are free to also begin a foreclosure action. Once you get a money judgment you cannot begin a foreclosure action until that judgment is returned by the sheriff fully or partially unsatisfied. The reverse, which did not occur in this case, is that when a foreclosure is begun, its existence is a bar against suing on the note, unless there are special circumstances that would lead a court to grant specific permission to sue on the note.

Complicated? A bit, but this case helps a great deal. It is worth consulting in one of those instances where the mortgage holder has a need to think about something other than a pure foreclosure action.

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