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Message from the Outgoing Chair

As my term as Chair of the Section comes to a close, I want to thank those who have contributed their time and talents to support Section activities. Committee chairs and their members have provided numerous CLE opportunities. Drafting, updating and improving forms for use in our practice is in the works. District representatives have organized both social and educational events, as well as community service projects. The authors who have contributed to our *Journal* and Co-Editors William Johnson, Marvin Bagwell, Vincent Di Lorenzo and Matthew Leeds, deserve special praise for their contributions and hard work. My thanks to every committee chair, district representative and all of members of the Executive Committee for their service to our Section.

Special thanks to Section officers, past and present. I have appreciated their advice and support throughout my years as an officer. Last, but certainly not least, my gratitude to Amy Jasiewicz at the State Bar office. She has been a wealth of knowledge about the policies and procedures we must follow. Her assistance in coordinating the many Section activities is invaluable.

In January the Section's by-laws were amended to include two out-of-state members on the Executive Committee. In addition, in recent months a Sponsorship Committee has been added as a new standing committee.

Incoming Chair Tom Hall has long been an active member of our Section's Executive Committee, having served in a number of capacities over the years. We can look forward to a busy and productive year under his leadership. He will be supported by a strong team of officers, Jerry Antetomaso, Ira Goldenberg and Michelle Wildgrube, moving through the ranks, and Spencer Compton as Budget Officer.

Again, I encourage you to join us for the Summer Meeting on July 26-29, at Water's Edge Resort & Spa in Westbrook, Connecticut. You can expect a terrific CLE program, and you will meet some wonderful people. Your spouse, significant other and children are welcome to join us. The venue has something to offer everyone. I can assure you that all will make new friends and have a good time.

Trish Watkins

Message from the Incoming Chair

I feel privileged and honored to serve as the Section Chair of the Real Property Law Section (RPLS). I follow a long line of prior Section Chairs, all of whom I greatly admire, have taught me much, are outstanding lawyers and are true professionals in every sense of the word. Our immediate past Chair, Trish Watkins, is no exception. Trish has worked tirelessly to guide our Section with her wisdom, good nature and dedication. I want to personally thank Trish for everything she has done for the Section. Trish has left me with some big shoes to fill.

There is much discussion these days, not only in the New York State Bar Association, but in all bar associations and associations for other professions (medical, accounting, engineering, etc.) about declining membership. I have heard many theories about why this is so. However, rather than dwell on why lawyers don't join a bar association or a Section such as the RPLS, I thought I would focus on some of the reasons why the RPLS has over 4,200 members. I can tell you, from my own personal perspective, that when I started practicing law, I was advised by many experienced attorneys that I "should" or "must" join the Bar Association and become active. The underlying message seemed to be that joining the Bar Association was in part a privilege once someone became a lawyer and was in part an obligation to our profession. I believe this message has, for whatever reason, become lost. Looking back, the reasons why I have remained active and will continue to remain active with the RPLS, include the following:

1. **Outstanding CLE**
   Year in and year out, the RPLS puts on fantastic CLE programs. Our recent CLE programs have covered numerous and varied topics in areas such as Brownfields Development, Title Agent Licensing, Not-for-Profit issues, Construction Rights of Adjacent Property Owners, Advanced Real Estate Topics, and Real Property Tax Assessment Litigation & Appeals, just to name a few. There is something for everyone.

2. **The Summer Meeting**
   Our Summer Meeting is held at a "destination resort" every July. This year our summer meeting is at Water's Edge Resort & Spa located in Westbrook,

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CT from July 26, 2018 through July 29, 2018. Sure, there is great CLE at the Summer Meeting. Equally important, in my mind, is the opportunity to meet and socialize with colleagues from all over the State and, indeed, some colleagues who practice in other states or foreign countries. The colleagues that you meet have a broad array of sub-specialties in all different facets of Real Estate Law—from tax certiorari proceedings, to commercial leasing, to foreclosures, to landlord and tenant, to affordable housing and on and on. While our members are all real estate lawyers, their specialties vary. Moreover, you, your spouse and your family get the opportunity to meet your colleagues, their spouses and their families. The Summer Meeting has fostered many friendships that have continued for decades. Once again, there will be a discount for members of the Section who are first time attendees at this year's Summer Meeting.

3. **Committee Work**
Getting on a committee and being involved has given me many opportunities and experiences that have broadened my outlook and taught me things that I never would have learned or encountered in my own practice. By way of example, going to Albany for lobbying days and advocating for issues of importance to our members has taught me much about the legislative process. Our committees get involved in a wide array of projects. The Section has nearly 30 committees and task forces which are listed in the back of this *Journal*, and a sign-up sheet for committees can be found on page 26.

4. **The Annual Meeting**
Again great CLE is provided by the Section at the Annual Meeting, which takes place in January. Many of our committees hold meetings during the Annual Meeting and some committees (notably Condos and Co-Ops and Not-for Profit) conduct additional CLEs specifically geared to their members.

5. **The *Journal***
The *Journal* produces scholarly pieces on a wide array of Real Estate issues written by practitioners who are truly experts in their field.

6. **Our Community Page on the NYSBA website and more specifically, our *Real Property Law Section Digest***
I am truly awestruck by the incredible volume and breadth of legal issues that are posted and the truly impressive number of thoughtful responses that often come from a variety of different perspectives. In the last 12 months, the *RPLS Digest* on the Communities page had 3,481 total posts (757 new threads, 2724 replies). While we have a tremendous number of people who post questions and responses, I am sure there are many more members who are simply following the *Digest* and learning something new all the time.

What have I gotten out of the benefits listed above? I have been able to effortlessly keep up to date with my CLE obligations while being made aware of new developments and cutting edge issues in real estate law. I have met and socialized with many colleagues who specialize in areas different from mine—giving me an additional resource of being able to pick up the phone and call a colleague who is truly an expert for advice when I am facing a difficult issue in an area that is not the main focus of my practice. I have been given the opportunity to speak at various CLE Seminars, which has given me increased visibility to my peers, my clients and potential clients. I have received referrals of a variety of matters from other Section members. I have made lasting friendships with a variety of wonderful people from all over the State. In short, my professional life and my personal life have been enriched.

How do you get these kinds of benefits from Section membership? You get them by putting effort in to your Section membership. You have to put the effort in first and then these benefits come; it just doesn't work the other way around. So the next time you think you are just too busy to go to that committee meeting or that you just have too much going on to go to the Summer Meeting, I would ask that you please try to put those thoughts aside and just do it.

If you are reading this message, it is likely that you are already a member. So to some extent, I am preaching to the choir. However, I would ask each of you to consider the following: 1. If you are a Member of the Section and you haven't done so, join a committee; 2. If you are a member of a committee—get active—contact the committee chair to see if there are any projects you can help with; offer to speak at the next committee meeting about a topic of interest to you; offer to assist in setting up and running the next committee meeting; 3. Write an Article for the *Journal*; 4. Think of something new that you would like to see from the Section or a specific committee and bring it to my attention or the attention of the committee chair. 5. Finally, and perhaps most importantly, when you are interacting with a young lawyer, please talk to them about becoming an active member of the Bar Association and the RPLS. Urge them to join the Section and explain to them the benefits of Section membership. Most of all, please be sure to convey the message that what you get out of the Bar Association and the Section depends entirely upon what you put into it.

I look forward to seeing you all at the Summer Meeting!!

Thomas J. Hall

Is a Tenant-Stockholder's Deduction under § 216(a) for "Real Estate Taxes" and "Interest" or for Something Else? The Question Recurs

By Joel E. Miller

Certain deduction-limiting provisions of the tax act that became law this past December have re-focused attention on a question of importance to personal-use owners of cooperative apartments, namely whether § 216(a) of the Internal Revenue Code ("Code") provides such owners with (a) two separate deductions, one for real estate taxes and one for interest (referred to herein as "the T&I Reading"), or (b) a single deduction that, although it refers to the corporation's deductions for real estate taxes and interest, is itself for something else (referred to herein as "the SE Reading").[1]

There is no doubt that proponents of the T&I Reading rely on the fact that a § 216(a) deduction, even if singular, is the sum of two identifiable numbers, one of which is based in part on a real estate tax deduction and one of which is based in part on an interest deduction. Proponents of the SE Reading, on the other hand, maintain that a § 216(a) deduction, however calculated, is for something else, and that the tax and interest references are merely to set a limit on the amount of the deduction, not to fix its character.

Introduction

Which of the two interpretations is correct has for many years been of significance for such owners. Both of the two separate deductions that exist under the T&I Reading—i.e., one for real estate taxes and one for interest—have for some time been limited in one way or another. On the other hand, there has never been a limitation that applies in terms to a something-else deduction under § 216(a). Thus, if the SE Reading is the correct one, personal-use cooperative apartment owners have for a long time been in a favored position vis-à-vis personal-use owners of single-family houses.

Moreover, the new law has made significantly more stringent the limitations on both the real estate tax deduction and the interest deduction. Hence, again if the SE Reading is the correct one, personal-use cooperative apartment owners are now even more than before better off in this respect than the personal-use owners of other types of residences.

As a result, the question is more likely than before to be authoritatively answered. That is not to say that there has been absolutely no guidance up to now. Indeed, powerful arguments can be made on both sides. The purpose of the present writing is to explore those arguments.

The following parts of this article consider (i) where § 216(a) fits in the overall scheme of the Code relative to deductions, (ii) § 216(a)'s genesis and history, (iii) the exact language of § 216(a), (iv) how a § 216(a) deduction is calculated, (v) common misstatements of the § 216(a) rule, (vi) the principal argument for the T&I Reading, (vii) the Code-based argument for the SE Reading, (viii) the regulations-based argument for the SE Reading, (ix) the IRS's position, and (x) three court opinions dealing with whether the tax-based component of a § 216(a) deduction is deductible for alternative minimum tax purposes.

Where § 216(a) Fits in the Scheme of the Code

We start with the Code's basic proposition that, absent a special rule, no taxpayer is entitled to a deduction for purely personal expenses. Code § 262(a) states quite clearly that, "Except as otherwise expressly provided …, no deduction shall be allowed for personal, living, or family expenses."

Two "expressly otherwise" provisions are well known. In order to encourage home ownership,[2] Congress has long allowed homeowners to deduct—to a certain extent, at least—both (i) "State and local … real property taxes"[3] and (ii) interest on indebtedness "incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer."[4]

Let us at this point consider a series of hypothetical cases in order to frame the issues to be discussed:

> **Example 1**: Sam owns a building containing 20 identical apartments. Alice is the tenant of one of those apartments, living in it and paying rent of $15,000 a year.
>
> In respect of the tax year in question (which we will assume is the same for both Sam and Alice), Sam makes the following payments (all items being related solely to the apartment house and all being currently deductible by him):

Real estate taxes	$80,000
Mortgage interest	$100,000
Other expenses	$96,000
Total	$276,000

It may be asked whether Alice is entitled to any deduction on account of her $15,000 rent payment. As noted above, if Alice is to have any deduction on account of her payment, she must find a Code provision that expressly allows it. She might argue that, of the $15,000 that she paid, Sam used $4,000 to pay real estate taxes and $5,000 to pay mortgage interest, so that she in effect made those payments. It is quite clear that such an argument would not win. Among other things, she did not pay real estate tax or interest; she paid only rent. It was Sam who paid real estate tax and interest.

> **Example 2**: Alice persuades Sam to reduce her rent to $6,000, in exchange for her directly paying $4,000 of the real estate tax on the building and $5,000 of the interest on the mortgage. Sam does not care. As he sees it, he is losing $9,000 of deductions, but will report $9,000 less of gross income—a wash insofar as he is concerned.

But it is clear that Alice fares no better here. It cannot be doubted that mere payment of someone else's obligation does not give rise to an income tax deduction for the payer, even if payment by the other person would give rise to an income tax deduction for that person. Consider what would be the result if the rule were otherwise. For example, well-to-do parents would be allowed income tax deductions for interest paid by them on indebtedness incurred by their low-bracket adult offspring. Clearly, any such payment would be treated as a gift to the child and an interest payment by the child.

As a matter of fact, it is not uncommon for business leases to require the tenant to pay all the real estate tax attributable to the rented space (obviously, with a rental less than it would otherwise be), the reason being to protect the landlord against potential increases in such tax. And the tenant is likely to claim an income tax deduction for "real estate tax" on account of such payment, with the landlord correspondingly not including that amount in his receipts for tax purposes. But that would be wrong. There is no doubt that the situation must be viewed as if the money had been paid to the landlord (and therefore includible by him for tax purposes) and the same amount paid by him as real estate tax.[5] And the tenant is viewed as having paid rent, not real estate tax.

Alice still has no income tax deduction.

> **Example 3**: Two changes: (i) Alice and Sam go back to the original deal and (ii) Sam conveys the building to a corporation in exchange for all 10,000 of its shares.

Alice must now make her rent payments to the corporation, but there is no change in her income tax situation.

> **Example 4**: Sam changes the corporation's documents so that it can qualify as a "cooperative housing corporation" as defined in § 216(b)(1), with 500 shares allocated to each apartment. A number of the corporation's tenants, including Alice, purchase the blocks of shares allocated to their respective apartments, paying a fair price therefor. Alice receives a proprietary lease that requires her to pay rent of $13,800 to the corporation for the year.

It seems clear that, assuming that (i) the corporation does qualify as a "cooperative housing corporation," (ii) Alice qualifies as a "tenant-stockholder" as defined in § 216(b)(2), and (iii) nothing prevents the result, § 216(a) will allow Alice to deduct $9,000. That does not, of course, answer the question posed above. Would Alice have two deductions—one being a real estate tax deduction in the amount of $4,000 under § 164 (via § 216(a)(1)) and one being an interest deduction in the amount of $5,000 under § 163 (via § 216(a)(2))—or would Alice have a something-else deduction in the amount of $9,000 under § 216(a) alone?

Before we zero in on the language of § 216(a), it will be instructive to review a bit of history.

The Genesis and History of § 216(a)

Unlike condominiums, housing cooperatives have been with us for well over 100 years.[6] And, very early on, owners of cooperative apartments began to claim that their form of home ownership was being discriminated against. They conceded that what they were paying each year was rent under a lease (whether denominated "maintenance," "occupancy charges," or something else), but they contended that they were not ordinary renters. Ordinary renters, they said, did not have a sizable investment in their residences. Cooperative apartment owners were really homeowners, they said, and should have the same income tax deductions as the owners of homes owned in other forms.

The 1928 Bill

The cooperative apartment owners had a measure of success in 1928. The House version of the Revenue Act of 1928 included the following three coordinated provisions that would have, respectively, (i) allowed individual cooperators to deduct amounts paid to the corporation that the corporation used to pay certain taxes and certain interest, (ii) denied to the corporation a deduction for those amounts (even though actually paid by it), and (iii) in order to avoid unfairness to the corporation, excluded those amounts from the corporation's gross income (even though actually received by it):

> SEC. 23 DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions: ***
>
> (q) Cooperative Apartments.—Amounts paid by an individual taxpayer during the taxable year to a corporation which owns or leases an apartment building and operates it under the cooperative plan if—
>
> (1) Such amounts are bona fide expended by the corporation in the same taxable year, in payment of taxes…or in payment of interest on its bonds or on other indebtedness incurred by

> it in the acquisition, construction, or maintenance of such apartment building or in the acquisition of the land on which the building is located….
>
> SEC. 24 ITEMS NOT DEDUCTIBLE.
>
> ***
>
> (d) Cooperative Apartments.—No deduction shall be allowed to any corporation which owns or leases an apartment building and operates it on the cooperative plan, in respect of any expenditures by the corporation on account of taxes or interest as specified in section 23 (q) (1).
>
> SEC. 22 *** (b) Exclusions from Gross Income.–-The following items shall not be included in gross income and shall be exempt from taxation under this title: ***
>
> (9) Cooperative Apartments.—In the case of a corporation owning or leasing an apartment building and operating it on the cooperative plan, the payments to such corporation on account of taxes and interest as specified in section 23 (q).[7]

However, the Senate declined to go along, and those particular provisions—which adopted what is properly referred to as a "pass-through" approach (meaning that items are excluded from consideration at the entity level but are instead taken into account at the level of other persons[8])—never became law.

The *Holden* Case

The owners of cooperative apartments did not give up trying to have homeowner-type income tax deductions when their legislative attempt foundered in 1928. They next presented their case to the Board of Tax Appeals, an administrative agency that was the predecessor of the United States Tax Court. But they were again unsuccessful. The Board's statement of the issue presented to it and its resolution were nicely set forth in the Board's opinion as follows:

> The sole issue in this case is whether the petitioner is entitled to deduct from his gross income for the taxable years certain amounts paid by him during said years on account of interest and taxes accruing on the cooperative apartment building in which the petitioner had leased a residential apartment under the terms of the lease contract referred to in our findings of fact hereinabove.
>
> The facts were stipulated by the parties, and the issue of law presented may be resolved into the question of whether or not the payments made by the petitioner were so made on account of his liability for interest and taxes as such. This question in turn depends upon the ownership of the apartment building, since the interest accrued and the taxes were levied upon the building and real estate.
>
> There can be no doubt that interest and taxes of the kind here involved, when liability is incurred and they are in fact paid as such by the taxpayer in the taxable year, constitute allowable deductions from gross income. Sec. 23(b) and (c), Revenue Act of 1928. However, where a taxpayer pays the interest and taxes of his creditor, or makes such payments in behalf of another person, either individual or corporate, they do not represent interest and tax obligations of the taxpayer and are not deductible as such by him.[9]

The *Wood* Case

The apartment owners next tried the District Court. But they fared no better there. Although, as the court stated, it was not bound by the Board of Tax Appeals decision, it reached the same conclusion:

> The question presented in this case is whether the complainant, Caryl H. Wood, is entitled to a deduction for interest and taxes paid of amounts contributed by her to the 136 E. 79th Street Corporation on its obligation for interest and taxes for the year 1933?
>
> The statute involved is the Revenue Act of 1932, ch. 209, 47 Stat. 169, so much of which as is necessary for consideration in this case *** clearly states, and in order to be entitled to a deduction for taxes paid in any tax year, the tax must accrue or be imposed against the person seeking such deduction, and this is also true as with reference to deductions for interest paid. Merchants Bank Bldg. Co. v. Helvering (C.C.A.) 84 F.(2d) 478, 481.
>
> The indebtedness for the taxes and interest in question was that of the 136 E. 79th Street Corporation, and not the indebtedness of the complainants.
>
> The taxes in question accrued against the building and the property which was owned by the 136 E. 79th Street Corporation, and not the complainants, and that is likewise true of the interest paid on the mortgage debt, which was interest paid on the indebtedness of the 136 E. 79th Street Corporation, and not the indebtedness of the complainants.
>
> The taxes and interest in question were actually paid by the 136 E. 79th Street Corporation and not by the complainants. ***
>
> The complainants contend that income tax laws enacted under the Sixteenth Amend-

> ment must regard matters of substance, and not mere form, and cites Weiss v. Stearn, 265 U.S. 242, 254, 44 S.Ct. 490, 491, 68 L.Ed. 1001, 33 A.L.R. 520, and this is generally true; but it is also true that questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants; but it does not seem to me that in the case at bar, the placing of the title in the 136 E. 79th Street Corporation was a mere matter of form, but was in reality a matter of substance.
>
> Under the terms of the lease from the corporation to the complainants, the amounts necessary to pay the proportionate share of taxes and interest was made payable to the corporation by the complainants, and not to the city nor the mortgagee.
>
> No one of the leasees could pay taxes and interest other than to the corporation, and failure to make the required payments to the corporation gave it the right to terminate the lease and remove the leasee.[10]

The court then added this interesting passage:

> The complainants cite section 360 of the Tax Law of the state of New York (Consol. Laws, c. 60) which provides as follows: "13. In the case of any taxpayer who is the owner of shares of stock in a corporation organized and existing exclusively for the purpose of owning and operating a cooperative multiple dwelling no part of the net earnings of which inures or is calculated or intended to inure to the benefit of any stockholder or individual, and all the expenses of which are paid annually by the stockholders in proportion to their ownership, a deduction shall be allowed to such taxpayer as to the share of his payments for all taxes, other than franchise taxes, paid or accrued by such corporation during the taxable year, and all interest paid or accrued by such corporation during the taxable year on its indebtedness."
>
> This law, of course, is not binding upon this court, in construing the Federal Revenue Act, but it does seem to me that the fact that in the state of New York it was found necessary to enact such legislation that it might well be assumed that failure of Congress to enact similar legislation showed that they had no such intention.[11]

The 1942 Law

The apartment owners' situation at that point and the next development were described as follows by the Tax Court in a 1972 opinion:

> It appears that the earliest consideration given to enacting a provision such as section 216 dates from 1928. The Senate Finance Committee deleted it from the House version of the Revenue Bill of 1928, citing tax avoidance and discrimination against ordinary renters as grounds for this action. Nine years later a Federal District Court in New York decided that the general provisions of the Code did not support the deduction of interest and taxes by cooperative stockholders and that if the benefit of these deductions were to be "passed through" to the stockholders, specific legislation would be necessary. *Wood* v. *Rasquin*, 21 F. Supp. 211, 213 (E.D.N.Y. 1937), affirmed per curiam 97 F. 2d 1023 (C.A. 2, 1938). Thereafter the interest in obtaining the enactment of relief legislation was renewed, and over the objection of the Treasury Department the predecessor of section 216 was added by the Senate to the Revenue Bill of 1942 and enacted into law.[12]

Significantly, when Congress enacted § 216's predecessor in 1942,[13] it was fully aware of the 1928 bill[14] but chose an approach radically different from the pass-through approach adopted in the earlier bill. Why it did that we do not know, but that it did do that is unmistakable.

Under § 216(a), as under its 1942 predecessor, a tenant-stockholder's rent payments are *not* treated as if they had been made, not to the corporation, but in part directly to a municipality as real estate taxes and/or in part directly to a lender as interest (with the corporation correspondingly (i) being denied deductions for payments actually made or accrued by it and (ii) being allowed to exclude those amounts from its gross income). On the contrary, under the law that was enacted and that we have today, the corporation must include all rent receipts from tenant-stockholders in its gross income and is entitled to deductions for its real estate taxes and/or interest according to the amounts actually paid or accrued. *In addition*, each tenant-stockholder is entitled to deduct a portion of the *rent* that he paid to the corporation. How that amount is determined is key to an understanding of the rule set forth in § 216(a).

It will be helpful in analyzing § 216(a), if one keeps in mind that it adopts a "duplication" approach in contradistinction to a pass-through approach.[15] As the statute is written, a single payment made by the corporation and deducted by it can *also* generate deductions for its shareholders. However unusual that may be, there can be no legitimate question about it. In the words of the IRS's general counsel, "such a double deduction result is inherent in the operation of Section 216."[16]

The Text of § 216(a)

For the reader's convenience, the text of § 216(a) is here set forth *in extenso:*

> **Allowance of Deduction**. In the case of a tenant-stockholder (as defined in subsection (b)(2)), there shall be allowed as a deduction amounts (not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year, but only to the extent that such amounts represent the tenant-stockholder's proportionate share of:
>
> (1) the real estate taxes allowable as a deduction to the corporation under section 164 which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated, or
>
> (2) the interest allowable as a deduction to the corporation under section 163 which is paid or incurred by the corporation on its indebtedness contracted—
>
> (A) in the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or
>
> (B) in the acquisition of the land on which the houses (or apartment building) are situated.

The Five Numerical Determinations: the Calculation

It is vital to be aware that application of § 216(a) to each eligible personal-use cash-method shareholder might require the determination of five different amounts—each of which is discussed below. As will be seen: first, two dollar amounts unique to that particular shareholder might have to be determined; in the next two steps, two different dollar amounts at the corporate level might have to be determined; and, finally, a multiplier unique to the shareholder might have to be determined. Only after all of that is done can the amount of the shareholder's deduction be calculated.

In order to have a numerical example, let us assume the following budget for a cooperative housing corporation having ten equal shareholders, of which John is one:

Inflow	
Outside income	$ 30,000
Maintenance	$120,000
Total	$150,000
Outflow	
§ 216(a)(1) real estate tax	$ 50,000
§ 216(a)(2) interest	$ 62,500
Other	$ 37,500
Total	$150,000

The first determination: the amount the shareholder actually paid as rent

As applied to the situation that we are considering, the starting point is, in the words of the statute, "amounts … paid … [by the shareholder] to a cooperative housing corporation within [his] taxable year."[17]

Although the point is perhaps arguable, it will be assumed for present purposes that the "amounts" referred to do not include any capital contributions.[18] For convenience, we shall refer to non-capital-contribution "amounts" as "rent."

To have an example, let us assume that John, an eligible personal-use cash-method shareholder, actually paid $9,000 within his taxable year to a "cooperative housing corporation" as rent.

The second determination: the amount the shareholder was obligated to pay as rent

Insofar as applicable to a cash-method taxpayer, the regulations provide that only a proportionate part of his otherwise deduction is allowable if he paid less than the full amount that he was supposed to pay.[19]

Assuming that that provision is valid, it is also necessary to determine how much the shareholder was obligated to pay as rent.

To continue with our example, we shall assume that, notwithstanding that he paid only $9,000, John's obligation was to pay $12,000. Thus, John paid 75 percent of what he should have paid.

The third determination: the relevant corporate-level real estate tax deduction

The statute does not refer to all real estate taxes deductible by the corporation. The only real estate taxes that are to be taken into account are those that were "paid or incurred by the corporation on the houses or apartment building and on the land on which such houses (or building) are situated."

If, for instance, the corporation had purchased an unrelated parcel as an investment, the taxes paid on that realty would not be taken into account to any extent.

Even if the focus is restricted to the taxes described in § 216(a)(1), there might have to be an adjustment. The regulations provide that if a corporation had income other than from tenant-stockholders, the otherwise relevant tax amount must be proportionately reduced on account of such "outside" income.[20] In our example, then, assuming the validity of the regulation, the relevant tax amount would be $40,000 (i.e., 80% of $50,000).

The fourth determination: the relevant corporate-level interest deduction

The statute does not refer to all interest deductible by the corporation. The only interest that is to be taken into account is that "paid or incurred by the corporation on its indebtedness contracted [for certain enumerated purposes].”

An example of a purpose not on the list might be a borrowing in order to fund a distribution to shareholders.

Even if the focus is restricted to the interest described in § 216(a)(2), there might have to be an adjustment. The regulations provide that, if a corporation had income other than from tenant-stockholders, the otherwise relevant interest amount is to be proportionately reduced on account of such “outside” income. [21] In our example, then, assuming the validity of the regulation, the relevant interest amount would be $50,000 (i.e., 80% of $62,500).

The fifth determination: the shareholder’s “proportionate share”

In the interest of simplicity, we shall assume that no special rule applies and also that there are no treasury shares. In that situation, a shareholder’s “proportionate amount” is simply the number of his shares divided by the total number of shares outstanding. [22]

If we assume that John held 100 shares and that the other shareholders held a total of 900 shares, his “proportionate share” would be 10%.

The calculation

Returning to our example, we are now ready to calculate John’s § 216(a) deduction.

First, we look at the amount that he actually paid—$9,000.

But John cannot deduct that full amount. The statute imposes a limit, namely his “proportionate share” of certain corporate-level deductions.[23] If we look only to the statute, ignoring the regulations, the limit would appear to be $9,000—i.e., John’s “proportionate share” (10%) multiplied by the total amount of the corporation’s relevant deductions ($90,000). If we apply the regulations, we must multiply the $9,000 by the percentage thereof that John is allowed to deduct as limited by his payment deficiency (75%). Our answer is $6,750.[24]

It will be noted that the result is merely a number of dollars. It is not on its face a deduction for real estate taxes and a deduction for interest.

To be sure, one can, as a matter of expression, simply divide the number of dollars and say that *x* is for real estate taxes and *y* is for interest. The question is whether the law requires that.

If so, how are *x* and *y* to be determined? Is it up to the IRS? Is the taxpayer permitted to make the decision? Are the numbers required to be proportional to the corporation’s relevant deductions, so that the $6,750 would be $3,000 for real estate tax and $3,750 for interest? Is the delinquency cut-down to be applied to real estate tax first, so that the $6,750 would be $1,750 for real estate tax and $5,000 for interest? Is the delinquency cut-down to be applied to interest first, so that the $6,750 would be $4,000 for real estate tax and $2,750 for interest?

Before we consider the arguments as to our basic question—i.e., whether any division is required—let us look at some things that intelligent discussion requires *not* be taken into account.

Misstatements of § 216(a)’s Rule

Unfortunately, it is not uncommon for overly terse purported statements of § 216(a)’s rule—especially where the statement is merely part of the background for a discussion of some other point — to be just plain wrong. And such economy of words can have a cost. Such pronouncements, if taken at face value, can be seriously misleading.

Sad to say, such misstatements are far from rare. Indeed, it is possible that the rule is misstated more often than it is stated correctly, and not infrequently by persons whose statements might be taken as authoritative. In order to demonstrate the point, a representative few of the many, many examples—in five different settings—are noted below.

> **In a published revenue ruling**
>
> The following statement appeared in a 1987 revenue ruling:
>
> [Congress was] willing to permit tenant-stockholders to deduct a share of their corporation’s mortgage interest and real estate taxes in proportion to their shareholdings.[25]

Whatever persuasiveness such a statement might have as to our basic question dissipates when one realizes that, aside from that issue, it contains three obvious errors.

Two of the errors have to do with ruling’s reference to “mortgage interest.” In that respect, the statement is both too broad and too narrow. The fact is that not all interest—even if payment of the indebtedness is secured by a mortgage—can be the basis of a § 216(a) deduction. On the contrary, the statute provides that indebtedness incurred for only certain specified purposes are to be taken into account. On the other hand, as to interest on indebtedness incurred for one of the specified purposes, nothing in the statute requires that its repayment be secured by a mortgage.

The third error—which is probably of more importance—is that the revenue ruling says, unqualifiedly, that a tenant-stockholder can deduct a fixed and determinable amount, namely his proportionate share of certain of the corporation’s expenses. The revenue ruling says nothing at all about any payment (or accrual) by the tenant-stockholder. Consider the case of a cash-method apartment owner who made no payment whatsoever to the corporation. Despite what the ruling says, it is clear that he is entitled to no deduction under § 216(a).

In point of fact, the regulations deal with the case of a tenant-stockholder who paid—not zero—but an amount that was less than he was supposed to pay. According to the regulations, he is entitled to only a fractional part of his share of the corporation's relevant interest and tax deductions.[26]

In a Tax Court opinion

The following passage appears in an opinion dealing with whether both a cooperative housing corporation and its shareholders could both claim depreciation deductions:

> We are concerned here with the distribution of tax burdens and benefits in the aftermath of the enactment of section 216 and its 1962 amendment, which recognizes cooperative ownership of what otherwise might be deemed rental property and *confers upon tenants who are cooperative stockholders the privilege of deducting from gross income State and local taxes and mortgage interest* paid by the corporation, and if otherwise allowable, depreciation. We think that the Congress intended that these deductions may not be claimed both on the corporate level and on the tenant-stockholder level, and that petitioner may not claim a deduction for depreciation.[27]

In a Court of Claims opinion

Here, the court's opinion does include a reference to "the tenant-stockholder claim[ing] real estate [sic] and interest deductions," but, as the context makes clear, that ought not be read as an adoption of the T&I Reading:

> During such year plaintiff was an apartment tenant stockholder in a New York corporation (the 120 East 81st Street Corporation) which she contends was a "cooperative housing corporation" as defined in Section 216(b) of the Internal Revenue Code of 1954 (26 U.S.C. § 216 (1964)). As such a stockholder, plaintiff would enjoy certain tax advantages, *i.e.*, in the computation of her individual income tax, she would be allowed as a deduction amounts paid to the cooperative to the extent that such amounts represented her proportionate share (based on the total shares outstanding) of the real estate taxes and mortgage interest allowable as a deduction to the cooperative.
>
> Under Section 216 (b) (1) (D), however, a corporation can gain status as a "cooperative housing corporation" only if at least 80 percent of its gross income (for the taxable year for which the tenant-stockholder claims the real estate [sic] and interest deductions) is derived from tenant-stockholders. Since the Commissioner of Internal Revenue determined that, for the years in question, the cooperative in which plaintiff was a tenant-stockholder did not so qualify, the deductions which plaintiff took for her pro rata portion of the mortgage interest and real estate taxes paid by the cooperative during such years were disallowed.[28]

Like many other more or less accurate statements of the rule, even the court's less abbreviated statement failed to recognize that only certain of the corporation's real estate tax and interest deductions were to be taken into account. And, again, the reference to "mortgage" interest does not comport with the statute's language.

In a Circuit Court opinion

Another example may be found in the following passage from a Second Circuit opinion dealing with an extremely complex issue arising under § 280A:

> Section 216 of the Code, moreover, permits a tenant-stockholder in a "cooperative housing corporation" to deduct amounts paid to the corporation to the extent that such amounts represent the proportionate share of real estate taxes and mortgage interest allowable as a deduction to the corporation. And Section 216(b)(1)(B) defines a "cooperative housing corporation" as one where each of the stockholders is entitled by reason of his ownership of stock "to occupy *for dwelling purposes* a house, or an apartment in a building, owned or leased by such corporation." (Emphasis added.) Thus, the Code permits shareholders to deduct mortgage interest, real estate taxes, and depreciation by virtue of the fact that the shares convey the right to occupy a "dwelling." Needless to say, the taxpayer in this case took these deductions under § 216—implicitly confirming that his stock conferred the right to "occupy [the apartment] for dwelling purposes."[29]

Among other inaccuracies, the court failed to recognize that only certain (not necessarily all) of the corporation's real estate tax and interest deductions are to be taken into account.

Unfortunately, the opinion has been quoted, out of context, for the proposition that § 216(a) "permits shareholders to deduct mortgage interest [and] taxes," notwithstanding that that point was not relevant to the issue before the court. See, for example, the following statement from a 2005 opinion of the same court in a case in which the point was pivotal:

We have thus stated that section 216 "permits shareholders to deduct…real estate taxes." *Holmes*, 85 F.3d at 960.[30]

In congressional committee reports

In connection with a 1986 modification of the deductibility of home mortgage interest, both the Senate Finance Committee and the House Ways and Means Committee referred to "the taxpayer's share under section 216 of interest expense of the housing cooperative allocable to his unit and to his share of common residential (but not commercial) areas of the cooperative."[31]

Summary

In view of the fact that it is plain that abbreviated statements like those quoted above, made as general background where the speaker's focus is elsewhere, do not reflect a considered judgment on the point, it would seem that they ought to be entitled to little weight.

Let us turn, then, to matters of more substance, looking first at the principal argument for the T&I Reading and then at the arguments for the opposite view based on the Code and the regulations.

The Principal Argument for the T&I Reading

Although the court's resolution of the issue before it actually turned on its interpretation of § 56(b)(1)(a)(ii) rather than on adopting the T&I Reading *per se*, the principal argument for that position was well stated as follows in a 2004 opinion of the Tax Court:

> [E]ven if section 56(b)(1)(A)(ii) were ambiguous, we could properly resolve the ambiguity by reference to Congress's explicit adoption of a policy of providing similar treatment of homeowners and tenant-stockholders in cooperative housing corporations.
>
> In 1942, Congress enacted the predecessor to section 216 to treat homeowners and tenant-stockholders of cooperative housing corporations similarly with respect to the deduction of real estate taxes and interest. Adoption of petitioners' position would permit tenant-stockholders of those corporations to deduct from AMTI amounts derived from their share of the real estate taxes paid by the corporations, even though homeowners may not deduct their real estate taxes from AMTI. In 1942, Congress made clear that tenant- stockholders should not be placed at a disadvantage compared to homeowners; it is just as inappropriate that they be given an advantage over homeowners for AMT purposes.[32]

The Argument for the SE Reading Based on Provisions of the Code

Although the point may not be determinative, it cannot be plausibly denied that the language of § 216(a) is more consistent with the SE Reading than with the T&I Reading.

Moreover, there is evidence within the Code itself—where drafting is likely to be more precise than in other places—that Congress has long so understood that section.

In defining "housing expenses"

In 1981, when Congress provided a definition of "housing expenses" for a certain purpose, it specifically excluded "interest and taxes of the kind deductible under section 163 or 164." Had Congress understood the T&I Reading to be the correct one, it would have stopped there. But it did not. Rather, it *also* excluded "any amount allowable as a deduction under section 216(a)." Plainly, Congress at that time did not believe that § 216(a) provided real estate tax and interest deductions.

In defining "miscellaneous itemized deductions"

Congress did pretty much the same thing again in 1986, when it divided certain deductions into two classes. One of those classes included both "the deduction under section 164 (relating to taxes)" and "the deduction under section 163 (relating to interest)." Again, had Congress believed that the T&I Reading was the correct one, it would have stopped there. But, again, it did not. Rather, it added to the list "the deduction under section 216 (relating to deductions in connection with cooperative housing corporations)."

In requiring reporting of "interest"

There was another relevant change in 1986. Congress had in 1984 enacted § 6050H, which requires special returns from certain persons who receive mortgage interest from individuals, which provision would have by its terms applied to cooperative housing corporations if they were receiving mortgage interest payments from their tenant-stockholders. But it appears that Congress after a period of time came to the conclusion that it would be unwise to rely on such a reading. In 1986, it added a new subsection (g), which includes the following:

> For purposes of subsection (a), an amount received by a cooperative housing corporation from a tenant-stockholder shall be deemed to be interest received on a mortgage in the course of a trade or business engaged in by such corporation, to the extent of the tenant-stockholder's proportionate share of interest described in section 216(a)(2).

If a payment *is* a payment of interest, it need not be "deemed to be" interest.

Contrary indications

Even the most ardent proponent of the SE Reading would have to admit that there is at least a modicum of Code support for the T&I Reading.

First is the heading of § 216: "Deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder." On the other hand, the heading of subsection (a) is "Allowance of deduction," not "deductions."

A more substantive argument can be based on § 691(b), which provides for certain deductions for a deceased taxpayer's successor who is obligated to and does pay certain of the decedent's obligations. There is no mention of any deduction under § 216(a), although among those covered are deductions under § 163 and § 164. Inasmuch as there would appear to be no reason to treat less favorably a successor who paid the decedent's back maintenance, the omission indicates that Congress thought that the mention of § 163 and § 164 was sufficient.

The Argument for the SE Reading Based on the Regulations

The regulations are, not surprisingly, in accord with the statutory provisions discussed above.

In defining "housing expenses"

The regulations include the following: "Housing expenses do not include *** [i]nterest and taxes deductible under section 163 or 164 or other amounts deductible under section 216(a)."

If the author of the provision believed that a cooperative apartment owner's § 216(a) deductions were for interest and taxes, then "other amounts deductible under section 216(a)" would be an empty set, inasmuch as there is no other possible deduction under § 216(a). Thus, it would appear that the regulation's author did not so believe.

It must be noted, on the other hand, that the provision includes a parenthetical describing § 216(a) as "relating to deduction of interest and taxes by cooperative housing corporation tenant."

In defining "miscellaneous itemized deductions"

The regulation's exclusionary list includes, in addition to "[t]he deduction under section164 (relating to taxes)"[33] and "[t]he deduction under section 163 (relating to taxes),"[34] "[t]he deduction under section 216 (relating to deductions in connection with cooperative housing corporations)."[35]

The cross references

As noted above, personal expenses are not deductible absent a specific allowance. In that connection, the regulations contain the following:

> Certain items of a personal, living, or family nature are deductible to the extent expressly provided under the following sections, and the regulations under those sections:
>
> (1) Section 163 (interest).
> (2) Section 164 (taxes).
>
> ***
>
> (9) Section 216 (amounts representing taxes and interest paid to cooperative housing corporation).[36]

Under § 216(a)

The regulations under § 216(a) itself do not directly address the issue. However, they do, no fewer than 14 times, refer to "a" deduction or "the" deduction," always in the singular.[37]

Under § 163(h)(3)

A temporary regulation includes the following:

> *Treatment of interest expense of the cooperative described in section 216(a)(2).* For purposes of section 163(h) and § 1.163-9T (disallowance of deduction for personal interest) and section 163(d) (limitation on investment interest), any amount allowable as a deduction to a tenant-stockholder under section 216(a)(2) shall be treated as interest paid or accrued by the tenant-stockholder.[38]

Although the referenced Code sections have been amended, there is no reason to suppose that the modifications would necessitate a change in the operative part of the quoted language.

Again, if a deduction *were* for interest paid (or accrued) by the tenant-stockholder, there would be no need to say that it "shall be treated as" interest so paid (or accrued).

The IRS's Position

Although the IRS has never directly addressed in terms the question as to which is the correct reading of § 216(a), there is no doubt that it espouses the T&I Reading.

As noted above, there are limitations of one kind or another on the deductions for real estate taxes and interest, and the IRS has taken the position that those limitations apply to what it sees as two separate deductions under § 216(a). As one example, see the following sentence from a current IRS publication: "To figure how the limits [on certain interest deductions] apply to you, treat your share of the cooperative's debt as debt incurred by you."[39]

The IRS's position is also made clear by its litigating position in the cases discussed below.

The AMTI Cases

The which-is-the-correct-reading question arises under § 56(b)(1)(A). That section lists a number of otherwise available deductions that are not allowable in computing alternative minimum taxable income. On that list, insofar as a personal-use taxpayer is concerned, is "taxes described in paragraph (1)…of section 164(a)." The not-allowed list does not in terms include deductions under § 216(a), and many taxpayers, relying on that fact, claimed § 216(a) deductions in computing their alternative minimum tax. The IRS objected, and the matter twice went to court. The IRS won both times, although, as shown in the below discussion, the decision in each case was based on something other than a reasoned adoption of the T&I Reading.

Rather, excerpts from the opinions are set forth below, so that the reader can decide for himself or herself just how much or how little they contribute to a resolution of the which-is-the-correct-reading question.

The *Guterman* case

It should be noted at the outset that the proceedings in this case were conducted under § 7463, subsection (b) of which provides that "A decision entered in any case in which the proceedings are conducted under this section shall not be reviewed in any other court and shall not be treated as a precedent for any other case." Also, the amount involved was small, the taxpayer represented herself, and there was no oral argument.[40]

In the words of the court, it was required to "decide whether a deduction allowed under section 216 for real estate taxes paid in connection with a cooperative housing corporation is an adjustment for purposes of the alternative minimum tax (AMT)."

It will be noticed that, in its statement of the issue, the court referred to "a deduction under section 216 for real estate taxes," thus in effect already deciding the issue before it. Along the same lines, the court stated as a fact that "petitioner was entitled to deduct real estate taxes … as her proportionate share of such taxes paid by the cooperative." In fairness, it must be noted that the taxpayer identified her deduction as being for "Co-op Real Estate Taxes." It is therefore not surprising that the court, without any discussion of the point, ruled as follows:

> It is clear from section 56(b)(1)(A)(ii) that the deduction allowed for real estate taxes paid is an adjustment for purposes of calculating AMT income. Section 216(a)(1) incorporates by reference section 164, and section 164 is specifically enumerated as an adjustment under section 56(b)(1)(A)(ii).

The *Ostrow* case in the Tax Court

This case presented the same issue that arose in the *Guterman* case. As stated by the Tax Court, "the sole issue for decision is whether a deduction allowed under section 216(a)(1) for petitioner wife's share of the real estate taxes paid by a cooperative housing corporation reduces alternative minimum taxable income."[41] Again, the court's statement of the issue—including the phrase "the petitioner wife's share of the real estate taxes"—assumed the answer to the key question.

However, there is a big difference in that in *Ostrow*, unlike in *Guterman*, the taxpayers made their position clear. The court, after discussing some of the background of § 216(a), summarized their "contentions" as follows:

> The deductions allowed under section 216 are not specifically listed in the relevant alternative minimum tax provision (section 56(b)) as deductions that are disallowed in computing AMTI. Petitioners contend that if Congress had intended to deny section 216 deductions in computing AMTI, it would have done so expressly.
>
> Petitioners point out that, in listing deductions that are not subject to the 2-percent floor of section 67(a), section 67(b) refers separately to "the deduction under section 164 (relating to taxes)" and "the deduction under section 216 (relating to deductions in connection with cooperative housing corporations)." Petitioners also point out that section 911(c)(2)(A)(ii) refers both to taxes deductible under section 164 and amounts allowed as deductions under section 216. Petitioners contend that those provisions show that where Congress intended to make an Internal Revenue Code provision apply to section 216, Congress did so explicitly.
>
> Thus, in sum, petitioners contend that Congress's failure to list section 216 in section 56(b) shows that section 216(a)(1) deductions are allowed in computing AMTI.[42]

The court disagreed for two reasons, which it summarized as follows: "because petitioners' position would cause dissimilar tax treatment of homeowners and tenant-stockholders in cooperative housing corporations, a result at odds with longstanding expressions of congressional intent" and "because of section 56(b)(1)(A)(ii)."[43]

The court's discussion of the "dissimilar tax treatment" point is quoted above.

The following is its full discussion of what it referred to as its "Statutory Analysis":

> "[T]axes described in" paragraph (1), (2) or (3) of section 164(a) are not deductible in computing AMTI. Sec. 56(b)(1)(A)(ii). A tenant-stockholder may deduct an amount equal to his or her share of the corporation's real estate taxes deductible under section 164. Sec. 216(a)(1). The phrase "taxes described in" section 164(a)(1) clearly applies to real estate taxes paid by a taxpayer and deductible under section 164.
>
> If Congress had intended the reference in section 56(b)(1)(A)(ii) to "taxes described in" section 164(a) not to apply to real estate taxes passed through to tenant-stockholders under section 216, Congress could have said "taxes deducted under" paragraph (1), (2), or (3) of section 164(a). Instead, section 56(b)(1)(A)(ii) refers to "taxes described in" section 164(a).
>
> Petitioners contend that Congress used the phrase "taxes described in paragraph (1), (2), or (3) of section 164(a)" in section 56(b)(1)(A)(ii) to deny deduction of real estate, personal property, and income taxes in computing AMTI while allowing deduction of section 59A environmental taxes and generation- skipping transfer taxes in computing AMTI. Whether or not section 56(b)(1)(A)(ii) has that effect, we do not agree that that reading precludes respondent's claim here; i. e., that a deduction under section 216(a)(1) based on taxes paid by a cooperative housing corporation is a deduction for taxes "described in" section 164(a).
>
> Petitioners also argue that if deductions under section 164 include real estate taxes paid by a cooperative housing corporation and deducted by a tenant-stockholder under section 216, references in sections 67(b) and 911(c)(2)(A)(ii) to both sections 164 and 216 would be redundant. We disagree. Section 67(b) refers to "the deduction under" sections 164 and 216, and section 911(c)(2)(A)(ii) refers to taxes "deductible under" section 164 and "a deduction under section 216(a)." We agree that a tax deductible under section 216 is not deductible under section 164. However, section 56(b)(1)(A)(ii), which is at issue here, refers to certain "taxes described in" section 164. We assume Congress used different language because it intended a different meaning.
>
> We agree with respondent that the phrase "taxes described in" section 164(a)(1) applies to a tenant-stockholder's deduction under section 216(a)(1) because the amount of that deduction is based on the amount of real estate taxes paid by the tenant-stockholder's cooperative housing corporation.[44]

The *Ostrow* case in the Second Circuit

The taxpayers appealed to the Second Circuit, which affirmed the Tax Court's decision. Its explanation was as follows:

> This appeal presents a purely legal issue that has not been decided by this Court or any other court of appeals: whether [the tax-based component of] a tenant-stockholder's deduction pursuant to I.R.C. § 216 is disallowed for alternative minimum tax ("AMT") purposes. We agree with the Tax Court that under the plain language of the statutory scheme—and 26 U.S.C. § 56(b)(1)(A)(ii) in particular—the [tax-based component of such a] deduction is not allowed in computing AMT. ***
>
> [T]he precise question is whether [the tax-based component of] a section 216 deduction is a deduction for "taxes described in … section 164(a)." Although section 56(b) does not expressly refer to section 216, we agree with the Tax Court that section 216(a)(1) provides a deduction for tenant-stockholders' share of real estate taxes, which are "taxes described in" section 164(a). The petitioners' argument for allowing the deduction would be stronger if section 56 restricted only "*deductions under* section 164(a)." *Cf.* 26 U.S.C. § 67(b)(2) (defining miscellaneous itemized deductions as deductions other than "the deduction under section 164"). But the "taxes described in" language is broader and, under a plain and ordinary meaning, applies to deductions for real estate taxes, whether the deduction is taken for the direct payment of such taxes (section 164) or the indirect payment of those taxes (section 216). That other provisions of the Tax Code may treat sections 164 and 216 distinctly does not alter our interpretation of the language of section 56(b).[45]

Notwithstanding the court's statement of "the precise question"—which would seem to be for all purposes—the court's reliance on the words "described in" in § 56 makes it is plain that the court's answer was actually only for AMTI purposes.

Conclusion

At this point in time, a number of tax practitioners are of the opinion that, despite the narrowness of the Second Circuit's focus, its ruling will be read by other courts as an across-the-board adoption of the T&I reading and will be followed by them in that respect. Some of their colleagues are not so sure, especially where language other than "described in" is employed. We shall have to wait and see.

Endnotes

1. The Code is Title 26 of the United States Code. In this article, citations in the form § ____ are to sections of the Code. The regulations issued under the Code are found in Title 26 of the Code of Federal Regulations. In this article, references to the "regulations" are references to those regulations, and citations in the form Reg. § ____ are to sections of those regulations.
2. *See, e.g.,* Sen. Rep't No. 313, 99th Cong. 2d. Sess. (1986) at 804 ("[T]he committee … believes that encouraging home ownership is an important policy goal, achieved in part by providing a deduction for residential mortgage interest."); H.R. Rep't No. 426, 99th Cong. 1st Sess. (1985) at 297 (same).
3. § 164(a)(1).
4. § 163(h)(3)(B)(i)(I).
5. Reg. § 1.61-8(c); Reg. § 1.162-11(a).
6. Indeed, had residential condominiums then existed, it is likely that the cooperative housing form would never have developed. See the following passage from a fairly recent Second Circuit opinion:

   > Combining the advantages of apartment occupancy with those of home ownership has long been a dream of urban dwellers. But direct ownership of "flats" has not been easily achieved. In Roman law, it may well have been forbidden; and at common law, though it was permitted, it was generally viewed as dangerously cumbersome in the absence of express statutory authorization. Nowadays, laws facilitating such "condominium" ownership have been enacted in both civil and common law lands. But long before the advent of such statutes, an alternate form of apartment ownership, the real estate stock-cooperative, had been developed in this country. Once established, it survived and continues to do so despite the flourishing of condominiums.

   Holmes v. United States, 85 F.3d 956, 957 (2d Cir. 1996). At this point, the court added the following trenchant observation: "Because the stock-cooperative was, at least in part, an attempt to accomplish by indirection what could not be done simply and straightforwardly, fitting it into the legal topography has not always been easy."
7. H.R. 1, 70th Cong., 1st Sess. As stated in House Rep. No. 2, at p. 14: "The general purpose of these provisions is to place the owner or long-term lessee of a cooperative apartment in the same position as the owner of a dwelling house so far as deductions for interest and taxes are concerned."
8. As to "pass-thru" or "pass-through" provisions generally, see § 67(c) and Reg. § 1.67-2T(g).
9. *Holden v. Commissioner,* 27 B.T.A. 530, 536 (1933). As a sidelight, it is interesting to note that Mr. Holden's proprietary lease sought to bolster his position by providing both (a) for payments of "rent" and (b) that "the Lessee covenants and agrees to pay to the Lessor or for its account (but not as rent)" the amounts that he had claimed as deductions. But the Board was not buying it. "[I]f the circumstances of the case establish that the payments of interest and taxes were made as part of the consideration for the lease of the apartment" the Board said, "then they constituted additional rent, and such fact is not changed and can not be disregarded because of a contrary statement contained in the lease contract between the petitioner and his lessor." *Id.* at 537.
10. *Wood v. Rasquin,* 21 F.Supp. 211, 212-3 (E.D.N.Y. 1937), *aff'd without op.,* 97 F.2d 1023 (2d Cir. 1938). It should be noted that a great deal of the District Court's discussion was based on its undiscussed assumption that tenant-stockholders of cooperative housing corporations owned real property rather than some other form of property.
11. *Id.* at 214.
12. *Park Place, Inc.*, 57 T.C. 767, 774-5 (1972).
13. Internal Revenue Code of 1939, § 23(z), added by P.L. 753, 56 Stat. 798, ch. 619, § 128 (1942). The provision originated in the Senate. See Sen. Rep. No, 1631, 77th Cong., 2d Sess. 97, 1942-2 C.B. 504, 577 (1942). There is no doubt that the general purpose was the same as under the un-enacted 1928 provisions. As stated in the Senate report (at 1942-2 C.B. 546): "The general purpose of this provision is to place the tenant stockholders of a cooperative apartment in the same position as the owner of a dwelling house so far as deductions for interest and real estate taxes are concerned." *Cf.* Rev. Rul. 87-130, 1972-2 C.B. 68: "The general purpose of section 216 is to place the tenant-stockholders of a cooperative apartment in the same position as the owners of dwelling houses so far as deductions for mortgage interest and real estate taxes in proportion to their shareholdings."
14. It was specifically called to the attention of the Senate Finance Committee. See testimony of J. Frederick Eagle, Hearings on the Revenue Act of 1942, p. 168 (July 27, 1942).
15. Probably for want of a better word, it is often said that § 216(a) provides for pass-throughs, but that is, strictly speaking, a misuse of the term, and, regrettably, a misuse that has sometimes led to a misunderstanding of the provision.
16. IRS General Counsel Memorandum 39289 (1984).
17. The statute says "the" taxable year, but, thereby avoiding any quibble on the point, the regulations specify that the shareholder's payment must be within *his* taxable year, not the corporation's. *See* Reg. § 1.216-1(a).
18. *Cf*. Reg. § 1.216-1(c).
19. Reg. § 1.216-1(b)(second and third sentences); Reg. § 1.216-1(h) (Example 3).
20. Reg. § 1.216-1(h)(Example 3).
21. *Id*.
22. See § 216(b)(3) and Reg. § 1.216-1(d).
23. An example might help clarify the "limit" concept. Suppose that a rule (admittedly fanciful) were to prescribe that a taxpayer must include in gross income all amounts that he or she received as gifts, but not more than his or her spouse received from selling champagne. Would it be correct to say that Mrs. B's gross income included whatever Mr. B received from selling champagne? What if she received no gifts? If she received gifts totaling $100 and he received $40 from selling champagne, did she receive $40 from selling champagne? Would that $40 be subject to a special tax on income derived from dealing in spirits?
24. *See* Reg. § 1.216-1(h)(Example 3).
25. Rev. Rul. 87-130, 1987-2 C.B. 68.
26. Reg. § 1.216-1(b)(second and third sentences); Reg. § 1.216-1(h) (Example 3).
27. *Park Place, Inc.*, 57 T.C. 767, 774 (1972) (emphasis added and footnote omitted). Although the point is not relevant to the present discussion, it should be noted that the court was clearly wrong about the both levels point.
28. *Eckstein v. United States*, 452 F.2d 1036 (Ct. Cl. 1971) (citation omitted).
29. *Holmes v. United States*, 85 F.3d 956, 960 (2d Cir. 1996).
30. *Ostrow v. Commissioner*, 430 F.3d 581, 582 (2d Cir. 2005). The *Ostrow* case is discussed below. As shown there, the court did not rest its decision on the *Holmes* dictum alone.
31. Sen. Rep't No. 313, 99th Cong. 2d. Sess. (1986) at 807 ; H.R. Rep't No. 426, 99th Cong. 1st Sess. (1985) at 299.
32. *Ostrow v. Commissioner*, 122 T.C. 378, 383 (2004), *aff'd,* 430 F.3d 581 (2d Cir. 2005). The decisions in both courts are discussed below.
33. Reg. § 1.67-1T(b)(6).
34. Reg. § 1.67-1T(b)(5).

35. Reg. § 1.67-1T(b)(11).

36. Reg. § 1.262(c).

37. *See* Reg. § 1.216-1(b) and (h).

38. Reg. § 1.163-10T(q)(3).

39. Publication 936, "Home Mortgage Interest Deduction" (2017), at p. 9.

40. *Guterman v. Commissioner,* T.C. Summary Opinion 2004-12 (Docket No. 15780-02S).

41. *Ostrow v. Commissioner*, 122 T.C. 378 (2004), *aff'd* 430 F.3d 581 (2d Cir. 2005). The appellate court's decision is discussed below.

42. 122 T.C. at 381.

43. *Id.* at 381-2.

44. *Id.* at 382-3 (citation omitted). As the court noted, the taxpayers' § 216(a) deduction did not have an interest-based component. *Id*. at n.6.

45. 430 F.3d at 582-3. At the end of the penultimate sentence in the quoted material, the court inserted a footnote reading as follows:

> "The petitioners repeatedly argue that section 216 provides a deduction for 'rent,' rather than real estate taxes. This argument is futile. [As to the tax-based component,] Section 216(a) unambiguously allows a deduction only to the extent that rent payments reflect the tenant-stockholders' proportionate share of 'the real estate taxes . . . incurred by the corporation.' 26 U.S.C. § 216(a)(1). Because the real estate taxes incurred by the corporation are "*taxes described* in" section 164, it is plain that the section 216 deduction may not be used in computing AMTI. *Id.* § 56(b)(1)(A)(ii) (emphasis added)."

Without the four sets of supplied bracketed words, the court's quoted statements are plainly incorrect, inasmuch as there might be an interest-based component as well. Doubtless, the court was misled by the happenstance that in the case before it the taxpayers' § 216(a) deduction had only a tax-based component.

With the firm of Miller & Miller LLP, Joel E. Miller was previously a Law Secretary to Honorable Harold R. Medina, Judge, U.S. Court of Appeals for the Second Circuit from 1956–1957. He was associated with Paul, Weiss, Rifkind, Wharton & Garrison, New York, N.Y., from 1957–1960; associated with and member of Demov, Morris, Levin & Shein, New York, N.Y., from 1961–1969, and a member of adjunct and full-time faculty at St. John's University School of Law between 1976 and 1989.

Joel has been the Chair, Subcommittee on Condominiums and Cooperatives, Committee on Real Estate Tax Problems, Section of Taxation with the American Bar Association; and Chair, Subcommittee on Liens, Co-operatives and Condominiums Committee, Real Property Law Section, and a member of the New York State Bar Association, Tax Section.

Mr. Miller is a co-author, *Modern Trust Forms and Checklists* (Warren, Gorham & Lamont, Inc. 1980); author of *Federal Taxation of Trusts* (Prentice-Hall, Inc., 1968); and a contributor to the *Tax Law Review, Journal of Real Estate Taxation, Journal of Taxation* and other legal publications on matters involving federal taxation and property law. He was the editor of *Real Estate Tax Ideas* 1979–1983, a member of several advisory boards, and a lecturer at various tax institutes.

An Overview of Real Estate Loan Forbearance Agreements—Part II

By Richard S. Fries

Part I of this article provided an overview of the commercial loan workout landscape and began a discussion of essential provisions to include in a "state of the art" commercial real estate loan forbearance agreement, including acknowledgement of indebtedness, ratification of loan documents, waiver of defenses and general release, forbearance expiration date and payment modification. Part II of this article will cover economic concessions, additional collateral, recourse and remedies.

Discounted Repayment Model: Property owners have little incentive to act merely as "brokers" for their lenders if the asset is worth less than the debt. They strive to create the equity that the marketplace or changes in the asset class have taken away since the loan was originated. The borrower brings to the lender its primary objective—payment on a date certain. This objective comes at a price if the property is worth less than the debt—the loan discount. The lender's collateral (and the scope of borrower and guarantor recourse) is no longer sufficient to secure repayment of the entire outstanding indebtedness; as such the parties would be better off negotiating a one-time cash payment in settlement of that obligation. Real estate has "right sized."

The discounted repayment model (a DPO, or discounted pay-off) allows the lender to receive consensually and predictably the financial equivalent of the successful foreclosure (i.e., fair market value of the collateral), but allows the borrower to retain ownership and achieve the potential upside of an improved marketplace, investment or capital event. The DPO works well in a non-recourse setting and in circumstances in which the borrower has proceeded honorably (i.e., the loan default is the result of market forces, such as increased construction costs, declining tenancies or revenue, and not fraud or misappropriation of revenue). The lender equates a discounted repayment to "victory, at the outset, in the foreclosure litigation."

Once the parties make a handshake "deal" on the discounted repayment amount, reality sets in—borrower needs time to "scour the market" for this discounted payoff. The forbearance agreement should deal with this as follows. Let's say the loan is $50 million and the "discounted repayment amount" is $38 million. Borrower has the right to repay and lender has the obligation to accept payment of the indebtedness at this discount provided borrower and guarantors have not otherwise defaulted under the forbearance agreement and such payment has been received by lender by the forbearance expiration date.

Richard S. Fries

Typically, borrower asks the lender to modify and reduce the loan to the discounted repayment amount at inception—requesting, on these facts, an immediate forgiveness of $12 million, before the lender has any assurance that the $38 million is forthcoming. Lenders should not fall prey to this tactic. Instead, the $50 million note should be split into two notes—Note A for $38 million, with interest at a modified pay rate, and Note B for $12 million, with interest paid (if at all) based on available cash flow. Note B will be forgiven only *after* Note A has been timely repaid in full. The discounted repayment option could be staged during the forbearance term with declines in the discount (increases in the repayment amount) for payments made at later dates. The business deal could vary, or complicate, this repayment scheme.

A common lender concern (the embarrassing "quick flip") can be avoided with the "equity sliver." The lender obtains a portion (or sliver) of the equity in the property (secured by a lien without remedies) to protect against a quick flip of the property to a third party at a profit mere moments after the borrower has repaid the debt at a discount. The "sliver" could burn away over time if the "quick flip" has not materialized.

Right-Sizing Obligations: Note A/Note B/Note C: Another workout strategy—"Note A/Note B/Note C"—involves slicing the underlying loan obligation to reflect current or revised economic realities and projections. The obligation is split into several sub-obligations. The primary obligation, represented by "Note A," is performed by borrower for the balance of the forbearance term. Note A reflects a more accurate valuation of the underlying collateral, the borrower's ability to make periodic payments, or the discounted repayment amount (if applicable). Interest on Note A is tied to the market.

Note B evidences a negotiated portion of the underlying obligation, which continues to accrue interest at a contract, default or some other modified rate. Interest on Note B is paid out of cash flow or another "good news" capital event if business or cash flow improves. Note B could either: (1) be a component of the discounted repayment amount, (2) represent debt that must be repaid if the forbearance period is extended into a "second term" if the project's economics improve or identified "good news" events occur or (3) be forgiven (at the end) if that is the parties' business deal.

Note C represents a "deferral" obligation, comprising the remaining indebtedness, with no debt service installments, payable—in full—only upon a subsequent default, non-payment of the discounted repayment amount, or other agreed-upon acts.

The obligation to repay the principal balances of Notes B and C is deferred, with forgiveness of Notes B and/or C (depending on the deal) to occur only upon the borrower's timely repayment of Note A in full. The overhang of Notes B and C provides significant financial incentives for the borrower and guarantors to repay Note A and perform the other terms of the restructured obligation. Like the equity sliver, Notes B and C also can be configured to prevent the borrower from capitalizing on a dramatic increase in the value of the collateral or an undisclosed, premeditated plan by the borrower to sell the collateral or bring in an investor at a profit.

Additional Collateral: In any workout, the lender is likely to request additional collateral. Borrower's initial response is that there is none. However, in exchange for meaningful economic concessions (including the option to repay at a discount), borrowers somehow find additional collateral. This collateral could consist of subordinate interests in other real property owned by the sponsor, membership interests in related projects, marketable securities, tax refunds, litigation recoveries, condemnation awards or preferred equity, among other assets. The lender's willingness to forbear or make economic concessions constitutes good, valuable, and sufficient consideration for the pledge of additional collateral.

Additional Guaranties; Expanded Non-Recourse Carve-Outs: Lenders will also seek new or enhanced recourse—in whole or in part (e.g., a portion of principal; debt service carry; "bad acts")—against borrower's principals or new investors. If previously absent, the guaranty covers state of the market and workout specific "bad boy" non-recourse carveouts such as bankruptcy, impermissible transfer of the property, interference with remedies, failure to deliver a deed in lieu of foreclosure, misappropriation of revenue or fraud. The guarantor should acknowledge the sufficiency of the consideration (forbearance, concessions) for this "credit enhancement."

Consent to Remedies: The effective forbearance agreement should, to some vigorously negotiated extent, contain the consent by borrower and guarantors to remedies. The nuances, immediacy, enforceability and implications of such remedies and the extent of borrower's consent thereto should be mastered by counsel before the workout discussions begin. The remedies include: (1) acceleration (bringing forward the entire debt); (2) consent to the appointment of a specific receiver and/or third party property manager; (3) consent to lender's computation of the indebtedness; (4) consent to entry of a judgment of foreclosure; (5) confessions of judgment; (6) tolling of the statute of limitations; (7) consent to jurisdiction (including federal court); (8) consent to an order of seizure of non-real estate collateral; (9) enforcement of "bad boy" guaranties; (10) implementation of the (hard) lock box for project revenue; and (11) consent to vacate the automatic stay in bankruptcy. Borrower (and guarantors) should acknowledge that their consent to these remedies is a material inducement to the lender for its grant of forbearance privileges and other economic concessions, on which lender relies to its detriment.

Because the judgment of foreclosure is consensual, the lender can bypass many of the time-consuming steps required in a judicial foreclosure action (such as the appointment of a referee to compute) and proceed (upon a default) to judgment and auction in a fraction of the time and cost—and with predictability. Courts typically react favorably where the lender secures the borrower's consent to foreclosure in exchange for forbearance or settlement with respect to a defaulted loan. Finality and judicial economy are achieved—consensually.

* * *

In any loan workout, the parties need to reconcile, amicably, their contrary objectives. The forbearance agreement can be used effectively to realize that goal. Workout specialists need to evaluate the risks attendant to today's judicial processes and the reactions and sympathies of the courts. They should understand the complexities and intricacies of various types of collateral and the disparate objectives of the holders of several tranches of debt (including market forces, changes, intercreditor arrangements, regulatory constraints and risks of loss), and master the dispute resolution mechanisms available to them. By doing so, the parties should be in a position to craft a forbearance agreement that is fair, efficient, and that works.

Richard S. Fries is a partner at Sidley Austin and one of the leaders of Sidley's real estate practice group. He is the co-chair of the Real Estate Financing Committee of the Real Property Law Section of the New York State Bar Association.

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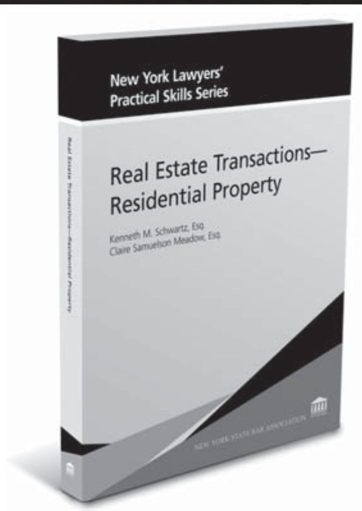

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Claire Samuelson Meadow, Esq.

Real Estate Transactions—Residential Property is a practical, step-by-step guide for attorneys representing residential real estate purchasers or sellers and covers sales of resale homes, newly constructed homes, condominium units and cooperative apartments. Included is a comprehensive collection of forms, including a variety of contracts of sale, rider clauses, brokerage agreements, and powers of attorney.

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Summer Meeting 2018

Westbrook, Connecticut

July 26-29, 2018

Water's Edge Resort and Spa
Westbrook, Connecticut

www.nysba.org/REALSU2018

Thursday, July 26

1:00 – 6:00 p.m.	**Registration** – Grand Foyer
1:30 – 2:30 p.m.	**Officer's Meeting** – Bill Hahn Room
3:00 – 5:00 p.m.	**Executive Committee Meeting** – Grand Ballroom
6:30 – 7:30 p.m.	**Cocktail Reception** – Royal Terrace
7:30 – 9:00 p.m.	**Dinner** – Royal Ballroom

Friday, July 27

7:30 – 8:15 a.m.	**Committee on Title and Transfer Breakfast Meeting**
7:30 a.m.	**Registration** – Royal Foyer
7:30 – 9:30 a.m.	**Continental Breakfast** – Royal Foyer Everyone, including spouses, guests and children, are invited to the continental breakfast.
8:15 a.m. – 12:00 p.m.	**GENERAL SESSION** – Royal Ballroom
8:15 – 8:30 a.m.	**Welcome and Introductory Remarks** Thomas J. Hall, Esq., Section Chair
	NYSBA Welcome
	Program Introduction Gerard G. Antetomaso, Esq., Program Chair
8:30 – 9:45 a.m.	**Case Law Update** *(1.5 credits in Areas of Professional Practice)* A summary of recent cases affecting all of our practices – some troubling, some groundbreaking, some humorous and always entertaining presented by two of the Section's most seasoned presenters.
Speakers:	Peter V. Coffey, Esq., Englert, Coffey, McHugh & Fantauzzi, LLP, Schenectady Michelle H. Wildgrube, Esq., Cioffi Slezak Wildgrube P.C., Schenectady
9:45 – 10:10 a.m.	**Great Ways to Meet Your Grievance Committee (and how to really get acquainted)** *(.5 credits in Ethics)* This presentation will include an overview of the attorney grievance process, appropriate response upon receipt of the dreaded letter and some suggestions on how to avoid ever hearing from your friends on the committee.
Speaker:	Leon T. Sawyko, Esq., Harris Beach PLLC, Rochester, NY
10:10 – 10:20 a.m.	**Refreshment Break** – Royal Foyer

10:20 – 11:10 a.m.	**Stop Overlooking the Insurance! Common Mistakes in Real Estate and Construction Contracts and How to Avoid Them** *(1.0 credits in Areas of Professional Practice)* An overview of the importance of reviewing and vetting insurance coverage and drafting needs to ensure that coverage is obtained. This overview is geared for attorneys representing landlords, property owners, apartment corporations, condominiums, developers and parties to construction agreements. The lecture will delve into key insurance exclusion provisions and definitions that must be accounted for during the drafting process of leases, alteration agreements, construction agreements, access agreements, and similar agreements.
Speakers:	Ariel Weinstock, Esq., Katsky Korins LLP, New York City Daniel M. Kessler, Esq., Turek Roth Grossman LLP, New York City Joanne Bentivegna, Construction Risk Partners, New York City
11:10 a.m. – 12:00 p.m.	**Real Property Tax Assessment and Review: Practice and Procedure** *(1.0 credits in Areas of Professional Practice)* This panel will include an in depth discussion of "Small Claims" Review (SCAR) which can result in a residential assessment reduction of as much as 25% (or greater, in some cases). We will discuss Full Value versus Fractionalized Assessments, the Administrative Process, and the anatomy of the trial of a commercial property (a/k/a The Battle of The Experts).
Speakers:	Sanford A. Pomerantz, Esq, Schroder & Strom, LLP, Mineola, NY Christopher P. Byrnes, Esq., Schroder & Strom, LLP, Mineola, NY
12:10 p.m.	**Fox Hopyard Golf Club** – www. golfthefox.com/fox-hopyard This masterfully crafted collection of holes will give you the feeling of playing through the mountains of Vermont, the lowlands of Kiawah and the links of Scotland all in one round. **First tee time is 1:00 p.m. Fee is $175** which includes green fees, box lunch and transportation. **Bus will leave promptly at 12:10 p.m. Pre-registration is required**.
2:00 p.m.	**Hiking Trails near Westbrook, Connecticut.** - www.alltrails.com/us/connecticut/westbrook An organized hike will be planned again this year. Look for more information soon.
6:30 – 7:30 p.m.	**Cocktail Reception** – Royal Terrace Ballroom Dinner is on your own this evening.

Saturday, July 28

8:00 a.m.	**Registration** – Royal Foyer
7:30 – 9:00 a.m.	**Continental Breakfast** – Royal Foyer Everyone, including spouses, guests and children, are invited to the continental breakfast.
8:30 a.m. – 12:00 p.m.	**GENERAL SESSION** – Royal Ballroom
8:30 – 9:20 a.m.	**Trust Me: The Dirt on Trust Ownership of Real Estate** *(1.0 credits in Areas of Professional Practice)* So a client walks into a bar (association) expressing an interest in transferring real property into a trust. How should you respond? When is a trust appropriate, or when is an LLC the better approach? This program will help you ask that client the right questions, review different types of trusts and the various purposes they serve, and discuss the issues (creditor protection; liability protection; ability to finance; transferability; title considerations and more) you need to consider to help clients achieve their particular goals.
Speaker:	Mindy H. Stern, Esq., Schwartz Sladkus Reich Greenberg Atlas LLP, New York City

9:20 – 10:10 a.m. **Even More Fun with Ethics**
(1.0 credits in Ethics)

A reprise of the interactive program using fact patterns derived from recent cases and ethics opinions. Contributors will be rewarded with chocolate.

Speaker: Anne Reynolds Copps, Esq., Copps, DiPaola Silverman PLLC, Albany, NY

10:10 – 10:20 a.m. **Refreshment Break**

10:20 – 11:10 a.m. **Implicit Bias and Diversity in the Legal Profession**
(1.0 credits in Diversity, Inclusion and Elimination of Bias)

This program will discuss implicit bias and how to recognize and address issues of biases that involve gender, race, ethnicity, sexual orientation, and age. The program will focus on how implicit biases can create barriers in the workplace and adversely affect hiring, training, retention, and advance of attorneys as well as work product and team output. In addition, the program will address the business case and positive impacts of diversity in the legal profession.

Speaker: Carrie H. Cohen, Esq., Morrison & Foerster LLP, New York City

11:10 a.m. – 12:00 p.m. **Not So Fast Assessor – The Reduction or Elimination of Taxes Based on Exemptions or Environmental No No's**
(1.0 credits in Areas of Professional Practice)

This program will address the variety and extent of RPTL Article 4 real property tax exemptions which apply to properties owned and operated by public entities, not-for-profit corporations, energy and utility companies and the impact of environmental factors on the valuation of property for assessment purposes.

Speakers: James S. Grossman, Esq., Barclay Damon LLP, Rochester, NY
Emanuela (Amy) D'Ambrogio, Esq., Barclay Damon LLP, Syracuse, NY

1:30 p.m. **Essex Steam Train and River Boat Tour** – www.essexsteamtrain.com

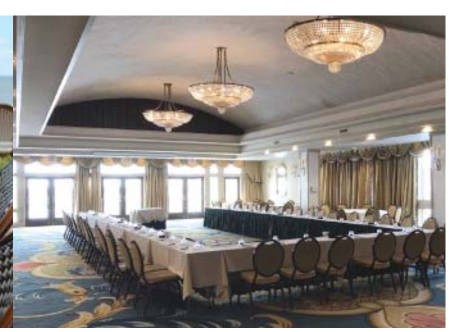
The Essex Steam Train & Riverboat's 2 ½-hour journey begins at the historic 1892 Essex Station for a 12-mile, narrated round-trip into the heart of the unspoiled Connecticut River Valley. The steam locomotive pulls vintage coaches through the quintessential New England towns of Deep River and Chester. A natural highlight is the undeveloped Selden Neck State Park, accessible only by boat. Essex Steam Train offers unique access to several coves and preserves, immersing passengers in an on-board eco-excursion. At Deep River Landing, passengers are escorted onto the Becky Thatcher riverboat for a 1 ½ hour cruise along the Connecticut River. **Fee is $22 per person. Pre-registration is required.**

6:15 p.m. Buses leave for the Old Lyme Country Club

6:30 – 7:30 p.m. **Cocktail Reception** at Old Lyme Country Club

7:30 p.m. **Dinner** at the Old Lyme Country Club





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Cocktail Reception at Water's Edge Resort
Friday, July 27 ___ (No. of ppl) attending
Cocktail Reception/Dinner at Old Lyme Country Club
Saturday, July 28 ___ (No. of ppl) attending

ACTIVITIES

Friday, July 27

___ (No. playing) $175 Golf Tournament - 12:10 p.m.
Golf player's name and handicap: ____________________
Golf player's name and handicap: ____________________

___ (No. of ppl) Hike - 2:00 p.m.

Saturday, July 28 – 1:30 p.m.

___ (No. participating) $22 Essex Steam Train and River Boat Tour

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___ Task Force on e-Recording Legislation (REAL5000)
___ Task Force on NYSID TI Regs (REAL4800)
___ Task Force on Zombie House (REAL5700)
___ Title & Transfer (REAL2200)
___ Website & Electronic Communications (REAL5400)

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Negotiating RPAPL § 881 License Agreements

By Adam Leitman Bailey, John M. Desiderio and Joanna Peck

RPAPL § 881 provides an expedited process whereby a property owner or developer, who seeks to make "improvements or repairs" to that owner/developer's real property, can commence a special proceeding to obtain a court order granting the owner/developer (the putative licensee") a temporary license to enter the property of an adjoining owner (the putative "licensor"): (a) where the planned improvements or repairs cannot be made without entering the adjoining premises, and (b) where the adjoining owner has refused to give the needed permission.[1] The statute is based in equitable principles, *see Chase Manhattan Bank v. Broadway, Whitney Company*, 57 Misc.2d 1091, 294 NYS2d 416 (Special Term, Sup. Ct., Queens Co.,1968), *affirmed*, 24 NY2d 927 (1969), whereby the court is empowered to grant the license, when, "in an appropriate case," entry by the licensee to the adjoining premises is shown to be necessary and "upon such terms as justice requires." The statute also makes the licensee liable to the adjoining owner licensor "for all actual damages occurring as a result of the entry."

Although RPAPL § 881 was described by a commentator, as recently as 2002, as a "little-used law"[2] it now clearly is no longer an overlooked and neglected statute. RPAPL § 881 is now required reading for all attorneys with developer clients seeking to build in New York City. The statute should also be required reading for attorneys with clients whose properties abut those where demolition and new construction is planned to take place.

It is well established that demolition of an old structure and construction of a new building is an "improvement" contemplated by RPAPL § 881.[3] Accordingly, most of the recent case law interpreting the statute has involved either entirely new construction or gut renovation of existing structures by developers and the protections required for the adjoining premises, not only from the ongoing work next door, but from work done in licensed areas of the adjoining premises or from licensed airspace over those premises.

What "justice requires" in each case depends (a) on the specifics of the proposed "improvements or repairs" planned for the property on which the work is to take place, (b) on the foreseeable and necessary protections required to safeguard persons and property on the adjoining premises, and (c) on what is deemed reasonable compensation for the adjoining owner-licensor's loss of enjoyment of that portion of the adjoining premises required for licensee's work to proceed.

Confirming the Necessity for the Work and Protections Required: The Developer's Perspective

Long before the need to apply to a court for an 881 license ever arises, the developer, as the party most interested in initiating the process of "improving" the property next to the adjoining premises, needs to be fully prepared (a) to justify the scope of the work for which it will require access, and (b) to show that it is ready to implement all necessary protections for the adjoining property. When first requesting a license from the adjoining owner, the developer should make a full presentation of what the construction project will entail, why the work requiring access cannot be done in some other way, and all the precautions that the developer must and will take to protect the adjoining owner's property. Such candor should not be held back, only to be grudgingly disclosed in the course of negotiations or ultimately in a later court proceeding.

The developer should present the adjoining owner with a complete set of construction plans showing the portion of the project that will impact on the adjoining property, together with complete written reports from the developer's architects and engineers of how the requested access will be used to perform the work required from the adjoining premises. The adjoining owner should not have to search Department of Buildings records to learn what impact the construction next door is likely to have on his property.

Written reports from the developers' engineers should also be given detailing all of the planned implementations of the protections that will be taken to safeguard the adjoining property during the access period. Such reports are especially important in connection with any excavation planned on the developer's property below the foundations of buildings on adjoining owners' properties.

Such expert reports would ultimately be required, in any event, to satisfy RPAPL § 881's requirements in any proceeding commenced upon the parties' inability to agree on all the terms of a license.[4] Thus, to induce a successful negotiation with the adjoining owner, the developer has every reason to be open and transparent from the very beginning, rather than engage in a hostile or otherwise difficult negotiation that is sure only to delay the project.

In this respect, the developer should also keep in mind that courts may now permit the adjoining owner to bring an RPAPL § 881 proceeding *in reverse* and impose a compulsory license agreement on the developer "where the parties cannot reach a licensing agreement and there is clear credible evidence that [developer] has entered or is about to enter or damage [adjoining owner's] adjoining property."[5]

It is also in the developer's interest, when initiating license negotiations, to fully disclose its plans for any necessary underpinning of the adjoining premises that the developer's project may require. This is because, if the developer is not able to reach agreement with the adjoining owner, the court could not issue an order compelling the adjoining owner to accept underpinning as part of an 881 license. Where underpinning is necessarily required as a safety measure, it constitutes a permanent encroachment on the adjoining property.[6] If underpinning should nevertheless be installed, in the absence of a license agreement, it would be subject to an action for ejectment and damages.[7] The developer should, therefore, seek early on to include a permanent easement for the required underpinning as part of any negotiated license agreement.

The Adjoining Owner's Perspective

It is just as important for the adjoining owner, once apprised of the developer's project on his doorstep, to engage his own architects and engineers to evaluate the planned construction work and protections presented by the developer, such as any proposed shoring, underpinning, and overhead cantilevered platforms and netting, and/or regarding safeguards for any cranes or superstructures that may be required during construction. However, the mission of the adjoining owner's professionals is to not only evaluate the adequacy of the planned protections disclosed by the developer, but whether or not the complexity of the construction abutting the adjoining owner's premises requires some greater protection than that described in the developer's presentation. Indeed, the adjoining owner's professionals need to place themselves "in the shoes" of the developer's consultants, to render the opinion that they would have given themselves if they had been originally engaged to consult on the project by the developer.

The adjoining owner's consultants also need to consider whether or not the neighbor's project involves any FAR (floor area ratio) and/or landmark issues that could possibly affect the owner's plans for future development of his own premises. If so, those issues need to be factored into any evaluation of the impact of the project on the premises and how those issues should be dealt with in any negotiated license agreement or in an RPAPL § 881 proceeding.

Such preparation by both sides is imperative, not only to successfully achieve a comprehensive license agreement, but to be ready to properly present the pros and cons of the parties' respective contentions to a court in the event of a breakdown in license negotiations. The court must be persuaded not only of the reasonableness and necessity of the scope of the work proposed or opposed by the parties, but also to determine whether or not the necessary work can be done in a manner not requiring the intrusive access sought.

Key Terms and Conditions of a License Agreement

As explained in *Rosma*,[8] in an RPAPL § 881proceeding:

The court must balance the competing interests of the parties and should grant the issuance of a license when necessary, under reasonable conditions, and where the inconvenience to the adjacent property owners is outweighed by the hardship of their neighbors if the license is refused.[9]

However, whether imposed by the court under RPAPL § 881 or negotiated between the parties, the terms and conditions of any license agreement will generally reflect the following sentiments expressed by the Court in *North 7-8 Investors v. Newgarden*.[10]

Section 881 provides that a license shall be granted 'upon such terms as justice requires.'[11] Such terms as justice requires extends to the nature and extent of access that is necessary, the duration such access may be necessary, as well as what protections may be necessary to safeguard the adjoining owner's property.

Among other things, a license agreement will generally include provisions covering the following important categories:

(a) a description of the scope of work to be conducted on the licensed premises (the "licensed work"), which is usually contained in one or more annexes to the agreement prepared by the developer's architects and engineers;

(b) the description of the location on the premises in which the licensed work will be permitted to be conducted (the "licensed premises"), the days and hours of the week when the licensed work may be performed (the "licensed work schedule"), and the period of time in which the licensed work is agreed to be completed (the "licensed term"), after which the developer is required to remove all of its work tools and materials and restore the premises to its original condition; so as to limit the disruption to the adjoining owner's peaceful enjoyment and use of his property as much as possible;

(c) the description of the agreed protections to be implemented for the licensed premises ("The Protective Work"),

(d) the indemnification provisions for any damages caused to either persons or property on the licensed premises (the "Indemnity Provision"),

(e) the insurance requirements the developer will be required to meet (the "Insurance Provision"),

(f) the reimbursement of the reasonable expenses incurred by the adjoining owner to engage attorneys to negotiate the license agreement, and to engage architects and engineers to evaluate the developer's plans for the project, the need for access to the owner's premises, the work to be conducted from the owner's premises, and the necessary protective measures required to be implemented to safeguard the licensed premises; since, as also noted in *Newgard*.[12]

The risks and costs involved in the use that a Petitioner makes of its neighbor's property should be wholly borne by the Petitioner. Equity requires that the owner compelled to grant access should not have to bear any costs resulting from the access, including steps necessary to safeguard their property.

And, in addition,

(g) the amount of an agreed license fee to compensate the adjoining owner for the loss of use and enjoyment of part of his property during the licensed term.

Determining the License Fee and Other Charges

The single most litigated issue in 881cases involves the determination of the amount, if any, of the license fees and reimbursable expenses to be paid to the adjoining owner for the duration of time it takes to complete the licensed work on his premises. The courts do generally agree that "the grant of licenses pursuant to RPAPL § 881 often warrants the award of contemporaneous license fees."[13] However, a survey of several decisions shows that courts have awarded monthly license fees, for relatively minor intrusive access to the adjoining premises, within a range generally no greater than $1,500 to $3,500, largely based on the court's own subjective perception of the amount of time and space of the adjoining premises of which the adjoining owner will lose peaceful enjoyment for the duration of the licensed work and licensed term. Cases awarding license fees within this narrow range involve compensation for maintaining a sidewalk shed extending 20 feet in front of the adjoining property ($1,500 for five months), entering upon adjoining owner's property for the purpose of erecting sidewalk bridging extending ten feet onto the sidewalk in front of the premises ($2,500 for 12 months), entering the airspace above a portion of the front and rear yard of the adjoining property ($3,000 for three months), construction of a cantilevered safety balcony which will project into the airspace over the adjoining property's roof deck ($3,500 for 12 months), erection of a two-legged protective shed on the adjoining property terrace ($2,500 for 12 months), entering upon the adjoining owner's property to effect repairs on petitioner's property ($2,000 for eight months).

Nevertheless, in none of the surveyed cases did the adjoining owner submit any evidence from a real estate broker to opine on the diminution in value caused to the property by loss of use and enjoyment of the licensed premises during the license term. If such evidence were presented in accordance with standards by which property appraisals are judged in other situations, such diminution findings could very well be deemed "actual [monthly] damages" under RPAPL § 881, and constitute part or all of the license fee awarded.

However, in a case involving substantially more intrusive work on two adjoining properties, in order to complete a $10 million renovation of a five-story townhouse, where one of the adjoining owners agreed to a stipulation accepting a $10,000 monthly license fee, the court ordered all parties to submit a joint license agreement containing the stipulated $10,000 monthly license fee for a period of one year unless the work would be completed in less than 12 months.[14] The *Chan* case suggests that, apart from how any court may decide a license fee application in an 881 proceeding where the parties before the court have not agreed on the amount, parties not resorting to court intervention are free to negotiate and agree on license fees of substantially greater amounts than have been awarded in any reported court decision.[15] In fact, parties have and continue to do so where it is in the interest of the developer to complete negotiation of a license agreement as speedily as possible. In such cases, monthly license fees of $10,000 to $15,000 have been negotiated.

Attorney Fees

The language of RPBPL 881 provides "sufficient statutory authority to award reasonable attorney fees as a condition of a license, where the circumstances warrant it."[16] Generally, where attorney fees are sought as a condition of the license rather than as an incident of litigation, attorneys' fees incurred in opposing an 881 petition are not deemed an incident of litigation, but instead are considered "a condition of the process of negotiating a license agreement."[17]

Security Fund Provisions

License agreements negotiated by the parties also often require the developer to deposit a fund into an escrow account ("the security deposit"), which may be held by the attorney for either the developer or the adjoining owner, whereby if the licensee breaches any of its obligations under the license or fails to repair damage caused by The protective work or otherwise, the adjoining owner may use, apply or retain the whole or any part of the security deposit to the extent reasonably necessary to cure the breach or repair the damage.

The security deposit should be an amount appropriately related to the potential amount of the damages that could be caused by the construction work described in the developer's plans and specifications and permitted by the Department of Buildings. In setting the amount, the parties may consider the amounts of monetary compensation awarded by the courts in reported cases where the developer's work was negligent and serious damages occurred. For example, in a case involving the negligent removal of lateral support for the adjoining property, the measure of damages was not only the "reasonable cost of restoration" less insurance payments received, but the total lost rent that the adjoining owner incurred as a result of the developer's negligence over five years, tenant relocation costs, brokers' fees, and additional expert fees to monitor the restoration—all of which amounted to approximately $2.7 Million.[18] Likewise, in appropriate cases, within the context of 881 proceedings, courts have recognized the potentiality of such damages occurring and have ordered developers to post bonds of $1 million, $1.5 million and $2 million.[19]

Better to Negotiate Than Litigate

Attorneys for developers need to consider that, while RPAPL § 881 is clearly designed to deal with the situation where the adjoining landowner has "refused" to grant a license, judicial intervention should be considered only as a last resort. Developers should use 881 solely for those cases where the "refusal" by the adjoining owner is clearly unwarranted, spiteful, or petty, and adjoining landowners should not seek to impose conditions on granting a license so onerous as to compel the developer to have a court set the license terms. The parties must consider that the court may have a perspective of the situation adverse to their own. The developer must consider that the court may not agree there is any necessity for accessing the adjoining property to perform the work.[20] Similarly, the adjoining owner must consider that the court may see the owner's refusal as a means of extorting a license fee much higher than either the complexity of the work or the amount of lost use and enjoyment of the accessed premises would warrant.[21] Developers also need to consider that resort to an 881 proceeding, although cast as a "special proceeding" intended for more swift judicial resolution, is nevertheless subject to the practicalities of court calendar delays. Unavoidable inherent court delay may impact on the developer's construction schedule and its ability to meet conditions required by construction loans; especially where a court order, whether granting or denying an 881 license, is always subject to a lengthy appeal process. Such considerations could weigh heavily on how willing a developer may be to agree or disagree to license terms that may seemingly be more favorable to the adjoining owner.

Conclusion

Each license agreement is *sui generis*, and the terms negotiated will vary in relation to the specific nature of the construction occurring on the developer's property and with respect to the specific work that must necessarily be done from the premises of the adjoining property. The discussion above has not exhaustively listed all of the many additional issues that need to be addressed in a license agreement, but it nevertheless does summarize the most important issues that the parties and their attorneys must consider when preparing to negotiate. As also noted above, either party may seek to negotiate terms that might not be readily included in any order issued by a court in an 881 proceeding. Nevertheless, where each party to a current negotiation has an incentive to conclude a satisfactory agreement as swiftly as possible, the parties should not be deterred from proposing license terms in their negotiation by what courts have done in matters where other parties have failed to agree prior to seeking judicial relief.

Endnotes

1. N.Y. Real Prop. Acts. § 881 (McKinney 2017).
2. *As quoted in Rosma Development v. South*, 5 Misc.3d 1014(A), 798 NYS2d 713 (Sup.Ct., Kings Co., 2004).
3. *See, e.g., Rosma, supra* note 2.
4. *See, e.g., Chase Manhattan Bank v. Broadway, Whitney Company*, 59 Misc.2d 1085, 300 NYS2d 80 (Special Term, Sup. Ct., Queens Co., 1969)("requirement of silicone [to complete repair of wall] should be substantiated by an expert in the field"); *see also McMullen v. HRH Construction*, 38 AD3d 206, 831 NYS2d 147 (First Dept. 2007) ("defendants' utter failure to show facts making entry necessary would require denial of any such RPAPL application," and defendants' assertion of entitlement to an RPAPL license was "risible").
5. *Chirichella v. BCBS Lorimer LLC*, 2017 WL 3386257 (N.Y. Sup.) 2017 NY Slip Op. 31665 (U) (Trial Order) Index No. 505985/2017 (Sup. Ct., Kings Co., 2017).
6. *See Broadway Enterprises v. Lum*, 16 AD3d 413, 790 NYS2d 402 (2d Dept. 2005). As a permanent encroachment "not now in existence," it "transcends the statute," *Foceri v. Fazio*, 61 Misc.2d 606, 306 NYS2d 1016 (Special Term, Sup. Ct., Queens Co., 1969), "goes beyond temporary access" and, therefore, is "beyond the scope of RPAPL 881." *North 7-8 Investors v. Newgarden*, 43 Misc.3d 623, 982 NYS2d 704 (Sup.Ct., Kings Co., 2014).
7. *See Broadway Enterprises, supra note 6; see also Sunrise Jewish Center of Valley Stream v. Lipko*, 61 Misc.2d 673, 305 NYS2d597 (Special Term, Sup. Ct. Nassau Co., 1969).
8. *Rosma, supra* note 2.
9. *Id.*
10. *Newgarden, supra* note 6.
11. N.Y. Real Prop. Acts. § 881(McKinney 2017).
12. *Newgarden, supra* note 6.
13. *DDG Warren v. Assouline Ritz 1*, 138 AD3d 539, 30 NYS3d 52 (1st Dep't 2016).
14. *See Chan v. Crown Wisteria*, 2015 WL 1757006 (2015) (Index No. 151966/14) (Trial Order, Sup. Ct., NY Co., 2015).
15. *Id.*
16. *Newgarden, supra* note 6.
17. *Id.*
18. *See East 77 Owners Co. v/ King Sha Group, Inc.*, 40 Misc.3d 1205(A), 975 NYS3d 365 (Sup. Ct., NY Co. 2014).
19. *See, e.g., Newgarden, supra* note 6.
20. *See, e.g., Lincoln Spencer Apartments v. Zeckendorf-68th Street Associates*, 88 AD3d 606, 931 NYS2d 69 (First Dept. 2011).
21. *See, e.g., 22 Irving Place Corp. v. 30 Irving LLC*, 57 Misc.3d 253, 60 NYS3d 640 (Sup.Ct., NY Co., 2017).

Adam Leitman Bailey is the founding partner of Adam Leitman Bailey, P.C. John M. Desiderio is a partner and chair of the firm's real estate litigation group. Joanna Peck is an associate of the firm.

Bergman on Mortgage Foreclosures

When Bank Statements Torpedo the Foreclosure

By Bruce J. Bergman

Usually computer-generated monthly statements from mortgagee banks to borrowers are a ubiquitous way for periodic installments to be remitted. But when borrowers are in arrears, especially if they are paying in fits and starts, with possible additional sums accruing (i.e., late charges, default interest, bounced check charges, among others), there is increased possibility for errors. Computers are marvels, of course, but humans program them and humans input information. Mistakes can, and do, occur.

If for some reason a lender statement or invoice recites a lesser sum to be paid than is actually due, might that be a basis for a borrower to avoid paying the correct sum, or even to defeat a foreclosure? Traditionally New York case law was comforting for the lender side on this point—there was no danger if a billing invoice was in error. A recent case, however, rules the other way and presents a sobering lesson. [See *2390 Creston Holdings LLC v. Bivens*, 149 A.D.3d 415, 51 N.Y.S.3d 61 (1st Dep't 2017).]

Addressing the typical circumstances where the lender was not in danger, in one instance, computer-generated billing statements were transmitted to a mortgagor in the first month after two separate foreclosures were begun. There was no evidence, however, that the bills misled the mortgagor into believing that there was a waiver of acceleration or that the respective foreclosures would be discontinued; in fact, no payments were made in response to the statements.[1] So the defense was rejected. In another case, without explanation, billing notices subsequent to default showing only the regular monthly mortgage payment due were held a meritless argument to estop acceleration.[2]

The fact pattern in the recent case tells a different story. A mortgage loan was seriously in default with considerable default interest due. An acceleration letter was sent which particularly pointed out that acceptance of any lesser sums would not be a waiver and that any changes had be in writing, the latter also a provision found in the mortgage. When the borrower submitted all the principal in arrears, but with interest only at the *note* rate, the bank inexplicably generated a statement showing an "adjustment" to the account with a credit for the difference between default interest and the note rate. Thereafter, the bank sent the borrower 20 consecutive invoices consistent with the original loan terms, that is, note rate interest.

The loan was assigned and the assignee, after making a demand, began a foreclosure based upon the continuing arrears in default interest. (After all, default interest as demanded in the acceleration letter had never been paid.) In granting summary judgment to the borrower, the court ruled that the "adjustment" in the bank's statement and the 20 consecutive invoices were inconsistent with demand for full payment of principal and interest—that is, counter to an acceleration. Moreover, even if the waiver asserted by the borrower was to be deemed a loan modification, and therefore required to be in writing, the bank was found to have expressly reversed the default interest rate and the default interest charges.

Bruce J. Bergman

In sum, the bank was held to have intentionally waived its right to acceleration with interest at the default rate. While previous cases had in essence said that erroneous monthly statement would not change the actual borrower's obligation, the particular adjustment statement here followed by 20 invoices not seeking default interest were enough for the court to conclude that the lender had indeed waived default interest.

Concededly, these are rather extraordinary circumstances. Nonetheless, they do urge that care in issuing monthly statements is very much in order. At some point, prior case law notwithstanding, the court may indeed find such statements to rise to the level of a waiver.

Endnotes

1. *Bercy Investors v. Sun*, 239 A.D.2d 161, 657 N.Y.S.2d 47 (1st Dep't 1997).
2. *Bank of New York v. Spring Glen Associates*, 222 A.D.2d 992, 635 N.Y.S.2d 781 (3d Dep't 1995).

Mr. Bergman, author of the four-volume treatise, *Bergman on New York Mortgage Foreclosures*, LexisNexis Matthew Bender, is a member of Berkman, Henoch, Peterson, Peddy & Fenchel, P.C. in Garden City. He is a fellow of the American College of Mortgage Attorneys and a member of the American College of Real Estate Lawyers and the USFN. His biography appears in *Who's Who in American Law* and he is listed in *Best Lawyers in America* and *New York Super Lawyers*.

Yellowstone Injunctions: Conflicting Appellate Division Judgments of Public Policy Are Likely to Result in Confusion

By Michael Sabony

In New York, commercial tenants facing lease termination will routinely seek a "*Yellowstone* injunction" to maintain the status quo until the dispute is resolved in court.[1] A creation of case law, the *Yellowstone* injunction originates from the Court of Appeal's 1968 decision in *First National Stores v. Yellowstone Shopping Centers*.[2] Designed to stop the running of the relevant cure period, *Yellowstone* injunctions protect tenants by allowing for the opportunity, subsequent to an unfavorable judgement on the merits, to cure any defaults and avoid forfeiture.[3] To obtain a *Yellowstone* injunction, courts simply require a tenant establish that: (1) it holds a commercial lease; (2) it received from the landlord either a notice of default, a notice to cure, or a threat of lease termination; (3) it requested injunctive relief prior to the termination of the lease; and (4) it is prepared to and maintains the ability to cure the alleged default by any means short of vacating the premises.[4] On January 31, 2018, the Appellate Division, Second Department, addressed the issue of whether the right to seek a *Yellowstone* injunction can properly be waived under the terms of a commercial lease.[5]

In April 2010, plaintiffs entered into commercial lease agreements for rental and retail property in Brooklyn. Included in the leases, Paragraph 67(H) provided that the tenant:

> waives its right to bring a declaratory judgment action with respect to any provision of this Lease or with respect to any notice sent pursuant to the provisions of this Lease. Any breach of this paragraph shall constitute a breach of substantial obligations of the tenancy, and shall be grounds for the immediate termination of this Lease.[6]

Four years later, on March 12, 2014, defendant issued plaintiffs a Notice to Cure, demanding alleged lease violations be cured by March 27, 2014. On March 19, 2014, plaintiffs filed an action for, among other claims, declaratory and injunctive relief. On March 26, 2014, one day before the given time to cure was set to expire, plaintiffs moved for a *Yellowstone* injunction. In response, defendant moved for summary judgment on April 25, 2014, contending that plaintiffs had contractually waived their right to seek injunctive relief.[7]

The Supreme Court denied plaintiffs' motion and instead granted the defendant's cross motion for summary judgment dismissing the complaint, holding that *Yellowstone* relief was encompassed within Paragraph 67(H)'s broader prohibition of declaratory judgment actions.[8] The Second Department granted plaintiffs' application for a temporary stay, pending resolution of the appeal.[9]

At the outset of its opinion, the court noted that plaintiffs' application for *Yellowstone* relief was timely, emphasizing that the motion had been made one day before the cure period had expired.[10] However, the court concluded that plaintiffs could not obtain a *Yellowstone* injunction under these circumstances. While not explicitly prohibited, a practical interpretation of Paragraph 67(H)'s language encompassed *Yellowstone* injunctions as the sort of declaratory relief plaintiffs had waived.[11] Therefore, the Second Department affirmed the Supreme Court's decision and concluded that plaintiffs had expressly waived their right to seek *Yellowstone* relief under the terms of their lease agreements.[12]

For the first time on appeal, plaintiffs argued that the waiver violated public policy and, therefore, was unenforceable.[13] The court refuted this argument and noted that, while contractual waivers may be void if against public policy, waivers are not to be lightly presumed and must reflect a party's clearly manifested intent to relinquish the right being waived.[14] Justifying its decision, the court identified "three distinct reasons" why the waivers did not violate public policy.[15]

First, the court emphasized the importance of, as a fundamental principle of jurisprudence, parties' right to freedom of contract.[16] Citing to a litany of tenant protections that the State Legislature has explicitly determined are not waivable, the court noted that the Legislature has not enacted any such prohibition of a tenant's right to waive declaratory relief as being void or unenforceable.[17] Consequently, the court declined to do so what the Legislature has not.

Second, "the parties were sophisticated entities that negotiated at arm's length and entered into lengthy and detailed leases defining each party's rights and obligations with great apparent care and specificity.[18] Furthermore, the court stated that "[t]o hold that the waiver of declaratory judgment remedies in contractual leases between sophisticated parties is unenforceable as a matter of public policy does violence to the notion that the parties are free to negotiate and fashion their contracts with terms to which they freely and voluntarily bind themselves."[19] Here, the court determined the leases' plain language reflected the parties' mutual understanding of plaintiffs' intent and right to freely, voluntarily, and knowingly waive the right to declaratory and injunctive relief.[20]

Third, the court said the waivers' limited nature still left plaintiffs with other sufficient judicial remedies.[21] The most notable, in the court's opinion, was plaintiffs' right to fully litigate and defend themselves in any summary proceeding initiated by defendant.[22]

For these reasons, the court held that "under the circumstances of this case, the commercial tenants' voluntary and limited waiver of declaratory judgment remedies in their written leases is valid and enforceable, and not violative of New York's public policy."[23] However, believing the waivers to be overly broad, the sole dissenting judge argued they violated public policy and were thus unenforceable.[24] *Yellowstone* injunctions serve a valuable public policy role in commercial landlord-tenant relations, the dissent reasoned, and because plaintiffs would be deprived of access to the courts, the waivers violated public policy and could not be enforced. [25]

The Second Department's holding in this case is especially significant when compared to the First Department's decision in *Village Center for Care v. Sligo Realty and Service Corp.*[26] In that case, a commercial tenant moved for a *Yellowstone* injunction after it was served with a notice to cure. In granting tenant's motion, the court noted that *Yellowstone* relief's purpose, to protect against leasehold forfeiture, is in line with New York's public policy against the leasehold forfeiture.[27] Importantly, the First Department recognized that "[t]he Court of Appeals has acknowledged that courts routinely grant Yellowstone relief to reflect this State's policy against forfeiture."[28]

This contrast illustrates a potential divide between the First and Second Departments. As previously mentioned, a contractual waiver is unenforceable if the waiver is contrary to public policy. While the Second Department did not consider the right to *Yellowstone* relief a matter of public policy and, therefore, is waivable, the First Department determined the right to *Yellowstone* relief was a matter of public policy. Until resolved, the resulting ambiguity will likely result in inconsistent application of the law by the lower courts charged with considering requests for *Yellowstone* injunctions.

Moreover, given the discrepancy between Departments, commercial landlords and tenants must be especially thorough during negotiations. Tenants must understand that a leasehold provision waiving their right declaratory relief may be interpreted as an implicit waiver of the right to *Yellowstone* relief and is, at least in the Second Department, likely to be upheld in court. Landlords, on the other hand, will likely look to include declaratory relief waivers with the hope that courts will, if necessary, construe tenants as having waived their right to seek *Yellowstone* relief. Until this issue is addressed, either by additional court decisions or by the state legislature, the likely result is uncertainty and confusion on the part of commercial landlords, tenants, and the attorneys acting on their behalf.

Endnotes

1. *Post v. 120 E. End Ave Corp.*, 62 N.Y.2d 19, 25, 475 N.Y.S.2d 821, 823 (1984).
2. *See generally First Nat'l Stores v. Yellowstone Shopping Ctr.*, 21 N.Y.2d 630, 290 N.Y.S.2d 721 (1968).
3. *Graubard Mollen Horowitz Pomeranz & Shapiro v. 600 Third Ave. Assocs.*, 93 N.Y.2d 508, 514, 693 N.Y.S.2d, 91, 95 (1999).
4. *225 E. 36th St. Garage Corp. v. 221 E. 36th Owners Corp.*, 211 A.D.2d 420, 421, 621 N.Y.2d 302, 303 (1st Dep't 1995).
5. *159 MP Corp. v. Redbridge Bedford, LLC*, N.Y. Slip Op. 00537, *1 (2d Dep't Jan. 31, 2018).
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.* at 2.
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.* at 3.
14. *Id.* at 4.
15. *Id.* at 3.
16. *Id.*
17. *Id.* at 4.
18. *Id.* at 4-5.
19. *Id.* at 5.
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.* at 1.
24. *Id.* at 8-9.
25. *Id.* at 9-12.
26. *See generally Vill. Ctr. For Care v. Sligo Realty & Serv. Corp.*, 95 A.D.3d 219, 943 N.Y.S.2d 11 (1st Dep't 2012).
27. *Id.* at 222, 943 N.Y.S.2d at 13.
28. *Id.*

Michael Sabony is a second-year student at St. John's University School of Law and a staff member of the *N.Y. Real Property Law Journal.*

Avella v. City of New York: Court of Appeals Holds Public Trust Doctrine Prevents Development on Parkland Absent Legislative Directive Authorizing Alienation

By Shannon Cogan

In the State of New York, certain land is set aside as parkland to be used for park purposes to the benefit of the public. Under the public trust doctrine, such parkland can only be alienated or used for non-park purposes if there is legislative approval.[1]

> *"The court narrowly construed Section 18-118, stating that the statute only authorized the 'rental' of the stadium and appurtenant grounds for the reasons enumerated in subsection (b), as evidenced by the title of the statute."*

In *Avella v. City of New York*, the plaintiffs alleged that a development proposal made to the city by the defendants included construction on state parkland in violation of the public trust doctrine.[2] In making the determination of whether this proposal was subject to the requirements set forth in the public trust doctrine, the court considered whether legislative approval was given to alienate the area at issue known as Willets West, an asphalt-covered 77 acres where Shea Stadium once stood.[3] This left the court with the question of whether the supposed "parkland" consisting of Willets West was in fact alienated, and thus available for non-park purposes, under existing legislation. The majority ruled that it was not alienated and still remained parkland under the public trust doctrine, enjoining any proposed development on the land.[4]

In arguing that the City had enacted legislation that authorized the alienation of the Willets West area, the defendants relied on Section 18-118 of the Administrative Code of the City of New York as legislative authorization for the development, under which they argued that the land had been alienated for non-park purposes.[5] Section 18-118 grants the City the right to enter into outside agreements concerning the use of the "stadium and appurtenant grounds" (referring to Shea Stadium and its related surroundings), for reasons stated in subsection (b) of the statute.[6] The defendants contended that their development project fell into the enumerated use of "improvement of trade and commerce," as set forth in subsection (b), under which they could use the stadium grounds, specifically the parking lot area known as Willets West.[7] However, the court rejected those contentions for the reason that the statute clearly and plainly does not authorize construction on the grounds in question. The court narrowly construed Section 18-118, stating that the statute only authorized the "rental" of the stadium and appurtenant grounds for the reasons enumerated in subsection (b), as evidenced by the title of the statute.[8] The legislative intent behind using such language here, as discussed by the majority opinion, is to allow the rental of such grounds for public purposes to ease the city's financial burden of the construction, maintenance, and operation of the stadium. The court also mentioned how this narrow interpretation is necessary to regulate parkland because a broad reading of statutes such as 18-118 would "authorize the private construction of anything deemed by the city" to relate to one of those purposes.[9]

The dissent took a much broader approach than the majority's narrow interpretation of Section 18-118 and the process by which parkland is alienated under the public trust doctrine. Chief Judge DiFiore claimed that subsection (a) of the statute directly authorizes the alienation of Willets West for non-park purposes, specifically to promote recreation, entertainment, and cultural betterment in addition to improving trade and commerce and that the development of the area is within this statutory authorization under subsection (b).[10]

> *"While the majority does not completely restrict development of Willets West—in fact, it addresses that a legislative authorization may be enacted in the future—the dissent presents a more practical conclusion in which Section 18-118 sets this area of land aside for a stadium and thus alienates it for non-park purposes."*

A major point made by the dissenting opinion in favor of allowing the development of Willets West is that it follows longstanding trends of sports arenas across the country that have attracted commercial developers to build in the areas surrounding these stadiums. Chief Judge DiFiore makes reference to the Circus Maximus in Ancient Rome as well as other major sports stadiums in

America to illustrate that shopping areas and commercial districts are historically situated in the same location as the stadium because of the economic benefits brought in by the crowds of spectators.[11]

This is a case that turns entirely on statutory interpretation. The majority construes Section 18-118 of the Administrative Code perhaps a bit too narrowly, making it difficult for any type of development to proceed that may raise an issue regarding the public trust doctrine. Under the majority's interpretation of the statute, legislation would be needed to expressly alienate any area of parkland before it can be used for any non-park purpose. This is burdensome to both the legislature and developers who, in situations like that in *Avella v. New York*, want to transform predominately unused parcels of land to create public benefits and bring economic growth to an area. While the majority does not completely restrict development of Willets West—in fact it addresses that a legislative authorization may be enacted in the future—the dissent presents a more practical conclusion in which Section 18-118 sets this area of land aside for a stadium and thus alienates it for non-park purposes.[12] Under the reasoning provided by the dissent, as long as there was legislative authorization for alienation of the land at issue, such authorization should be enough for the City to allow development in a manner which comports with the betterment of the city, as addressed by subsection (b) of Section 18-118.[13]

Endnotes

1. *Avella v. City of New York*, 29 N.Y.3d 425, 58 N.Y.S.3d 236 (2017).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. Administrative Code of the City of New York § 18-118.
7. *Avella v. City of New York*, 29 N.Y.3d 425, 58 N.Y.S.3d 236 (2017).
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. Administrative Code of the City of New York § 18-118.

Shannon Cogan is a second-year student at St. John's University School of Law and a staff member of the *N.Y. Real Property Law Journal*.

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Attorney Opinion Letters
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Schulte Roth & Zabel LLP
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New York, NYNY 10022-4728
gregory.pressman@srz.com

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crussell@harrisbeach.com

Awards
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pcoffey@ecmlaw.com

Commercial Leasing
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501 Madison Avenue, Room 402
New York, NY 10022-5635
success1968@hotmail.com

Robert J. Shansky
Scarola Zubatov Schaffzin PLLC
1700 Broadway, 41st Floor
New York, NY 10019
rjshansky@szslaw.com

Sujata Yalamanchili
Hodgson Russ LLP
The Guaranty Building
140 Pearl Street Suite 100
Buffalo, NY 14202-4040
syalaman@hodgsonruss.com

Condemnation, Certiorari and Real Estate Taxation
Karla M. Corpus
National Grid
300 Erie Boulevard West
Syracuse, NY 13202
kmcorpus@gmail.com

Steven Wimpfheimer
Steven Wimpfheimer, Esq.
166-25 Powells Cove Blvd.
Whitestone, NY 11357
wimpf1@gmail.com

Condominiums & Cooperatives
Dale J. Degenshein
Stroock & Stroock & Lavan LLP
180 Maiden Lane, Suite 3961
New York, NY10038
ddegenshein@stroock.com

Condominiums & Cooperatives (continued)
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Schwartz Sladkus Reich Greenberg
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9th Floor
New York, NY 10016
ssladkus@ssrga.com

Continuing Legal Education
Scott A. Sydelnik
Davidson Fink LLP
28 E. Main Street, Suite 1700
Rochester, NY 14614
ssydelnik@davidsonfink.com

David J. Zinberg
Ingram Yuzek Gainen Carroll &
Bertolotti, LLP
250 Park Avenue, 6th Floor
New York, NY 10177
dzinberg@ingramllp.com

Diversity
Antar P. Jones
The Law Office of Antar P. Jones, PLLC
538 East 24th Street
Brooklyn, NY 11210
antar@antarlaw.com

Harry G. Meyer
Rockledge, FL 32955
hgmeyer96@gmail.com

Green Real Estate
Joel I. Binstok
York Consulting
570 Lexington Avenue, Suite 2900
New York, NY 10022
JBinstok@yorkleaseaudit.com

Nicholas M. Ward-Willis
Keane & Beane, PC
445 Hamilton Avenue
Suite 1500
White Plains, NY 10601
nward-willis@kblaw.com

Land Use and Environmental Law
Alan J. Knauf
Knauf Shaw LLP
2 State Street, 1400 Crossroads Building
Rochester, NY 14614-1314
aknauf@nyenvlaw.com

Linda U. Margolin
Margolin Besunder, LLP
1050 Old Nichols Road
Suite 200
Islandia, NY 11749
lmargolin@margolinbesunder.com

Landlord and Tenant Proceedings
Paul N. Gruber
Borah, Goldstein, Altschuler,
Nahins & Goidel, P.C.
377 Broadway
New York, NY10013
pgruber@borahgoldstein.com

Peter A. Kolodny
Kolodny PC
15 Maiden Lane
Suite 2000
New York, NY10038
pk@kolodnylaw.com

Legislation
Richard A. Nardi
Loeb & Loeb LLP
345 Park Avenue
21st Floor
New York, NY10154
rnardi@loeb.com

Samuel O. Tilton
Woods Oviatt Gilman LLP
700 Crossroads Building
2 State Street
Rochester, NY 14614-1308
stilton@woodsoviatt.com

Low Income and Affordable Housing
Richard C. Singer
Hirschen Singer & Epstein LLP
902 Broadway
13th Floor
New York, NY 10010
rsinger@hseny.com

Membership
Jaime Lathrop
Law Offices of Jaime Lathrop, PC
641 President Street
Suite 202
Brooklyn, NY 11215-1186
jlathrop@lathroplawpc.com

Harry G. Meyer
Rockledge, FL 32955
hgmeyer96@gmail.com

Not-for-Profit Entities and Concerns
Susan E. Golden
Venable LLP
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New York, NY 10020-1700
SGolden@Venable.com

Anne Reynolds Copps
Copps DiPaola, PLLC
126 State Street, 6th Floor
Albany, NY 12207
arcopps@coppsdipaola.com

Professionalism
Patricia E. Watkins
Bartlett, Pontiff, Stewart & Rhodes PC
One Washington Street
P.O. Box 2168
Glens Falls, NY 12801-2168
pew@bpsrlaw.com

Nancy A. Connery
Schoeman, Updike & Kaufman
551 Fifth Avenue
New York, NY 10176
nconnery@schoeman.com

Public Interest
Maria Theresa DeGennaro
Empire Justice Center
Touro Law Center PAC
225 Eastview Drive
Central Islip, NY 11722
mdegennaro@empirejustice.org

Daniel Farwagi Webster
Webster & Dubs, P.C.
37 Franklin Street
Suite 1000
Buffalo, NY 14202

Publications
Marvin N. Bagwell
Old Republic National Title Insurance Co.
400 Post Avenue, Suite 310
Westbury, NY 11590
MBagwell1@OldRepublicTitle.com

Vincent Di Lorenzo
St. John's University School of Law
8000 Utopia Parkway
Belson Hall, Room 4-46
Jamaica, NY 11439
dilorenv@stjohns.edu

William P. Johnson
Nesper, Ferber, DiGiacomo,
Johnson & Grimm, LLP
200 John James Audubon Parkway
Suite 302
Amherst, NY 14228
wjohnson@nfdlaw.com

Matthew J. Leeds
Ganfer & Shore LLP
360 Lexington Avenue
New York, NY 10017
mleeds@ganfershore.com

Real Estate Construction
Gavin M. Lankford
Harris Beach PLLC
99 Garnsey Rd
Pittsford, NY 14534-4532
glankford@harrisbeach.com

Brian G. Lustbader
Schiff Hardin LLP
666 5th Avenue
Suite 1700
New York, NY 10103
BLustbader@schiffhardin.com

Real Estate Financing
Richard S. Fries
Sidley Austin LLP
787 Seventh Avenue
New York, NY 10019
richard.fries@sidley.com

Heather C.M. Rogers
Davidson Fink LLP
28 East Main Street, Suite 1700
Rochester, NY 14614
hrogers@davidsonfink.com

Real Estate Workouts and Bankruptcy
Garry M. Graber
Hodgson Russ LLP
The Guaranty Building
140 Pearl Street, Suite 100
Buffalo, NY 14202-4040
ggraber@hodgsonruss.com

Daniel N. Zinman
Kriss & Feuerstein, LLP
360 Lexington Avenue
Suite 1200
New York, NY 10017
danzinmanesq@gmail.com

Sponsorship Committee
Ira S. Goldenberg
Goldenberg & Selker, LLP
399 Knollwood Rd.
Suite 112
White Plains, NY 10603-1937
igoldenberg@goldenbergselkerlaw.com

Student Affairs Committee
Shelby D. Green
Pace University School of Law
78 North Broadway
White Plains, NY 10603-3796
sgreen@law.pace.edu

Ariel Weinstock
Katsky Korins LLP
605 3rd Avenue
16th Floor
New York, NY 10158-0180
aweinstock@katskykorins.com

Title and Transfer
Gerard G. Antetomaso
Evans Fox LLP
100 Meridian Centre Blvd.
Suite 300
Rochester, NY 14618
jerry@evansfox.com

Gilbert M. Hoffman
Vanguard Research & Title Services, Inc.
499 South Warren Street
Suite 210
Syracuse, New York 13202
Gilbert.Hoffman@vgrti.com

Toni Ann Christine Barone
Law Firm of Barone & Barone,LLP
43 New Dorp Plaza
Staten Island, NY 10306
tabarone@verizon.net

Website and Electronic Communications
Susan M. Scharbach
D'Agostino, Levine, Landesman
& Lederman, LLP
345 Seventh Avenue
23rd Floor
New York, NY 10001
sscharbach@dagll.com

Michael P. Stevens
4-74 48th Avenue
Apt. 5G
Long Island City, NY 11109
michaelpstevens@gmail.com

Task Force on Attorney Escrow
Gilbert M. Hoffman
Vanguard Research & Title Services, Inc.
499 South Warren Street
Suite 210
Syracuse, New York 13202
Gilbert.Hoffman@vgrti.com

Benjamin Weinstock
Ruskin Moscou Faltischek, P.C.
1425 RXR Plaza
East Tower
15th Floor
Uniondale, NY 11556-1425
bweinstock@rmfpc.com

Task Force on Bylaws
Karl B. Holtzschue
Law Office of Karl B. Holtzschue
122 East 82nd Street
New York, NY 10028
kbholt@gmail.com

Task Force on Draft Department of Financial Services Title Insurance Regulations
Gerard G. Antetomaso
Evans Fox LLP
100 Meridian Centre Blvd.
Suite 300
Rochester, NY 14618
jerry@evansfox.com

Thomas J. Hall
The Law Firm of Hall & Hall, LLP
57 Beach Street
Staten Island, NY 10304-0002
hallt@hallandhalllaw.com

Task Force on Zombie House
Joel H. Sachs
Keane & Beane PC
445 Hamilton Ave
White Plains, NY 10601
jsachs@kblaw.com

Leon T. Sawyko
Harris Beach PLLC
99 Garnsey Road
Pittsford, NY 14534
lsawyko@harrisbeach.com

Section District Representatives

First District
Joel I. Binstok
The York Group LLC
5557 Fifth Avenue
14th Floor
New York, NY 10017
JBinstok@yorkleaseaudit.com

Second District
Lawrence F. DiGiovanna
Abrams Fensterman
1 MetroTech Centre
Suite 1701
Brooklyn, NY 11201
LDiGiovanna@abramslaw.com

Third District
Alice M. Breding
Law Office of Alice M Breding, Esq., PLLC
632 Plank Road
Suite 201
Clifton Park , NY 12065-6588
alice@bredinglaw.com

Fourth District
Michelle H. Wildgrube
Cioffi Slezak Wildgrube P.C.
1473 Erie Boulevard
1st Floor
Schenectady, NY 12305
mwildgrube@cswlawfirm.co

Fifth District
Ann Marie McGrath
Law Office of Ann McGrath
8196 Oswego Rd.
Liverpool, NY 13090
annmcgrathesq@msn.com

Sixth District
John E. Jones
Hinman Howard & Kattell, LLP
700 Security Mutual
80 Exchange Street
Binghamton, NY 13901-3400
jonesje@hhk.com

Seventh District
Kirsten Winninghoff Lamb
Webber Law, PLLC
3313 Chili Ave.
Suite. C
Rochester, NY 14624
Klamb@blaketwebber.com

Eighth District
David Christopher Mineo
Chicago Title
55 Superior Boulevard
Mississauga, ON L5T2X9
Canada
dmineo@ctic.com

Ninth District
Lisa M. Stenson Desamours
1400 Half Moon Bay Drive
Croton On Hudson, NY 10520
lmstenson1@gmail.com

Tenth District
Daniel J. Baker
Certilman Balin Adler & Hyman, LLP
90 Merrick Avenue
9th Floor
East Meadow, NY 11554
dbaker@certilmanbalin.com

Sanford A. Pomerantz
Schroder & Strom LLP
7 Jodi Court
Glen Cove, NY 11542
sandyslaw@optonline.net

Eleventh District
Steven Wimpfheimer
166-25 Powells Cove Blvd.
Whitestone, NY 11357-1522
wimpf1@gmail.com

Twelfth District
Vacant

Thirteenth District
Toni Ann Christine Barone
Law Firm of Barone & Barone, LLP
43 New Dorp Plaza
Staten Island, NY 10306
tabarone@verizon.net

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NYSBA
NEW YORK STATE BAR ASSOCIATION
REAL PROPERTY LAW SECTION
One Elk Street, Albany, New York 12207-1002