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A Message from the Section Chair

A Proud Profession

"A Lawyer is to do for his client all that his client might fairly do for himself, if he could."

Samuel Johnson (1709-1784), quoted in *Boswell's Life of Johnson*, 1791

Surely we can find it in our hearts to forgive the lack of gender neutrality in a remark made over two centuries ago when the term 'female lawyer' was an oxymoron. Rather, it is for us to focus on the simple wisdom of Samuel Johnson's observation.

Nothing serves to improve the public perception of our profession more than our own commitment to professionalism itself in our daily practice. Three of our own Real Property Law Section Executive Committee Members were recently honored for living by the tenet of Samuel Johnson: Bernard Rifkin, Peter Coffey and Anne Reynolds Copps.

Bernard Rifkin has served our Section for decades as a prolific writer, lecturer and analyst, always working to cultivate knowledge of the law beyond its use for clients and employing that knowledge in reform of the law. Mr. Rifkin received the Section's Professionalism Award at the Annual Meeting in January. Still full of wit, Bernard remarked, "You do not know how grateful I am that I am not receiving this award posthumously." We feel the same way, Bernard.

Peter Coffey has worked tirelessly for years on the Professionalism Committee of our Section. He is phenomenally productive in creating, organizing and presenting Continuing Legal Education Seminars on matters of ethics, including the orchestration of a unique panel at the Annual Meeting in January. In addition, Peter takes as many as a dozen pro bono cases a year, most recently volunteering his time and expertise to help low-income Capital District residents keep their homes. He is a passionate supporter of equal justice and devoted to the highest quality of legal services he can

Inside

SIGNIFICANT CHANGES IN NEW YORK RULES GOVERNING FIDUCIARY APPOINTMENTS (SEE PAGE 3)

provide, no matter what a client's means. Peter Coffey is the consummate professional, and we are honored to have him among our ranks.

Anne Reynolds Copps has been co-chairing our new committee on Not-For-Profit Entities. Anne just received the State Bar's Professionalism Award. She is a very busy solo practitioner, who is nonetheless generous with her time in mentoring young lawyers. She is compassionate, dedicated and tireless in pursuing her clients' best interests. Anne also volunteers her time for numerous projects that benefit the community and the profession.

The preamble to the Model Rules of Professional Conduct remind us that, "As a public citizen, a lawyer should seek improvement of the law, the administration of justice and the quality of service rendered by the legal profession." Nothing serves our profession better than living these principles, as have Bernard, Peter and Anne.

John J. Privitera

Significant Changes in New York Rules Governing Fiduciary Appointments

By Terrence M. Gilbride

On November 15, 2002, Chief Justice Judith Kaye signed into effect sweeping new rules pertaining to the appointment of fiduciaries by New York courts. These rules, which replace the existing Part 36 of the Rules of the Chief Judge, can be found at 22 N.Y.C.R.R. Part 36. These new rules are quite comprehensive in scope and apply to a wide variety of fiduciary appointments by New York State courts.[1] The rules address, among other things, the process for appointing fiduciaries, the basis for disqualification of certain individuals from serving as fiduciaries, certain compensation limitations for fiduciaries, the application and training requirements for fiduciaries, and the procedure for the tracking and reporting of fiduciary appointments. The portions of the rules that speak to fiduciary disqualification became effective on January 1, 2003. All other portions of the rules become effective on June 1, 2003.[2]

Under this new measure, judges are required to appoint fiduciaries from lists of qualified persons to be created and maintained by the Chief Administrator of the Courts.[3] The rules provide that these lists will be maintained on a separate basis for each category of fiduciary appointment.[4] The rules do provide in certain limited instances for appointment of parties who are not on the list.[5] Given the stated policy of the new rules and the narrowness of these exceptions, though, it is safe to assume that most fiduciary appointments after June 1, 2003 will be off of the list of qualified persons.[6]

To get onto the list of qualified fiduciaries, a person will need to file an application with the Office of Court Administration.[7] Application forms, which should be available within a month, can be obtained from the local fiduciary clerk or go online to www.courts.state.ny.us and click on "Fiduciary appointments in New York State."

In addition to satisfactorily completing the application, persons seeking to be on the list of qualified fiduciaries must also complete a training program approved by the Chief Administrator. The rules are not specific on the requirements for the training program. Under the rules, the Chief Administrator is simply given the authority to establish requirements for education and training of applicants.[8]

> *"At the request of Chief Judge Lippman, the New York State Bar Association has directed the Real Property Law Section to develop and implement a statewide training program for all persons wishing to serve as receivers."*

Although the new rules do not expressly provide for separate training programs for each category of fiduciary, Chief Administrative Judge Jonathan Lippman has indicated that training programs will need to be specific to the area of appointment. Judge Lippman has also indicated that for certain types of fiduciaries, such as Article 81 guardians and court evaluators, the current training program established under the Mental Hygiene Law will satisfy the training requirement for inclusion on the list for this category of fiduciary.[9]

It has been determined, moreover, that the training requirement for persons wishing to serve as referees will be satisfied if that person certifies that he or she has read a training manual which will be included with the fiduciary application. For persons performing services on behalf of guardians or receivers as counsel, accountants, auctioneers, appraisers, property managers or real estate brokers, the Office of Guardianship and Fiduciary Services has indicated that no specific training program will need to be completed. Rather, in order to fulfill the education and training requirements for these types of appointments, interested persons must include a resume with their fiduciary application showing education and experience appropriate to the area of prospective appointment.

Attorneys who wish to serve as receivers will need to complete a training program approved by the Chief Administrator. At the request of Chief Judge Lippman, the New York State Bar Association has directed the Real Property Law Section to develop and implement a statewide training program for all persons wishing to serve as receivers. More information about this program will be disseminated shortly. In the meantime, all persons who engage in this area of practice should familiarize themselves with new Part 36 and its impact.

For more information on new Part 36, contact:

NYS Office of Court Administration
Office of Guardianship and
Fiduciary Services
140 Grand Street, Suite 701
White Plains, New York 10601
914-682-3210
FAX 212-457-2608
E-mail: cdevlin@courts.state.ny.us

Endnotes

1. 22 N.Y.C.R.R. Part 36.1 which provides, in pertinent part:

   (a) Except as set forth in subdivision (b), this Part shall apply to the following appointments made by any judge or justice of the Unified Court System:

(1) guardians;

(2) guardians ad litem, including guardians ad litem appointed to investigate and report to the court on particular issues, and their counsel and assistants;

(3) law guardians who are not paid from public funds, in those judicial departments where their appointments are authorized;

(4) court evaluators;

(5) attorneys for alleged incapacitated persons;

(6) court examiners;

(7) supplemental needs trustees;

(8) receivers;

(9) referees (other than special masters and those serving otherwise in a quasi-judicial capacity);

(10) the following persons or entities performing services for guardians or receivers:

(i) counsel

(ii) accountants

(iii) auctioneers

(iv) appraisers

(v) property managers

(vi) real estate brokers

(b) Except for sections 36.2(c)(6) and 36.2(c)(7), this Part shall not apply to:

(1) appointments of law guardians pursuant to section 243 of the Family Court Act, guardians ad litem pursuant to section 403-a of the Surrogate's Court Procedure Act, or the Mental Hygiene Legal Service;

(2) the appointment of, or the appointment of any persons or entities performing services for, any of the following:

(i) a guardian who is a relative of the subject of the guardianship proceeding; a person or entity nominated as guardian by the subject of the proceeding; a person or entity proposed as guardian by a party to the proceeding; or a person or entity having a legally recognized duty or interest with respect to the subject of the proceeding;

(ii) a guardian ad litem nominated by an infant of 14 years of age or over;

(iii) a nonprofit institution performing property management or personal needs services, or acting as court evaluator;

(iv) a bank or trust company as a depository for funds or as a supplemental needs trustee;

(v) a public administrator or public official vested with the powers of an administrator;

(vi) a person or institution whose appointment is required by law;

(vii) a physician whose appointment as a guardian ad litem is necessary where emergency medical or surgical procedures are required.

(3) an appointment other than above without compensation, except that the appointee must file a notice of appointment pursuant to section 36.4(a) of this Part.

2. Baxter, Kathleen, "New Rules Governing Fiduciary Appointments Adopted," New York State Bar Association *State Bar News*, January, 2003.

3. 22 N.Y.C.R.R. Part 36.2(b)(1).

4. 22 N.Y.C.R.R. Part 36.3(c).

5. 22 N.Y.C.R.R. Part 36.2(b)(2) and (3).

6. 22 N.Y.C.R.R. Part 36.0 provides as follows:

"Public trust in the judicial process demands that appointments by judges be fair, impartial and beyond reproach. Accordingly, these rules are intended to ensure that appointees are selected on the basis of merit, without favoritism, nepotism, politics or other factors unrelated to the qualifications of the appointee or the requirements of the case.

"The rules cannot be written in a way that foresees every situation in which they should be applied. Therefore, the appointment of trained and competent persons, and the avoidance of factors unrelated to the merit of the appointments or the value of the work performed are the fundamental objectives that should guide all appointments made, and orders issued, pursuant to this Part."

7. 22 N.Y.C.R.R. Part 36.3(a).

8. 22 N.Y.C.R.R. Part 36.3(b).

9. Letter dated January 2, 2002 (sic) from Chief Administrative Judge Jonathan Lippman to Lorraine Power Tharp, President, New York State Bar Association.

Terrence M Gilbride is a partner at Hodgson Russ LLP in Buffalo, and Co-Chair of the Real Property Law Section Continuing Education Committee.

Property Condition Disclosure Act: First Case Has Right Result for Wrong Reasons

By Karl B. Holtzschue

In the first published case on the Property Condition Disclosure Act, a New York Civil Court judge in Richmond County[1] held that sellers who gave a Property Condition Disclosure Statement (PCDS) under the Property Condition Disclosure Act (PCDA)[2] were not liable under the PCDA or under common law fraud because they were not proven at trial to have actual knowledge of the defect.

Facts Proven at Trial

The sellers gave the purchasers a PCDS answering "unknown" to question 20 as to rot or water damage to structures. In fact, the sellers answered "unknown" to 30 of the 48 questions. The purchasers hired an inspector to inspect the structures, but *that inspection did not include the swimming pool*. An adjustment was made in the purchase price to reflect that the deck around the pool was not in good condition. The pool was an in-ground pool that was placed mostly above ground. When the deck was removed after the closing, it was noticed that the main supports and body of the pool had rot which if left untreated would cause the pool to collapse. A contractor found new patches around the bottom of pool to prevent the liner from pushing out. Debris under the deck obscured the rot; had the deck been removed, the rot would have been visible. Consequently, the judge found after a trial that the sellers did not have constructive knowledge of the condition. The existence of the rot was not easily discoverable upon reasonable observation. The judge found that the evidence supported the sellers' claim that they did not have actual knowledge of the condition of the pool because it was not visible prior to their giving the PCDS. It was not clear that the rot was patent, that is, discoverable upon reasonable inspection by the sellers or the purchasers. No evidence was introduced as to prior repairs, so the purchaser failed to prove that the sellers had actual or constructive knowledge due to prior work. The sellers had rented the premises for nine years before 1999.

Note that the statutory PCDS form fails to ask about "material defects" in a swimming pool, the critical issue in this case and one of the few items not included in the lengthy list of mechanical systems and services and other items in questions 26 through 47. That omission forced the purchasers in this case to claim rot in a structure under question 20.

Right Result, But Wrong Reasons

The sellers were sued for improper completion of the PCDS. After a trial, the judge, on his own motion, also considered a possible claim for common law fraud. The purchasers lost on both causes of action. So far, so good. The result is correct on these facts under both the PCDA and the common law, but the reasoning of the opinion and analysis of the PCDA is faulty in many respects. The opinion does not cite a single case or article—on the PCDA, caveat emptor or anything else—except for Shakespeare.[3] The following discussion is presented in an attempt to provide an interpretation of the statute by one who actively participated in its enactment, with references to relevant books, articles and cases.

The result is surely correct under RPL § 465(2), as the PCDA provides a remedy against a seller who *provides a PCDS* only if the sellers had actual knowledge and willfully defaulted by lying when the sellers said "unknown" on the PCDS. The purchasers did not prove that the sellers had actual knowledge of facts contradicting their statement in the PCDS, so the purchasers properly lost the case.

> *"Having a knowledgeable professional inspect all aspects of the residence should be the first priority in buying a home."*

The result is also correct under a common law fraud theory. The purchasers could also sue for common law fraud for a willful misrepresentation made in the PCDS, but they would win only if the sellers had actual knowledge (and, under the case law, the purchasers did not fail to use means available to them to discover the defect). The purchasers did not prove that the sellers had actual knowledge. The defect was not patent, it was latent. To be liable for a latent defect, the sellers had to have actual knowledge (here they had none) and a duty to speak (none shown here). The sellers could not be liable for a negligent misrepresentation because the sellers did not have constructive knowledge either. Neither the sellers nor the purchasers had the means to discover the rot.[4] Consequently, the purchasers also properly lost on common law fraud.

Mistakes by the Purchasers

The purchasers in this case made two fatal mistakes. *First and foremost*, they failed to have the inspector who inspected the house also inspect the swimming pool (though it is unclear whether an inspector had the duty to look behind the debris under the deck). Having a knowledgeable professional inspect all aspects of the residence should be the first priority in buying a home. Trying to get the seller to disclose observable defects should be a secondary effort. *Second*, the purchasers should have tried to add the swimming pool to the list of equipment covered by the PCDS (or add a representation to that effect in the contract) and made that disclosure survive the closing. The sellers' attorney would probably have resisted the disclosure and strongly advised against survival. Survival-of-condition representations that can be inspected is rightly not customary in residential sales. The purchaser has the duty to get the property inspected.

On the other hand, in my opinion (and that of Professor Prosser), requiring disclosure by the seller of defects that are not discoverable by a reasonable inspection by the purchaser would be appropriate and fair. Unfortunately, such a disclosure requirement has been expressly rejected by New York case law.[5] One of the main virtues of the PCDA is that it provides some redress for this shortcoming in the New York law of caveat emptor.

Analysis of PCDA Remedies

The opinion correctly states that the purchasers were not entitled to the $500 credit under RPL § 465(1), because that remedy only applies if the seller *fails to deliver the PCDS* in a timely manner. Here, the sellers did so, and the remedy provided under that section by its terms does not apply.

The only other remedy expressly provided in the PCDA is under RPL § 465(2), which states that a seller who *provides a PCDS* shall be liable for actual damages for a willful failure to perform the requirements of the PCDA, in addition to any other existing equitable or statutory remedies. In an attempt to interpret the PCDA, the judge looked at other consumer protection legislation, such as the statute on home improvement contracts that provides a private action for fraud and an injunction action by the state Attorney General.[6] As a result of this comparison, the judge stated he did not find that the PCDA provides a specific right of action to the purchaser for "a breach of the Disclosure form" (the PCDS). Consequently, he held that the purchasers had no cause of action under the PCDA, saying that RPL § 465(2) has a "nebulous legal effect," fails to create a right of action for improper completion, is unclear and is therefore unenforceable.[7]

> *"Intentional misrepresentation, such as outright lying, is actionable under the PCDA; negligent misrepresentation is not."*

The judge states that it was not clear to him what RPL § 465(2) means.[8] He asks what does "*requirements of this article*" mean? Does it mean "truthful completion" of the PCDS? It clearly does mean that (as well as timely delivery). The essential requirements are (1) that the seller reveal its *actual* knowledge in response to the questions and (2) that the seller is responsible only for *willful* failure to comply. Accordingly, the seller is not responsible for "constructive" knowledge (knowledge that a reasonable seller should have known in the circumstances). That test was proposed in the original legislation, but was deliberately deleted from the final statute.[9] A constructive knowledge test was thought to be too much of a trap for the unwary seller. Under the same approach, the seller is liable only for a *willful* failure, not a negligent one. Intentional misrepresentation, such as outright lying, is actionable under the PCDA; negligent misrepresentation is not.

For example, if it could be shown that the sellers in this case had in the past received a proposal to repair the swimming pool (and had not had the repair done),[10] the purchasers might have argued that the sellers had constructive knowledge of the defect even if the sellers claimed they forgot about the proposal and denied having actual knowledge at the time they delivered the PCDS. Would Question 20 as to "rot" in structures (which does not expressly refer to swimming pools) have reminded the sellers of the repair proposal? Did the repair proposal refer to "rot"?[11] This clearly raises a question of credibility as to the sellers' actual knowledge at the moment of signing the PCDS. But if the sellers are believed by the trier of fact, the statute provides no remedy to the purchasers. In that case, the sellers did not have actual knowledge and were not in willful default of the requirement to disclose. It should be remembered that the stated purpose of the statute is to aid in the inspection process, not to set a trap for unwary and unsophisticated sellers using a "constructive" knowledge mechanism and vaguely worded questions.

The sellers in this case tried to protect themselves by answering "unknown" to 30 of the 48 questions. The judge rightly observed that an "unknown" answer should trigger a duty on the purchasers to inquire about the subject matter, especially where, as in this case, the sellers answered "unknown" to most of the questions. A purchaser who accepts a PCDS with "unknown" answers should be on notice that the subject matter should be inspected. Such a purchaser does not waive claims for defects; the purchaser can sue and win if the seller is proven to have lied about not knowing. This can be shown by evidence that the seller had actual knowledge of the defect (e.g., by a prior report on the condition by a contractor or proof of active concealment or partial disclosure). Claims of partial disclosure may well increase where a PCDS is given.

But in this case, the sellers answered "unknown" many times and still got sued and had to pay to defend a litigation. The judge rightly asked why a sellers' attorney would ever advise the clients to give a PCDS and expose themselves to litigation when they could decline to do so and just give a $500 credit at the closing. Many attorneys who have attended my lectures on the PCDA have come to the same conclusion.[12] This case should increase their numbers.

Analysis of Common Law Fraud Action

Having found no cause of action under the PCDA, the judge, on his own motion, analyzed whether the evidence provided at trial would support a cause of action for "breach of contract" [sic] or common law fraud. The judge rightly noted that delivery of a PCDS provides purchasers with a document that can be used against sellers in a common law suit for fraud or negligent misrepresentation. Thus, the PCDS gives purchasers an advantage in subsequent litigation. Moreover, the PCDA expressly states that it does not "limit any existing legal cause of action or remedy at law, in statute or in equity."[13]

The judge rightly noted that nothing in the PCDA required that information in the PCDS be included in the contract of sale. The PCDA merely requires that the PCDS be "attached" to the contract. The PCDS and the contract are separate documents.[14] Consequently, the claim of misrepresentation in the PCDS alone will not support a cause of action for breach of contract. But a misstatement in a PCDS can support a claim of fraudulent misrepresentation under the common law. If the sellers lied on the PCDS about their actual knowledge of the misstatement, they could be sued for fraud.

Would constructive knowledge support a fraud claim? It could as a theoretical matter, but the claim has almost never been made in recent caveat emptor cases and the real hurdle in New York is to show that the seller had a duty to disclose the defect.[15] The judge rightly points out, I think, that the PCDA does not eliminate a common law cause of action based on constructive knowledge. By contrast, as discussed above, the PCDA does give the seller a defense to an action under the PCDA based on constructive knowledge.

Merger Clauses Do Not Protect Against Fraud

The judge states that any rights of the purchasers under the PCDA were merged in the contract and would not survive execution of the contract, based on the standard NYSBA contract "as is" clause disclaiming reliance on prior statements as to condition and the standard merger clause as to all prior understandings.[16] While he was correct in observing that nothing in the PCDA indicates that a PCDS disclosure is intended to survive, he failed to take note of the many New York cases holding that such merger clauses do not prevent a fraud claim.[17] Consequently, a fraud action based on a PCDS misrepresentation is still available after contract signing and after the closing. While this is an error in the holding, it should not change the result, because no fraud was proven in this case.

The limitation to actual damages in RPL § 465(2) eliminates all other categories of damages under the PCDA, but does not limit damages under a common law fraud suit. The judge also rightly observed that the PCDA does not preclude a suit for specific performance.

Since the purchasers did not prove that the sellers had actual knowledge of the latent defect in this case, the judge rightly held that the purchasers should lose under a common law fraud theory.

Analysis of $500 Credit Remedy

The judge also did an analysis of RPL § 465(1), which provides that a seller who *fails to provide* a PCDS prior to the signing by the buyer of a binding contract of sale must provide to the buyer at the closing a credit of $500 against the agreed upon purchase price. In this case, the sellers did provide the PCDS in a timely manner, so they would not be required to provide the credit. As dictum, the judge stated that the requirement of a $500 credit at closing would be enforceable. He also correctly observed that a "willful failure" under the PCDA does not refer to a refusal to provide a $500 credit at closing. RPL § 465(1) makes no reference to any reason why the PCDS is not delivered as required, whether willful or otherwise. *Any* failure to deliver results in the $500 credit.

It is not true that the seller gets no relief from litigation by giving the credit. Giving the credit and denying the purchaser a PCDS deprives the purchaser of a document to use in litigation that could establish a written misrepresentation. If there is no such document, the purchaser must prove a misrepresentation amounting to fraud that is made other than in the PCDS.

As the judge observed, the PCDA makes no express provision of redress for a seller's refusal to give the $500 credit at closing. It logically follows, however, that a purchaser who does not receive the credit can sue for it after the closing as a breach of the statute.

Real Property Transfer Tax and HUD-1

By way of dictum, the judge offered his opinion that the state and city are entitled to collect transfer taxes on the original sale price, not on the price reduced by the $500 credit, because the credit is only given at the closing. I did not initially read the statute that way, but, as a savvy title insurance company attorney observed to me when I raised the question: "As to the state transfer tax, it is a two-dollar problem."[18]

Two different title companies have since informed me that the state takes the same position as the judge. So, my advice is: pay the two dollars. It is much wiser to finesse this issue than to even think about risking a contest on it. It then follows that the $500 credit should be shown on the HUD-1 Settlement Statement as a reduction in the amount due the seller in a line in section 500.

Endnotes

1. *Malach v. Chuang*, N.Y. Civil Court, Richmond County, N.Y.L.J., Jan. 10, 2003.
2. RPL §§ 460-467.
3. This author has studied and written on caveat emptor for many years and participated in the enactment of the PCDA. *See* Holtzschue on Real Estate Contracts § 2.2.11 (PLI); New York Practice Guide: Real Estate § 2.11[5]; "Caveat Emptor" in Warren's Weed New York Real Property (analyzing over 130 cases); Holtzschue, *Disclosure Act: The New $500 Credit Option in Real Property Law*, N.Y.L.J., Nov. 13, 2002; Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 (Winter 2002); Holtzschue, *Caveat Emptor Ain't What It Used to Be: New Developments, Trends and Practice Tips*, 25 N.Y. Real Prop. L.J. 3 (Winter 1997).
4. If the purchasers could have proven that the sellers knew of the defect and lied about it, the purchasers would still have won because they were not shown in this case to have the means to discover it themselves. That purchasers must use means available despite misrepresentation by sellers is firmly established in the New York cases. *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 184 N.Y.S.2d 599 (1959). In the great majority of cases the purchaser has been found to have the means available. Holtzschue on Real Estate Contracts § 2.2.11.1.3.
5. *Stambovsky v. Ackley*, 169 A.D.2d 254, 572 N.Y.S.2d 672 (1st Dep't 1991), which discussed and expressly rejected the Prosser rule. See texts cited, *supra*, note 4.
6. GBL §§ 772 and 774.
7. The use of "may" in the PCDS form, which is meant merely to inform the purchaser, does not cast doubt on the mandatory language of the remedy section of the statute. The judge suggested that the PCDA must be redrafted to achieve the stated purpose of consumer protection. The author believes that the statute is sufficiently clear to be enforceable. Anyone who participated in the original legislative process would probably not welcome a redrafting attempt.
8. RPL § 465(2): "Any seller who provides a property condition disclosure statement . . . shall be liable only for a willful failure to perform the requirements of this article. For such a willful failure, the seller shall be liable for the actual damages suffered by the buyer in addition to any other existing equitable of statutory remedy."
9. Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 (Winter 2002).
10. Neither of which was proven in this case, as the judge noted.
11. One of the problems with this case is that the purchaser was trying to tie the general question about rot in structures to the defective condition of the swimming pool. If there had been a question about material damage to the swimming pool, the purchasers might have had an easier case.
12. Holtzschue, *Disclosure Act: The New $500 Credit Option in Real Property Law*, N.Y.L.J., Nov. 13, 2002. For a contrary prior view that this author believes to be incorrect, *see* Krieger, *Property Condition Disclosure Act: Another Interpretation*, N.Y.L.J., June 27, 2002.
13. RPL § 467.
14. It is conceivable that a PCDS could be expressly incorporated by reference in the contract of sale. Such a move should be rejected by sellers, to prevent a breach of contract claim (including application of the six year contract statute of limitations).
15. Extremely few New York cases have held that the seller has a duty to disclose defects. Compare one of the few, *Young v. Keith*, 112 A.D.2d 625, 492 N.Y.S.2d 489 (3d Dep't 1985) (failure to disclose serious disrepair of water and sewer systems held to be concealment of material fact with intent to defraud) with *Venezia v. Coldwell Banker Sammis Realty*, 704 N.Y.S.2d 663 (2d Dep't 2000) (seller had no duty to speak about contamination of groundwater, even where seller was plaintiff in class action against the polluter!). See also texts in note 3.
16. NYSBA Residential Contract of Sale paragraphs 12 and 28, respectively.
17. *See e.g.*, *Bridger v. Goldsmith*, 143 N.Y. 424, 38 N.E. 458 (1894) (party who perpetrates fraud may not contract for immunity).
18. The rate of the New York State Real Estate Transfer Tax is $2 per $500 of consideration. Tax Law § 1402. The rate of the New York City transfer tax on one- to three-family houses is one percent (in this case, $5), where the price is $500,000 or less (1.425% if more). Tax Law § 1201(b).

Karl B. Holtzschue is an attorney in New York City, a member of the Executive Committee of the Real Property Law Section of the New York State Bar Association, an Adjunct Professor at Fordham Law School, an author of books on real estate and a frequent lecturer.

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Municipal Border Wars—Size Does Matter!

By Joel H. Sachs

A long time ago, a famous actress and performer, Mae West, came up with a clever motto: "Size does matter." Unlike what you may be thinking, Mae West was not referring to something she had seen in an X-rated movie. Rather, Mae was clairvoyant in that she foresaw the coming of the "Big Box" retail store phenomenon in the United States.

There is no real definition of a "Big Box" retail store. Characteristics associated with it are a retail operation occupying over 50,000 square feet, a high sales volume and a low price mark-up. Dean Schwanke of *Urban Land* magazine has categorized Big Box retailers into three sub groups: 1) discount department stores such as Wal-Mart, K-Mart and Target; 2) warehouse clubs such as Sam's, Costco and Price Club, and 3) category killers such as Home Depot, Sports Authority and Barnes & Noble.

In a book entitled *Cities Back from the Edge*,[1] Roberta Brandes Grantz has described category killers. They have, she says, acquired their affectionate nickname because "[t]hey don't mean to compete with existing businesses. They mean to kill them off and monopolize the market."[2] Once the competition is demolished, the store shifts the product mix, increases prices, and reduces the staff. She presents the following retail strategy scenario:

> "Attack" teams are put together for the first few months of operation of a new store. If a new store is meant to operate with 100 employees, the "attack" team will contain 150 and will include friendly, helpful salespeople for the first several months. The first-time shopper at the store has a positive experience and saves money at first. Customers are won early. Local stores close. Some try to reposition themselves to fit a new market.
>
> "Adjust," they are admonished. They try, without access to Wall Street funding or helpful politicians. Some succeed. They change their product mix, emphasize service and specialty goods. Many fail. Some maybe remain in business, but barely.[3]
>
> And as the category killer's smaller competition disappears, the helpful employees also disappear and prices begin to rise. It is important to note that these disposable employees are included in the initial job creation estimates, so the number of long-term jobs is often significantly less than the developers would have the public and its officials believe.
>
> "Variable pricing" is another weapon wielded by the category killers. Such "loss leaders" give the impression of wider price savings. But the car bound nature of such retailers makes comparison-shopping difficult and inconvenient, leaving customers at the store manager's mercy.

In any event, like it nor not, Big Box stores are here to stay. Of utmost concern are the impacts of the Big Box stores on the immediate neighborhood, the municipality and the adjacent municipalities. Most Big Box retailers come to municipalities with promises of significant increases in revenues from both real property taxes and sales taxes. They also bring with them promises of significant new jobs for local residents. At the same time, the character of the community in the immediate vicinity of a Big Box store changes. Traffic congestion almost always follows a Big Box store. Acres of parking are needed to attract customers. Moreover, Big Box stores inevitably harm small local businesses which are either forced to make major adjustments to their merchandising, or in many cases, simply go out of business. Entire downtown areas of many of our older cities have been abandoned as consumers travel to the nether reaches of the municipality in search of bargains at a Big Box.

The positioning of the Big Box retailers is usually at the outskirts of a municipality away from the downtown area, where land is usually more readily available and at lower cost; this obviously has detrimental impacts upon the neighboring municipality. Although the Big Box retailer has promised increased taxes and jobs, these mostly go to the municipality wherein Big Box will be located, not to the neighboring municipality. Accordingly, the other municipality is left with no taxes, fewer jobs, lots of traffic congestion and significant strains on its municipal infrastructure system.

"Entire downtown areas of many of our older cities have been abandoned as consumers travel to the nether reaches of the municipality in search of bargains at a Big Box."

The most significant grievance of the other municipality is having no approval or veto power over a Big Box proposal in a neighboring city, town or village. This leads to frustration which begets intermunicipal warfare—"Border Wars," something which has become all too common in New York state and throughout the country.

The weapons of intermunicipal warfare are many and range from tactics such as closing adjacent streets; blocking utility connections; designating adjacent areas as parks, historic or critical environmental significance; public protests; picketing; and of course, lawsuits and counter lawsuits. The following are four examples to illustrate this point.

IKEA

The City of New Rochelle, in Westchester County, has seen its downtown business district wither. It needs new retailers, a broader tax base and jobs. In the late 1990s, IKEA, a major Swedish furniture retailer, announced that it would open a Big Box store within the City of New Rochelle. However, the location it chose was on the border of the Town of Mamaroneck, a relatively wealthy community which would receive none of the benefits, but most of the adverse impacts of the proposed IKEA store. The proposed IKEA would have over 300,000 square feet of retail space and over 1,600 parking spaces. Again, no permits or approvals were needed from the Town of Mamaroneck, but it would receive all the adverse impacts.

As a result, the Town of Mamaroneck on April 12, 2000 enacted the so-called "Local Impact Review Law" (Local Law No. 4-2000) which requires major project developers in neighboring municipalities to seek approval permits from the Town of Mamaroneck in connection with development proposals that would impact the Town of Mamaroneck. The purpose of the law is set forth as follows:

> Major development projects in areas that abut, adjoin or are adjacent to the Town of Mamaroneck can result in substantial impacts to the streets and areas that surround them within the Town of Mamaroneck, including, but not limited to impacts upon natural resources, noise, traffic, cultural or aesthetic resources, existing patterns of population concentration, and community or neighborhood character. The purpose of this Chapter is to address those impacts and thereby provide for the proper care, management and use of the streets and highways of the Town of Mamaroneck, and the protection, safety, health and well-being of persons and property therein. This Chapter is intended to supersede any provision of the Town Law that is inconsistent herewith.

Shortly after the enactment of the Local Impact Review Law, the inevitable litigation commenced. The City of New Rochelle, home of the proposed IKEA, sued in State Supreme Court to have the law declared unconstitutional. The Town of Mamaroneck had the action removed to Federal Court. The Federal Court remanded the matter back to State Court.[4]

The Mayors of other economically depressed cities within New York state rallied to support the City of New Rochelle, fearful that their municipal neighbors might enact similar laws. Nevertheless, due to overwhelming public pressure from both within and outside of the City of New Rochelle, the Mayor of the city finally asked IKEA to reduce the size of its proposed retail store by some 50,000 square feet, and also to pay for the cost of constructing new access ramps from Interstate Highway 95 (the Connecticut Turnpike) to the proposed store. Somewhat surprisingly, IKEA balked and indicated to the city that it could not afford to comply with both requests. Accordingly, in January 2001, IKEA notified the city that it was withdrawing its development proposal and would seek an alternate location in the Northeast.

As an ironic footnote, in October 2001, the Westchester County Supreme Court invalidated the Town of Mamaroneck's Local Impact Review Law.[5] Although the court's decision was based upon the failure of the town to comply with the requirements of the New York State Environmental Quality Act (SEQRA) the language in the court's decision illustrated the court's feelings towards laws such as the Local Impact Review Law in the Town of Mamaroneck:

> This local law is apparently without precedent in the State of New York. It creates a second environmental review process which requires a permit from the Town Board in order to undertake certain projects in any of the above-named bordering municipalities (Section 130-3, *supra*). On its face, it gives veto power over certain major projects elsewhere unless "the Town Board shall grant a permit upon finding that the impacts associated with the project can be mitigated and that all such mitigation measures have been incorporated into the plan for the project." (Section 130-5, *supra*).
>
> Although this local law in its text does not specify any particular neighboring municipality or any particular proposed development project, the record leaves no doubt that the motivating factor for enacting it was to block the planned construction of an IKEA retail furniture store on 14.9 acres of the 16.4 acres of the Fifth Avenue Urban Renewal Area in the City of New Rochelle.

The proposed IKEA store drew vehement opposition from many especially because of its potential impact on local traffic.

The record also shows that the Town Board did not want to wait until after the possible approval of the IKEA project by the City of New Rochelle to bring a court challenge by way of a CPLR Article 78 Proceeding. The Town Board preferred to act preemptively by enacting this law.[6]

In any event, insofar as the IKEA Big Box proposal in the City of New Rochelle is concerned, may it rest in peace. Now let us turn to another Border War with a very different result.

Stew Leonard's

For those of you who live upstate, Stew Leonard's is the downstate equivalent of Wegman's, a massive supermarket/carnival chain which is a great place to go shopping with the kids. Further, like IKEA, Stew Leonard's demands a huge retail sales area with lots of parking. Several years ago, Stew Leonard's approached the City of Yonkers, in Westchester County, in the hopes of opening its first store in New York state. The City of Yonkers welcomed Stew Leonard's with open arms as well as two other Big Box stores, namely, Home Depot and Costco. All the stores were to be located on a large site in Yonkers, but in close proximity to its border with the Town of Greenburgh, its more affluent neighbor to the north.

At the time of its initial application, the only roads that accessed the site through the City of Yonkers were Austin Avenue and Sprain Road which bisected the site. It was necessary for Yonkers to close the southerly portion of Sprain Road in order to create an integrated site. Further, residents of the Austin Avenue area of Yonkers simply refused to have all vehicular traffic going through their streets, and persuaded the City of Yonkers to dead end Austin Avenue before it reached the site.

Accordingly, the only remaining access roads to the proposed Big Box retail center would be either from the northerly portion of Sprain Road, located in the Town of Greenburgh, or from a New York State Thruway ramp. Not surprisingly, the Town of Greenburgh indicated that it was abandoning and permanently closing Sprain Road, indicating that it did not wish its town road to be the sole municipal artery to receive all traffic going to and from the shopping center.

"If nothing else, Municipal Border Wars have resulted in a bonanza for attorneys."

Needless to say, the road closing by the Town of Greenburgh engendered the inevitable Border War litigation between the City of Yonkers and Greenburgh. After a tentative court settlement was finally reached between Yonkers and Greenburgh allowing the reopening of Sprain Road on a limited basis, another adjacent municipality, the Village of Ardsley, commenced litigation claiming it would be adversely affected by the new traffic patterns arising from the settlement between Greenburgh and Yonkers. The Yonkers and Greenburgh settlement was abrogated by the Appellate Division.[7] As this article is written, the litigation continues. At each court appearance, there are attorneys from the City of Yonkers, the Town of Greenburgh, the Village of Ardsley, the Morris Companies (the developer of the site), Stew Leonard's, Home Depot, Costco, Westchester County and the New York State Thruway Authority. If nothing else, Municipal Border Wars have resulted in a bonanza for attorneys.

Home Depot

Two other Big Box lawsuits are worthy of mention. The Big Box retailer Home Depot had proposed constructing a massive retail store within the Village of Port Chester, a working class community which is directly adjacent to the City of Rye, one of the wealthiest cities in the state. Home Depot's application to construct a 200,000 square foot store on the road that is a boundary between Port Chester and Rye raised numerous concerns by the City of Rye and its residents, including traffic congestion, policing problems, inconsistencies with long range planning goals, loss of neighborhood character, etc. This has led to a number of lawsuits.[8] The most interesting one, *Home Depot USA v. Mayor of the City of Rye*,[9] involved a situation wherein the City of Rye was required to give a ministerial consent to the widening of a county road which abutted the Home Depot site. Although such consents were routinely given to the county by the City Engineer, the City Council—due to the political outcry—decided that it rather than the City Engineer would make the determination whether or not to consent to the road widening. Needless to say, the City Council refused to consent to such ministerial approval.

In a strongly worded decision, Justice James Cowhey of the Westchester County Supreme Court found that the refusal of the City of Rye to sign off on the ministerial highway permit lacked any rational basis and that such conduct was so "outrageously arbitrary as to constitute a gross abuse of governmental authority" and "that Defendant's act was for purely improper political reasons and that such actions constituted a flagrant abuse of political power." Pursuant thereto, the court indicated that Home Depot had successfully established a claim for monetary damages against the City of Rye pursuant to 42 U.S.C. § 1983, the Federal Civil Rights Act, based upon defendant's unconstitutional refusal to approve the highway-widening permit.

Target

One final Border War tale: A proposed Target Big Box retail store on the border of the Village of Pelham, an affluent Westchester County village, and the City of Mount Vernon has engendered no less than 14 lawsuits in an attempt to block the project. All have been unsuccessful.[10] Aside from the usual lawsuits alleging undue traffic congestion, one strategy of the Village of Pelham has been to try blocking the relocation of a county sewer line running through the subject property, which relocation is absolutely necessary in order to construct the Big Box retailer on the site. In an act of utter frustration, the Mayor of the City of Mount Vernon has indicated his municipality is preparing a separate legal action against the Village of Pelham seeking the lost tax revenues that the city has been unable to receive due to four years of legal wrangling over this project.

The stories of these Border Wars could go on and on. However, the point is clear: Whenever a major Big Box retailer seeks to locate in close proximity to another municipality which has different interests, goals and agendas, conflict is sure to result. Each municipality has its own land use, environmental and economic interests. Each municipality is concerned only with its own interests, not with regional interests. Each municipality has its own land use approval and environmental impact review process.

Are there any viable answers to this dilemma? Some commentators have suggested that where a Big Box retailer is being proposed at or near a municipal boundary the two impacted municipalities could enter into intermunicipal agreements which would try to address the impacts of such Big Box retailers in a coordinated manner. Such intermunicipal agreements are specifically provided for in New York.[11] Such intermunicipal agreements could, in theory, call for the creation of joint municipal review boards, the adoption of consistent comprehensive land use plans and the creation of joint programs for land use administration and enforcement. Is it realistic to believe that intermunicipal agreements can be hammered out by the municipal protagonists? It appears doubtful.

Others have suggested that these disputes can only be resolved by mediation or arbitration. An agreement between the two competing municipalities to share the tax benefits of the Big Box retailer and also to share the municipal expenditures necessary to improve the infrastructure that will pave the way for a Big Box retailer are other possible means to solve the problem.

However, assume that your client is the Big Box retailer proposing to locate on the boundary of two municipalities and is caught in the crossfire of a major Border War. Does the client retreat in the way IKEA did in New Rochelle or does it stay and fight the way Stew Leonard's did in Yonkers? Are compromises really possible? One thing is for certain. We can expect more Border Wars throughout New York state and the United States in the coming years. Yes, size does matter!

Endnotes

1. Roberta Brandes Grantz, *Cities Back from the Edge*, (John Wiley & Sons, Inc. 1998).
2. *Id.* at 172.
3. *Id.* at 172–73.
4. *City of New Rochelle v. Town of Mamaroneck*, 111 F. Supp. 2d 353 (S.D.N.Y. 2000).
5. *City of New Rochelle v. Town of Mamaroneck*, N.Y.L.J., Oct. 22, 2001, at 29, col. 1 (2001 N.Y. Slip Op. 404670, 2001).
6. *Id.*
7. *Village of Ardsley v. City of Yonkers*, 264 A.D.2d 517, 694 N.Y.S.2d 724 (2d Dep't 1999).
8. *See, e.g., Home Depot USA, Inc. v. City of Rye*, 259 A.D.2d 547, 684 N.Y.S.2d 908 (2d Dep't 1999).
9. Index No. 5316-97 (Sup. Ct., Westchester Co. 2001).
10. *See, e.g., Pelham Council of Governing Boards v. City of Mount Vernon Industrial Development Agency*, 187 Misc. 2d 444, 720 N.Y.S.2d 786 (Sup. Ct., Westchester Co. 2001) and *Pelham Council of Governing Boards v. City of Mount Vernon*, 186 Misc. 2d 301, 717 N.Y.S.2d 866 (Sup. Ct., Westchester Co. 2000).
11. The General City Law § 20-G, the Town Law § 284 and the Village Law § 7-741.

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Agricultural Districts and Agricultural Assessments

By John E. Blyth

1. Introduction

New York's agricultural district legislation was first adopted in 1971 as Article 25-AA of the Agriculture and Markets Law.[1] Since that time, it has been amended often. Once created, an agricultural district provides numerous "protections" for a farmer. These protections, in turn, may present severe problems for a developer who later attempts to convert the land to a non-farming use, not only from the resultant, sudden increase in real property taxes attributable to the land converted,[2] but also from the other seemingly "developer-friendly" statutes (primarily zoning and environmental) which are trumped by the Agriculture and Markets Law.

After a survey of the legislation surrounding the creation of an agricultural district, attention will be given to some of the problems which this legislation and the accompanying case law present to a real estate developer of land located within such a district.

Adoption of the agricultural district legislation was partially in response to the New York state constitutional mandate[3] to the legislature to provide for the protection of agricultural lands.[4] Since then, agricultural districts and lands with agricultural assessments committed to farming have thrived.[5] Between 1972 and 1996, the number and acreage of agricultural districts in New York state have grown from 19 districts with an area of 171,528 acres to 411 districts with a total of 8.5 million acres.[6]

2. Agricultural Districts

a. Creation of Agricultural Districts

The agricultural district creation process is lengthy, complicated and subject to much review. Initiated by an owner or owners of land,[7] the proposal must be approved by the county legislative body[8] which, after receiving the reports of the county planning board and of the county agricultural and farmland protection board,[9] holds a public hearing, upon notice, into the merits of the proposal.[10] Upon adoption of the plan, the proposal is submitted to the Commissioner of Agriculture and Markets for further review or modification.[11]

The proposal may recommend an appropriate review period of either eight, twelve or twenty years.[12]

> *"The agricultural district creation process is lengthy, complicated and subject to much review."*

Upon the creation of an agricultural district, the description thereof—which shall include tax map identification numbers for all parcels within the district in relation to tax parcel boundaries—is filed by the county legislative body with the county clerk, the county director of real property tax services and the Commissioner.[13]

b. Effects of Agricultural Districts

(1) Land Used in Agricultural Production

Any owner of land used in agricultural production[14] within an agricultural district is eligible for an agricultural assessment.[15] If an applicant rents land from another for use in conjunction with the applicant's land for the production and sale of crops, livestock or livestock products, the gross sales value of such products produced on such rented land is added to the gross sales value of such products produced on the land of the applicant for purposes of determining eligibility for an agricultural assessment on the land of the applicant.[16]

(2) Taxation of Land Used in Agricultural Production

The portion of the value of land utilized for agricultural production within an agricultural district which represents an excess above the agricultural assessment is not subject to real property taxation.[17] Such excess amount is entered on the assessment roll in the manner prescribed by the Office of Real Property Services.[18]

c. Conversion[19] and Roll-Back Payment

If land within an agricultural district which received an agricultural assessment is converted into a non-agricultural use, the land so converted shall be subject to payments equaling five (5) times the taxes saved in the last year which the land benefitted from an agricultural assessment, plus six percent (6%) interest per year compounded annually for each year which an agricultural assessment was granted, not exceeding five (5) years. The amount of taxes saved for the last year in which the land benefitted from an agricultural assessment shall be determined by applying the applicable tax rates to the excess amount of assessed valuation of such land over its agricultural assessment as set forth on the last assessment roll which indicates such an excess. If only a portion of the parcel as described on the assessment roll is converted, the assessor shall apportion the assessment and agricultural assessment attributable to the converted portion, as determined by the last assessment roll for which the assessment of such portion exceeded its agricultural assessment. The difference between the apportioned assessment and the apportioned agricultural assessment shall be the amount upon which payments shall be determined.[20]

d. Who Pays Upon Conversion and Roll-Back?

Logic would dictate that the person who has had the benefits of reduced real property taxes during the period when his or her farmlands were in an agricultural district should bear the risk of payment upon a conversion and roll-back. The statute does not, however, support that position.

Payment of the roll-back is imposed upon the new owner of the converted farmland.[21] Real property taxes are imposed upon the land, not upon the owners of land.[22] An assessor who determines that there is liability for payments and penalties is required to notify the landowner (now the buyer and not the seller) of such liability at least ten (10) days prior to the date for hearing complaints in relation to assessments (i.e., grievance day).[23]

Section 310 of the Agriculture and Markets Law requires a seller of lands within an agricultural district to make disclosure—when any purchase and sale contract is presented for the sale, purchase or exchange of that land—that the land is being used for agricultural purposes and that the farming activities may cause noise, dust and odors (*see* Section 3.b., *infra*). This disclosure duty does not, however, extend to any payment or penalty of taxes attributable to a conversion of the land from an agricultural to a non-agricultural use.

Although not specifically stated in the statute, the obligation to pay presumably may be shifted by agreement between the seller and the buyer.

The obligation to notify the assessor of a conversion lies with the owner. Such notification must be made within 90 days of the conversion, and the failure of the landowner to make such notification subjects the owner to a penalty.[24]

However, if an agricultural district is abolished, all responsibility ceases for maintaining land formerly within the district in an agricultural state and no roll-back may be levied.[25]

e. Agricultural Lands Outside of Districts; Agricultural Assessments

An owner of land used in agricultural production outside of an agricultural district may also be eligible for an agricultural assessment even though the land is not located in an agricultural district. The owner must satisfy the requirements of § 305 (a), (b) and (f),[26] which are similar to the requirements for setting up an agricultural district under § 306.

If the land which received an agricultural assessment is converted at any time within eight (8) years from the time an agricultural assessment was last received, such conversion shall subject the land converted to payments as compensation for the prior benefits of agricultural assessments.[27] If any part of the land is converted from such agricultural production during the statutory period, such conversion constitutes a breach of the commitment, disqualifying all of the land subject to the commitment from being entitled to an agricultural value assessment and imposing penalties.[28]

The amount of the payments shall be equal to five (5) times the taxes saved in the last year in which the land benefitted from an agricultural assessment, plus interest of six percent (6%) per year compounded annually for each year in which an agricultural assessment was granted, not exceeding five years.[29] A penalty levied pursuant to § 306 is a lien on the entire parcel containing the converted land, even if less than the entire parcel was converted.[30]

3. Agriculture and Markets Law Trumps Other Laws

a. Restrictive Local Laws and Ordinances; the Right to Farm Law

Local governments may not enact ordinances that would restrict or regulate farm structures or farm practices within a district beyond the requirements of health and safety.[31] This means that a municipality cannot prohibit a farmer from spreading manure as he sees fit, provided the farmer follows "sound agricultural practices."[32] Such an agricultural practice does not constitute a private nuisance[33] and the farmer's manure management program does not have to comply with the State Environmental Quality Review Act.[34] Presumably, a farmer could also, with impunity, run a high speed sprayer at 5:00 AM if he or she chooses.

Town of Lysander v. Hafner[35] illustrates the point concerning the right to farm. Defendants owned and operated a commercial farm in the Town of Lysander in an agricultural district created pursuant to § 303. In 1999, defendants attempted to install several mobile homes for housing migrant workers on the farm. The mobile homes did not comply with a town zoning ordinance requiring that all one-story single family dwellings have a minimum living area of 1,100 square feet. Citing § 305(a)(1)(a) to the effect that local governments shall not unreasonably restrict or regulate farm operations within agricultural districts, the Court of Appeals held that the defendants may permit migrant workers to use the mobile home without obtaining the otherwise necessary building permits from the Town. In doing so, the Court of Appeals reversed both the Supreme Court and the Appellate Division.[36]

b. Disclosure

Since 1992, when any purchase and sale contract is presented for the sale, purchase or exchange of real property located partially or wholly within an agricultural district, the prospective grantor shall present to the prospective grantee a disclosure notice which informs prospective residents that the property they are about to acquire lies partially or wholly within an agricultural district and that farming activities occur within the district. Such farming activities may include, but not be limited to, activities that cause noise, dust and odors. Prospective residents are also informed that the location of property within an agricultural district may impact the ability to access water and/or sewer services for such property under certain circumstances.[37]

b. Other Exemptions

Members of the NYSBA Environmental Law Section have assembled a list of agricultural exemptions from environmental laws and regulations. They include Environmental Impact Review (SEQRA); Private Nuisance Actions; Water Pollution Control; Wetlands, Streams and Watercourses; Mined Land Reclamation; Hazardous Substance/Petroleum Remediation/Waste Disposal and Air Pollution.[38] Neal D. Madden, Esq., has also outlined the Impact of Environmental Laws and Regulations on New York Agriculture.[39]

4. Discovering Agricultural Districts and Lands Subject to Agricultural Assessments

As indicated above, upon creation, a description of the agricultural district (an "ag commitment" in the vernacular) or of lands receiving an agricultural assessment must be filed with the local county clerk.[40] That filing should be picked up by a title company in the course of its searching the records and should therefore be apparent to the title examiner. Additionally, the Real Property Transfer Report Form RP-5217 contains a box to be checked if the property is located within an agricultural district and if the buyer received a disclosure notice indicating that the property is in an agricultural district.

Local title companies report, however, that renewals and extensions of those filings by the county have not been prevalent in the last few years. As a consequence, a title company employee may well assume that the designation has lapsed and, therefore, will not include the designation in the search.

Another and perhaps better way of detecting the presence of an agricultural district and of lands subject to agricultural assessments is by means of a tax search. If there is one, a searcher will note the district number on the tax search.

The problem, however, is that lawyers (and brokers who prepare purchase and sale agreements subject to attorney approval) often do not have the benefit of a redated abstract of title, a preliminary title report or a current tax search with respect to a given parcel of land. Therefore, they may be ignorant of the agricultural classification in effect.

The statutory right to farm, guaranteed by the Agriculture and Markets Law, permits activities that cause noise, dust and odors, sometimes objectionable to those who do not have a right to farm, and requires a seller to disclose those activities to a buyer. The real estate developer, however, must look further. Agricultural districts present unexpected surprises, particularly in the areas of real property taxation, zoning and environmental uses.

Endnotes

1. Agriculture and Markets Law §§ 300-310, earlier referred to as the Agricultural Districts Law.

2. According to unpublished data, agricultural assessments allow farmland owners to save about $50 million in property tax payments each year, approaching 25 percent of the New York farm real estate tax bill. Nelson Bills and Jeremiah Cosgrove, Agricultural and Farmland Protection Boards, http://www.cardi.cornell.edu/research_briefs/CDR6-2.cfm.

3. N.Y. Const. art. 14, § 4 provides in pertinent part:

   "The policy of the state shall be to . . . encourage the development and improvement of its agricultural lands for the production of food and other agricultural products. The legislature, in implementing this policy, shall include adequate provision for the . . . protection of agricultural lands. . . ." (Effective January 1, 1970).

4. It is hereby found that many of the agricultural lands in New York state are in jeopardy of being lost for any agricultural purposes. When non-agricultural development extends into farm areas, competition for limited land resources results. Ordinances inhibiting farming tend to follow, farm taxes rise and hopes for speculative gains discourage investments in farm improvements, often leading to the idling or conversion of potentially productive agricultural land.

   The socioeconomic vitality of agriculture in this state is essential to the economic stability and growth of many local communities and the state as a whole. It is, therefore, the declared policy of the state to conserve, protect and encourage the development and improvement of its agricultural land for production of food and other agricultural products. It is also the declared policy of the state to conserve and protect agricultural lands as valued natural and ecological resources which provide needed open spaces for clean air sheds, as well as for aesthetic purposes.

   The Constitution of the State of New York directs the Legislature to provide for the protection of agricultural lands. It is the purpose of this article to provide a locally initiated mechanism for the protection and enhancement of New York state's agricultural land as a viable segment of the local and state economies and as an economic and environmental resource of major importance. Agric. & Mkts. § 300 (this version of § 300 repealed former § 300 and became effective on March 1, 1988.)

   This policy is also extended to state agencies: It shall be the policy of all state agencies to encourage the maintenance of viable farming in agricultural districts and their administrative regulations and procedures shall be modified to this end insofar as is consistent with the promotion of public health and safety and with the provisions of any federal statutes, standards, criteria, rules, regulations or policies, and any other requirements of federal agencies, including provisions applicable only to obtaining federal grants, loans or other funding. Agric. & Mkts. § 305(3).

5. From 1970 to 2000, state legislatures across the country actively pursued an agenda intended to address the needs of the agricultural economy. Individually, these measures were motivated by a

variety of objectives that address specific problems or issues affecting the ability of agricultural enterprises to achieve profitable operation. These measures include (i) assistance in dealing with real estate taxes, (ii) the creation of agricultural districts, (iii) commitment to future agricultural use through the sale of an agricultural conservation easement, (iv) protecting agricultural operations from nuisance suits and ordinances, (v) regulating land application of nutrients and (vi) coordinating agricultural preservation measures with land use planning measures. John C. Becker, *Promoting Agricultural Development Through Land Use Planning Limits*, 36 Real Prop. Prob. & Tr. J. 619 (Winter 2002). In addition, cluster zoning with a conservation subdivision (a form of zoning that allows houses to be built close together in areas where large minimum lot sizes are generally required) and purchasing development rights (PDR) serve the same objectives. New York State has established an Agricultural and Farmland Protection Implementation Program which provides 75% of the cost of eligible PDR projects. Http://www.saratogafarms.com/agriculture5.htm.

There are a total of 18 agricultural district laws in 16 states. In 1965, California enacted the California Land Conservation Act to preserve agricultural land and open space and to promote efficient urban patterns (the "Williamson Act"). American Farmland Trust—Farmland Information Center, Farmland Information Library. http://www.farmlandinfo.org.

6. http://www.geocities.com/rural_urban/agzoneprograms.html.

7. The Commissioner may also create agricultural districts covering any land in units of 2,000 or more acres not already districted under Agric. & Mkts. § 303 if (a) the land encompassed in a proposed district is predominately unique and irreplaceable agricultural land; (b) the Commissioner of Environmental Conservation has determined that such district would further State environmental plans, policies and objectives and (c) the Director of the Division of the Budget has given approval of the establishment of such area. Agric. & Mkts. § 304 (1). A map of the created district is filed by the Commissioner with the county clerk of each county in which the district or a portion thereof is located and publication of such filing shall be made in a newspaper of general circulation within the district to be created. *Id*. at § 304(3). The district must be reviewed every eight-, twelve-, or twenty-year period after creation. *Id*. at § 304(4). In the case of an agricultural district created pursuant to § 304, the state shall provide assistance to each taxing jurisdiction in an amount equal to one-half of the tax loss that results from requests for agricultural assessments in the district. Agric. & Mkts. § 305(1)(e).

8. Agric. & Mkts. § 303(1). The owner or owners must own at least five hundred acres or at least ten percent (10%) of the land proposed to be included in the district, whichever is greater. *Id*.

9. Agric. & Mkts. § 303(4). The county agricultural and farmland protection board, consisting of eleven members, at least four of whom shall be active farmers, is established by a county legislative body. Agric. & Mkts. § 302(1).

10. Agric. & Mkts. § 303(2).

11. Agric. & Mkts. § 303(4).

12. Agric. & Mkts. § 303(1).

13. Agric. & Mkts. § 303(7).

14. "Land used in agricultural production" means not less than ten acres of land used as a single operation in the preceding two years for the production for sale of crops, livestock or livestock products of an average gross sales value of $10,000 or more; or, not less than ten acres of land used in the preceding two years to support a commercial horse-boarding operation with annual gross receipts of $10,000 or more, subject to the approval of the county legislative body. Land used in agricultural production shall not include land or portions thereof used for processing or retail merchandising of such crops, livestock or livestock products. Land used in agricultural production includes a variety of other enumerated uses. Agric. & Mkts. § 301(4).

15. Agric. & Mkts. § 305(1). Land used in agricultural production shall be assessed and taxed in the manner provided by Article 25-AA of the Agriculture and Markets Law. Real Property Tax Law § 481. The exemption from taxation of structures and buildings essential to the operation of agricultural and horticultural lands is governed by Real Property Tax Law § 483 and is subject to the interpretation of much statutory language.

    Portions of a farm used for marketing farm products or an agricultural amusement center (comprised of hay bale maze and pet feeding area) do not qualify for agricultural assessment. However, portions used as a "corn maze" may qualify, provided the corn is eventually harvested and marketed in the same manner as other crops. 10 Op. Counsel SBRPS No. 13.

16. Agric. & Mkts. § 305(1)(a).

17. The intent of the law is to provide an agricultural value assessment for lands devoted to agricultural production. Data is (sic.) gathered from all available sources to compute annually an average agricultural value per acre on a county-wide basis. The difference between this value and the standard market value assessment, if higher, is treated as exempt for taxation purposes. 4 Op. Counsel SBEA No. 32.

18. Agric. & Mkts. § 305(1)(b). The exemption from taxation includes an exemption for school district taxes. 3 Op. Counsel SBEA No. 33.

19. "Conversion" means an outward or affirmative act changing the use of agricultural land and shall not mean the non-use or idling of such land. Agric. & Mkts. § 301(8). The mere filing of a subdivision plan did not constitute conversion of agricultural property to a non-agricultural use. A triable issue of fact was present whether clearing fruit trees from the parcel and marking the lots effected a sufficient change in the use of the parcel so that it could no longer be used for agricultural production. *Pezzo v. Mazzetti*, 202 A.D.2d 935, 609 N.Y.S.2d 699 (3d Dep't 1994). Where the owner complied with the statutory requirements for classification as an agricultural tax parcel, the assessor could not add additional requirements, *viz.*, that horse boarding be a year-round activity or that it be open to the public. *Lufkin v. Assessor of the Town of Washington*, 185 Misc. 2d 779, 713 N.Y.S.2d 914 (Dutchess Co., Sup. Ct. 2000). *Accord*, 8 Op. Counsel SBEA No. 67 (August 1, 1985).

    Land within an agricultural district and eligible for an agricultural assessment shall not be considered to have been converted to a use other than for agricultural production solely due to the conveyance of oil and gas rights associated with that land. Agric. & Mkts. § 305(1)(d)(iv).

    The purchase of land in fee by the City of New York for watershed protection purposes for the conveyance of a conservation easement by the City of New York to the Department of Environmental Conservation, which prohibits future use of the land for agricultural purposes, shall not be a conversion of parcels and no payment is due. Agric. & Mkts. § 305(1)(d)(vii).

    The owner of a farm was not entitled to a property tax exemption with respect to a thirty-nine (39) acre non-contiguous parcel where he ceased using it for farming because he no longer had practical access to it from the destruction of the town bridge which had connected it to the main parcel which was used for farming. It was immaterial that the land could no longer be farmed because the town had decided not to repair the bridge. *VanNorstrand v. Board of Assessors*, 139 A.D.2d 790, 526 N.Y.S.2d 664 (3d Dep't 1988).

20. Agric. & Mkts. § 305(1)(d)(i).

21. Although land was converted to a non-agricultural use in 1989, any rollback

penalty taxes should have been calculated and assessed on the 1990 tax roll. That assessment did not automatically take place because fact issues existed as to whether the clearing of some or all of the fruit trees on the property, together with the marking of lots, effected sufficient change in use of the lots that they could no longer be used for agricultural production and thus whether they could be deemed to have been converted from agricultural use to non-agricultural use. *Pezzo v. Mazzetti*, 202 A.D.2d 935, 609 N.Y.S.2d 699 (3d Dep't 1994).

22. Payments shall be added by or on behalf of each taxing jurisdiction to the taxes levied on the assessment roll prepared on the basis of the first taxable status date on which the assessor considers the land to have been converted. Agric. & Mkts. § 305 (1)(d)(i). The property is liable for the payments for conversion. 8 Op. Counsel SBEA No. 109, overruled in part, 10 Op. Counsel SBRPS No. 36.
23. Agric. & Mkts. § 305(1)(d)(iii)(a). Failure to provide such notice shall not affect the levy, collection, enforcement or payment of payments. *Id*.
24. Agric. & Mkts. § 305(1)(d)(ii).
25. 4 Op. Counsel SBEA No. 88.
26. Agric. & Mkts. § 306(1).
27. Agric. & Mkts. § 306(1). An owner of land who has committed to an eight-year period must file a new eight-year commitment at the end of the first eight-year period in order to have the assessment continued. 4 Op. Counsel SBEA No. 13.
28. Agric. & Mkts. § 306(2). Where the agricultural value assessment has been granted by the assessor and a conversion of the property from agricultural to other uses follows, then the penalties set forth in the statute would apply. Such is not the case where the assessor never granted the agricultural assessment. *Sidnam v. Town of Lewisboro*, 129 Misc.2d 622, 493 N.Y.S.2d 725 (Sup. Ct., Westchester Co. 1985).
29. Agric. & Mkts. § 306(2).
30. Agric. & Mkts. § 306(4).
31. Agric. & Mkts. § 308.
32. Agric. & Mkts. § 308(1)(b). Since June 1998, the Commissioner has issued sixteen formal opinions regarding sound agricultural practices. file:\\C:\Cornell\Agricultural20%and20%Farmland%Protection%Boards.html.
33. Agric. & Mkts. § 308(3).
34. *Pure Air & Water, Inc. v. Davidson*, 246 A.D.2d 786, 668 N.Y.S.2d 248 (3d Dep't 1998), *appeal dismissed without opinion*, 91 N.Y.2d, 671 N.Y.S.2d 716, 694 N.E.2d 885 (1998), and *appeal denied*, 92 N.Y.2d 807, 678 N.Y.S.2d 593, 700 N.E.2d 1229 (1998), and *appeal dismissed*, 93 N.Y.2d 1013, 697 N.Y.S.2d (1999).
35. 96 N.Y.2d 558, 733 N.Y.S.2d 358, 759 N.E.2d 356 (2001).
36. This case is at variance with *Town of Beckman v. Sherman*, 213 A.D.2d 627, 624 N.Y.S.2d 951 (2d Dep't 1995), holding that § 305(2) did not exempt property owners from any and all zoning regulations as to their addition of structures to farm, arguing that the structure at issue (mobile home) was a "farm structure."
37. Agric. & Mkts. § 310.
38. The same group has also prepared a list of Land Use and Environmental Laws Applicable to Agriculture. Peter G. Ruppar, Larry Weintraub and Thomas M. Shephard, New York State Bar Association, Environmental Law Section, Agricultural Environmental Law Task Force, http://www.nysba.orga/sections/environ/committees/agriculturerural/ag.outline.exemptions.html. (November 9, 1999).
39. *Business, Tax and Estate Planning for the Agricultural Client*, NYSBA CLE (May 1995).
40. Agric. & Mkts. § 303(7).

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Palazzolo v. Rhode Island The Supreme Court Opens the "Takings" Door a Bit Wider

By Karl S. Essler

Introduction

Palazzolo v. Rhode Island[1] has caused quite a stir in the land use area. Although it is too early to tell what the ramifications of the decision will be on the practice of land use and zoning law in New York state, the decision appears to have significantly altered the long-standing New York principle that a preexisting land use regulation bars a subsequent purchaser from bringing a regulatory takings claim. It remains to be seen, however, just how broad the practical impact of this decision will be.

Facts

Palazzolo involves the regulation of coastal property by the Rhode Island Coastal Resources Management Council (Council). In 1959, Petitioner and his associates, as Shore Gardens, Inc. (SGI), acquired title to approximately 20 acres of coastal property located in the Town of Westerly, most of which is salt marsh subject to tidal flooding. Soon after the acquisition, Petitioner bought out his associates and became the sole shareholder of SGI. In the first decade of SGI's ownership, the corporation made intermittent applications to various state agencies for approvals to fill the property. One such proposal submitted to the Town of Westerly in 1962 was to subdivide the property into 80 lots for sale as single-family residences.[2] The corporation proposed filling the entire 20 acres in order to achieve this development. The application was denied for lack of essential information. A year later, SGI resubmitted essentially the same application, and in 1966, while that application was still pending, it submitted another application calling for a more limited filling of the property for a private beach club. Both of these applications received initial approval from the Rhode Island Department of Natural Resources; however, the agency later withdrew approval citing adverse environmental impacts. SGI did not challenge this determination.

> *"It remains to be seen, however, just how broad the practical impact of this decision will be."*

After the 1966 application, no further attempts to develop the property were made for over a decade. During that time, two significant events occurred. First, in 1971, Rhode Island enacted legislation creating the Council, an agency charged with the duty of protecting the state's coastal properties, which in turn promulgated regulations severely restricting the ability to develop the coastal portion of Petitioner's property. Second, in 1978, SGI's corporate charter was revoked for failure to pay corporate income taxes, causing the property to pass to Petitioner as the corporation's sole shareholder.

In 1983, Petitioner renewed efforts to develop the property. An application to the Council resembling the 1962 application sought permission to fill the entire marsh land area. The Council rejected the application noting it was "vague and inadequate for a project of this size and nature." Petitioner did not appeal the agency's determination.

Petitioner made a more specific and limited proposal in 1985. The new application sought to fill 11 acres of the property to construct a private beach club. Under the agency's regulations, a landowner wishing to fill salt marsh in this area needed a "special exception" from the Council. In a short opinion the Council said the beach club proposal conflicted with the regulatory standard for a special exception. In order to secure a special exception, the proposed activity must serve "a compelling public purpose which provides benefits to the public as a whole as opposed to individual or private interests." At this point, Petitioner appealed the ruling to the Rhode Island courts, challenging the decision as contrary to principles of state administrative law. The Council's decision was affirmed.

Petitioner also filed an inverse condemnation action in Rhode Island Superior Court, asserting that the state's wetlands regulations, as applied by the Council to his parcel, had taken the property without compensation in violation of the Fifth and Fourteenth Amendments. The suit alleged the Council's action deprived him of "all economically beneficial use" of his property, resulting in a total taking requiring compensation under *Lucas v. South Carolina Coastal Council*[3] and sought damages in the amount of $3.15 million. This figure was arrived at from an appraiser's estimate as to the value of a 74-lot residential subdivision. The Superior Court ruled against Petitioner. The Rhode Island Supreme Court affirmed, holding that: (1) Petitioner's takings claim was not ripe; (2) Petitioner had no right to challenge regulations predating 1978 when he succeeded to legal ownership of the property from SGI; and (3) the claim of deprivation of all economically beneficial use was contradicted by undisputed evidence that he had $200,000 in development value remaining on an upland portion of the property. In addition, the court concluded that Petitioner could not recover under the more general test for a regulatory taking under *Penn Central Transportation Co. v. City of New York*.[4] On the *Penn Central* claim, the date of acquisition of the parcel was found determinative and the Court held that Petitioner had "no reasonable investment-backed expectations that were affected by this regulation" because it pre-dated ownership.

The Supreme Court of the United States granted certiorari and, in a 5-4 decision, overruled the Rhode Island Supreme Court on the first two points (ripeness and regulations predating ownership); found that Petitioner was not deprived of all economic use of his property because the value of the upland portion was substantial, and thus could not establish a *Lucas*-type claim; and remanded for further consideration of the claim under the principles set forth in *Penn Central*.

Discussion

The Takings Clause of the Fifth Amendment, applicable to the states through the Fourteenth Amendment, prohibits the government from taking private property for public use without just compensation. The clearest taking occurs when government encroaches on or physically occupies private land for its own purpose. However, *Pennsylvania Coal Co. v. Mahon*[5] recognized that a taking may occur in instances where government actions do not encroach upon or occupy property, yet still affect and limit its use to such an extent that a taking occurs. One clear example of this is when a regulation denies all economically beneficial or productive use of land.[6] However, where a regulation places limitations on land that fall short of eliminating all economically beneficial use, a taking nonetheless may have occurred, depending on a number of factors including the regulation's economic effect on the landowner, the extent to which the regulation interferes with reasonable investment-backed expectations and the character of the government action.[7]

1. Whether Petitioner's claim was ripe

Much of the *Palazzolo* decision deals with whether the claim was ripe for review. In *Williamson County Regional Planning Comm'n v. Hamilton Bank of Johnson City*,[8] the Court held that a takings claim challenging the application of land use regulations is not ripe unless the government entity charged with implementing the regulations has reached a final decision regarding the application of the regulations to the property at issue. A final decision by the responsible state agency informs the constitutional determination whether a regulation has deprived a landowner of all economically beneficial use of the property, or defeated the reasonable investment-backed expectations of the landowner to the extent that a taking has occurred. These matters cannot be resolved in definitive terms until a court knows "the extent of permitted development" on the land in question.[9]

Much of the debate over whether the issue was ripe for adjudication focused on whether the Council's denial of Petitioner's plan was a final decision indicating that no less intense development would be considered. While a landowner must give a land use authority an opportunity to exercise its discretion, once it becomes clear that the agency lacks the discretion to permit any development, or the permissible uses of the property are known to a reasonable degree of certainty, a takings claim is likely to have ripened. The majority found that the Council left no doubt as to whether Petitioner would be allowed to fill any portion of the property. Given the regulatory requirement for a "compelling public purpose which provides benefits to the public as a whole," the majority concluded that it was clear there could be no fill for any ordinary private land use; no fill for a beach club; no fill for a subdivision; and no fill for any likely or foreseeable use. The dissent felt that further applications were necessary to determine to what extent the Council might allow development on this property.

The debate on this issue brings up an interesting point of whether an agency must provide some guidance to an applicant when denying a land use application as to whether any less intense development would be permitted. If a 74-lot subdivision is unacceptable, should an agency be in the position of providing guidance to an applicant that a 40-lot subdivision would be permitted? Or in the alternative, should an applicant be forced to bring numerous applications (an expensive process to say the least) and have each one denied before he may gain access to the courts on a takings claim? This is just one of a number of difficult issues brought to light (but hardly resolved) as a result of this decision. The majority, at least, seems inclined to lessen the ripeness burden where it is fairly clear that further applications are futile.

2. The effect of pre-existing regulations on a takings claim

For most land use practitioners and legal commentators, this issue is the most widely discussed aspect of the *Palazzolo* decision. Many states, including New York, have long followed the rule that postregulation acquisition of title was fatal both to the claim for deprivation of all economic use (a *Lucas* claim) and to a *Penn Central* claim for significant economic loss. The logic behind this rule is that property rights are created by the State. Therefore, by prospective legislation the State can shape and define property rights and reasonable investment-backed expectations. Thus, a purchaser or successive title holder is deemed to have notice of an earlier-enacted restriction and to have taken that restriction into account in acquiring the property, and is therefore barred from claiming that it effects a taking due to a loss in value. The Supreme Court's simple answer to this reasoning, and surely the most quotable language of this decision is that, "The State may not put so potent a Hobbesian stick into the Lockean bundle."[10]

The right to improve property is subject to the exercise of reasonable state authority, including zoning and land use restrictions. However, in the majority's view, enactments that are unreasonable, or beyond the scope of the police power, do not become any less so through the passage of time or title. To rule otherwise "would absolve the State of its obligation to defend any action restricting land use, no matter how extreme or unreasonable," provided that title to the property has passed from the original owner.[11] The Court concluded that this would put an expiration date on the Takings Clause, thereby depriving future generations of the right to challenge unreasonable limitations on the use and value of land. Another area of concern driving the Court's decision was the time involved with ripening a takings claim and the ability to fully adjudicate it in the judicial system. An owner with a ripe takings claim could potentially die, thereby causing title to pass to his heirs who would then have no right to pursue the claim given that they took title subject to, and with prior notice of, the offending restriction.

On this issue, only Justice Stevens specifically dissented. He based his dissent on the rather technical view that the taking occurs at the moment the regulation which deprives the property of value goes into effect, and therefore any damage claim resulting from the taking belongs exclusively to the owner at that time. Justice Stevens apparently assumed, without explaining why, that a subsequent transfer of title would or could *not* also include a transfer of the right to challenge the taking. The principal dissent, authored by Justice Ginsburg, addressed only the ripeness issue and offered no opinion on the rights of a subsequent owner to assert a takings claim. Justice Breyer, however, wrote a separate dissent in which he noted his agreement with Justice O'Connor that a transfer should not automatically bar a takings claim, but should be a factor to be considered in a *Penn Central* analysis.[12]

As stated previously, New York has long adhered to the rule that a prior restriction bars a subsequent purchaser from recovering under a takings analysis. In *Annello v. Zoning Bd. of Appeals*,[13] the Court of Appeals denied the Petitioner's takings claim that the village's steep-slope ordinance constituted a taking as applied to her property because it restricted the size of the lot upon which a single-family house could be built to 4,200 square feet where the ordinance required a minimum of 5,000 square feet. The Zoning Board's denial of a request for a variance was upheld because the steep-slope ordinance was in effect for two (2) years prior to Petitioner's purchase of the property.

Gazza v. New York State Department of Environmental Conservation[14] involved the denial of an application for a tidal wetlands permit to build a single-family home on a residentially zoned property. Findings made by the Court of Appeals showed that Petitioner paid $100,000 for the property with the full knowledge that a single-family residence would require setback variances due to the proximity of any house to the wetlands. The value of the property with the single-family residence would have been approximately $396,000. The Court concluded that despite being denied a variance, Petitioner had no investment-backed expectation that a single-family home would be permitted on the property. Furthermore, due to the fact that the tidal wetland regulations existed prior to Petitioner taking title to the property, the regulatory limitation was a pre-existing limitation on Petitioner's title. Therefore, Petitioner never had any interest in the property regulated by the wetlands restrictions and could not challenge such regulations as a taking.

Kim v. City of New York[15] involved a long-standing common law rule and a provision of the City Charter requiring property owners to maintain lateral support for a public highway. Since the rule was in place prior to Petitioner's acquisition of title, the City's subsequent enforcement of the obligation by depositing fill on Petitioner's property along the highway did not constitute an unconstitutional taking. Petitioner's title never encompassed the property interest that he claims had been taken. Again, the fact that the restriction existed prior to Kim's purchase of the property was one of the determining factors in the denial of his takings claim.

2a. The O'Connor-Scalia Debate

Justices O'Connor and Scalia filed concurring opinions in an effort to further define the effect of a preexisting land use restriction on a subsequent purchaser in a takings analysis. Justice O'Connor clearly indicated that, although a preexisting restriction does not necessarily preclude a takings claim, it is one factor that should be considered in the *Penn Central* analysis.[16] Her reasoning is that the regulatory scheme in place at the time of acquisition of title plays an important role in defining the investment-backed expectations of the purchaser. Thus, a speculating developer may purchase property at a reduced price due to the regulatory scheme in place, and later claim a taking and reap a windfall if successful. Justice O'Connor's view would take into account the regulations in place at the time of purchase in order to prevent this particular scenario. As noted above, Justice Breyer, in his dissent on the ripeness issue, specifically espoused Justice O'Connor's view on the subsequent owner issue.

Justice Scalia took the opposite view that a preexisting regulation is never a bar on a subsequent owner from pursuing a takings claim and should be given no weight whatsoever. If a taking exists, the transfer of title, in his view, does nothing to change that fact. That the potential exists for a more knowledgeable and risk-prone developer to purchase property at a reduced price due to an imposed restriction, and later develop the property to its full potential after successfully challenging what is actually an invalid restriction, is merely the result of market forces where those with superior knowledge and desire to take greater risks are rewarded for their ingenuity. Justice Scalia finds it patently unfair to reward government which is the only party in the transaction that has acted illegally by placing the restriction on the property in the first place.

Given the two concurring opinions in this case, and the silence of the rest of the majority on this point, it is not entirely clear what, if any, role that preexisting land use restrictions will have on a subsequent purchaser takings claim. It is interesting to note that Palazzolo himself acquired title by operation of law, and not by purchase. It may be that, other than Justice Scalia, other members of the Court would not be so sympathetic to a subsequent purchaser who made a conscious investment decision with knowledge of the existing land use restrictions. It is safe to say at a minimum that a preexisting restriction does not per se prevent a subsequent purchaser from pursuing a takings claim, and that indeed is a departure from existing New York law.

3. Failure to show that the regulation denies all economically beneficial or productive use of Petitioner's land

Although Petitioner cleared some major obstacles in this case, the fact remains that the Court agreed with the Rhode Island Supreme Court that Petitioner's claim fails under the *Lucas* analysis. A portion of Petitioner's 20-acre parcel is considered "upland" upon which Petitioner would have received permission from the Council to construct a single-family home which would have a value of approximately $200,000. Thus, the Court concurred with the lower court decision that Petitioner was not denied all economically beneficial or productive use of his land.

4. Remand for further analysis under *Penn Central*

The Court remanded the case back to the Rhode Island Supreme Court for further analysis of whether Petitioner's claim meets the criteria for a taking under the *Penn Central* analysis (i.e., the regulation's economic effect on the landowner, the extent to which the regulation interferes with reasonable investment-backed expectations, and the character of the government action and presumably, if Justice O'Connor has her way, the effect of the land use restrictions prior to acquisition of title). At the time of this writing, the last entry found in the online database is an Order from the Rhode Island Supreme Court directing the parties to brief the following issues:

a) the need for a survey of the Palazzolo property in respect to that portion thereof which is below the mean high water line in tidal effect;

b) information regarding the initial purchase price of the property by Shore Gardens, Inc.;

c) the proceeds and/or other consideration received by SGI when six of the parcels were sold from the original lands purchased;

d) the relevance of the Public Trust Doctrine as described in *Greater Providence Chamber of Commerce v. Rhode Island*[17] to the reasonable investment-backed expectations of plaintiff Palazzolo.

5. The denominator question

A key element of the takings analysis is defining the relevant parcel of property allegedly "taken" by the government. The Court has consistently held to the theory that they look at "the parcel as a whole."[18] However, the issue of what constitutes the whole parcel has not been clearly defined and continues to be a point of contention.

Petitioner sought to revive his argument that the approximately 2 acres located in the upland area was a separate and distinct parcel from the remaining 18 acres. Although the Court did not address this issue, defining the whole parcel is not an easy task in this case. Should a court look at the six (6) lots previously sold off by SGI and include them in the whole parcel? Is there any reason to conclude that the upland portion is a separate and distinct parcel? What about other property that Petitioner owned in the area, should that also be considered in the whole parcel question?

Many commentators have historically questioned the Court's rationale in defining the whole parcel. One such commentator has posed the theory that the Court should look at the deprivation of economic value as the result of a regulation, and not simply the amount of acreage lost.[19] This particular area bears close scrutiny as the Court hears future takings cases.

6. Conclusion

Although the majority decision in *Palazzolo* clearly effects a significant change in takings jurisprudence, particularly as previously recognized in New York, the practical effect of this decision remains to be seen. Given the broad reach of the police power and the authority that states have to enact zoning laws and land use restrictions, and the demanding standards any plaintiff must still meet under either a *Lucas* or *Penn Central* analysis, most enactments are likely to be found within the province of the states' regulatory powers and thus immune from a takings challenge. For enactments that are in the gray area, rather than a state relying on the fact that the regulation was in place prior to the complaining property owner's acquisition of title, the state must now arguably develop a record showing that the regulation is a reasonable restriction to prevent an actual harm. If the question is one that is fairly debatable, then the restriction will still be upheld. However, to the extent that this decision has opened the door to more potential plaintiffs, it is likely to encourage more owners to assert takings claims, leading to more generally unsuccessful litigation. Perhaps its greatest impact will be in encouraging municipalities to be somewhat more flexible in applying restrictive regulations in the face of threatened takings litigation.

Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency[20]

This case is separate and distinct from *Palazzolo*, but it is the most recent land use decision handed down by the United States Supreme Court, and at least merits mention here. In a 6-3 decision, the Court held that a land use moratorium that prevented development on certain property in the Lake Tahoe Basin for 32 months was not a per se taking of property requiring just compensation.

The case involves a complex set of facts and land use regulations that sought to curb the explosion of development in the Lake Tahoe Basin which covers parts of Nevada and California. The Tahoe Regional Planning Agency imposed two moratoria, totaling 32 months, on development in the Lake Tahoe Basin while formulating a comprehensive plan for the area. The case seems to suggest (the dissent more so than the majority) that the Agency had considerable difficulty in resolving internal disputes which in part led to the lengthy moratoria.

> *"Perhaps its greatest impact will be in encouraging municipalities to be somewhat more flexible in applying restrictive regulations in the face of threatened takings litigation."*

Petitioner relied on *Lucas* and *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*.[21] Although *First English* involved a temporary stay on construction, the focus of the decision was based on from what point compensation was due a property owner once the court finds that a regulatory taking occurred. The Court did not rule on whether a temporary land use moratorium created a taking by depriving a property owner of all economic use of his land.

The majority found that the proper analytical framework for this case was the balancing approach of *Penn Central*. The Court again addressed the "whole parcel" issue and found that the 32-month delay did not permanently deprive a property owner of all economic use of his property to a point where such property would not recover its value. Severing a 32-month period from the entire bundle of property rights and considering the impact on that segment was, in the Court's view, inappropriate. The majority was also concerned that if the 32-month moratoria constituted a taking, then other administrative delays in granting building permits and enacting land use regulations could also be found to be takings. This would leave state and local governments with no planning tools whereby development would cease in order to study and enact reasonable land use restrictions. The Court found it better that the legislative branch deal with this issue rather than have the Court enact a sweeping rule that could have adverse consequences.

The dissent was much more concerned with the administrative delay and the seeming failure of the Agency to address the issues presented to it in a reasonable time period. The dissent did not put forth the theory that every temporary delay or moratorium would create a taking. However, egregious delays of the sort found here were beyond any reasonable land use practice, and therefore should have been considered a taking. The dissent also found that the delay was much greater than 32 months, as they considered the injunction issued by a lower court that had the effect of preventing development on Petitioner's property beyond the initial 32 months to be part of the overall restriction on development.

Again, this case is not likely to create a major shift in the land use area. It is a well-accepted practice for government to enact temporary moratoria to study its land use policies and to develop or update zoning ordinances. One potentially adverse effect of this decision is that administrative delay may increase given that the 32-month delay in this case was found to be reasonable. A review of New York law found that:

1. In *Lakeview Apartments v. Stanford*,[22] the court found that a moratorium must be for a reasonable period of time. The town enacted a moratorium on commercial development and multi-family housing in 1977 and extended it each year until 1982 when action was brought. At time of decision, the law was still in effect. The court found that the moratorium was not reasonable.

2. In *In re West Lane Properties v. Lombardi*,[23] a 90-day moratorium is reasonable.

3. In *Russo v. New York State Department of Environmental Conservation*,[24] a three-year moratorium is very questionable.

4. In *Lake Illyria Corp. v. Gardiner*,[25] four years is unreasonable.

It bears watching whether the *Lake Tahoe* case will create a shift in New York law to allow longer moratoria. Even if that turns out to be the case, the nature and extent of municipal action during the moratorium will likely still be a critical factor in determining the reasonableness of the moratorium period.

Endnotes

1. 533 U.S. 606 (2001).
2. *Id.* at 613. Through the various transactions that happened during this period through which SGI sold six (6) lots to other parties, ultimately leaving the corporation with 74 lots.
3. 505 U.S. 1003 (1992).
4. 438 U.S. 104 (1978).
5. 260 U.S. 393 (1922).
6. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). In 1986, David Lucas paid $975,000 for two residential lots on Isle of Palms in Charleston, South Carolina. In 1988, South Carolina adopted the Beachfront Management Act which had the effect of prohibiting Lucas from erecting any habitable structures on the lots. The Supreme Court held that this amounted to a taking because it denied all economically beneficial or productive use of the land.
7. *Penn Central*, 438 U.S. 104. *Penn Central* involved an attempt by the Penn Central Transportation Company to construct a 50-story office building above the Grand Central Terminal. The Terminal was designated a historical landmark under New York City's Historic Preservation Law. In order to further develop the property, permission from the Landmarks Preservation Commission was necessary. Penn Central pursued two applications, both of which were denied by the Commission. Penn Central filed a claim alleging that the application of the Landmarks Law had taken its property without just compensation. In a 6-3 decision, the Court upheld the Landmarks Law.
8. 473 U.S. 172 (1985).
9. *MacDonald, Sommer & Frates v. Yolo County*, 477 U.S. 340, 351 (1986).
10. *Palazzolo*, 533 U.S. at 627.
11. *Id.*
12. *See* Section 2a, *infra*.
13. 89 N.Y.2d 535, 656 N.Y.S.2d 184 (1997).
14. 89 N.Y.2d 603, 657 N.Y.S.2d 555 (1997).
15. 90 N.Y.2d 1, 659 N.Y.S.2d 145 (1997).
16. The factors identified in *Penn Central* for evaluating a regulatory takings claim are the economic impact of the regulation on the claimant; the extent to which the regulation has interfered with the distinct investment-backed expectations of the claimant; and the character of the governmental action. The Court found that Penn Central could continue to use the terminal for its current use and that the development rights to construct an office building could be transferred to another property in the area. Thus, the regulation did not run afoul of the first two inquiries. A governmental action that involves the physical invasion of property may more readily be found a taking than when government interference arises from a public program that simply adjusts the benefits and burdens of economic life to promote the common good. Given that the Court found the Landmarks Law to be a substantial public benefit, the character of the government action was within the limits of the police power.
17. 657 A.2d 1038 (R.I. 1995).
18. *Penn Central*, 438 U.S. 104; *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470 (1987).
19. *See* John E. Fee, *Unearthing the Denominator in Regulatory Takings Claims*, 61 U. Chi. L. Rev. 1535 (1994).
20. 535 U.S. 302 (2002).
21. 482 U.S. 304 (1987). *First English* involves an ordinance enacted by Los Angeles County that prevented construction on the Church's property after a flood had destroyed a campground. The law in California provided that no compensation was due a landowner until a court declared that a taking had indeed occurred as a result of the regulation. Once a court found that a regulation created a taking, compensation was due only if the state sought to continue enforcement of that regulation. The Supreme Court disagreed with this analysis and found that compensation was due a landowner from the point that a regulation creates a taking.
22. 108 A.D.2d 914, 485 N.Y.S.2d 801 (2d Dep't 1985).
23. 139 A.D.2d 748, 527 N.Y.S.2d 498 (2d Dep't 1988).
24. 55 A.D.2d 935, 391 N.Y.S.2d 498 (2d Dep't 1977).
25. 43 A.D.2d 386, 352 N.Y.S.2d 54 (3d Dep't 1974).

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The Second Department Muddies the Waters

By Jerome M. Lasky

Courts write decisions for two purposes. First, the decision declares the winner. Second, the decision sets forth the applicable principles of law on the basis of which the winner was determined. The first purpose of a decision, the designation of the winner, is of importance primarily to the litigants. The second purpose, setting forth the applicable principles of law, is important as a guide to the entire Bar as well as to all businesses confronting similar problems. Future conduct is guided by the principles of law set forth in these decisions.

The second purpose of the decision is particularly important when the subject matter of a litigation is title to real estate. The principles applied in deciding real estate cases is important to those who buy and sell real estate and to those who advance mortgage loans on the security thereof. It is also of particular importance to title companies, which must rely on precedent in deciding whether or not to insure a fee title or a mortgage.

One area of the law affecting title to real estate which was long in doubt arose under the following set of facts:

Plaintiff institutes an action seeking relief which would affect the title to real estate, as for example, an action to enforce a contract of sale or to foreclose a mortgage or to declare the validity or priority of a mortgage. The lower court decides that issue adversely to plaintiff and plaintiff takes an appeal. While the appeal is pending, there is no *lis pendens* against the property, either because none was ever filed or, although filed, it had expired because it was not renewed within the requisite time or had been cancelled pursuant to court order.

During the pendency of the appeal, the property is sold or mortgaged to a third party. After consummation of the sale or mortgage, plaintiff's appeal is heard and the appellate court reverses the lower court's dismissal of the complaint, thereby sustaining plaintiff's claim which affects title to the real estate. The obvious question presented is whether the third-party purchaser or mortgagee acquired title free of plaintiff's claim.

CPLR 5523 provides that where a court reverses or modifies a final judgment or order, the court may order restitution of property or rights lost by the judgment or order, with one significant exception. The exception is that where the title of a purchaser in good faith and for value would be affected by the reversal, the court may order the value or the purchase price restored. Pursuant to this section, the third-party purchaser or mortgagee acquiring title or rights as mortgagee during the pendency of an appeal takes subject to the outcome of the appeal. If, however, such third-party purchaser or mortgagee was a purchaser "in good faith and for value," then the successful appellant would not have any rights in the real estate but would be relegated to a claim for money damages. A good-faith purchaser for value during the pendency of an appeal from a judgment or order affecting title would acquire title to the real estate free of the outcome of the appeal.

In order to insure that a third-party purchaser in good faith for value will not be able to obtain title to the property free of the outcome of the pending litigation, the appellant must obtain a court order pursuant to CPLR 5519(c) staying enforcement of the lower court judgment pending the appeal. Alternatively, the appellant could arrange for a *lis pendens* to be filed against the property and continued in force until the litigation is finally resolved.

CPLR 5523 posed a special problem as to the circumstances under which a purchaser or mortgagee satisfies the requirements of a purchaser in good faith for value. The value part was always easy to ascertain; the "good-faith" part presented a more difficult problem. Ordinarily, when a prospective purchaser or mortgagee has notice of a pending problem affecting title, or with the exercise of reasonable diligence would have such notice, such a purchaser or mortgagee could not be a good-faith purchaser for value because of their actual or imputed knowledge of the title impediment. Thus, it would seem that where the prospective purchaser or mortgagee was aware of the pending appeal, the outcome of which would affect title, such a purchaser or mortgagee could not be a good-faith purchaser. This problem was finally resolved by the Court of Appeals in *DaSilva v. Musso*,[1] where the Court held that actual knowledge of the pending appeal would not prevent a third-party purchaser of the property from becoming a good-faith purchaser under CPLR 5523.

Knowledge of the pending appeal, therefore, became irrelevant for purposes of CPLR 5523. An appellant desiring to prevent a purchaser or mortgagee from acquiring title to the property free of the outcome of the appeal either had to: 1) obtain an order staying enforcement of the lower court judgment pursuant to CPLR 5519(c) or 2) file and continue a *lis pendens* against the subject property until the appeal was concluded. Absent either alternative, a good-faith purchaser for value would obtain good title to property free of the outcome of the appeal, and the appellant, if successful on the appeal, would be relegated to a claim for money damages.

In view of *DaSilva,* the law now seemed clear. Absent a CPLR 5519(c) stay or a continuance of the *lis pendens*, a good-faith purchaser for value, even if it knew of the appeal, could purchase the property or place a mortgage thereon free of the outcome of the pending appeal, and the appellant, if successful, would be relegated to claim for money damages.

The *DaSilva* decision was followed by *Aubrey Equities v. Goldberg*,[2] a case in the Appellate Division, First Department. In that case, a mortgagee commenced a foreclosure action and moved for summary judgment, which was granted. Defendant appealed but did not apply for a stay. Defendant's previously filed *lis pendens* had expired without being renewed. The foreclosing mortgagee proceeded with the foreclosure sale. At the foreclosure sale, the defendant-appellant notified all present that an appeal had been taken from the order granting summary judgment and distributed a written notice to all those present at the foreclosure sale, warning that the successful purchaser would take subject to the outcome of that appeal. The property was purchased at the foreclosure sale by a third party for value, and it was conceded that this third party had notice of the pending appeal and of the warning by the defendant-appellant.

Subsequently, the Appellate Division reversed the granting of the motion for summary judgment, rescinded the judgment of foreclosure and sale pursuant to which the foreclosure sale had been held, and reinstated the defendant's answer. The successful defendant then sought to set aside the sale to the third-party purchaser on the grounds that it could not have been a purchaser for value because it had actual notice of the appeal. The Appellate Division upheld the title of the third-party purchaser. The Appellate Division also held that the purchaser's rights had not been affected despite such actual notice, citing *DaSilva*, and that since the successful defendant had not obtained a stay pursuant to CPLR 5519(c), defendant acquired no rights in the property by reason of reversing the summary judgment and vacating the judgment of foreclosure and sale. The successful appellant was relegated to a claim for money damages against the foreclosing mortgagee, that is, to the consideration paid to the foreclosing mortgagee by reason of the foreclosure sale.

> *"What was once thought to have been resolved, now seems subject to question, at least so far as the validity and priority of mortgages is concerned."*

Aubrey Equities confirmed what the title industry and real estate investors believed had been resolved by *DaSilva*. A successful appeal would not affect the title of a good-faith purchaser for value, and actual knowledge of the pending appeal would not prevent a purchaser from becoming a good-faith purchaser. The only way to prevent a purchaser from acquiring rights in the property superior to those of a successful appellant would be to obtain a stay pending the outcome of the appeal pursuant to CPLR 5519 or to continue the *lis pendens* in effect while the appeal was being conducted.

Now, along comes the Appellate Division, Second Department, to muddy the waters in its recent decision of *Marcus Dairy, Inc. v. Jacene Realty Corp.*[3] What was once thought to have been resolved, now seems subject to question, at least so far as the validity and priority of mortgages is concerned.

In *Marcus Dairy*, plaintiff brought an action to determine the priority of two duly recorded mortgages. Plaintiff held a 1988 mortgage on the subject premises and defendant held a 1995 mortgage thereon. The Supreme Court, Westchester County, had previously ordered that plaintiff's 1988 mortgage be discharged and its *lis pendens* canceled. The judgment so ordering was entered in the County Clerk's Office, but the discharge of the mortgage was never entered in the land records. Thus, plaintiff's mortgage had never been discharged of record in the land records. Plaintiff appealed the judgment discharging its mortgage and applied to the Appellate Division, Second Department, for a stay pursuant to CPLR 5519 pending the outcome of said appeal. The Second Department, however, denied a stay. Subsequently, the judgment ordering the discharge of plaintiff's mortgage was reversed by the Appellate Division and thereafter a judgment was entered in the lower court in favor of plaintiff directing the reinstatement of plaintiff's 1988 mortgage.

Unfortunately, between the time of the original judgment in 1994 and its subsequent reversal in 1996, there were several conveyances of the property, and, significantly, the 1995 mortgage in favor of defendant was recorded against the property, presenting the question of whether the 1995 mortgage was subordinate to plaintiff's 1988 mortgage, as reinstated. The Supreme Court had resolved this issue in accordance with the principles laid down in *DaSilva.* It held that the successful appellant had knowledge of the pending appeal but that under *DaSilva* this was irrelevant. The issue thus raised was whether the 1995 mortgagee qualified as a good-faith purchaser for value, entirely apart from its knowledge of the pending appeal. If it did, it held the 1995 mortgage free of the plaintiff's reinstated 1988 mortgage. If it did not, it held the 1995 mortgage subject to that reinstated mortgage. The Supreme Court held that it did not because the 1995 mortgagee should have known, in the exercise of reasonable diligence, that its mortgagee did not have the income or employment necessary to qualify for that mortgage and it should also have known that the various prior transfers of title were fraudulent conveyances because they were made without consideration.

Thus, the Supreme Court, in *Marcus Dairy*, followed *DaSilva*. Even though there had been no stay and no *lis pendens*, the reinstatement on appeal of the 1988 mortgage nevertheless took priority over defendant's 1995 mortgage because the mortgagee of the 1995 mortgage was not a good-faith purchaser for value, having failed to exercise due diligence concerning its prospective mortgagor. Knowledge by the 1995 mortgagee of the pending appeal was not relevant to this holding. Rather, the 1995 mortgagee did not qualify as a purchaser in good faith for reasons other than its awareness of the pending appeal.

On appeal from the Supreme Court decision in *Marcus Dairy*, the Second Department affirmed, thereby holding that the 1988 mortgage which had been reinstated on appeal was a valid lien against the premises, prior in right to the defendant's 1995 mortgage. However, in so affirming the lower court, the Appellate Division specifically declined to follow the reasoning of the lower court, but rather reached the same result on an entirely different basis, one which ignores *DaSilva*. In so doing, it is submitted that the Appellant Division, Second Department, has reopened the entire question of the rights of a mortgagee acquired during the pendency of an appeal. The legal principles which were believed to be applicable in determining the priority and validity of mortgages made during the pendency of an appeal are now uncertain.

The reason offered by the Second Department in refusing to follow *DaSilva* is that *Marcus Dairy* is distinguishable because, unlike *DaSilva*, it involved rights in respect of a mortgage and not title to real property. Obviously, this is a difference, but it should not be a basis for distinguishing *DaSilva*. The very same argument had been made to the Supreme Court, which rejected it. Although noting that *DaSilva* involved the purchase and sale of real property, the Supreme Court held that the same rules would nevertheless apply to "the purchase of an interest in real property by a mortgage," stating: "For at least the past 150 years, the same principles of priority have applied to both deeds and mortgages (e.g., *Fort v. Burch* 1849 WL 51117 6, Barb. 60). The plaintiff has failed to identify any statute or case which would justify a different result."

"The fact that an application for a stay was made and denied should be irrelevant to any decision."

Section 240(2) of the Real Property Law makes it clear that, like a deed, a mortgage is a conveyance. There seems to be no basis for differentiating between a conveyance by deed and a conveyance by mortgage for purposes of a stay pending appeal, and the Second Department offers none. Assuming that the mortgagee of the 1995 mortgage qualified as a good-faith purchaser for value (an issue which the Second Department did not consider), then its mortgage would not have been affected by the reversal of the judgment discharging the 1988 mortgage and the holder of the 1988 mortgage would have been relegated to a claim for money damages, presumably against the fee owner who had conveyed and mortgaged the property free of the 1988 mortgage during the pendency of the appeal. The obligation of the fee owner to pay the 1988 mortgage would not, however, have affected the lien or priority of the 1995 mortgage.

In any event, the Second Department decided that *DaSilva* did not apply where the validity or priority of mortgages was at issue. Presumably, the real estate and title industries and the Bar can continue to rely on *DaSilva* where fee title is affected by the appeal, but in view of *Marcus Dairy*, it would seem that they can no longer do so when the validity or priority of a mortgage is the subject of the appeal.

What, then, are the principles of law to be applied to determine the rights of the parties where an appeal involves the validity or priority of a mortgage, absent a continuing *lis pendens* and the appellant has failed to obtain a stay pursuant to Section 5519(c)? Unfortunately, the Second Department provides no guidance in this regard. It would certainly seem that one need not consider whether the mortgagee was a good-faith purchaser for value in order to decide the rights of the parties. The Appellate Division, Second Department, offers two reasons for its holding that the reinstatement on appeal of the 1988 mortgage rendered it prior in right to the 1995 mortgage.

The first reason given by the Second Department for its holding was that the appellant had sought a CPLR 5519(c) stay but that its application had been denied. Is the Second Department holding that applying for a stay is the equivalent of obtaining it? That can hardly be the case. The Second Department may have regretted denying plaintiff's application for a stay, but that should not affect the outcome of the case. The fact that an application for a stay was made and denied should be irrelevant to any decision.

The only other reason given by the Second Department for its decision was that the holder of the 1995 mortgage had title insurance which failed to exclude the 1988 mortgage as an exception to title. Thus, the Court noted, the plaintiff, holder of the 1995 mortgage, could recover its loss resulting from the decision that the 1988 mortgage continued as a prior lien against the property from its title company. Certainly the right to recover under an insurance policy should not be the basis for deciding a case. One can only question whether the outcome would have been different if the 1995 mortgagee had opted not to take title insurance, or if the title insurer had excepted the 1988 mortgage from its coverage. Whether or not a party has insurance to cover a particular loss should have no bearing whatever on the outcome of a litigation. Cases should be decided on the applicable law and not on whether a particular loss is covered by insurance.

Unfortunately, in *Marcus Dairy*, the Second Department offers no guidance for determining the validity and priority of a mortgage made after an appeal, absent a stay or continuing *lis pendens*, where the appeal results in a reversal. The decision appears to be based solely on a determination by the Court as to what would be a fair outcome, without enunciating supportable principles of law on which the Bar and the real estate industry and title companies may rely in the future to justify such outcome.

As a consequence of the decision by the Second Department in *Marcus Dairy*, the Bar and the real estate and title industries are now faced with uncertainty as to the rights of a mortgagee of a property which is subject to a pending appeal involving the validity or priority of an existing mortgage, where there is no continuing *lis pendens* and no stay pending the appeal. All the rules which one had every reason to believe had been finally resolved by *DaSilva*, and which still seem to be applicable when the appeal involves title to the property, are now completely unsettled where the validity and priority of a mortgage is at issue. It is submitted that the Second Department has done a disservice to the real estate and title industries, as well as to the Bar, by first failing to set forth the applicable principles of law on which it relied to reach its decision in *Marcus Dairy*, and second offering as the sole justification for its decision that one of the parties would recover its loss because it carried title insurance and that another of the parties had made an unsuccessful application for a stay pending the appeal.

"Whether or not a party has insurance to cover a particular loss should have no bearing whatever on the outcome of a litigation."

Endnotes

1. 76 N.Y.2d 436, 560 N.Y.S.2d 109 (1990).
2. 247 A.D.2d 253, 668 N.Y.S.2d 598 (1st Dep't 1998).
3. 298 A.D.2d 366, ___ N.Y.S.2d ___ (2d Dep't 2002).

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"Provided Title Is Not Rendered Unmarketable Thereby"

By James M. Pedowitz

The phrase, "provided title is not rendered unmarketable thereby" (hereinafter "the Clause") is frequently found in a contract of sale, added to one or more "subject to" clauses dealing with survey matters, liens or encumbrances that may affect the title. Since the Clause thoroughly negates the clause to which it has been added, one wonders why it would not have been simpler to delete the entire clause from the contract. What is accomplished by retaining it?

Although the Clause is usually encountered in residential contracts of sale, it is also utilized to a considerable extent in commercial transactions.

We see the Clause used most frequently with respect to the exception: "any state of facts that an accurate survey would show" (hereinafter the "Survey Exception").

The Clause means that the purchaser will accept the title and make no objection to whatever facts an accurate survey may disclose, such as encroachments by the structure onto adjoining property—even on the street, or the encroachment by a neighbor's structures onto the subject property or some substantial variations between the record lines of title and fences or retaining walls, or the numerous other facts that are shown in the survey reading which is part of the title exceptions in the title report.

All of these survey exceptions affect marketability of title, unless they come within the category of "*de minimus*," a phrase that defies specific description. There are no hard and fast rules on what is or is not "*de minimus*." The Clause is a "seller's clause" and a purchaser who accepts it accepts all of the risks that an accurate survey, if and when made, will disclose. The fact or facts disclosed may not only make the title technically unmarketable, but could be very onerous and/or expensive to correct.

It is usually the purchaser's attorney who then requests or requires the addition of "provided that title is not rendered unmarketable thereby." When it is added, it has the effect of totally canceling the entire clause. The Survey Exception could just as well been totally deleted.

The entire purpose of the Clause was to protect the seller from a claim that the facts, when disclosed by the survey, may render the title unmarketable. The addition of the phrase has destroyed that protection. If the fact or facts disclosed by the survey are material and affect marketability, the seller can reject the title just as confidently as if there were no Survey Exception. If the facts disclosed by the survey would not make the title unmarketable, it does not then matter whether there is any provision with respect thereto.

The seller's attorney who accepts the addition of the phrase, may not fully appreciate that there is now no protection for the seller, even with respect to matters against which a title company may be willing to provide some practical protection. For instance, a wall of the building may encroach on a neighbor's property by several inches. It affects the marketability of the title, but the title company may be willing to insure that the encroaching wall may remain undisturbed so long as it stands. This is only one example of many situations where some affirmative insurance may be available. However, with the Clause added, all of the options are held by the purchaser.

There are also a number of survey facts that render a title technically unmarketable, but which a willing buyer or lender would normally accept. Some examples include: encroachments on or over the street by a roof cornice, show windows, window trim, fire escapes, entrance steps or cellar doors, or even a party wall agreement. With the Clause, the buyer has the option to reject the title or to demand some type of price concession.

The standard of "unmarketable" is both strict and harsh. It is for that very reason that many printed form contracts have tried to substitute the more lax standard of insurability by purchaser's title insurers as a substitute for marketability. True, it gives less protection against technical defects, but it is a much more practical solution in most cases.

This article will not dwell extensively on the differences between marketable and insurable title. However, since almost every transaction requires mortgagee financing, the mortgage lender will insist on an insurable title in every case, although its standard for insurability will probably be somewhat stricter than what is available to the purchaser. A willing lender will disregard minor survey exceptions even though they affect "technical" unmarketability. Knowledgeable purchasers' attorneys can usually negotiate almost equivalent protection for their purchaser-client with the title insurer.

With respect to the Survey Exception problem, the first thing to do is to determine if there is an existing survey that shows the existing improvements on the property (preferably with a reading of that survey from the seller's title policy). The attorney for the seller should then start with making the contract subject to the facts shown on that survey, referring to the surveyor, date and job number, and annex a copy to the contract as an exhibit. It then becomes the responsibility of the attorney for the purchaser to determine whether those facts present a problem.

The attorneys must still deal with any significant changes that would be shown either on an update of that survey or by a new survey. Assuming that the seller has title insurance, any error in the old survey that still affects marketability will be covered by the seller's title insurance. Anything new disclosed by the update is and should be the responsibility of the seller. However, even that can be alleviated to a considerable extent by adding: "and subject to any additional state of facts since that date that an accurate survey would show, provided that purchaser's lender does not refuse to close the mortgage loan by reason thereof." From a practical point of view, if the new facts are acceptable to a mortgage lender, they ought to be acceptable to a willing purchaser.

Another frequent example of the use of the Clause is in dealing with restrictive covenants, easements, and/or agreements of record that affect the property. In almost every case, one of these matters will affect the marketability of title. It cannot be emphasized too strongly how important it is for a purchaser's attorney to read and evaluate the effect of each document in the above-referenced categories, as possibly affecting the title and the potential, as well as the present, use of the property.

Unfortunately, many sellers' attorneys do not have easy access to readable copies of these documents, or in some cases are unwilling or unable to identify all of those that affect the property. They then take what they consider an easy way out by making the contract of sale "subject to restrictive covenants, easements and agreements of record, if any."

". . . every real estate transaction, including the purchase or sale of a one-family dwelling, may contain a potentially explosive problem."

Of course, the addition of the Clause would totally negate that "subject to" clause. Some attorneys try to deal with the problem by adding a palliative phrase to their "subject to" provision by the addition of "provided that the existing improvements on the premises will not be disturbed," or "provided that they are not violated by the existing improvements." To a discerning buyer's attorney, either of these modifications is inadequate. It deals only with the present improvements on the property. It does not deal with either use, or with future alterations, additions or new construction.

There is no real substitute for reading and understanding both the present and future effect that these "encumbrances" have on the property. A restrictive covenant may not be violated by the existing one-family residence but may prohibit any addition to the structure, its conversion to a two-family or even its partial use as a professional office. Some restrictions even deal with paint color, exterior materials or a host of other limitations on what can be done with or on the property.

A simple "subject to utility easements of record, if any," may turn out to be a 40-foot-wide high-power line that can be constructed in the future, or even an ordinary telephone line and poles that can be constructed to run through the plot. Even a limitation to "provided that it only affects an area within five (5) feet of lot lines," can be a problem if the present plot lines do not comport with the lot lines on the filed subdivision map of which the premises are a part, or if the present plot is comprised with more than one lot on a filed map.

The object of the attorneys should be to eliminate as many provisions in the contract as possible that can become contentious if, as sometimes happens, the other side changes from willing to unwilling. It is then that the "nit-picking" starts.

Most experienced attorneys who have done considerable real estate work are familiar with these cautions. However, many less experienced attorneys may look at a printed real estate contract form as a simple transaction. Maybe it really is, but every real estate transaction, including the purchase or sale of a one-family dwelling, may contain a potentially explosive problem. Forewarned is forearmed.

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Title Insurance: “Rights of Tenants or Persons in Possession”

By James M. Pedowitz

Ever since title insurers discontinued doing personal inspections of the property (about 40 to 50 years ago), the following exception routinely appears in title reports: “Rights of Tenants or Persons in Possession.” This exception deals with two distinctly different classes of persons, and possibly two different sets of circumstances.

First, with respect to tenants. The exception, as phrased, is broad enough to cover any and all “rights” of any person or entity, that come within the category of “tenants.” It should be noted that the exception is not limited to possessory or similar rights that may be contained in a lease. Many tenants do not have a lease, and they, as well as those who do, may have or claim additional “rights,” such as an option to purchase, an unrecorded mortgage, or even an unrecorded deed, easement or agreement covering some right or interest in the property.

Although RPL § 290 includes in its definition of “conveyance” a lease for a term exceeding three years, there is no requirement that a lease exceeding three years be recorded. In fact, other than the loss of benefits associated with the recording act, an unrecorded lease having a term exceeding three years is still a valid lease between its parties. Compliance with RPL § 290 protects the lessee against a “purchaser” in good faith and for a valuable consideration who might claim some superior right. However, when the lessee under an unrecorded lease is in possession, the tenant may have equivalent rights, as will be explored later in this article.

In fact, it can be argued that the non-recording lessee in possession under a lease exceeding three (3) years may have better protection if the lease is later modified. RPL § 291-cc provides:

> Where a lease or memorandum of such lease has been recorded an unrecorded agreement modifying such lease or memorandum is void as against a subsequent purchaser in good faith and for a valuable consideration, and the possession of the tenant shall not be deemed notice of the modification, unless the agreement of modification or a memorandum thereof is recorded prior to the recording of the instrument by which the subsequent purchaser acquires his estate or interest.

So, if the lease modification is not recorded, the tenant in possession under an unrecorded lease or memo thereof can enforce all of the rights under the lease as modified even against a subsequent purchaser in good faith and for valuable consideration, while if the lease or a memo thereof was recorded, the modification could not be enforced against a subsequent bona fide purchaser. A tenant under a lease for three (3) years or less is also a “tenant” having “rights” covered by the exception first noted above.

Since the title exception is so broad, many attorneys try to limit the exception to “Rights of Tenants, as tenants only” with the intention of limiting the excepted “rights” to those possessory rights normally attributable to a tenant; and the ambiguity will probably be interpreted in favor of the insured.

In certain circumstances even this limitation could be further limited by a title insurer or even eliminated, with a proper affidavit. If it can be established that there are no tenancies or persons in possession other than the owner and the owner’s family, the exception could also be deleted.[1] If there are one or more leases, *all* of which are recorded and excepted in the title report, the exception should also be deleted, or limited to “Rights of the tenants under the leases set forth herein.”

The additional part of the exception that also excepts the rights of “persons in possession” should raise even more concern. New York courts have long followed the doctrine of “possession as notice.”[2] “The general rule is that actual possession of real estate is notice to all the world of the existence of any rights which the person in possession is able to establish.”[3] Although much criticized,[4] it continues to be the rule[5] and is a trap for the unwary, because it disregards and overrides the effect of the recording acts. For instance, in *Phelan v. Brady*, one of the occupants of a tenement house held an unrecorded mortgage that the court determined to be superior to the rights of a purchaser for value of that building. The purchaser had in fact inspected the building but had not inquired from the tenants as to the nature of their interest. The fact that the building housed numerous tenants did not matter at all to the court. The mortgage held by the tenant was recognized as a lien on the property even though it could have been, but was not, recorded.

Recently, in an unpublished opinion, the Supreme Court in Suffolk County[6] held that the exception of “rights of tenants or persons in possession” clearly applied also to a claim of adverse possession of 17 years being alleged by a neighbor as to a strip of land on the neighbor’s side of a wire fence, privet and arborvitae hedges separating the premises, and on which the neighbor also cut the grass regularly. The court relied heavily on the decision of the Appellate Division, Second Department in *Herbil Holding Co. v. Commonwealth Land Title Insurance Company*,[7] reciting the following statement:

> The title company does not want to be held responsible for some unknown person who might be able to make a claim founded on either the possession alone (*i.e.* adverse possession) or an instrument which would not cross the examiner's path if the public records were examined—for example, an unrecorded deed.[8]

The Suffolk County decision appears to be consistent with rulings in other states on title policy exceptions with similar language, although some of those exceptions are limited to rights or claims "not shown by the public record."[9] However some courts require that the possession also be of the type that is "open, visible and notorious."[10] The *Fekishazy* decision is also one of several authorities that the possession that will be deemed equivalent to actual notice must be "inconsistent with the title of the apparent owner by the record."[11]

Similar to the exception as to tenants, a proper affidavit should be sufficient to eliminate the exception as to "persons in possession" when it can be established by credible affidavit that the only occupants are the owners, their family or tenants.

It is doubtful if an exception as to the "rights" of tenants, or of persons in possession, would totally protect the title insurer if the title records that should have been examined would disclose either a recorded lease or memorandum thereof, or a document which was the basis for the claim of possession. The decision in *Smirlock*[12] seems to have settled the point that a title insurer cannot rely on a general exception to cover up its failure to properly examine the public records and report all defects and encumbrances that would have been disclosed by a proper title examination.

An attorney bears an obligation to the client to review the title report carefully, including all of the "standard" exceptions and to have as many as possible eliminated or modified in order to obtain maximum protection for the client.

Endnotes

1. *Fekishazy v. Thomson*, 204 A.D.2d 959, 612 N.Y.S.2d 276 (3d Dep't 1994); *leave to appeal denied*, 84 N.Y.2d 812, 622 N.Y.S.2d 915 (1995).
2. *Phelan v. Brady*, 119 N.Y. 587, 23 N.E. 1109 (1890).
3. *Wardell v. Older*, 70 A.D.2d 1008, 1009, 418 N.Y.S.2d 196, 198 (1979) (*quoting Ehrlich v. Hollingshead*, 275 A.D. 742, 87 N.Y.S.2d 682 (4th Dep't 1949)).
4. *See* Milton R. Friedman, *Contracts and Conveyances of Real Property* § 3.5 (6th ed. 1998).
5. *Fekishazy*, 204 A.D.2d 959.
6. *Price v. Monette*, No. 01-10882 (N.Y. Sup. Ct. Jan. 3, 2002).
7. 183 A.D.2d 219, 590 N.Y.S.2d 512 (2d Dep't 1992).
8. *Id.* at 228.
9. *Bothin v. Cal. Title Ins. & Trust Co.*, 96 P. 500 (Cal. 1908); *Polito v. Chicago Title & Trust Co.*, 138 N.E.2d 710 (Ill. App. 1956).
10. *Shaver v. National Title & Abstract Co.*, 361 S.W.2d 867 (Tex. 1962); *Southwest Title Ins. Co. v. Plemons*, 554 S.W.2d 734 (Tex. App. 1977).
11. *Holland v. Brown*, 140 N.Y. 344, 348, 35 N.E. 577, 578 (1893) (and also referring to *Schenectady Sav. Banks v. Wertheim*, 237 A.D. 311, 313, 261 N.Y.S. 193 (3d Dep't 1932), *aff'd* 268 N.Y. 585).
12. *L. Smirlock Realty Co. v. Title Guarantee Co.*, 52 N.Y.2d 179, 437 N.Y.S.2d 57 (1981).

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Stolen Identity—A Real Estate Caveat

By James M. Pedowitz

The subject of "stolen identity," or identity theft, has received considerable publicity of late. There are people who would prefer to have another identity, possibly yours, or some other that is more creditworthy than their own; especially if their own has been besmirched or ruined by their activities.

Having written previously on the subject,[1] it would be appropriate to point out that identity theft can be another problem that is not covered by the title insurance, and which should be part of the due diligence by the attorney, especially when representing a lender in a mortgage transaction.

". . . identity theft can be another problem that is not covered by the title insurance, and which should be part of the due diligence by the attorney, especially when representing a lender in a mortgage transaction."

Stolen identity and title insurance was dealt with by the New York Appellate Division, Second Department in its August 14, 2000 decision in the case of *Brucha Mortgage Bankers Corp. v. Nations Title Insurance of New York, Inc.*[2] The case involved an individual who had falsely represented his identity, acquired title under that false identity, made a note and mortgage under the same false name and then defaulted in his payments. This resulted in a foreclosure by and sale to the mortgagee. The mortgage lender then sued its title insurer to recover damages it incurred. The court said:

> It is well settled that "[a] title insurer's obligation to indemnify is defined by the policy itself and limited to the loss in value of the title as a result of title defects against which the policy insures" (*Citibank v. Chicago Tit. Ins. Co.*, 214 A.D.2d 212, 221, 632 N.Y.S.2d 779). "[A] policy of title insurance is a contract by which the title insurer agrees to indemnify its insured for loss occasioned by a defect in title" (*L. Smirlock Realty Corp. v. Title Guar. Co.*, 52 N.Y.2d 179, 188, 437 N.Y.S.2d 57, 418 N.E.2d 650, see, Insurance Law § 6401). Such a policy entitles the insured to indemnity only to the extent that its security is impaired and to the extent of the resulting loss which it sustains. (*Diversified Mtge. Investors v. U.S. Life Tit. Ins. Co.*, 544 F.2d 571, 574, n 2 (2nd Cir.); see, *Halfmoon Professional Offs. v. American Tit. Ins. Co.*, 235 A.D.2d 801, 652 N.Y.S.2d 390).
>
> Contrary to the plaintiff's contention, inasmuch as a valid title was transferred, and it received a valid and enforceable first mortgage lien on the property, as evidenced by its ability to successfully foreclose, the defendant satisfied its obligations under the policy (see, *Citibank v. Chicago Tit. Ins. supra* at 222, 632 N.Y.S.2d 779).

The problem goes beyond forgery, a risk against which the title policy does protect the insured. If X and his wife, Y, own property, and X, and his girlfriend Z (purporting to be Y), sign a note and mortgage as X and Y, that is a forgery. But, if X and Z (using the name of Y) buy a condo as their love nest, take the deed in the name of X and Y, and sign a note and purchase money mortgage, using those same names, (X and Y) by which they acquired the property, the mortgage is a perfectly good mortgage. This is not withstanding that "Z" was using the name of Y, and may even have shown an altered driver's license to confirm her false identity.

A serious problem will arise, however, when X and Z (using Y's name) break up, and a mortgage foreclosure is started. When the process server seeks out the true Y, she will deny (truthfully) that she ever signed the mortgage. If and when X admits that Z (using Y's name) was the mortgagor, the lender may encounter quite a problem in locating "Z" (a.k.a. "Y"). The title insurer cannot be expected to help since the mortgage (and the deed) is perfectly valid, even though one of the names was an assumed one.

The problem can be more complex when the assumed identity is that of a person residing in another state, and where there is no purported marital relationship. For example, John Doe who has no credit, buys a house in Brooklyn, using the stolen identity of Peter Poe, residing in Chicago. Doe, posing as Poe and using Poe's Chicago address and social security number, accepts the deed and executes a note and mortgage. When the mortgage goes into default and foreclosure starts, it is a very shocked Peter Poe who is served with a summons and complaint in Chicago.

The scenario is similar, but the Peter Poe who was served in Chicago is not the person who owns the property, or who signed the note and mortgage. At this point the foreclosing attorney must first learn the true identity of the borrowers, if possible, before proceeding further by amending the caption of the action, and then, if possible, effecting service of the summons on Doe, a.k.a. "Poe." It may become necessary to effect service by publication with all of the extra work and problems that such process can entail.

The latter example (with names changed), describes an actual case that was recently encountered. The title insurer declined liability.

Identity theft, which has become much more common, has also become a problem to automobile casualty insurers. In an article in the *New York Law Journal*,[3] there is reference to another article on the subject.[4] The article examines several automobile liability insurances cases (assigned risk) involving an insured imposter. The insurer sought to avoid liability on uninsured motorist no-fault claims on the basis that since the real person whose identity had been assumed admitted that they were not the insured, and the imposter could not be identified, that there was no insured, so no one could claim any benefits under the uninsured motorist coverage under the policy.

The courts,[5] noting that insuring automobiles is a "serious responsibility, fraught with public interest," held the insurers responsible to the same extent as though the imposter was a real person. In the Nassau County case, Justice Cahn held that "for the benefit of the public, carriers must investigate and verify information supplied by applicants before issuing policies." This holding is totally rational and justified since the insurance company knows that an automobile cannot be lawfully operated without insurance, and since the insurer accepted the premium and issued the insurance, they therefore must be prepared to honor the policy when an innocent person is injured and claims the benefit of the policy coverage.

"[T]he problem of identity theft is real . . . extra effort must be taken in investigating and verifying the identity and the background of all of the parties with whom you or your clients deal."

Another way to look at it is that the insurer, having accepted the imposter as an insured, and taken the imposter's premium, cannot deny the benefits of the policy to whomever is entitled to the coverage.

In the title insurance situation, the mortgagee is entitled to the coverage of the policy, but cannot expand the coverage to include assurance that the mortgagor is who he or she purports to be, other than that the mortgagor is the same person who acquired and owns the mortgaged property.

Identity theft can sometimes result in forgery, but when title to real property is acquired in an assumed name, the subsequent use of the assumed name in dealing with that property need not be a forgery.

What does it teach us? That the problem of identity theft is real, and that extra effort must be taken in investigating and verifying the identity and the background of all of the parties with whom you or your clients deal. This is another risk not covered by a title policy.

Endnotes

1. *What Title Insurance Does Not Cover*, N.Y. Real Prop. L. J., Vol. 28, No. 1 (NYSBA Winter 2000).
2. 275 A.D.2d 337, 712 N.Y.S.2d 151.
3. Norman H. Dachs & Jonathan A. Dachs, *Shunning Arbitration at No-Fault Disputes/Identity Theft*, N.Y.L.J., Jan. 14, 2003, p. 3 col. 1.
4. *Assigned Risk Insurance and the Case of a Imposter*, N.Y.L.J., Nov. 26, 2002, p.1, col. 1.
5. *See Allstate Ins. Co. v. Sullam*, 76 Misc. 2d 87, 106; *Aetna Cas. And Sur. Co. v. O'Connor*, 8 N.Y.2d 359, 364 (1960).

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Bergman on Mortgage Foreclosures:

When the Borrower Tenders *All* Arrears

By Bruce J. Bergman

Among the most frequently asked questions directed to counsel by mortgagees holding a defaulted mortgages is, "What do I do with the check the borrower sent?"

Why the principles may sometimes appear elusive is understandable. The answer to the question depends upon *when* the check is submitted and how much the check is for. In the meanwhile, a case confirms what deserves to be a recognized principle: Acceptance of a check for *full* arrears ends the ability to proceed with a foreclosure.[1] That the aphorism is perhaps not as obvious as it seems is underscored by the battle in the cited case, which actually proceeded to an appeal-level court for resolution!

But before offering the lesson of the ruling, a quick review of this sometimes slippery subject may be helpful. *Before* acceleration, a lender or servicer can—and should—accept any monies remitted by a borrower. Don't worry about the bugaboo of waiver. There is nothing to waive. Until acceleration, a borrower has every right to pay arrears. So, if a check is for *less* than all sums due, take it and, if you wish, accelerate, because a default is in existence. If the remittance expunges all defaults, then by definition no default survives and there wouldn't be a basis to accelerate and foreclose in any event. (Note, of course, that if a Fannie Mae/Freddie Mac form of mortgage is used, a thirty-day cure letter is a prerequisite to acceleration. This is commonplace for residential mortgages, unlikely in commercial mortgages.)

The next scenario in order is the sending of the thirty-day cure letter—a typical requirement in the residential situation. If prior to conclusion of the thirty days a borrower submits less than the aggregate of all past-due sums, when the cure period expires, there is still a default. The same rules then apply. Acceleration and foreclosure would be authorized so there would be no need to reject these insufficient sums. The reverse is a tender during the cure period of *full* arrears. Then the default *is* extinguished and there is no basis to accelerate or foreclose.

"Before acceleration, a lender or servicer can—and should—accept any monies remitted by a borrower."

This all becomes a bit trickier once acceleration has been declared. Then, accepting any amount from the borrower *appears* to be inconsistent with acceleration and smacks of waiver. It is not—in New York at least. A lender *can* keep the check or checks if they are insufficient to reinstate the mortgage—that is, to pay all past-due principal, interest, late charges, legal fees and disbursements, advances and any other amounts validly secured by the mortgage.

The discomfort, though, arises from these inquiries. Might a borrower later in the case—for example with an answer (necessitating a motion for summary judgment) or an eve of sale order to show cause—argue the waiver defense? He might. Could a sympathetic court stumble on the law and be persuaded that the borrower's position is correct? It might. In the end, a lender should make a *business* decision weighing the value of receiving monies across a portfolio of loans against the possible danger of an occasional borrower dazzling a court with canny footwork.

This then leads to the last choice—precisely the point of the cited case—tender of full arrears after acceleration. Here, the lender proceeded to foreclosure sale and was prosecuting an eviction when the borrower obtained an order to show cause to vacate the judgment of foreclosure and sale. It appears perhaps unlikely, but the borrower produced pre-judgment canceled checks which seemed to demonstrate a tender of payments corresponding to the amount due on the mortgage pursuant to the complaint. (Obviously the lender or servicer had accepted those checks.)

Additionally, the borrower argued that she neglected to appear in the foreclosure action, relying upon acceptance of the checks as confirmation of reinstatement. Critically, the mortgage contained the Fannie Mae/Freddie Mac provision that arrears had to be accepted until issuance of the judgment of foreclosure and sale, then to elicit discontinuance of the foreclosure.

All this was enough to suggest to the court that issues existed as to whether the borrower's account was accurately credited with the payments evidenced by the canceled checks. The circumstances also suggested to the court that the borrower had a reasonable excuse for defaulting and a possibly meritorious defense—the two standards to be met to vacate a judgment. The ultimate result was that the appeals court remanded the case to the trial court to explore the factual issues raised.

Whether the borrower truly had a valid defense here is not the issue. It seems remote—though hardly impossible—that the lender knowingly accepted reinstatement, but nevertheless forged ahead with foreclosure. If they did, it wasn't smart, which is precisely the point of all this. Most often, the goal of a foreclosure is to capture the arrears and revivify a performing loan. If all arrears are tendered prior to judgment, the lender or servicer would probably prefer it. If it's a Fannie Mae/Freddie Mac mortgage form, the lender or servicer *must* accept, even if the preference might be to the contrary.

Endnote

1 *Embanque Capital Corp. v. Geathers*, 224 A.D.2d 238, 637 N.Y.S.2d 413 (1st Dept. 1996).

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Book Review: *New York Commercial Mortgage Transactions*

By Joshua Stein
Reviewed by Steven M. Alden

New York Commercial Mortgage Transactions is a wonderful resource and educational tool for New York real estate financing lawyers. Mr. Stein's book is a one-volume, loose-leaf work, published by Aspen Law & Business and is designed for periodic updates. Mr. Stein also runs a novel interactive publishing experiment—corrections, clarifications and reader comments which may be posted on a dedicated Web site.

The book's 18 chapters include a short general overview, usury, selected provisions to include in New York mortgages, common issues, construction loans and the lien law, four separate chapters on the mortgage recording tax, title insurance, including a guide to endorsements, closing issues, protecting rental income and leases, the borrower's agenda, defaults and acceleration, foreclosure and other remedies, New York's non-judicial foreclosure statute, choice of law and multi-state issues, and lost notes. These chapters are followed by five appendices (containing roughly 40 percent of the total pages in the book), consisting of extracts from selected New York statutes, selected New York regulations, the 1998 New York mortgage loan opinion report, the ALTA 1992 Loan Policy, and selected provisions from the Title Insurance Rate Manual.

While the book often reads like a treatise, with frequent and extensive statutory and case citations, it is wonderfully user-friendly, written in a clear, plain-English, conversational style and can be read and enjoyed by beginning practitioners as well as experienced commercial mortgage attorneys. At the same time, with its many on-target tips, succinct explanations of the law, sample provisions and form language, the book is an excellent teaching tool and reference source for the novice as well as for sophisticated real estate lawyers.

As Mr. Stein notes, much of the complexity of New York mortgage practice is caused by the mortgage recording tax. Accordingly, he devotes almost one-half of the total text to this subject. As he also notes, New York's statutory approach to construction lending, its treatment of mechanics' liens, with its "trust fund" procedure, and the use of separate acquisition, building and project loan mortgages, are somewhat unique.

One comment: Mr. Stein's focus on the "standard" real estate mortgage transaction and the unusual aspects of New York mortgage practice have an unfortunate consequence in that he does not say enough about equity, participating and shared-appreciation mortgages, leasehold mortgages and mezzanine financing (a chapter on which would be more useful than the chapter on usury restrictions which, as Mr. Stein tells us, only apply "in the occasional weird case" or in "rare factual circumstances"). Further, as a lesser comment: A section should be added dealing with mortgages from not-for-profit corporations.

The book contains a very good mix of mortgage practice, practical advice and constructive criticism of several aspects of New York mortgage law and practice. It includes a roadmap to the standardized mortgage covenants contained in the Real Property Law, a useful discussion of often overlooked provisions of New York law (e.g., the Streit Act—although it could also include a reference to RPAPL § 1351, a unique provision of New York law which permits partial foreclosure and foreclosure without acceleration), model provisions with quite useable discussion (as the author wisely notes, "Model language cannot merely be shoveled from this book into a document without thinking about context, clarity, the exact words being used, and their meaning and effect in a particular document. Readers will need to think.") and nuggets of wisdom (e.g., expedited CPLR 3213 enforcement of guaranties and why a New York mortgage need not waive prepayment premiums in case of condemnation), all interspersed with the well-placed wry comment that keeps his text wonderfully entertaining.

The book's extensive treatment of New York's mortgage recording tax laws, regulations and procedures and their effects on New York practice includes discussion of transactions involving multiple properties, multiple mortgages or multiple lenders, the multiplication of mortgages, the consolidation of mortgages, mortgage spreader agreements, mortgage severance agreements, off-balance sheet financing structures (including synthetic leases), revolving loans, letter of credit facilities, collateral assignments of existing mortgages and leases, swap agreements and title policy endorsements. He also discusses the warehousing of mortgages, RPL § 275, Tax Law § 255 and the "tedious formalism" and "hypertechnical approach" engendered by New York's mortgage recording tax. (Indeed, the treatment gets so technical that even Mr. Stein, in three instances, cites Tax Law § 275 when he means to cite RPL § 275.) As Mr. Stein notes, "the weird and wonderful world of New York mortgage recording tax" results in complex "transactions that would be utterly issue-free in most other states."

With its straightforward treatment of the law, description of the lore and suggestions for the practice of New York commercial real estate financing, the book is a valuable and welcome addition to any real estate lawyer's library.

Case Note

Denial of State's defense of Eleventh Amendment Immunity: Congress validly abrogated state immunity from suit in federal court in passing the Railroad Revitalization and Regulatory Reform Act, 49 U.S.C. § 11501, and the *Ex Parte Young* doctrine permitted the exercise of jurisdiction over state officials in an action alleging excessive property assessments in violation of this Act.
CSX Transp. Inc. v. N.Y. State Office of Real Prop. Servs., 306 F.3d 87 (2d Cir. 2002).

Facts: On February 13, 2001, plaintiff-appellee, CSX Transportation, Inc. (CSX), brought suit in the United States District Court for the Southern District of New York seeking preliminary and final injunctive relief against defendants-appellants, the New York State Office of Real Property Services (ORPS) and an individual defendant class comprised of state officials in all taxing jurisdictions in which CSX operates, collectively known as "State Defendants." By bringing this action, CSX wished to enjoin these parties from assessing, levying, or collecting *ad valorem*[1] taxes on its rail transportation property in New York State for the 2001 tax year.

ORPS is an executive department of the government of the State of New York, charged by statute with the administration of various matters pertaining to real property taxation in New York.[2] Under New York law, railroad property receives a partial tax exemption based on a "railroad ceiling."[3] A railroad ceiling is the maximum value on which a tax district may levy real property taxes on railroad real property. Railroad real property is exempt from *ad valorem* taxation imposed by assessing units to the extent that its assessed value exceeds the railroad ceiling.[4] Among its many duties, ORPS is responsible for determining these "railroad ceilings."

Congress, in passing the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act"), 49 U.S.C. § 11501, prohibited states from engaging in certain acts that "unreasonably burden and discriminate against interstate commerce."[5] Thus, the 4-R Act prohibits a state or its subdivision from assessing railroad property at a higher percentage of the property's true market value than the percentage applied to other commercial and industrial property.[6] The 4-R Act provides that the federal courts shall have concurrent subject matter jurisdiction with state courts over any violations of the Act.[7]

In its complaint, CSX alleges that the State Defendants violated the 4-R Act by assessing and planning to assess its properties in New York state at a rate at least 5 percent higher than the ratio of assessed value to true market value of other commercial and industrial property in the districts in which it operates.

The State Defendants, in their answer, raised Eleventh Amendment immunity as one of their defenses and subsequently moved for judgment on the pleadings on grounds that the Eleventh Amendment barred the relief sought by CSX, and also that *Ex Parte Young*[8] did not permit suit to be maintained against the individual defendants.[9]

The district court denied the State Defendants' motion for judgment on the pleadings, defendants-appellants appealed from this Order, and the Second Circuit affirmed.

Issue: (1) Whether in enacting the 4-R Act, Congress validly abrogated the states' Eleventh Amendment sovereign immunity and lawfully subjected them to federal suits raising claims of excessive property assessment and taxation, and **(2)** Whether the individual defendants-appellants are amenable to suit under the doctrine of *Ex Parte Young* for actions alleged to constitute excessive property assessments in violation of the 4-R Act.

Analysis:

Issue (1): Validity of Congress' Abrogation of State's Eleventh Amendment Immunity.

CSX argued that in passing the 4-R Act, Congress abrogated New York's immunity from suit. In turn, the first issue to be decided was whether Congress validly abrogated the states' Eleventh Amendment sovereign immunity and lawfully subjected the states to federal suits. The Court stated that the Eleventh Amendment assures that each state is a sovereign entity in our federal system and that it is inherent in the nature of sovereignty not to be amenable to suit by any individual litigant without the sovereign's consent.[10] Yet, according to the Supreme Court's decision in *Seminole Tribe v. Florida,* state immunity from suit under the Eleventh Amendment is not absolute; Congress may abrogate a state's sovereign immunity if it: (1) "unequivocally express[s] its intent to abrogate the immunity," and (2) acts "pursuant to a valid exercise of power."[11]

Under the first prong of the congressional abrogation test, the Court explained that "'Congress may abrogate the States' constitutionally secured immunity from suit in federal court only by making its intention unmistakably clear in the language of the statute.'"[12] The Court found that in the case at bar "this requirement is clearly satisfied here because § 11501 of the 4-R Act explicitly vests jurisdiction not only in the state courts, but also in the 'district court[s] of the United States . . . to prevent a violation' of the 4-R Act. Accordingly, Congress' intent to abrogate the states' immunity is clear."[13]

Under the second prong of the congressional abrogation test, the Court inquired into whether the 4-R Act was passed pursuant to a valid exercise of congressional power. The Court started its analysis by reaffirming the principle that "Congress may not abrogate state immunity pursuant to its Commerce Clause powers."[14] The Court recognized that "Section 5 of the Fourteenth Amendment allow[s] Congress to abrogate the immunity from suit guaranteed by [the Eleventh] Amendment."[15] Based on these constitutional norms, the Court did not agree with the argument posed by the State Defendants that the Act "was a classic exercise of [Congress'] Commerce power" and was not undertaken in response to the Equal Protection Clause.[16] The Court therefore concluded "Congress validly passed the 4-R Act pursuant to its authority under Section 5 of the Fourteenth Amendment."[17]

The Court felt that based on the 4-R Act's explicit prohibition against discriminatory conduct on the part of states, coupled with the legislative history and clear intent of Congress to alleviate allegedly discriminatory taxing schemes, were sufficient to demonstrate that the 4-R Act was passed pursuant to Congress' Fourteenth Amendment powers.[18] Therefore, in enacting the 4-R Act, Congress validly abrogated the states' Eleventh Amendment sovereign immunity and lawfully subjected the states to federal suits raising claims of excessive property assessment and taxation.

Issue (2): Individual defendants are amenable to suit under the doctrine of *Ex Parte Young*.

The Court then turned to the second issue of whether an action could independently be maintained against the individual defendants in this suit. Under the doctrine of *Ex Parte Young* there is an exception to the sovereign immunity which allows for "'a suit [for injunctive relief] challenging the constitutionality of a state official's actions in enforcing state law' under the theory that such a suit is not 'one against the State,' and therefore not barred by the Eleventh Amendment."[19]

The Court went on to say that "in determining whether the doctrine of *Ex Parte Young* avoids an Eleventh Amendment bar to suit, a court need only conduct a straightforward inquiry into whether the complaint alleges an ongoing violation of federal law and seeks relief properly characterized as prospective."[20]

Based on this test and the precedent established by the Second Circuit's decision in *Consol. Rail Corp v. Town of Hyde Park*[21] that "ORPS possesses both the power and the duty under New York law to control assessment of railroad taxes for the local districts," the Court concluded that "such a straightforward inquiry here reveals that *Ex Parte Young* permits jurisdiction over the individual defendants for prospective relief because of their role in railroad property assessments and the alleged violation of the 4-R Act."[22] The Court further remarked that "*Ex Parte Young* allows for jurisdiction over the individual defendants inasmuch as it is in the performance of their duties that there may be an ongoing violation of federal law."[23]

In turn, and for the foregoing reasons, the Second Circuit affirmed the judgment of district court.

Endnotes

1. "A tax imposed proportionally on the value of something (esp. real property), rather than on its quantity or some other measure." *Black's Law Dictionary* (Bryan A Garner ed., 2d Pocket Edition, West 2001).
2. *See* N.Y. Real Prop. Tax Law § 202.
3. N.Y. Real Prop. Tax Law § 489(p).
4. *Id*.
5. 49 U.S.C. § 11501(b).
6. *Id*.
7. *Id*. at § 11501(c).
8. *Ex Parte Young*, 209 U.S. 123, (1908).
9. U.S. Const. amend XI. (The Eleventh Amendment provides that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State").
10. *CSX Transp. Inc. v. N.Y. State Office of Real Prop. Servs.*, ___ F.3d ___, 2002 WL 31116641at *5 (2d Cir. Sept. 25, 2002) (citing *Seminole Tribe v. Florida*, 517 U.S. 44, 54 (1996)).
11. *Id*. (quoting *Seminole*, 517 U.S. at 55).
12. *Id*. (citing *Dellmuth v. Muth*, 491 U.S. 223, 228 (1989) (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985)).
13. *Id*.
14. *Id*. at *6 (citing *Seminole*, 517 U.S. at 72-73).
15. *Id*. (citing *Seminole*, 517 U.S. at 59).
16. *Id*.
17. *Id.* at *8
18. *Id*.
19. *Id*. at *9 (citing *Ex Parte Young*, 209 U.S. at 154).
20. *Id*. (citing *Verizon Md., Inc. v. Public Services Comm'n of Maryland*, 122 S.Ct. 1753, 1760.)
21. 47 F.3d 473 (2d Cir. 1995).
22. *CSX,* 2002 WL 31116641 at *10
23. *Id*.

By Devin Ryan '05

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