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In Memoriam—Beverly T. Mitchell

This issue of the *Journal* is dedicated by the Section's Executive Committee to the memory of Beverly T. Mitchell, a beloved member of the Committee, who died on February 17, 1998 from injuries sustained in a pedestrian/vehicle accident. Beverly was a principal in the Albany firm of McNamee, Lochner, Titus & Williams, and was Co-Chair of the Section's Committee on Commercial Leasing. While one could determine her many accomplishments from her resumé—i.e., valedictorian of her Albany Law School class—you did not know the real Beverly until you met her. She was an absolute delight to work with, being able to represent her clients to the fullest while not turning a typical transaction into an adversarial proceeding. She always rose above the fray. For someone with so many gifts and skills—intelligence, wisdom, common sense, grace—she was incredibly modest. She treated all people equally and with true kindness and decency. The Executive Committee has lost a wonderful colleague and contributor, the legal community has lost a role model attorney, and the world has lost an exquisite person. To her husband, Bob, her parents, siblings and the rest of her family, we send our deepest sympathies—their loss is immeasurable.

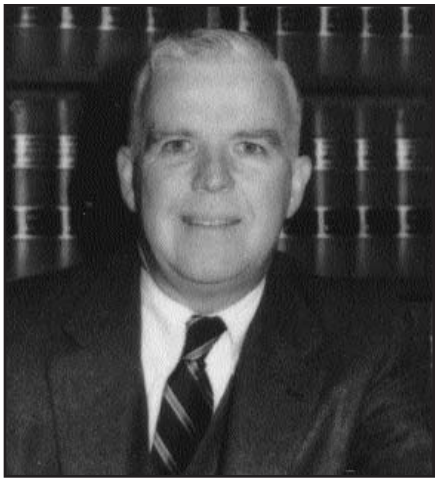
INSIDE

Message From the Section Chair

The Real Property Law Section's Annual Meeting took place at the Marriott Marquis on Thursday, January 29, 1998 as part of the New York State Bar Association's Annual Meeting. **Lorraine Power Tharp** arranged for a stimulating and informative program. We express our gratitude to her.

The day began with the nomination of officers for the year beginning June 1, 1998. Lorraine Power Tharp of Albany was nominated to be Section Chair. **Steven G. Horowitz** of New York City was nominated to be First Vice Chair. **James S. Grossman** of Rochester was nominated to be Second Vice Chair. The new kid on the block is **Melvyn Mitzner** of New York City, who was nominated to be Secretary. It is a well-deserved honor. Mel has worked long and hard for the Section as Co-Chair of the Committee on Title and Transfer. All were elected unanimously.

After the election, the day's program commenced. **Steven D. Cohen**, Real Estate Counsel with Bell Atlantic, spoke on "Telecommunications Issues in Commercial Lease Negotiations." **Marty Shlufman** of Garden City and **Ed Baer**, a partner in Borah, Goldstein, Altschuler & Schwartz, P.C., discussed "Rent Regulation—Summary of the New Legislation." **Dorothy Ferguson**, of Harter, Secrest & Emery, discussed "Third Party Opinion Letters." **Josh Stein**, a partner in Latham & Watkins and also Co-Chair of the Committee on Commercial Leasing, discussed



"Current Committee Projects Including Leasing Checklists for Landlord and Tenant." A "Tax Certiorari and Condemnation Update" was presented by **Jon N. Santemma** of Santemma & Deutsh, Mineola, and Larry Zimmerman of the Helm, Shapiro firm in Albany. "Condominium Lending" was discussed by **Matt Leeds**, a partner in New York City's Robinson Silverman. "Implementation of the New York City Watershed Agreement and Its Impact on Real Estate Development" was analyzed by **Joel Sachs**, a partner in Keane and Beane, White Plains, and Co-Chair of our Committee on Environmental Law. Recent cases in which environmental regulations were claimed to have constituted a taking were examined by **John Privitera**, a partner in McNamee, Lochner, et al., of Albany.

The workings of the legislative review process and current bills of interest were discussed by **Bob Hoffman**, the Co-Chair of our Committee on Legislation. **Jerry Hirschen** and **Brian Lawlor**, Co-Chairs of the Committee on Low Income and Affordable Housing, discussed "New York State Affordable Housing Initiatives, HUD Reorganization and Expiring Section 8 Contracts."

Steve Bloom of Robinson Silverman discussed the always-troubling issue of diplomatic immunity and the ability to dishonor lease obligations. The final speaker of the program was Mel Mitzner, who spoke on the Marketable Record Title Act.

The Section Luncheon heard a stimulating talk by **Joseph B. Lynch**, Acting Commissioner of the Division of Housing and Community Renewal.

Our committees functioned at many meetings during the two days of the Section's Meeting. I urge those lawyers who are members of the Section but have never attended an Annual Meeting at the Marriott or a Summer Meeting to please do so. You will be welcomed not only to the Section Meeting but also to Committee Meetings with open arms. This summer's meeting will be at the Otesaga in Cooperstown, New York. Our committees and their chairs are listed in the rear of this publication. I urge you to participate.

Finally, I wish all of you a healthy, happy and prosperous 1998.

John G. Hall

DENNIS C. VACCO
Attorney General

STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL

RESPONSE OF ATTORNEY GENERAL DENNIS C. VACCO
Preparation of Purchase and Sale Contracts by Real Estate Brokers

Dear Mr. Lee:

This responds to your "Open Letter to Attorney General Dennis C. Vacco" published in the New York Real Property Law Journal (Vol. 25, No. 3, 1997). In your letter you refer to a formal opinion of the Attorney General issued to the New York State Department of State regarding the preparation of purchase and sale contracts by real estate brokers. Counsel to that Department requested our guidance as to whether the preparation of these contracts by real estate brokers constitutes the unlawful practice of law. Based on our evaluation of New York statutes and case law, we provided the Department of State with clear standards regarding the preparation of these contracts by real estate brokers. You have asked that we reiterate those standards.

We began by noting that the New York statutes forbidding the unauthorized practice of law were enacted to protect the public. We recognized that consideration should be given to the continuing tradition in this State of allowing lay persons to draft simple contracts. In setting standards for preparation of purchase and sale contracts by real estate brokers, however, we emphasized that this tradition is tempered by the fact that the so-called simple contract will in this context affect very substantial legal rights—the purchase and sale of a home. Our opinion also considered that typically a broker representing one party to a transaction prepares documents affecting the legal rights of both the buyer and the seller. With these factors in mind, we set forth clear standards for the preparation of purchase and sale contracts by real estate brokers.

We concluded that a broker or realtors' association that prepares a simple fill-in-the-blanks purchase and sale contract "can avoid the unlawful practice of law by including in the contract a condition making it subject to approval by each party's attorney."

Alternatively, we stated that brokers can utilize a contract form that has been approved by a recognized bar association in conjunction with a recognized realtors' association provided that the form only requires that the brokers fill in non-legal provisions such as the names of the parties, the date and location of the closing, a description of the property and the consideration for sale. The broker may not develop any "legal terms." Further, we stated that since the contract establishes significant legal rights and obligations, "it should clearly and prominently indicate on its face that it is a legally binding document and clearly and prominently recommend that the parties seek advice and counsel from their lawyers prior to affixing their signatures to the document." Significantly, we found that brokers may not add provisions to these standard fill-in-the-blanks contracts "unless they make the entire contract subject to and conditioned upon the review and approval of each party's attorney."

We also concluded that brokers must refrain from providing any legal advice to their clients. They may not discourage the parties from seeking advice from their attorneys.

Finally, we stated that brokers may provide purchase and sale contracts, subject to the above conditions, only as part of the purchase and sale of real estate and may not charge a separate fee for preparation of the contract or share in the fees of attorneys for preparation or review of these contracts.

As is evident, our opinion is clear and unequivocal in advising the Department of State as to the standards and conditions applicable to preparation of purchase and sale contracts by real estate brokers. I thank you for your letter and thank the Journal for the opportunity to publish this response regarding this significant public issue. Attached is a copy of Formal Opinion No. F 96-11.

Very truly yours,

DENNIS C. VACCO
Attorney General

Opn. No. F 96-11

JUDICIARY LAW § 484; REAL PROPERTY LAW § 441-c.

Real estate brokers are not engaged in the unauthorized practice of law if they prepare purchase-and-sale contracts that expressly state the documents are subject to review by the parties' attorneys, or if they use forms approved by the appropriate organizations and do not insert any material requiring legal expertise. This limited privilege must be narrowly circumscribed.

Your counsel has requested an opinion regarding the preparation of purchase-and-sale contracts by real estate brokers licensed by the Department. Specifically, your counsel has asked whether preparing such documents constitutes the unauthorized practice of law.

Judiciary Law § 484 provides in part:

> No natural person shall ask or receive, directly or indirectly, compensation for appearing for a person other than himself as attorney in any court or before any magistrate, or for preparing deeds, mortgages, assignments, discharges, leases or any other instruments affecting real estate, wills, codicils, or any other instrument affecting the disposition of property after death, or decedents' estates, or pleadings of any kind in any action brought before any court of record in this state, or make it a business to practice for another as an attorney in any court or before any magistrate unless he has been regularly admitted to practice, as an attorney or counselor, in the courts of record in this state.

In *Matter of Duncan & Hill Realty, Inc. v Department of State*, 62 AD2d 690 (4th Dep't), *app dismissed*, 45 NY2d 821 (1978), the court upheld the Department's determination that a broker who was not a licensed attorney demonstrated untrustworthiness and incompetence in violation of Real Property Law § 441-c, finding that when he prepared documents that included detailed mortgage terms he had devised, he engaged in the unauthorized practice of law.

The court recognized that real estate brokers and agents have drafted "simple" contracts between their clients as a part of their professional work. *Duncan & Hill, supra*, 62 AD2d at 696. It noted that, historically, as long as brokers had not held themselves out to be attorneys, had confined their activities to transactions in which they were serving as brokers, and had made no additional charge for preparing these incidental and simple documents, courts had held that they were not engaged in the unauthorized practice of law. *Id.*; cases cited.

As noted by the court in *Duncan & Hill*, 62 AD2d 690, *supra*, however, a real estate broker typically serves either the buyer or the seller. Therefore, the references in the cases to brokers "serving their clients" in relation to a specific transaction rests on the erroneous assumption that brokers represent both the seller and buyer. *Duncan & Hill*, *supra*, at 696.

The court relied on *People v Title Guarantee and Trust Co.*, 227 NY 366 (1919), in which the Court of Appeals held that a corporation was not performing legal services when its employees prepared a chattel mortgage and bill of sale for real property by filling in blanks in forms at the customer's direction as an incident to its regular business. The Court noted that under the governing statute, a corporation could not practice law, but that it could perform services "that may be performed by a layman." *People v Title Guarantee and Trust Co., supra*, at 373. The Court took judicial notice of "a widespread custom which has prevailed from time out of memory in this state" that laymen may draw simple instruments. *People v Title Guarantee and Trust Co., supra*, at 375. If the Legislature intended to curtail this practice, it would have clearly so stated in the statute governing practice of law by individuals. *Id.* Because the Legislature had not done so the Court concluded that corporations were not barred from preparing simple instruments.[1]

The court in *Duncan & Hill* acknowledged the custom that lay persons have been permitted to prepare simple contracts and went on to identify weaknesses in the justifications commonly advanced for the traditional view.[2]

> . . . the so-called "simple" contract is in reality not simple. It is often the most important legal transaction that the average person will ever undertake—the purchase of a home, and it involves very substantial legal rights which deserve the advice and guidance of a lawyer. The argument that the need for expediting such transactions justifies their consummation without reference to an attorney is specious. The protection of the interests of the parties to such contracts is sufficiently important to justify a little delay for reflection and legal advice, so as to guard

> against a thoughtless drafting of a hastily conceived contract. The personal interest of the broker in the transaction and the fact that he is employed by one of the opposing parties are further reasons to require that, insofar as the contract entails legal advice and draftsmanship, only a lawyer or lawyers be permitted to prepare the document to ensure the deliberate consideration and protection of the interests and rights of the parties. *Duncan & Hill, supra*, 62 AD2d at 696-97; footnote omitted.

The court noted that the statutes forbidding unauthorized practice of law were enacted to protect the public and concluded that the privilege accorded real estate brokers and agents "must be circumscribed for the benefit of the public to ensure that such professionals do not exceed the bounds of their competence and, to the detriment of the innocent public, prepare documents the execution of which requires a lawyer's scrutiny and expertise." 62 AD2d at 698. The court noted that the American Bar Association and the National Association of Real Estate Brokers had established practical guidelines. *Duncan & Hill, supra*, at 697 n 2. The court also noted that the National Conference of Lawyers and Realtors (a joint committee of the American Bar Association and the National Association of Real Estate Brokers [*Duncan & Hill, supra*, at 699, n 4]) had prepared a model form contract of sale for review by State and local bar associations and realtor committees, which may amend the model to conform to local law and custom. *Duncan & Hill, supra*, at 698 n 4.[3]

Recognizing the intent to protect the public, the court went on to state:

> It is for this reason that real estate brokers and agents must refrain from inserting in a real estate purchase offer or counteroffer any provision which requires the exercise of legal expertise. Thus it is not proper for such a broker to undertake to devise the detailed terms of a purchase-money mortgage or other legal terms beyond the general description of the subject property, the price and the mortgage to be assumed or given. A real estate broker may readily protect himself from a charge of unlawful practice of law by inserting in the document that it is subject to the approval of the respective attorneys for the parties. Moreover, a real estate broker or agent who uses one of the recommended purchase offer forms referred to above, or one recommended by a joint committee of the bar association and realtors association of his local county, who refrains from inserting provisions requiring legal expertise and who adheres to the guidelines agreed upon by the American Bar Association and the National Association of Real Estate Brokers, above noted, has no need to worry about the propriety of his conduct in such transactions. 62 AD2d at 701.

You have advised us that the Department continues to apply the standards set forth in *Duncan & Hill* in administrative proceedings where brokers are charged with untrustworthiness or incompetence based on the alleged unauthorized practice of law.[4]

We believe that in setting standards for the unlawful practice of law by real estate brokers regarding the preparation of purchase and sale contracts consideration should be given to the tradition in this State of allowing lay persons to draft simple contracts. However, this factor must be tempered by the fact that the so-called simple contract will in this context affect very substantial legal rights—the purchase of a home. Also, we take into consideration that typically a broker representing one party to the transaction prepares documents that affect the legal rights of both the buyer and the seller.

Under these circumstances, we believe that a broker or realtors' association that prepares a simple fill-in-the-blanks purchase and sale contract can avoid the unlawful practice of law by including in the contract a condition making it subject to approval by each party's attorney. Alternatively, brokers can utilize a fill-in-the-blanks form that has been approved by a recognized bar association in conjunction with a recognized realtors' association. Such an approved form would only require that the real estate brokers fill in non-legal provisions such as the names of the parties, the date and location of the closing, a description of the property, the consideration for sale and any other relevant facts. The brokers would not be required to develop any "legal terms." Further, since the contract establishes significant legal rights and obligations, it should clearly and prominently indicate on its face that it is a legally binding document and clearly and prominently recommend that the parties seek advice and counsel from their lawyers prior to affixing their signature to the document.

The brokers must refrain, even with respect to these simple fill-in-the-blanks contracts, from providing

legal advice to their clients. Nor may they discourage the parties from seeking advice from their attorneys. Brokers may not add provisions to the standard fill-in-the-blanks contracts unless they make the entire contract subject to and conditioned upon the review and approval of each party's attorney. Brokers may provide purchase and sale contracts, subject to the above conditions, only as an incident of the purchase and sale of real estate and may not charge a separate fee for preparation of the contract or share in the fees of attorneys for preparation or review of these contracts.

Endnotes

1. In concluding that the appellant corporation did not represent to the public that it practiced law and only filled in the blanks on the chattel mortgage and bill of sale of real property as an incident of its business as a title guarantee and trust company, the Court of Appeals narrowed the inquiry to whether the actual preparation of the document amounted to the rendering of legal services. *People v Title Guarantee and Trust Co., supra*, 227 NY at 371-372. The Court concluded that the services did not fall within that category. *People v Title Guarantee and Trust Co., supra*, at 377. In dictum, the Court noted the potential difficulty of determining what constitutes a simple instrument and the futility of attempting to create a general rule, stating that such determinations must be made on a case-by-case basis. Id., at 377-378.

2. In *People v Title Guarantee, supra*, a 4-3 decision, Judge Pound, in a concurring opinion, could not adopt as a test for performing legal services whether the instruments were simple or complex. "The most complex are simple to the skilled and the simplest often trouble the inexperienced. Skill is sought when another is employed to do the work." *People v Title Guarantee, supra*, at 379. If the services are of a character generally performed by lawyers as a part of their ordinary routine, they should be characterized as legal services. *People v Title Guarantee, supra*, at 379-380. Judge Pound concurred in the result, however, based on his finding that the services were incidental to the corporation's business, and it did not represent to the public that it would prepare legal instruments generally. *People v Title Guarantee, supra*, at 379-380. In dissenting, Judge Cardozo, joined by two justices, accepted Judge Pound's conception of legal services, finding there was sufficient evidence for the jury's finding of a violation of the statute. *People v Title Guarantee, supra*, at 381.

3. The form was designed with boldface print at the top alerting both parties to the real estate transaction that, when signed, the instrument becomes a binding contract, and cautioning them that it is desirable that they consult their respective attorneys. *Duncan & Hill, supra*, at 698.

4. Subsequent Appellate Division decisions are consistent with *Duncan & Hill. See, Matter of Mulford v Shaffer*, 124 AD2d 876 (3d Dept 1986) (charge of untrustworthiness and incompetence supported when record showed broker inserted broad, legally significant contingency clause, failed to suggest agreement be reviewed by attorney, gave advice re legal effect of provisions and charged a fee for preparing documents); *Matter of Sorrentino v Shaffer*, 125 AD2d 956 (4th Dept 1986) (charge of untrustworthiness and incompetence sustained when broker discouraged purchaser from seeking legal advice, failed to use a form advising parties to seek legal advice, and failed to insert a contingency clause essential to protection of buyer's interest); *Matter of Tucci v Dept. of State*, 63 AD2d 835 (4th Dept 1978) (broker engaged in unauthorized practice of law when he drafted legal documents including a revised purchase offer and gave advice as to their legal effect).

U.S. Supreme Court Decision Gives Municipalities Greater Control Over Land Development Proposals by Religious Organizations

by Beth P. Sachs and Joel H. Sachs*
White Plains, New York

Over the past several years, numerous religious organizations have claimed in a variety of contexts that they are either exempt or are entitled to preferential treatment insofar as various land development proposals are concerned. Very often such organizations claim that based upon First Amendment guarantees, as well as federal statutory protections, municipalities cannot apply their zoning, planning, historic preservation and environmental laws to religious organizations in the same manner in which such laws are applied to developers. However, these religious organizations received a serious, albeit non-fatal, blow to these contentions as a result of a June 25, 1997 decision of the United States Supreme Court in *City of Boerne v. Flores*.[1]

In a six to three vote, the Supreme Court declared that Congress exceeded its legislative authority under the Fourteenth Amendment when it passed the Religious Freedom Restoration Act ("RFRA").[2] In so doing, the Court addressed procedural issues of federalism, the separation of powers doctrine and the meaning of the free exercise clause in light of local zoning and environmental laws of general applicability and the people's interest in religious liberty.

The controversy in *City of Boerne* arose when St. Peter's Catholic Church, built in the Texas Mission style in 1923, announced an expansion plan to accommodate its growing membership. Prior to the submission of the expansion plan, the Boerne City Council passed an ordinance empowering the city's Historic Landmark Commission to prepare a city preservation plan that included the church property. The ordinance required city approval of any construction affecting buildings within the designated historic district. Subsequently, city officials rejected the Archbishop's building permit request, stating that the proposed expansion threatened the city's historic preservation plan and would adversely affect the Historic District's architectural and historic character.

"RFRA prohibits government from substantially burdening a person's exercise of religion even if the burden results from a rule of general applicability . . ."

Archbishop P.F. Flores brought suit against the City of Boerne in federal court, alleging that the city's refusal to grant the permit violated RFRA and effectively limited the right of the church to use its property for the religious purposes for which it was intended, and that this amounted to a compensable taking under the Texas and United States constitutions. The city countered that the RFRA was unconstitutional under the First Amendment's establishment clause, the Tenth Amendment, the Fourteenth Amendment and the separation of powers doctrine.

The District Court held that RFRA was facially invalid because it infringed upon the power of the judiciary in violation of *Marbury v. Madison*[3] and upheld the city's denial of the permit for church expansion.[4] The United States Court of Appeals for the Fifth Circuit overturned the ruling and held RFRA constitutional and applicable to local ordinances that protect historic districts and landmarks.[5]

RFRA prohibits government from substantially burdening a person's exercise of religion even if the burden results from a rule of general applicability, unless the government can apply a strict scrutiny test and demonstrate that the burden 1) is in furtherance of a compelling governmental interest and 2) is the least restrictive means of furthering that interest. RFRA created a statutory right to challenge any government action that burdens the exercise of religion and forces government to demonstrate a compelling justification for a challenged restriction. RFRA was enacted in response to *Employment Division Department of Human Resources of Oregon v. Smith*,[6] in which the Supreme Court upheld against a free exercise challenge a state law of general applicability criminalizing peyote use. The state law was applied to deny unemployment benefits to Native American church members who lost their jobs because of peyote use, which members claimed was inherent to their native religious practices. The Supreme Court ruled that reli-

gious groups had no constitutional right to object to laws of general applicability that have the effect of incidentally burdening religion. The Court rejected the church members' argument that peyote use was protected by the free exercise clause and was improper grounds for denial of unemployment benefits.

"In City of Boerne*, the Supreme Court ruled that RFRA was not a proper exercise of congressional enforcement power because it offended vital principles necessary to maintain the separation of powers and the federal-state balance."*

In enacting RFRA, Congress relied on its powers under the equal protection clause of the Fourteenth Amendment as applied to the states, and on Article 5 of the Constitution, which empowers Congress to enforce those guarantees by appropriate legislation. It pointed out that the Supreme Court's ruling in *Smith* "virtually eliminated the requirement that the government justify burdens on religious exercise imposed by law neutral toward religion." The purpose of RFRA was to "restore the compelling interest test . . . and to guarantee its application in all cases where free exercise of religion is substantially burdened." RFRA thereby obligated the states to exempt religiously motivated activity from laws that are otherwise valid and generally applicable to all citizens.

In *City of Boerne*, the Supreme Court ruled that RFRA was not a proper exercise of congressional enforcement power because it offended vital principles necessary to maintain the separation of powers and the federal-state balance. Writing for the majority, Justice Kennedy stated that it was beyond the constitutional authority of Congress to legislatively impose a change in the interpretation of the free exercise clause, as it was the Court's duty to "say what the law is," even where the Constitution expressly grants Congress the power to enforce constitutional rights.[7] Justice Kennedy wrote that "[l]egislation which alters the meaning of the free exercise clause cannot be said to be enforcing the clause. Congress does not enforce a constitutional right by changing what the right is. It has been given the power 'to enforce,' not the power to determine what constitutes a constitutional violation."[8]

The Supreme Court viewed RFRA's strict scrutiny language as "the most demanding test known to constitutional law" which in this context reflects "a lack of proportionality or congruence between the means adopted and the legitimate end to be achieved."[9] The Court held that the congressional power to enforce constitutional liberties under section 5 of the Fourteenth Amendment is "remedial" and "preventative" in nature and does not extend to altering the "substantive" meaning of the constitutional right itself. The Court distinguished RFRA from cases such as *South Carolina v. Katzenbach*,[10] which upheld federal laws that banned literacy tests and voting requirements for voter registration, classifying these laws as remedial and preventative measures designed to prevent unconstitutional behavior of states by the denial of equal protection under the law. However, it classified RFRA as an overly broad measure that allowed religious groups to circumvent a generally applicable law created by local governments under their police power to regulate the health, safety and welfare of the citizens.

The Court stated that RFRA's sweeping coverage ensures its intrusion at every level of government, displacing laws and prohibiting government actions regardless of their subject matter. The Supreme Court further indicated that any law is subject to challenge, but those challenged under RFRA are not motivated by religious bigotry in most instances. The Court implied that the legislation can protect the exercise of religion only in the relatively rare instances in which government has deliberately singled out a religious practice for prohibition or persecution.

Justice Kennedy noted that the statute was far too sweeping for the problems it intended to remedy, as there was no evidence of a pattern of religious discrimination beyond the incidental burdens that arise from historic preservation, zoning and environmental laws. Kennedy stated that "the act is so out of proportion to a supposed remedial or preventive object that it cannot be understood as responsive to, or designed to prevent, unconstitutional behavior. It appears, instead, to attempt a substantive change in constitutional protections."[11]

The Court indicated that federalism permits states to exercise police power over individuals, unless the exercise of that power violates the rights of individuals under the Bill of Rights as incorporated by the Fourteenth Amendment. In such instances Congress can enact remedial or preventative measures to guard individual rights. However, under a separation of powers theory, the Supreme Court held that it, not Congress, is the final authority on the interpretation of constitutional provisions and the arbiter of the scope of individual rights with which the states are forbidden to interfere. The Court concluded that RFRA unlawfully usurped the power of the federal judiciary and the states and was "a considerable intrusion into the states' traditional prerogatives

and general authority to regulate for the health and welfare of their citizens."

In a separate concurring opinion, Justice Stevens found that RFRA violated the establishment clause of the First Amendment because it granted rights to religious practitioners that were not available to others.

City of Boerne explored the nature of the balance of power between Congress and the federal judiciary, as well as the increasingly tense debate between historic preservationists, land use planners, and environmentalists on one hand and religious organizations on the other with regard to the power of municipalities to subject properties owned by religious organizations to generally applicable land use and environmental ordinances. By striking down RFRA, the Court sided with those who advocate making land use, historic preservation and environmental controls equally applicable to both private property owners and religious organizations.

Within days of the Supreme Court's decision in *Boerne*, religious organizations in New York and other states began lobbying their respective state legislatures to enact a Religious Freedom Restoration Act at the state level. The decision in *City of Boerne*, holding that Congress exceeded its legislative authority under the Fourteenth Amendment when it enacted RFRA, seemingly left the door open for states to enact comparable legislation.

Accordingly, within the month, Assembly Bill No. 8499 and Senate Bill No. 5673 were introduced in Albany for the explicit purpose of protecting religious organizations from having to comply with local land use, historic preservation and environmental laws and other similar municipal ordinances in New York State. Such bills resurrected the "compelling state interest" test and indicated that before the state and its municipalities can apply a law to a property owned by a religious institution, they must demonstrate a compelling state interest. The operative language of the bills was that "[g]overnment may substantially burden the exercise and enjoyment of religion only if its demonstrates that the burden to the religion is in furtherance of a compelling governmental interest and is the least restrictive means for furthering that governmental interest."[12] Such bills, drafted in haste in the waning days of the 1997 session, never made it to the floor of the state legislature. Nevertheless, it is probable that similar legislation will be introduced in Albany in 1998.

"The decision in City of Boerne*, holding that Congress exceeded its legislative authority under the Fourteenth Amendment when it enacted RFRA, seemingly left the door open for states to enact comparable legislation."*

However, the question remains: even if such state legislation could pass constitutional muster, is such legislation really necessary in the state of New York? There is an extensive body of case law in New York wherein courts have balanced the exercise of police power by the municipality against claims that local legislation was interfering with the free exercise of religion. Although these cases for the most part have recognized the legitimate health, safety and welfare concerns of municipalities, they have generally indicated that a municipality must modify some of its regulatory standards in addressing religious uses.[13] Thus, even though RFRA has been struck down by the Supreme Court, and even if the New York State Legislature does not enact a state version of RFRA, prevailing case law in New York seems to indicate that a religious organization with a land development proposal will not be held to the same strict regulatory standard as a private developer.

Endnotes

1. 117 S. Ct. 2157 (1997).
2. 42 U.S.C. § 2000bb (1993).
3. 5 U.S. 137, 1 Cranch 137, 2 L.Ed 60 (1803).
4. Flores v. City of Boerne, 877 F.Supp. 355 (W.D. Tex. 1995).
5. City of Boerne v. Flores, 73 F.3d 1352 (5th Cir. 1996).
6. 94 U.S. 872, 108 L.Ed.2d 876, 110 S.Ct. 1595 (1990).
7. City of Boerne, 117 S.Ct. at 2172.
8. *Id.* at 2164.
9. *Id.* at 2171.
10. 383 U.S. 301, 15 L.Ed.2d 769, 86 S. Ct. 803 (1966).
11. City of Boerne, 117 S.Ct. at 2159.
12. 1997 S. Bill 5673 § 276(2).
13. *See* Cornell University v. Bagnardi, 68 N.Y.2d 583, 510 N.Y.S.2d 861 (1986); Jewish Reconstructionist Synagogue of the North Shore, Inc. v. Village of Roslyn Harbor, 38 N.Y.2d 283, 379 N.Y.S.2d 747 (1975); Diocese of Rochester v. Planning Board of Town of Brighton, 1 N.Y.2d 508, 153 N.Y.S.2d 849 (1956).

***Beth P. Sachs is a second year student at Cardozo Law School. Joel H. Sachs is a partner at Keane & Beane, P.C. in White Plains and Co-chair of the Environmental Law Committee of the Real Property Law Section.**

How Far Can Courts Stretch *BFP v. RTC* Before the Supreme Court Speaks Again?

by Troy Gardiner Pieper*
Uniondale, New York

In *BFP v. Resolution Trust Corp.*,[1] the United States Supreme Court, in a five to four decision, held that "reasonably equivalent value" of foreclosed real property under Bankruptcy Code section 548(a)(2)[2] is whatever price the property commands at a properly conducted, procedurally regular foreclosure proceeding. This settled a long-standing disagreement among federal circuit courts on the application of fraudulent transfer laws to noncollusive regularly conducted foreclosure sales, but left open questions of the valuation of property sold via tax or sheriff sale, or transferred in a non-foreclosure sale context. This article will explore the limits of the protection afforded by *BFP* and the areas that the decision does not cover.

I. The Road to *BFP*: Mortgage and Fraudulent Transfer Law

Modern American mortgage law has its roots in English common law. Trying to avoid the harshness of common law strict foreclosure, American courts adopted foreclosure by sale to preserve the debtor's equity where said equity exceeded the amount due on the mortgage. To this day, foreclosure methods are heavily regulated by state legislatures in order to safeguard the interests of mortgagors, but in many instances state legislation in this area fails to adequately protect those interests.

Fraudulent transfer laws serve as additional defenders of the defaulting mortgagor; they are designed to protect a debtor's assets for the benefit of unsecured creditors, they promote fair play and positive relations among debtors and creditors, and they protect legitimate creditors by consciously allocating the risk to the transferees that a transaction may be deemed made at less than arm's length.

"[F]oreclosure methods are heavily regulated by state legislatures in order to safeguard the interests of mortgagors, but in many instances state legislation in this area fails to adequately protect those interests."

Section 548 of the Bankruptcy Code creates a federal cause of action in which a trustee or debtor in possession may avoid a pre-petition "transfer" as fraudulent. Short of meeting the difficult burden of proving actual fraud,[3] a trustee may prove a transfer to be constructively fraudulent by demonstrating by a preponderance of the evidence that the debtor had an interest in the mortgaged property, the debtor transferred that interest within one year of filing the bankruptcy petition, at the time of the transfer the debtor was insolvent or became insolvent as a result thereof, and the debtor recovered less than "reasonably equivalent value" for the transfer.[4]

Additionally, since the Statute of 13 Elizabeth[5] transfers calculated to place a debtor's property beyond the reach of creditors have been condemned as fraudulent. More recently, the common law of fraudulent transfers was codified in 1918 by the Uniform Fraudulent Conveyance Act (U.F.C.A.), and supplanted by the Uniform Fraudulent Transfer Act (U.F.T.A.) which was approved by the National Conference of Commissioners on Uniform State Law and now has been adopted in most states, not including New York, where the U.F.C.A. remains the law.[6] Fraudulent transfers, therefore, are condemned outside the bankruptcy context, enabling the trustee of the bankruptcy estate to bring a fraudulent transfer avoidance action under section 544(b) of the Bankruptcy Code[7] using a state law vehicle.

In *Durrett v. Washington National Insurance Co.*,[8] the Fifth Circuit set aside a foreclosure sale due to inadequate price; this was the first decision to set aside a foreclosure sale based on the theory that the below market sale of a property constituted a fraudulent transfer under section 67(d)(1) of the 1978 Bankruptcy Act,[9] the predecessor to section 548 of the Bankruptcy Code. The court found that a foreclosure sale yielding fifty-seven percent of the property's fair market value constituted a fraudulent conveyance. The *Durrett* court, in dicta, noted that it was "unable to locate a decision of any district or appellate court dealing only with a transfer of real property as the subject of attack under section 67(d) of the Act, which has approved the transfer for less than 70 percent of the market value of the property." Following the decision, courts and foreclosing mortgagees interpreted the "Seventy Percent Rule" or "*Durrett* Rule" as requiring that mortgagees bid seventy percent of the fair market value.

Courts following *Durrett* effectively supplanted state law by superimposing a federal minimum bid requirement on state foreclosure sales. Other courts rejected the *Durrett* Rule.

The Bankruptcy Appellate Panel of the Ninth Circuit rejected the *Durrett* Rule in *Madrid v. Lawyers Title Insurance Corp.*[10] as did the Sixth Circuit Court of Appeals in *In re Winshall Settlor's Trust,*[11] while the Seventh Circuit adopted a totality of the circumstances approach in *Bundles v. Baker*.[12]

"By insuring the finality of foreclosure sales, the decision [*in* BFP v. Resolution Trust Company] *represents another victory for secured creditors."*

II. *BFP* : The Supreme Court Defines "Reasonably Equivalent Value"

In 1994, the United States Supreme Court squarely addressed the issue of what constitutes "reasonably equivalent value" at a foreclosure sale. In *BFP v. Resolution Trust Company*,[13] the Court held that "reasonably equivalent value" for foreclosed property is the price in fact received at a foreclosure sale in which all the requirements of the State's foreclosure law have been complied with. By insuring the finality of foreclosure sales, the decision represents another victory for secured creditors.[14]

In *BFP*, a partnership had been formed to purchase a beach-front home in California. The partnership took title subject to a first lien deed of trust in favor of Imperial Savings Association. Upon the partnership's default, Imperial entered a notice of default and scheduled a properly noticed foreclosure sale. The sale was completed on July 12, 1989, whereupon the property was purchased by a third party for $433,000. In October, 1989, the partnership filed a Chapter 11 bankruptcy petition, and, acting as debtor-in-possession, subsequently filed an adversarial proceeding against the purchaser claiming that the property was worth over $725,000; the partnership argued that the sale was for less than reasonably equivalent value and was, therefore, constructively fraudulent.

In the five to four decision,[15] the Court, per Justice Scalia, began by analyzing the various circuits' interpretations of "reasonably equivalent value." Citing the reliance of *Durrett* and *Bundles* on a fair market value benchmark, the Court rejected their interpretations of section 548(a)(2). The Court reasoned that although the "fair market value" appears throughout the Bankruptcy Code, section 548 "seemingly goes out of its way to avoid this term." Following the presumption that Congress acts "intentionally and purposefully" when selecting particular language for one section of a statute and omitting it in another section, the Court concluded that fair market value could not be the measure of validity for a transfer within the meaning of section 548. The Court further supported this rationale by noting that fair market value is the "antithesis" of the value obtainable under forced-sale conditions; because of the conditions and restraints inherent in the forced sale context, the price received always will be lower than the appraised fair market value.

The Court rejected the attempt to advocate a "reasonable" or "fair" forced sale price. The Court noted that such an approach would require a court to make policy judgments, a task not authorized by the Bankruptcy Code. Abiding by what it perceived to be deference by Congress to the states, the Court refused to create a federal standard for reasonable equivalence that would interfere with state policy and extend federal bankruptcy law. Concluding that a "federally created cloud" could cover real property titles purchased at foreclosure sales, the Court opted, in the absence of clear and manifest statutory authority, not to "disrupt the harmony and preempt traditional state law" absent "clearer textual guidance." The Court reasoned that it is "black letter" law that mere inadequacy of price obtained at a regularly conducted foreclosure sale is insufficient to overturn the sale unless the price is so inadequate as to "shock the conscience of the Court." The Court held that the price received at a noncollusive, regularly conducted foreclosure sale constitutes reasonably equivalent value "so long as all the requirements of the State's foreclosure law have been complied with."

Justice Souter, in a biting dissent, criticized the Court's opinion for permitting a mere "peppercorn paid at a non-collusive and procedurally regular foreclosure sale" to conclusively represent reasonably equivalent value for the sale of real property. Finding the majority's interpretation to be inconsistent with the text, structure, and history of the statute, especially in light of the 1984 amendments to section 548, Justice Souter dissented based upon his interpretation of the plain meaning of the statute.

The dissent also questioned to what extent the majority intended its holding to apply to the bids of foreclosing mortgagees. In *BFP*, the Court addressed a foreclosure sale to a third party bidder, but may have left unsettled the issue of the bidding mortgagee. Clearly contrary to the debtor's interest, the mortgagee's motivation in bidding is to recover his or her own collateral in the property. In this context, however, it should be noted that the debtor may

seek protection from state law requirements of adequate notice and publication.

Justice Souter further noted that under the majority's opinion, "nothing would prevent a debtor who deeded property to a mortgagee 'in lieu of foreclosure' prior to bankruptcy from having the transaction set aside" under section 548(a)(2) of the Bankruptcy Code. When the seller of the equity of redemption in the mortgaged property finds that the sale price will not enable the seller to recover the interest or the principal, the seller may choose to avoid a foreclosure suit and deficiency judgment, or the potential tax liability arising as a product of the sale, and instead deed the property directly to the mortgagee in full satisfaction of the mortgage debt. Accepting that a deed in lieu of foreclosure has always borne risks, Justice Souter felt the risk was compounded by the fact that these transactions will not be afforded the same protection from section 548(a)(2) attack as properly conducted foreclosure sales. However, Justice Souter's dissent fails to accept or to recognize that a deed in lieu of foreclosure is a private sale not subject to state law requirements, but certainly still subject, like all private transfers, to fraudulent transfer treatment.

III. What *BFP* Doesn't Cover

The approach adopted by the majority favors not only purchasers at foreclosure sales, but creditors, mortgagees and title companies by providing for finality of transfers. Since 1991, the Supreme Court has heard seven cases of particular interest to large institutional lenders, and all seven decisions favored those creditors.[16] Similarly, four decisions have resulted in favorable decisions for governmental claimants.[17] The losers in these cases were the least unified and politically powerful groups, unsecured general creditors and, oftentimes, debtors; additionally, two decisions that favored debtors operated to the disadvantage of unsecured general creditors.[18]

The *BFP* holding is not a total windfall for institutional lenders. First, no presumption of "reasonably equivalent value" exists with respect to the price obtained at an improperly conducted mortgage foreclosure sale. Second, in light of the fact that some states allow the setting aside of a foreclosure sale based upon inadequacy of price, a properly conducted sale yielding a low price may not always be immune from state law attack. Third, many states permit avoidance of foreclosure sales where collusion exists. If a sale was per se collusive, for example where the price was fixed or the bid monopolized, the sale might be avoided under either state or federal law. In *BFP*, the Supreme Court mentions collusion only in its initial statement of the issue of the case, leaving the discussion and ultimate determination up to future litigation presumably upon state law.

Another limitation concerns Uniform Commercial Code article 9 secured creditors. Section 9-504(1) of the U.C.C. requires a foreclosing creditor to sell in a "commercially reasonable" manner.[19] Commercially reasonable sales have been interpreted as approximating fair market value. Despite the aforementioned principle that article 9 sales that conform to U.C.C. section 9-504(1) will not be set aside for inadequate price, some bankruptcy courts have expressed a willingness to treat pre-petition commercially reasonable article 9 sales as constructively fraudulent under section 548 of the Bankruptcy Code. In practice, however, properly conducted sales regularly survive fraudulent transfer scrutiny. Even if a low price raises a presumption that a sale was not "commercially reasonable," the sale will be judged by that standard, not by the reasonably equivalent value standard of Bankruptcy Code section 548(a)(2).[20] In fact, U.C.C. section 507[21] provides that if a sale has been commercially reasonable, it may not be attacked by showing that the price obtained was for less than fair market value. This reasoning appears circular in that a commercially reasonable sale, one approximating fair market value, will not be attacked as fraudulent if sold for a price that is well below fair market value as long as the sale is commercially reasonable. Perhaps *BFP* should be extended to U.C.C. article 9 cases in light of the fact that fair market value seems even less relevant in the commercially reasonable equation than it does in the reasonably equivalent value context.

"Perhaps BFP *should be extended to U.C.C. article 9 cases in light of the fact that fair market value seems even less relevant in the commercially reasonable equation than it does in the reasonably equivalent value context."*

The U.C.C. also provides the creditor with the option of strict foreclosure.[22] U.C.C. section 9-505(2) enables a secured creditor who has seized the collateral to retain the collateral in full satisfaction of the debt owed and thus avoid a sale. When the value of the property is approximately equivalent to the amount of debt outstanding, the secured creditor may choose to surrender any right to seek a deficiency judgment against the debtor because strict foreclosure essentially extinguishes the debt. The debtor, as a *quid pro quo,* would then surrender any right to the surplus. This

election should not enable the creditor to avoid completely judicial review of "value," but, without a sale, *BFP* offers little assistance; of course, the strict foreclosure would be subject to fraudulent transfer laws.

IV. Expansion of *BFP* Beyond the Court's Holding?

The Court in *BFP* significantly limited its holding to mortgage foreclosures or deed of trust liens, by specifically stating that it expressed no opinion as to how its holding might affect transfers not involving real property or not involving forced sales.[23] Several lower courts, however, have looked to *BFP* for guidance in these unintended areas.

A. Real Estate Tax Sales

The greatest discrepancies in price adequacy may occur in real estate tax sales. Where the price sought and obtained at a regularly conducted foreclosure sale of real property will often yield a price somewhat analogous to the fair market value of the property, a tax sale is designed to yield merely the amount equivalent to the tax deficiency.

Although *BFP* specifically emphasized that the opinion does not cover real estate tax sales, courts have looked to *BFP* for guidance.[24] These courts focus upon the *BFP* Court's conclusion that "[m]arket value, as it is commonly understood, has no applicability in the *forced sale* context." They scrutinize state foreclosure laws to determine whether the state laws governing procedures and safeguards of real property foreclosures sufficiently are similar to those state laws governing the same for tax foreclosures to justify the tax foreclosures' inclusion in *BFP*. They focus on the general policies of the *BFP* decision and their applicability in the tax sale context. Some courts have gone as far as to hold that properly conducted pre-petition tax foreclosures conclusively are presumed to have yielded reasonably equivalent value and are therefore not subject to attack as constructively fraudulent. Several commentators have suggested that, after *BFP*, no regularly conducted, noncollusive pre-petition levy or execution sale is subject to attack under section 548(a)(2)(A).[25]

B. Sheriff's Sales and Foreclosures of Personal Property

Similar in purpose to tax foreclosure sales, sheriff's sales are designed solely to recover an amount owed, no matter how small, through the sale of a debtor's assets. Such a sale occurs irrespective of the fair market value of the property and is intended to compensate the creditor for his or her loss, not to produce a fair and adequate sale. Several courts have looked to *BFP* for aid in determining whether a sheriff's sale was for reasonably equivalent value. For example, in *In re O'Neill*,[26] the court, following *BFP*, first looked to whether the sheriff's sale was conducted according to Pennsylvania law. Finding absent the circumstances which would justify the only challenges permitted to attack a sheriff's sale under Pennsylvania law (fraud in the conducting of the sale and lack of authority in the sheriff), the court found the sale to be proper, and, therefore, for reasonably equivalent value.

Some commentators have suggested that sheriff's sales and foreclosures on personal property should be controlled by a *Durrett* or a *Hulm/Bundles* approach, even though such transactions might not be avoidable under state law.[27] Some courts followed this suggestion,[28] but these courts fail to note the similar procedural safeguards erected in sheriff's sale regulations that are present in foreclosure legislation. For instance, debtors are entitled to mandatory notice of sale, thus providing them a similar opportunity to perform and avoid an inadequate sale price.

C. Utilizing *BFP* in the Absence of a Foreclosure Sale

The decision in *BFP* provides little guidance to section 548 cases that do not involve foreclosure sales. For example, some courts have permitted attacks on pre-petition terminations of leases as fraudulent conveyances in the bankruptcy of tenants.[29] In 1984, in *In re Ferris*,[30] the Tenth Circuit found that a leasehold termination was a "transfer" that could be avoided as constructively fraudulent for lack of reasonably equivalent value. In 1985, the Sixth Circuit Bankruptcy Court, in *In re Queen City Grain, Inc.*,[31] held that a lease termination is a "parting of an interest in property," and therefore a "transfer" within the meaning of section 548 of the Bankruptcy Code. At least one commentator argues that a lease termination is not a "transfer" of a property interest, but merely the expiration of one, and therefore the doctrine of constructive fraud has no application in the avoidance of noncollusive lease terminations.[32] This commentator believes the aforementioned cases confuse terminations with transfers and ignore the effects of anti-assignment and anti-subletting provisions on the value of leases. Without a forced sale, a landlord would be unable to assert *BFP*'s public sale as conclusive proof of reasonably equivalent value, leaving courts with the same definitional problems that existed before *BFP*.

In *In re R.M.L., Inc.*,[33] the Third Circuit faced a transfer of funds to a bank from the debtor in bankruptcy's

estate. Because the transfer was not in the form of a forced sale, the court found the rationale of *BFP* was irrelevant to its determination of reasonably equivalent value. The court looked to *BFP* only for its interpretation of section 548 of the Bankruptcy Code. In defining reasonably equivalent value for itself, the court cited *BFP* 's admission that section 548 only defines "value," and reasoned, with the aid of a pre-*BFP* case, that "Congress left to the courts the obligation of marking the scope and meaning of" reasonably equivalent value. Utilizing a totality of the circumstances test, taking into account fair market value and considering the arm's length relationship and the parties' good faith, the court determined that the minimal "value" conferred was not reasonably equivalent value. Following *BFP*, several circuits have continued to struggle with reasonably equivalent value in non-sale transfers.[34]

V. Conclusion

The holding of *BFP* serves several important purposes in the foreclosure sale area. The Court's preservation of regularly conducted sales serves such public policy interests as finality of sale, title insurability, bona fide purchaser protection and reconciliation of the realities of low forced sale bids. For these reasons the definition of "reasonably equivalent value" works well in the forced sale context, and, therefore, courts applying it to non-real estate foreclosure sales have not stretched impermissibly the rule of *BFP*. But, the definition fails to provide sufficient guidance in section 548 cases that lack an involuntary transfer. Hopefully, the Supreme Court will again speak on the issue of "reasonably equivalent value" and expand it to include or exclude definitively some of the areas discussed herein. For if the definition, like the one expounded in *BFP*, is to be devoid of any comparison to fair market value, the courts in several jurisdictions, particularly those following the *Durrett* and *Bundles* approaches, will be forced to reevaluate their criteria.

"Hopefully, the Supreme Court will again speak on the issue of 'reasonably equivalent value . . .' "

Endnotes

1. 114 S. Ct. 1757 (1994).
2. 11 U.S.C. § 548(a)(2) (1986 & Supp. 1996).
3. *See* Mark X. Mullin & Robin E. Phelan, *How Much is That Doggie in the Window: Valuation Issues in Bankruptcy Cases*, 709 PLI/COMM.405, 450 (Jan. 1995) (establishing whether transfer was made with actual or fraudulent intent is a substantial and difficult burden that trustee must overcome). Courts will consider circumstantial evidence known as "badges of fraud." *Id.*

   The most common badges of fraud include the following:

   > (i) a transfer of substantially all of the debtor's assets;
   >
   > (ii) although legal title has passed to another, the debtor still enjoys the benefits of the assets;
   >
   > (iii) the debtor secretly transferred the property;
   >
   > (iv) the transfer was to an insider or family member;
   >
   > (v) the debtor knows of the existence of a possible claim against the debtor; and
   >
   > (vi) the debtor received less than adequate consideration for the transfer.

   Id. at 450-51.
4. 11 U.S.C. § 548(a)(2).
5. 13 Eliz. c. 5 (1570), *in* D. EPSTEIN & J. LANDERS, DEBTORS AND CREDITORS 134 (1978); Robert M. Zinman, James A. Houle & Alan J. Weiss, *Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits*, 37 BUS. LAW. 977, 988 n.59 (May 1984). The Statute 13 Elizabeth provided, in pertinent part: "[C]ovinous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments and executions . . . devised and contrived of malice, fraud, covin, collusion or guile, to the end purpose and intent, to delay, hinder or defraud creditors and others . . . shall be . . . utterly void, frustrate and of none effect . . . ." *Id.*
6. N.Y. Debtor and Creditor Law §§ 270-281 (McKinney 1990).
7. 11 U.S.C. § 544(b) (1986 and Supp. 1996).
8. 621 F.2d 201 (5th Cir. 1980).
9. 11 U.S.C. § 107(d) (1978). Section 67(d) provided, in relevant part:

   > (1) For purposes of, and exclusively applicable to this subdivision: . . .
   >
   > (e) Consideration given for the property or obligation of a debtor is "fair"
   >
   > (1) when, in good faith, in exchange and as a fair equivalent thereof, property is transferred . . . .

   Id.
10. 21 B.R. 424 (Bankr. 9th Cir. 1982), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984).
11. 758 F.2d 1136 (6th Cir. 1985).
12. 856 F.2d 815 (7th Cir. 1988).
13. 114 S. Ct. 1757, 1761 (1994).
14. *See* Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 114-15 (1996) (illustrating recent trend of Supreme Court to favor institutional lenders at expense of small unsecured creditors).
15. 114 S. Ct. 1757 (1994). Justices Rehnquist, O'Connor, Kennedy and Thomas constituted the majority. *Id.* Justice Souter, joined by Justices Blackmun, Stevens and Ginsburg, wrote the dissent. *Id.* at 1767.
16. *See* United States v. Winstar Corp., 116 S. Ct. 2432 (1996); Citizens Bank v. Strumpf, 116 S. Ct. 286 (1995); *BFP*, 114 S. Ct. 1757; Rake v. Wade, 508 U.S. 464 (1993); Nobelman v. American Sav. Bank, 508 U.S. 324 (1993); Dewsnup v. Timm, 502 U.S. 410 (1992); and Union Bank v. Wolas, 502 U.S. 151 (1991).
17. *See* United States v. Nordic Village, Inc., 503 U.S. 30 (1992); Board of Governors of the Fed. Reserve Sys. v.

MCorp Fin., Inc., 502 U.S. 32 (1991); Holywell Corp. v. Smith, 503 U.S. 47 (1991); United States v. Noland, 116 S. Ct. 1524 (1996); and United States v. Reorganized CF & I Fabricators, 116 S. Ct. 2106 (1996). *But see Winstar*, 116 S. Ct. 2432 (holding in favor of three financial institutions in FIRREA suit with government).

18. *Id.* at 115 (citing Taylor v. Freeland & Kronz, 503 U.S. 638 (1992); and Patterson v. Shumate, 504 U.S. 753 (1992)).

19. U.C.C. § 9-504(1) (1972). Section 9-504(1) provides, in pertinent part: "A secured party after default may sell, lease, or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing." *Id.*

20. Jeff Bohm & David B. Young, *Preferences and Fraudulent Transfers: A Lender's Perspective*, 737 PLI/COMM. 102, 198 (1996).

21. U.C.C. § 9-507 (1992).

22. U.C.C. § 9-505(2) (1972). Section 9-505(2) authorizes strict foreclosure: "In any other cases [than those set forth in § 9-505(1)] involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. . . ." *Id.*

23. *BFP*, 114 S. Ct. at 1761 n.3 (emphasizing that the opinion "covers only mortgage foreclosure sales of real estate," and noting that "considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different").

24. *See, e.g.*, Russell-Polk v. Bradley (*In re* Russell-Polk), 200 B.R. 218 (Bankr. E.D. Mo. 1996) (applying *BFP*'s § 548(a)(2) "reasonably equivalent value" analysis to noncollusive tax foreclosure sale); Golden v. Mercer Co. Tax Claim Bureau (*In re* Golden), 190 B.R. 52 (Bankr. W.D. Pa. 1995) (same); Hollar v. Meyers (*In re* Hollar), 184 B.R. 243 (Bankr. M.D. N.Car. 1995) (same); Lord v. Neumann (*In re* Lord), 179 B.R. 429 (Bankr. E.D. Pa. 1995) (same); Comis v. Bromka (*In re* Comis), 181 B.R. 145 (Bankr. N.D.N.Y. 1994) (same); McGrath v. Simon (*In re* McGrath), 170 B.R. 78 (Bankr. D.N.J. 1994) (same); T.F. Stone Companies, Inc. v. Harper (*In re* T.F. Stone Companies, Inc.), 170 B.R. 884 (Bankr. N.D. Tex. 1994) (applying *BFP* analysis to § 549(c) "present fair equivalent value" in upholding tax sale of property with fair market value of between $50,000 and $60,000 for price of $325). *But see* Butler v. Lejcar (*In re* Butler), 171 B.R. 321 (Bankr. N.D. Ill. 1994) (questioning, in dicta, whether *BFP* applies should apply to § 549(c) tax sales in Illinois since tax sale bids are in no way based on value of subject property); McKeever v. McLandon (*In re* McKeever), 166 B.R. 648 (Bankr. N.D. Ill. 1994) (following *Bundles* in pre-*BFP* tax sale case and permitting debtor-taxpayers to set aside fraudulent transfer to extent of their combined homestead exemption in property).

25. *See, e.g.*, Bohm & Young, *supra* note 20, at 197 (1996).

26. 204 B.R. 881 (Bankr. E.D. Pa. 1997). *See also* Donovan v. Donovan (*In re* Donovan), 183 B.R. 700 (Bankr. W.D. Pa. 1995) (upholding properly conducted Pennsylvania sheriff's sale of real property worth $130,000 for $67,000); Stato v. Salvioli (*In re* Stato), 1994 WL 764601 (Bankr. M.D. Pa. 1994) (denying summary judgment to challenger of properly conducted Pennsylvania sheriff's sale real property); Garrett v. Walker (*In re* Garrett), 172 B.R. 29 (Bankr. E.D. Ark. 1994) (avoiding sheriff's sale of vehicle upon finding that, under Arkansas law, sale was not properly conducted and was not noncollusive).

27. Bohm, *supra* note 20, at 189-90; Koger & Acconia, *The Hulm Decision: A Milestone for Creditors*, 91 Comm. L.J. 301 (1986).

28. Bohm, *supra* note 20, at 190. *See, e.g.*, Aspedon v. Labbee (*In re* Aspedon), 73 B.R. 538 (Bankr. S.D. Iowa 1987) (avoiding as not reasonably equivalent and therefore constructively fraudulent, sale upon successful bid of $27,000 at sheriff's sale for undivided one-half interest in farm land appraised at approximately $110,000); Apollo Hollow Metal & Hardware Co. v. Borchers & Heimsoth Constr. Co. (*In re* Apollo Hollow Metal & Hardware Co.), 71 B.R. 179 (Bankr. W.D. Mo. 1987) (holding that creditor's successful bid of $6,800 at sheriff's sale was not reasonably equivalent value for inventory worth $30,000). *Accord* Betinsky v. Continental Bank (*In re* Betinsky), 45 B.R. 244 (Bankr. E.D. Pa. 1984) (finding that debtor stated valid cause of action in arguing that pre-petition sheriff's sale of personal property should be set aside).

29. *See, e.g.*, Ferris v. W.P. Atkinson (*In re* Ferris), 415 F. Supp. 33 (W.D. Okla. 1976); Eder v. Queen City Grain, Inc. (*In re* Queen City Grain, Inc.), 51 B.R. 722 (Bankr. S.D. Ohio 1985); *see generally* Andrew M. Friedman, *Ding, Dong,* Durrett *Didn't Die: Landlords Take Cover*, N.Y. REAL PROP. L.J., vol. 23, 6 (Winter 1995) (concluding that cases applying fraudulent transfer law to lease terminations are wrongly decided because lease terminations are not "transfers" of property, and even if they were, they are not normally for less than reasonably equivalent value).

30. 415 F. Supp. 33 (W.D. Okla. 1976).

31. 51 B.R. 722 (Bankr. S.D. Ohio 1985).

32. Friedman, *supra* note 29, at 7 (distinguishing lease termination due to operation of conditional limitation to involuntary transfer caused by foreclosure and voluntary transfer of leasehold estate from tenant to landlord).

33. 92 F.3d 139 (3d Cir. 1996).

34. *Id.* at 148. For example, the court cited Young v. Crystal Evangelical Free Church (*In re* Young), 82 F.3d 1407 (8th Cir. 1996) (determining whether "value" obtained in exchange for charitable contribution); Hodge v. Magic Valley Evangelical Free Church, Inc. (*In re* Hodge), 200 B.R. 884 (Bankr. D. Idaho) (same); Chomakos v. Flamingo Hilton (*In re* Chomakos), 69 F.3d 769 (6th Cir. 1995) (examining whether debtors obtained "value" in exchange for gambling losses), *cert. denied*, 116 S. Ct. 1568 (1996); *Morris Communications*, 914 F.2d at 458 (attempting to determine "value" of shares in corporation whose only asset was license application pending before FCC; license had only one in twenty-two chance of approval); Butler Aviation Int'l Inc. v. Whyte (*In re* Fairchild Aircraft Corp.), 6 F.3d 1119, 1125-26 (5th Cir. 1993) (deciding whether money debtor spent in failed attempt to keep airline afloat conferred "value").

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New York State Bar Association Committee on Professional Ethics

Ethics Opinion 693 (Issued August 22, 1997)

Nonlawyer Employees; Escrow Accounts; Attorney's Signature

New York Code of Professional Responsibilities, applicable sections: DR 1-104; DR 9-102(A), (B); DR 9-102(E); EC 3-6.

Question

May a lawyer allow a paralegal to use a stamp bearing the lawyer's signature to execute checks drawn on a client escrow account?

Opinion

This Committee and others have frequently addressed issues arising from a lawyer's delegation of tasks to a nonlawyer employee.[1] The question in this inquiry is whether, consistent with DR 9-102(E), a lawyer may allow a nonlawyer employee to use a signature stamp to execute checks drawn on the lawyer's client escrow account.[2] The inquirer notes that the purpose of the signature stamp is to facilitate procedures at the closings of real estate transactions.

The New York Lawyer's Code of Professional Responsibility contemplates that lawyers will delegate tasks to nonlawyers.[3] We have recently opined that it is permissible for lawyers to delegate attendance at a real estate closing to a paralegal, where the delegating lawyer is available by telephone as necessary, the particular closing is "ministerial" and several other conditions are satisfied.[4] In our opinion we noted that all tasks assigned to a paralegal must be "within the limits prescribed by law" and "clearly limited to those functions not involving independent discretion or judgment."[5] We acknowledged that many real estate and mortgage closings do not require the paralegal to exercise independent discretion or judgment.[6]

It is the attorney or a member of the attorney's firm who is the custodian of the funds of the client.[7] DR 9-102(A) and (B) generally require that a lawyer deposit client funds in identifiable bank accounts within the state and segregate such funds from the lawyer's general funds.[8] An attorney is personally and professionally liable for funds and property entrusted to him or her by a client and must exercise the highest degree of care in preserving and protecting such funds and property.[9] Consistent with these principles, DR9-102(E) provides that "[o]nly an attorney admitted to practice law in New York State shall be an authorized signatory of a special account." A nonlawyer may not be a signatory on a special account and a lawyer may not give such a person signatory power on such account.[10]

Although it is clear that only a lawyer may control the lawyer's client escrow account and be a signatory of it, the Rule does not address whether a lawyer may delegate the task of signing his or her name to escrow account checks to others, and if so whether a signature stamp can be used for that purpose. Based on the analysis of proper delegation in our previous opinions, we believe that it is ethically permissible for a lawyer to authorize a paralegal to make use of the lawyer's signature stamp on checks drawn from a special account at closings under certain conditions and with proper controls. As with the rest of a paralegal's duties at a real estate closing,[11] the lawyer must consider in advance how the paralegal will use the signature stamp—including approving the purpose of the anticipated payments to be made by such checks, the nature of the payee and the authorized dollar amount range for each check to be issued—and review afterwards what actually happened to assure that the delegation of authority has been utilized properly. As a practical matter, compliance with these restrictions will limit the use of the signature stamp by a paralegal to those circumstances in which the lawyer can reliably forecast events at the closing.

Attorneys must be aware that responsibility for client funds may not be delegated, and attorneys authorizing paralegals to use signature stamps on checks drawn from escrow accounts are "completely responsible" to the client for any errors or misuse of the stamp.[12] Attorneys must take steps to safeguard the use of the signature stamp to avoid any misappropriation of client funds.

Conclusion

A lawyer may allow a paralegal to use a signature stamp to execute escrow checks from a client trust account so long as the lawyer supervises the delegated work closely as provided in this Opinion and exercises complete professional responsibility for the acts of the paralegal.

Endnotes

1. *See, e.g.*, N.Y. State 677 (1995) (see page 17, this issue); N.Y. State 255 (1972); N.Y. State 44 (1967); N.Y. City 1995-11 (1995); N.Y. City 666 (1985); Nassau County 90-13; ABA 316 (1967).
2. *See* DR 9-102(B).
3. DR 1-104; EC 3-6; See N.Y. City 1995-11.
4. N.Y. State 677 (1995).
5. N.Y. State 677; *see* ABA 316 (1967); N.Y. State 255 (1972); N.Y. City 666 (1985).
6. N.Y. State 677.
7. DR 9-102; N.Y. State 570 (1985); Nassau County 88-31.
8. N.Y. State 570 (1985).
9. Nassau County 88-31.
10. *In re* Gambino, 205 A.D.2d 212, 619 N.Y.S. 2d 305 (2d Dep't 1994) (lawyer violated DR 9-102(E) by permitting nonlawyer daughter to be signatory on special account); *In re* Stenstrom, 194 A.D.2d 277, 605 N.Y.S. 2d 603 (4th Dep't 1993) (lawyer violated DR 9-102(E) by permitting nonlawyer ex-wife to be signatory on special account).
11. See N.Y. State 677.
12. N.Y. State 677; DR 1-104.

New York State Bar Association Committee on Professional Ethics

Ethics Opinion 677 (Issued in 1995)

Delegation of Lawyer's Duties to Paralegal

New York Code of Professional Responsibilities, Applicable Sections: DR 1-104(A); EC 1-8; EC 3-1; EC 3-5; EC 3-6.

Question

May an attorney representing a bank in a real estate transaction delegate attendance at the closing to a paralegal if the attorney is available by telephone?

Opinion

Nearly thirty years ago this Committee began sketching the ethical line that distinguishes the properly delegable tasks from those which only a lawyer may perform, and the obligations of a delegating attorney.[1] Fueled by technological and economic change, the question again arises: may the attorney send a paralegal to a real estate closing, and if so, under what circumstances?

Whether a task may be given over to a nonlawyer depends fundamentally on whether the task constitutes the practice of law. The Code affords no definition of legal practice. Rather, and "functionally,"

> the practice of law relates to the rendition of services for others that call for the professional judgment of a lawyer. The essence of the professional judgment of the lawyer is the educated ability to relate the general body and philosophy of law to a specific legal problem of a client."[2]

Among activities incident to but not themselves legal practice are some that the lawyer may ask the nonlawyer to perform. The employed nonlawyer may not be given tasks that "lawyers may not do [nor] do the things that lawyers only may do."[3] All assigned tasks must be "within the limits prescribed by law."[4] And, the touchstone of all the distinctions: no ethical delegation will "extend to any matter where the exercise of professional legal judgment is required.[5]

The set of ethical and appropriate delegations to nonlawyers we have long called, borrowing from the common law, "the merely ministerial."[6]

Hence, as we have previously stated in N.Y. State 44 (1967), a nonlawyer should not be asked to:

> argue motions, conduct examinations for the purpose of taking the depositions of a witness, or conduct examinations on supplementary proceedings. A clerk **may, without his employer being present, attend mortgage closings** and other out-of-court matters, but only so long as his responsibilities are clearly limited to those functions not involving independent discretion or judgment. (emphasis added).

We assume that real estate and mortgage closings, or some of them, are as unlikely now as ever they were to require either "independent discretion or judgment" from a paralegal assigned to monitor the ceremony. So long as the closing is properly described as "ministerial," a lawyer may ethically delegate attendance at such a closing to a paralegal, provided the lawyer discharges his duty to the client properly in the delegation of this task.[7]

EC 3-6 outlines three minimum additional and necessary conditions of ethical delegation:

> Such delegation is proper if the lawyer maintains a direct relationship with the client, supervises the delegated work, and has complete professional responsibility for the work product. This delegation enables a lawyer to render legal service more economically and efficiently.

We address each of these. First, delegation must neither interfere with nor substitute for the continuing and direct relation between lawyer and client. As EC 3-1 instructs, the prohibition against unauthorized legal practice "is grounded in the need of the public for integrity and competence" in those who provide legal services. The primacy of the relation between client and lawyer is intended to secure that competence and integrity. If delegation imperils the unmediated relation between client and lawyer, whether in a particular arrangement, or consequent to a pattern of delegation, it goes too far. The lawyer has clients. The paralegal assists.

Second, the lawyer must supervise properly both the substantive and ethical sufficiency of all delegated work. Thus, the lawyer must assure the competence of work performed under delegation. This means the lawyer must consider in advance what will occur under delegation, and review after the fact what in fact occurred, assuring its soundness. Further, whatever

occurs under delegation ought generally to comport with what was anticipated. If the unfolding of the "merely ministerial" should happen to reveal the "discretionary," the lawyer must have in place a plan that prevents the practice of law by the unauthorized, and that plan must not prejudice the client.

DR 1-104(A) provides that the delegating lawyer is responsible:

> for conduct of a non-lawyer employed or retained by or associated with the lawyer that would be a violation of the Disciplinary Rules if engaged in by a lawyer if: (1) The lawyer orders the conduct; or (2) The lawyer has supervisory authority over . . . the non-lawyer, and knows or should have known of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action."

The obligation of the delegating attorney to review and scrutinize the conduct of the paralegal for conduct forbidden a lawyer is of a very high order.[8]

The Committee notes that these "supervisory" obligations may or may not be satisfied by an absent lawyer who is available only by telephone. If the lawyer has rightly assessed the nature and complexity (or lack of it) of the task, and the suitability and background of the paralegal, and if an adequate plan has been made to cope with the unforeseen, the telephone may be all the tool that could be desired. If this proves not to be the case, however, the lawyer's ethical obligations may be found wanting.

Third, the delegating attorney is "completely responsible" for the work-product of the delegation. This requisite may be read as a restatement of the obligations described above with this addition: whatever may be the law of intervening causes or contributory negligence, from an ethical standpoint the lawyer who assigns a nonlawyer to work on a client's matter had better be right about the suitability of that task for delegation, and the suitability of that employee for the task at hand. The delegating lawyer is "completely responsible."

We note that this opinion is consistent with that of other ethics committees that have considered the issue.[9] Although the facts of any given delegation will vary, in the end this Committee believes that what is central and unchanged is that the nonlawyer must not be given any task which "calls for the exercise of a lawyer's judgment or participation."[10]

Conclusion

For the reasons set forth above, the proposed delegation of a paralegal to attend a real estate closing, where the delegating lawyer is available only by phone as necessary, may be entirely permissible, provided the particular closing is "ministerial," and the conditions described above are met.

Endnotes

1. N.Y. State 44 (1967).
2. EC 3-5.
3. ABA 316 (1967), cited with approval, N.Y. State 255 (1972).
4. N.Y. State 255 (1972).
5. N.Y. State 304 (1973).
6. "That which is done under the authority of a superior; opposed to *judicial*. That which involves obedience to instructions, but demands no special discretion, judgment, or skill." BLACK'S LAW DICTIONARY 996 (6th ed. 1990).

   We note that we have also concluded that a nonlawyer ought not to be permitted to supervise a will execution. N.Y. State 343 (1974). The test is not only whether the task seems ministerial in the abstract, but what consequences follow from the lawyer's presence or absence. N.Y. State 343 held that a delegation of a will execution:

   > [was] tantamount to counseling a client about law matters and [therewith] permitting a paralegal to engage in the practice of law. Not only is strict compliance with a statute required, but the presence of the attorney provides added assurance that the Will was properly executed by a competent testator.

7. The Committee believes that the analytical framework provided in this opinion is applicable to delegation arising in the representation of either buyer or seller at a real estate closing, as well as to the representation of the lender at issue in this opinion. Whether in the particular circumstances a buyer's lawyer or a seller's may properly delegate attendance to a paralegal, and if so, whether telephone contact will suffice, depends upon the facts of the particular representation. As distinct from representation of the institutional lender, the buyer or seller may be expected to be present at the closing and ask questions that a paralegal ought not answer. In light of this we believe that if a lawyer for buyer or seller concludes that a paralegal can properly appear at the closing, it would likely be the wiser practice to inform the client in advance that the lawyer plans to have a paralegal attend the closing.
8. *See also* EC 1-8 ("A law firm should adopt measures giving reasonable assurance . . . that the conduct of nonlawyers employed by the firm is compatible with the professional obligations of the lawyers in the firm.").
9. *See, e.g.*, N.Y. City 1995-11; Nassau County 90-13 (1990).
10. N.Y. City No. 78 (1927-28).

Authorized Signatories on Escrow Accounts: Ethics Opinion 693 Is Misplaced

by Peter V. Coffey
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There was a time in New York, at least Upstate, when lawyers were most proud that they could personally compute tax adjustments and would not discuss such adjustments with a secretary, for that involved the practice of law. How our viewpoint has changed.

How much it is changed can be seen from a report issued by a Committee, commissioned by the Bar Association, to undertake a review of the role of the paralegal. This report documents the critical role played by paralegals in the practice of law.[1] The concept of the critical role of the paralegal gained further recognition when the Bar Association Committee on Professional Ethics issued Ethics Opinion 677[2] in which the Ethics Committee declared that the attendance by a paralegal at a real estate closing, where the supervising attorney was available only by phone, was permissible providing the particular closing was "ministerial" and other conditions set forth in the Opinion were met.

Next question: May the paralegal sign the checks disbursing the mortgage proceeds at a closing? There cannot be a more ministerial act than this, right? Of course, the person performing this function must be able to think quickly, keep several matters in mind and add correctly. As we are well aware, in a race between the paralegal and the attorney, bet on the paralegal.

And so the Ethics Committee of the Bar Association had presented to it a question as to whether or not the delegation of duties previously authorized in Opinion 677 could encompass the delegation to the paralegal the task of signing the attorney's name to an escrow account check and, if so, whether a signature stamp could be used for that purpose. Relying to a great extent upon its analysis set forth in previous Opinions and most particularly Opinion 677, the Committee concluded that the answer to the question was yes, and the delegation of this task to the paralegal was permissible in this specific situation presented—the signing of the checks was through the use of a stamp bearing the lawyer's signature. In so deciding, the Opinion discussed at length the restrictions placed upon the attorney delegating such a task to the paralegal and the duty of supervision.

In my opinion this analysis is in direct conflict with Disciplinary Rule 9-102(E) which states:

> Authorized signatories:
>
> All special account withdrawals shall be made only to a named payee and not to cash. Such withdrawals shall be made by check or, with the prior written approval of the party entitled to the proceeds, by bank transfer. *Only an attorney admitted to practice law in New York State shall be an authorized signatory of a special account.*[3]

Control has been surrendered in this situation. In a matter so sensitive as the power to disburse client's trust funds, the restrictions set forth in Opinion 693, imposing upon the attorney a substantial supervisory obligation, are insufficient to justify the negation of the responsibility and prohibition set forth in DR 9-102(E). Opinion 693 points out that the attorney who seeks to delegate the authority to the paralegal remains responsible for misuse of the stamp. I understand this to mean that if the paralegal should steal money the attorney would be responsible for paying it back to the client. However, on this point the 1995 report of the Lawyer's Fund for Client Protection (hereinafter Lawyer's Fund) reports that since 1982 there have been 3,294 claims processed resulting in the payment by the fund of $49.3 million. The Lawyer's Fund vigorously sought restitution, but only collected $2.3 million and much of that came from collateral sources and not from the attorneys. Accordingly, the record of success in obtaining monies from attorneys where there has been a theft from an escrow account is not a good one. I have spoken to several, but not all, counsels on various Committees on Professional Disciplines and the unanimous opinion of those spoken to is that Ethics Opinion 693 will not be followed by the Disciplinary Committees.

There are few areas—in fact, there are no areas—of practice more ethically sensitive than the attorney's escrow account. As the former Chairman of a Committee on Professional Standards (Third Department) I can assure you that no area of practice will cause visitation by the Committee swifter or more thoroughly than an actual or even perceived problem with an escrow account. Accordingly, I strongly suggest that real estate attorneys comply most strictly with Disciplinary Rule 9-102(E) as reliance upon Opinion 693 is misplaced.

Endnotes

1. *See Guidelines for the Utilization by Lawyers of the Services of Legal Assistants*, approved by the House of Delegates on June 19, 1976, and thereafter revised December, 1996, and available through the Bar Association.
2. See page 17, this issue.
3. N.Y. Code of Professional Responsibility § 9-102, N.Y. JUD. LAW (McKinney's 1992) (emphasis added).

Recent Amendments to New York Law

Amendment to Real Property Actions and Proceedings Law § 1354
Mandatory Payment of City Liens in Foreclosure

On July 21, 1997, Real Property Actions and Proceedings Law section 1354 was amended[1] to enable smaller cities to collect overdue revenue more easily without having to resort to additional costly measures (e.g., in rem foreclosures and tax lien sales). Prior to this legislation, section 1354 affected only those cities in the state with a population over one million, which in effect only applied to New York City. Now, referees conducting mortgage foreclosure sales in cities having a population of 300,000 or more shall pay out of the proceeds of sale "any liens or incumbrances placed by a city agency upon the real property which have priority over the foreclosed mortgage" (e.g., taxes and assessments).

The amended section now reads as follows:

> § 1354. Distribution of proceeds of sale
>
> 1. The officer conducting the sale shall pay, out of the proceeds, unless otherwise directed, the expenses of the sale, and pay to the plaintiff, or his attorney, the amount of the debt, interest and costs, or so much as the proceeds will pay and take the receipt of the plaintiff, or his attorney, for the amount so paid, and file the same with his report of sale.
>
> 2. The officer conducting the sale shall pay out of the proceeds all taxes, assessments, and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. In any city *having a population of three hundred thousand or more,* such officer shall pay out to the proceeds any liens or incumbrances placed by a city agency upon the real property which have priority over the foreclosed mortgage. The sums necessary to make those payments and redemptions are deemed expenses of the sale. The provisions of this subdivision shall not apply to any judgment in any action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder.
>
> 3. The officer conducting the sale after fully complying with the provisions of subdivisions one and two of this section and if the judgment of sale has so directed shall pay to the holder of any subordinate mortgage or his attorney from the then remaining proceeds the amount then due on such subordinate mortgage, or so much as the then remaining proceeds will pay and take the receipt of the holder, or his attorney for the amount so paid, and file the same with his report of sale.
>
> 4. All surplus moneys arising from the sale shall be paid into court by the officer conducting the sale within five days after the same shall be received.

Endnote

1. Chapter 232, Laws of 1997.

BERGMAN ON MORTGAGE FORECLOSURES . . .

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Assignment of Rents—What's It Worth?*

Although an assignment of rents clause is common to almost any reasonably well-drafted mortgage, its uses and limitations may not be so widely understood, which lends value to the musings here. First, the clause will have utility as a weapon only where the property produces income. The minimal or threshold example would be a two-family house. Obviously more fertile is a four- or six-family dwelling, or an apartment building or shopping center.

Assuming there is income to capture, there are three related concepts to compare: mortgagee in possession, receivership and assignment of rents. The receivership is obviously the most common, and with good reason. The receiver is an independent party (usually an attorney) appointed by the court (upon application) who is authorized to collect the rents, issues and profits of the mortgaged premises. Not incidentally, the receiver also protects and preserves the property, making repairs when necessary. At the end of the foreclosure, the net funds collected are applied in reduction of the mortgage debt. A corollary benefit is that the receiver cuts off any income stream from the property to the borrower, thus diminishing the will (and the funds) to interminably delay the case. Also, the receiver must post a bond to provide recourse if he fails to discharge his duties or performs them negligently.

Less utilitarian is becoming a mortgagee in possession. In essence, (although there is more to this) the mortgagee itself can become a substitute for a receiver and take control of the premises. An immediately recognizable problem with that is liability—to say nothing of having qualified staff to oversee the task. Insurance helps, but the lender itself becomes responsible for repairs, any waste that occurs, accidents at the premises and the like. Not surprisingly, lenders would usually prefer the insulation of a receiver.

Finally, we come to the assignment of rents, the foundation of this review. The heart of the usual mortgage clause is the assignment of rents at the premises to the lender, but triggered only upon default. Whether this assignment is automatic upon default or requires an affirmative demand by the lender depends upon the wording of the provision.

Assuming a lender wishes to avail itself of this remedy, as a practical matter a writing would be conveyed to the borrower exercising the assignment. Then letters would go to the various tenants demanding that rents be paid directly to the lender.

But if concepts surrounding assignments of rents are somewhat obscure among professionals, one can imagine how perplexed tenants would be when told to pay rent to someone other than their landlord. When, as they almost invariably will, tenants inquire of the landlord (borrower), the response will be to ignore the demand from the lender and continue paying rent in the normal course.

Experience suggests that while some very few tenants *will* pay the lender, most will simply seize the opportunity to pay no one. What, then, does the lender do? The answer leads to the ultimate shortcoming of the assignment of rents provision. The lender could initiate a suit against each tenant to collect rents becoming due from the date of demand. Even if the tenants then pay, future defaults will require future suits. More disconcertingly, the cost of these actions would be disproportionately high given the amount at issue. Militating most strongly against using the assignment of rents: a summary proceeding cannot be employed—that is, eviction is not a remedy![1] The assignee is simply not a landlord and, as an agent, has no right to possession. This remains so even if the assignment of rents clause also contains an assignment of lease aspect.[2]

To glean the benefit of proceeding with the assignment of rents invites a return to the receivership. A receiver is empowered to collect all rents due at the time of his appointment. When a plaintiff elects to pursue a receivership, while in special

cases it can be obtained in a matter of days, sometimes it can take weeks. If a lender *first* exercises the assignment of rents, should the tenants react in the usual fashion by ceasing rent payments to anyone, there will be that much more rent "due," which the receiver can collect rather than the defaulting borrower!

So, limited though its utility may be, there is a role for the assignment of rents in some cases.

Endnotes

1. Suderov v. Ogle, 149 Misc.2d 906, 574 N.Y.S.2d 249 (App. Term 1991), citing, *inter alia*, Poughkeepsie Sav. Bank v. Sloane Mfg. Co., 84 A.D.2d 212, 445 N.Y.S.2d 560.
2. Suderov v. Ogle, *supra*., citing Mooney v. Byrne, 163 N.Y. 86, 57 N.E. 163; Carr v. Carr, 52 N.Y. 251.

****Mr. Bergman, author of the two-volume treatise, *Bergman on New York Mortgage Foreclosures*, Matthew Bender & Co., Inc. (Rev. 1996), is a partner with Certilman Balin Adler & Hyman in East Meadow, New York, outside counsel to a number of major lenders and servicers and an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course. He is also a member of the National Foreclosure Professionals and the American College of Real Estate Lawyers and is on the faculty of the Mortgage Bankers Association of America School of Mortgage Banking.**

Recent Cases of Interest

The following case summaries were prepared by members of the St. John's University School of Law Real Property Law Society.

Foreclosure: Warranty of habitability shifts to receiver in foreclosure proceeding. *Fourth Federal Savings Bank v. 32-22 Owners Corp.*, 236 A.D.2d 300, 653 N.Y.S. 2d. 588 (1st Dep't 1997).

Facts: Receiver sought application against non-party commercial and residential tenants to compel payment of accrued rent. Receiver had been appointed by the Supreme Court, New York County in a mortgage foreclosure action commenced by plaintiff, Fourth Federal Savings Bank, against defendant-owners of a building at 32 East 22nd Street in Manhattan. The receiver was authorized to collect rents from the building's five tenants: two commercial, two residential, and one loft tenant authorized for business use. All five leases expire in June 2008. The tenants have withheld rent since the appointment of the receiver in August 1994, claiming that the building's landlord and the appointed receiver had breached the warranty of habitability set forth in Real Property Law section 235-b. The tenants allege that the elevator was inoperable, the roof leaked, and other problems abounded, leaving the premises in a grossly inferior condition. In addition, the tenants allege to have collectively spent more than $50,000 in repairs to the building.

Supreme Court, New York County, granted receiver's application and issued an order compelling payment of past due rent on pain of eviction. The court held that the receiver was an officer of the court and not an agent of the owner/mortgagor, and that because the receiver was required to use rent proceeds to operate and preserve the property, tenants could not withhold rental payments. The tenants appealed the decision.

Issue: Whether the responsibility to maintain building premises shifts to a receiver in a foreclosure action.

Analysis: Appellate Division, First Department modified the lower court's order in part and affirmed in part. The appellate court modified the order to the extent of denying the application as against the residential tenants, and otherwise affirmed the order as to the commercial tenants.

The court addressed the issue of the warranty of habitability of residential premises set forth under Real Property Law section 235-b.[1] The receiver argued that he is not bound by the warranty of habitability because the original motion was made in the context of a foreclosure proceeding, not in a landlord-tenant proceeding. Therefore, he should be protected from the obligation of a landlord to fulfill the warranty of habitability under the lease, and the tenant can sue the landlord under this warranty in a separate proceeding.

The court rejected receiver's argument as irrelevant because there is nothing in section 235-b that reflects its intent to limit its application to a particular forum or proceeding. To the contrary, the language of the Supreme Court's order empowered the receiver to commence summary eviction proceedings where the warranty of habitability defense could be raised. The fact that the receiver chose not to commence a separate proceeding does not relieve the Supreme Court of its obligation to give the tenant a fair hearing on the habitability issue.

The court stated that under Real Property Law section 235-b the warranty of habitability "is a fundamental feature of the lease of residential property, and assures that the duty to maintain the premises in a habitable condition is coextensive and interdependent with the duty to pay rent." The court expressed the view that when the responsibility for this maintenance shifts to the receiver during a foreclosure proceeding by order of attornment, this interdependence is not altered. The court reiterated that the receiver in a foreclosure action "occupies the same position as the owner or mortgagor for a variety of purposes," and that the terms of the landlord's rental agreement also binds the receiver. The court stated that since the receiver has a legal duty to maintain the property in good repair and will be liable for damages for the failure to do so pursuant to General Obligations Law section 9-101,[2] the responsibility to make repairs to comply with the warranty of habitability is consistent with that duty.

The court went on to state that the Supreme Court order appointing the receiver also supported the view that the warranty of habitability claim is applicable to this foreclosure action. The appointment order expressly required the receiver to "make repairs necessary to the preservation of the property" and to give priority to "the correction of immediately hazardous and hazardous violations of housing maintenance laws." The order, however, forbids the receiver from incurring obligations in excess of the cash on hand without prior court approval. But pursuant to Civil Practice Law & Rules 8004b (hereinafter CPLR), a court may order the party who

applied for the receiver—the bank, in this case—to pay for the necessary expenditures if the receiver lacks the funds. The court indicated that although it would be easier for the bank and the receiver if the repairs were funded subsequently from the rental proceeds, it has been previously held that such a view would compel tenants to advance funds for housing they were not receiving.[3]

Therefore, the Appellate Division, First Department ruled that the warranty of habitability claims can be raised against the receiver in a foreclosure proceeding, and therefore should be addressed by the trial court before compelling residential tenants to pay past due rents under pain of eviction.[4]

In a dissenting opinion, Justice Andrias argued that the Supreme Court order should be affirmed. The Justice reiterated that upon attornment, a typical landlord-tenant relationship is created. But in this case there has been no attornment because rents have not been paid since the appointment of the receiver. Therefore, absent a landlord-tenant relationship, a summary proceeding for non-payment of rent cannot be brought, and the receiver's only remedy is to ask the court to enforce its order directing attornment or to issue a writ of assistance.

Thus, the court properly refused to permit the tenants to assert warranty of habitability claims as a defense and was correct to order the payment of rent and arrears by all tenants in occupancy. Without such funds, the Justice argued, the receiver would have no funds to maintain or effect any repairs to the property and the court's mandate would be frustrated.

Dimitrios Kolovos '99

Endnotes

1. Section 235-b. Warranty of habitability:

   1. In every written or oral lease or rental agreement for residential premises the landlord or lessor shall be deemed to covenant and warrant that the premises . . . are fit for human habitation and for the uses reasonably intended by the parties and that the occupants of such premises shall not be subjected to any conditions which would be dangerous, hazardous or detrimental to their life, health or safety. . .

   2. Any agreement by a lessee or tenant of a dwelling waiving or modifying his rights as set forth in this section shall be void as contrary to public policy.

2. GOL § 9-101. Liability of receiver of rents and profits appointed in mortgage foreclosure.

   A receiver . . . shall be liable, in his official capacity, for injury to person or property sustained by reason of conditions on the premises, in a case where an owner would have been liable. . .

3. *See* Department of Housing Preservation and Development v. Sartor, 109 A.D. 2d. 665, 487 N.Y. S. 2d. 1 (1st Dep't 1995); Schactman v. State Division of Housing and Community Renewal, 143 A.D.2d 53, 531 N.Y.S.2d 804 (1st Dep't 1988).

4. The commercial tenants are not protected under the warranty of habitability in this case and are presumably obliged to pay rent to the receiver under the court order.

* * *

Landlord-Tenant: Agreement to extend term of lease deemed new lease and subordinate to intervening mortgage. *Dime Savings Bank of New York, F.S.B. v. Montague Street Realty Associates*, 1997 WL 668354 (New York Court of Appeals, October 21, 1997).

Facts: Non-party tenant, European American Bank (EAB) entered into a lease, as tenant, with Montaco Realty Company (Montaco), as landlord, on November 18, 1982. The ten-year lease term commenced on June 1, 1983 and was to end on May 31, 1993. Montaco sold the building to Montague Street Realty Associates (MSRA) prior to April 1987.

In April 1987, MSRA mortgaged the property to Dime Savings Bank of New York (Dime). The mortgage expressly prohibited MSRA from accepting prepayments of installments of rents to become due under any lease of the mortgaged property and provided that each new lease was subject and subordinate to the mortgage.

On October 15, 1992, EAB executed an Amendment to Lease with MSRA providing, *inter alia*, for a five-year extension of the lease and that EAB prepay rent for the period of June 1993 to May 1994 in the amount of $160,000. Additionally, the amendment incorporated by reference the terms of the original lease, one of which was paragraph 7, which provided the lease would be subject and subordinate to all mortgages that "may now or hereafter" encumber the property. EAB made the $160,000 payment.

MSRA subsequently defaulted on the mortgage and Dime commenced this mortgage foreclosure proceeding. A court-appointed receiver compelled EAB to attorn for rents for March, April, and May 1983. However, EAB refused to pay rent for the period June 1993 through May 1994, claiming that it had previously paid the rent in accordance with the lease extension agreement. The receiver then moved by order to show cause to compel EAB to attorn for rents payable. The Supreme Court granted receiver's motion and ordered EAB to pay $160,000. The Appellate Division affirmed and EAB appealed, arguing that the lease extension agreement was a continuation of the 1982 lease. As such, its tenancy predates the Dime mortgage and it is thereby not bound by the covenant prohibiting prepayment of rent.

Issue: Whether an agreement between a tenant and landlord/mortgagor that extended the term of the lease constituted a new lease subject to an existing mortgage or was a continuation of an existing lease.

Analysis: The Court of Appeals affirmed the decision of the Supreme Court, holding that the lease extension agreement entered into between MSRA and EAB was a new and separate agreement subject to the existing mortgage. Judge Ciparick, writing for a unanimous Court, noted that the original lease had no option to renew, and that the agreement entered into in October 1992 was with a new landlord, MSRA. Furthermore, the new agreement incorporated terms from the original Montaco lease, including paragraph 7, and contained several new provisions that were to take effect after the expiration of the Montaco lease. One of these new provisions, the Court believed, was the prohibition on the prepayment of rent.

As a result, the Court ruled that the lease extension was an entirely new agreement instead of a continuation of the original agreement, and that the rent prepayment should be applied to the new lease term rather than the original lease term. The Court went on to hold that since pledged collateral cannot be impaired by a postdated agreement, and since Dime's mortgage predated the new lease, EAB's rights pursuant to the lease were subordinate to the terms of Dime's mortgage. Accordingly, the Court of Appeals affirmed the judgment of the Supreme Court and Appellate Division that the new lease was subject to the covenant prohibiting the prepayment of rent without the mortgagee's permission.

R. Joseph Coryat '99

*** * ***

Landlord-Tenant: Successor landlord not liable for predecessor's rent overcharges. *Gaines v. New York State Division of Housing and Community Renewal*, 1997 WL 638455 (N.Y. 1997).

Facts: In a CPLR article 78 proceeding, a tenant challenged a determination of New York State Division of Housing and Community Renewal (DHCR) made in response to her 1991 filing of a rent overcharge complaint against the owner of a New York City rent-stabilized apartment. At the time of the complaint, the owner of the property, Cornelia Associates (Cornelia), was also a debtor-in-possession in a chapter 11 proceeding. Two years later when DHCR made a determination on the complaint, ACB Realty Corporation, the current owner, purchased the property. In its decision, DHCR determined that as a consequence of the intervening judicial sale of the property, the successor landlord was not liable for the rent overcharges exacted by the previous owner and was only liable for the refund of an excess security deposit.

The dispute began in 1991 when Cornelia was in chapter 11 bankruptcy. By July 1992 the Bankruptcy Court of the Southern District of New York judicially ordered Cornelia to sell the property to Home Savings Bank of America (Home Savings), the holder of the mortgage. In June of 1993, Home Savings sold the property to ACB. After the sale of the property to ACB, DHCR made a determination that liability was to be assessed against Cornelia in the amount of $12,147.84, and against Home Savings in the amount of $1,466.17.

Carryover liability for rent overcharges by predecessor landlords is authorized by Rent Stabilization Code N.Y. Comp. Code R. & Regs title 9, section 2526.1(f)(2) (hereinafter N.Y.C.R.R.). This provision, however, also extends an exemption from carryover liability to current owners who purchase upon judicial sale.[1] Tenant argued that ACB, a successor purchaser, should be liable for the entire overcharge because it was not the "purchaser at the judicial sale." On review, the commissioner of DHCR ruled that the judicial sale exemption in the code is applicable to current owners who have taken title through a purchaser at a judicially ordered sale. The Supreme Court denied tenant's challenge to DHCR's determination. The Appellate Division reversed finding nothing in the regulation to indicate that the exemption should be applied to successor purchasers and noted that successor purchasers may obtain a clause in the contract of sale to protect themselves from possible overcharge liability.[2] DHCR was granted leave to appeal.

Issue: Whether the judicial sale exemption for landlord carryover liability created in section 2526.1(f)(2) of the Rent Stabilization Regulations applies to an owner who takes title through a purchaser at a judicially ordered sale.

Analysis: Applying a standard of judicial deference toward DHCR's interpretation of the Rent Stabilization Code, the Court of Appeals found that DHCR's interpretation of the judicial sale exemption to include successor purchasers is "rational, and consistent with the policies behind both the imposition of carryover liability in general and the judicial sale exemption from such liability."[3] The court agreed with DHCR that the lack of available presale rental records necessitates the extension of the exemption to successor purchasers. Moreover, given DHCR's role in promulgating and administering the regulation, its determination should be upheld, "if that interpretation is not irrational or unreasonable."[4]

Construing the language of 2526.1(f)(2), the court found that the

phrase "no records sufficient to establish the legal regulated rent were provided at [the] judicial sale" was a condition precedent that, when met, gives an exemption to both a purchaser "at" the sale and "a current owner who purchases upon such judicial sale." By applying the plain meanings for the word "upon," the court determined that a successor purchase was contingent upon the judicial sale such that the source of the purchase was the judicial sale, and the result of the judicial sale was the successor purchase.

The court noted that historically, carryover liability for rent overcharges had been judicially imposed before its inclusion in the current Rent Stabilization regulations. From the former Rent Stabilization Code, the court derived the rationale for carryover liability, which stems from a section that mandated the keeping of records of the legal rent by landlords at all times. This requirement made it possible for a successor landlord to be able to protect itself in the event the previous owner was guilty of a rent overcharge. In the case of title obtained through a judicial sale, an exemption from carryover liability was created for landlords where rent records were not available. This exemption was meant to prevent properties from being unmarketable in sales where the previous owner, turned debtor-in-possession, had no incentive to provide records.[5]

Based on these considerations, the court determined that the successor purchaser would be affected by the unavailability of prior rental records where a judicial sale has occurred to an equal if not greater degree than a purchaser at the judicial sale. The court reasoned that the probability of unavailability of records increases for successor purchasers and thus an inequity would arise in imposing carryover liability resulting from pre-judicial sale overcharges. Expanding on the notion of adverse impact on the marketability of judicial sales, the court continued that the risk of unknown carryover would decrease the amount a purchaser would be willing to pay. The Court of Appeals rejected the Appellate Division's notion that absent a legal exemption, a successor purchaser could require a protection clause in the contract, pointing out that such an act would shift the risk of unknown overcharge back to the purchaser at the sale and that this would also have an adverse effect on judicial sales. Without a persuasive argument for affirming the appellate decision, the order was reversed, with costs, and the petition dismissed.

Natalie A. Bruzzese '99

Endnotes

1. Section 2526.1(f)(2) of 9 N.Y.C.R.R. provides:

   (f) *Responsibility for overcharges.*

   (2) For overcharge complaints filed or overcharges collected on or after April 1, 1984, a current owner shall be responsible for all overcharge penalties, including penalties based upon overcharges collected by any prior owner. However, in the absence of collusion or any relationship between such owner and any prior owner, where no records sufficient to establish the legal regulated rent were provided at a judicial sale, a current owner who purchases upon the judicial sale shall be liable only for his or her portion of the overcharges, and shall not be liable for treble damages upon such portion resulting from overcharges caused by any prior owner.
2. Gaines v. New York State Division of Housing and Community Renewal, 230 A.D.2d 631, 646 N.Y.S.2d 106, (1st Dept., 1996)
3. Gaines v. New York State Division of Housing and Community Renewal, 1997 WL 638455, (N.Y.) (No.158). *1
4. *Gaines*, 1997 WL 638455, (N.Y.)(No. 158)*3
5. *Id.* at *1 (citing *Matter of* Sharon Towers Realty v. New York State Div. of Hous. and Community Renewal, Sup Ct, Queens County, 1988 and Matter of Herman Mgt., Inc v. New York City Conciliation and Appeals Bd., Sup Ct., N.Y. County, 1985.)

* * *

Landlord-Tenant: Rent stabilization as it applies to lodging houses such as a hotel. *Gracecor Realty Co., Inc. v. William Hargrove*, 90 N.Y.2d 350, 660 N.Y.S.2d 704 (1997).

Facts: Appellant-landlord brought a holdover proceeding against respondent-tenant arguing that the tenancy had expired and the tenant's right to occupy the space was terminated by a properly served 30-day notice of termination. The property in question was a hotel owned by the landlord that the tenant had lived in for a continuous two-year period and used as his only place of residence.

The tenant argued that the space was subject to rent stabilization rules as a "housing accommodation" and that landlord was thus required to state in the notice of termination the authorized grounds for terminating a rent-stabilized tenancy, which was not done. The Civil Court, New York County, granted tenant's motion to dismiss, agreeing with tenant that the facility was governed by rent stabilization laws and landlord failed to state grounds for the termination in the termination notice.

The landlord appealed the dismissal to the Supreme Court, Appellate Term, which affirmed the lower court's decision.[1] On further appeal, the Supreme Court, Appellate Division, also affirmed the decision, and granted the landlord leave to appeal to the Court of Appeals.[2]

Issue: Whether the space a tenant occupies in a lodging house, such as a hotel, fits within the definition of "housing accommodation" under the Rent Stabilization Code and is therefore subject to rent stabilization regulations.

Analysis: The Rent Stabilization Law ("RSL") is a New York City law that governs rent stabilization within the city.[3] RSL covers

"housing accommodations in Class A or Class B multiple dwellings." The hotel in question was classified as a class B multiple dwelling by the New York City Department of Buildings.[4]

Under the Rent Stabilization Code, a "housing accommodation" is defined as "[t]hat part of any building or structure, occupied or intended to be occupied by one or more individuals as a residence, home, dwelling unit or apartment, and all services, privileges, furnishings, furniture and facilities supplied in connection with the occupation thereof."[5] Several factors must be considered in determining whether the space in issue can be properly characterized as a "housing accommodation" for purposes of the RSL, including: the length of time landlord allows tenant to continuously occupy the same space, whether tenant has any other place of residence and whether landlord places any limitations on tenant's use and control of the premises.

According to the record, landlord allowed tenant to occupy the space for a continuous two-year period and use the space as his only residence. Furthermore, the landlord permitted the tenant to retain a key over an extended time so that he could restrict others from his area, and let tenant store his personal possessions inside a locker within the confines.

The Court disregarded the landlord's argument that the space's structural configuration prevents it from being construed as a "housing accommodation" for rent stabilization purposes, ruling that the plain meaning of the Rent Stabilization Code's definition of "housing accommodation" contradicts such a contention.

Furthermore, the Court disagreed with landlord that deference should be given to the interpretation of the Division of Housing and Community Renewal, the New York City agency responsible for administering the rent stabilization laws. In prior matters, DHCR has rendered living compartments in lodging houses as exempt from rent stabilization laws. Although the Court agreed that such questions do indeed fall within the expertise of the DHCR, the Court stated that the hotel in issue was not under the jurisdiction of DHCR and that, in this instance, DHCR's determination is inaccurate.

The Court of Appeals affirmed the order of the Appellate Division and ruled that the hotel space in question did fall under the laws governing rent stabilization and the laws required appropriate grounds for termination be given to the tenant in the notice of termination.

Jeffery W. Brown '99

Endnotes

1. Gracecor Realty Co., Inc. v. Hargrove, 160 Misc.2d 963, 615 N.Y.S.2d 213 (1st Dep't 1994).
2. Gracecor Realty Co., Inc. v. Hargrove, 221 A.D.2d 237, 634 N.Y.S.2d 1 (1st Dep't 1995).
3. Rent Stabilization Code, N.Y. Unconsol. Laws § 2520.6 (McKinney 1997).
4. Multiple Dwelling Law § 4(9).
5. 9 N.Y.C.R.R. § 2520.6(a).

* * *

Landlord-Tenant: Landlord's liability for injury to tenant's employee. *Miele v. UDC-Ten Eyck Development Corp.*, 652 N.Y.S.2d 164 (3d Dep't 1997).

Facts: The plaintiff, Joseph P. Miele, a supervisor for the New York State Department of Social Services, was injured in the course of his employment on August 18, 1991 when a section of the raised tile flooring of the Ten Eyck Office Building in Albany collapsed. The building was leased to plaintiff's employer, New York State, by the defendant, owner of the building, pursuant to a lease agreement dated April 15, 1974.

The lease agreement provided, *inter alia*, that at the expiration of the lease the premises were to be conveyed by the defendant/owner to the tenant, New York State, without additional payment therefor. It also allowed the owner to enter the building at all reasonable times to perform its lease obligations. The lease also provided that the lessee could make reasonable alterations and additions to the building or any part at its own expense. Owner's written consent was required, however, if the proposed work would materially affect the exterior appearance or the structural components of the building.

All actual work on the office building was performed by or through the tenant, New York State. In fact, the repair work for a previous accident involving floor tiles was done by a state-hired contractor, and a state-hired general mechanic repaired the raised tile floor after the Miele accident. The defendant/owner never inspected any of the work or repairs made to the building.

The employee sued the building owner for injuries sustained in the accident. The Supreme Court, Schenectady County, granted employee's motion for summary judgment, ruling that the building owner retained control of the building as a matter of law and owed a duty of reasonable care to the employee. Relying on *Guzman v. Haven Plaza Housing Development Fund*,[1] the court ruled that the building owner's retention of the right to enter and inspect the premises in order to perform his duties under the lease, coupled with the lease provision requiring written consent for material changes, was sufficient to create a duty of reasonable care. The court went on to find that section 1153.1 of the New York State Uniform Fire Prevention and Building Code,[2] imposed an obliga-

tion on the building owner to make the building "safe and secure," and that the plain language of section 1153.1(a) "leaves no doubt that defendant was required to maintain [the building's] structural integrity."

Building owner appealed the judgment of the Supreme Court, Schenectady County.

Issue: Whether building owner, who is the titleholder of the premises but who relinquished exclusive possession, operation and control of the premises to the tenant, New York State, is responsible for the injuries to tenant's employee.

Analysis: The Appellate Division, Third Department reversed the decision of the Supreme Court, Schenectady County. Relying on *Garcia v. Dormitory Authority of New York*,[3] the appellate court found that the owner's reservation of the right to enter the premises was not a sufficient retention of control to subject it to liability for failure to maintain the premises in good repair. In *Garcia*, the First Department made this ruling when it found that the lease in question was not a standard lease agreement, but rather one part of an extensive financing transaction. The appellate court held the case at bar was factually similar.

Lastly, the appellate court found the lower court to be incorrect when it concluded that 9 N.Y.C.R.R. section 1153.1(a) imposed a duty on the building owner to make the premises safe and secure. This section requires a showing of imminent danger as a result of structural instability, fire, explosion or other hazardous situation, in order to impose a duty to make the premises secure. The floor collapse does not constitute an imminent danger.

As a result, the Appellate Division, Third Department found that the building owner, through the lease agreement, effectively relinquished exclusive possession, operation and control of the building to the tenant, New York State, and had no duty to repair. Therefore, the Appellate Division reversed the decision of the Supreme Court, Schenectady County, ruling that the building owner was not responsible for the injuries sustained by the tenant's employee.

Lori S. Hatem '99

Endnotes

1. 69 N.Y.2d 559, 516 N.Y.S.2d 451 (1987).
2. 9 N.Y.C.R.R. § 1153.1:

   > (a) A building or structure which is in imminent danger to life and safety as a result of structural instability, fire, explosion or other hazardous situation shall be made safe and secure or demolished and removed by the owner thereof.

3. 195 A.D.2d 288, 599 N.Y.S.2d 600 (1st Dep't 1993).

* * *

Zoning and Planning: Special use permit not required for facility deemed to be a religious and charitable organization and not a rooming house. *Capital City Rescue Mission v. City of Albany Board of Zoning Appeals*, 652 N.Y.S.2d 388 (3d Dep't 1997).

Facts: In August 1995, Capital City Rescue Mission, a not-for-profit corporation, sought a building permit to construct a facility in Albany that would serve as a rescue mission for disadvantaged citizens. The plans for the building called for the construction of a two-story facility containing classrooms, two kitchens, a clothing distribution center, bedrooms for staff members, a chapel, space for "residents," and space for "transient" uses.[1] The Rescue Mission stated that it would use this facility to provide physical, emotional, spiritual and psychological support to disadvantaged individuals through counseling, medical care and educational training. Items such as food, shelter and clothing were also to be provided.[2]

The City of Albany denied the Rescue Mission's request for a permit, claiming that the facility did not qualify as a "house of worship" under the city's zoning ordinance but more closely resembled a rooming house, which required a special use permit. The city based its conclusion on the fact that although the facility included a small chapel, almost the entire second floor of the building was intended for residents and/or transients.[3] The Rescue Mission took the position that the building actually fell within the definition of a "charitable or religious institution" as defined by the City Zoning Ordinance of City of Albany section 27-202,[4] and as such did not require a special use permit. The Rescue Mission brought a proceeding pursuant to CPLR article 78 to review the decision of the City Board of Zoning Appeals, but its application for review was dismissed by the Supreme Court, Albany County. In this proceeding, Rescue Mission appeals the judgment entered by the Supreme Court, Albany County.

Issue: Whether the City of Albany erred in rejecting a building permit for a not-for-profit facility when it concluded that the facility, which was aimed at providing food, shelter, clothing, counseling, medical care and education for disadvantaged individuals, did not fall within the definition of a "house of worship/charitable or religious institution" pursuant to Zoning Ordinance of City of Albany section 27-202, which are exempted from the special use permit requirement.

Analysis: The Appellate Division, Third Department stated that it would be permitted to set aside a board's decision "where it is found to be illegal, arbitrary or an abuse of discretion."[5] But if it found that the board's decision was rational and supported by substantial

evidence, it could not be overturned. To make this determination, the court examined the definitions of a "rooming house" and a "charitable religious institution" put forth in the city zoning ordinance.[6]

According to the ordinance, a "charitable or religious institution" is the "headquarters, offices or facility from which a not-for-profit charitable or religious organization conducts its business in service to the community."[7] The definition for a "rooming house" is a "building containing a single dwelling unit and rooms for the rooming and/or boarding of at least three (3) persons, but not more than twenty-five (25) persons by prearrangement for definite periods of not less than one (1) week."[8] The court determined that the Rescue Mission satisfied the necessary elements for a "charitable or religious institution" within the meaning of section 27-202, and indicated that the Zoning Board, in its review, failed to address this question. The court stated that since zoning ordinances are in derogation of the common law they are to be strictly construed, and any ambiguity will be resolved in favor of the property owner.

In this case, the organization was clearly not-for-profit and its religious status was evident in its mission statement, which stated that the purpose of the organization was to provide support, spiritual and otherwise, to disadvantaged individuals. The court found that these goals and acts placed the building within the definition of a charitable or religious institution.

Furthermore, the court agreed with the Rescue Mission that the facility did not fit the definition of a rooming house, and that the Zoning Board's determination was limited to the conclusion that the facility "would appear to constitute or closely resemble a rooming house." The building did not contain a single dwelling unit, nor was it limited to boarding less than 25 people. In addition, it did not require prearrangement to live there. Accordingly, since the facility was not a "rooming house," and since the Zoning Board never addressed the issue of whether the facility fit within the definition of a religious or charitable institution, even though this argument was raised by the Rescue Mission, the board's decision was irrational and the court annulled the Zoning Board's denial of the building permit.

Dawn M. Velez, '99

Endnotes

1. Capital City Rescue Mission v. City of Albany Board of Zoning Appeals, 652 N.Y.S.2d 388, 389.
2. *Id.* at 390.
3. *Id.*
4. Albany, N.Y., Zoning Ordinance § 27-202.
5. *Capital City Rescue Mission*, 652 N.Y.S.2d 388, 389 (citing Khanuja v. Denison, 203 A.D.2d 679).
6. Albany, N.Y., Zoning Ordinance § 27-202.
7. *Id.*
8. *Id.*

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DENNIS C. VACCO
Attorney General

PAMELA JONES HARBOUR
Deputy Attorney General

February 4, 1998

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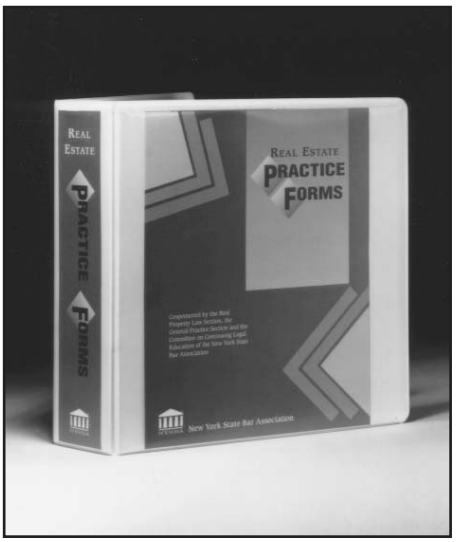

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