NYSBA

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N.Y. Real Property Law Journal

A publication of the Real Property Law Section
of the New York State Bar Association

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Message from the Outgoing Chair

Karl B. Holtzschue

It's been a busy year and, as of this writing, less than a month to go in my term. I want to thank my fellow officers, Peter Coffey, Joel Sachs and Anne Reynolds Copps and fellow RPLS Executive Committee members for all their help and support. They are an outstanding group of real estate lawyers and devote a great number of hours and effort to carry out the work of our Section. As you will see below, responding to and proposing legislation has been a major focus this year. Following are some of the highlights of the year:

1. **Adverse Possession Bill Proposed**. A9156 / S5364A (Sen. Little) was an attempt to reverse the outcome in *Walling v. Przybylo*, 7 N.Y.3d 228 (2006), by providing that a title claim based on adverse possession could not succeed if the claimant had knowledge of the true ownership. Our Section opposed the bill (RPLS Legislation Memorandum #13) because it contained ambiguities and raised important issues, and the Governor vetoed the bill. Our Task Force on Adverse Possession studied the law and recommended a better alternative to help ensure that homeowners are on notice of adverse possession, to eliminate claims based on minor encroachments and lawn mowing and to generally clarify the RPAPL provisions, though not reversing the result in *Walling*. The RPLS Executive Committee approved the bill and we obtained approval from the NYSBA Executive Committee. It was introduced on April 29 as a courtesy by Senator Little as S7915, who also reintroduced her old bill as S7917. We met with her on April 29 and she still insisted on denying adverse possession to possessors with knowledge of true ownership, asking that we come up with a compromise to achieve both her goals and ours. We met with her again on May 14 to argue for our bill.

2. **Title Agents and Service Charges Bill**. The Section successfully negotiated an exclusion from the controlled business prohibition for attorney title agents and examining counsel in the title agents registration bill (A1743 / S877) and consequently supported the bill. Our Title and Transfer Committee has drafted a bill to require disclosure of service charges to consumers in connection with title insurance that would separately identify (1) payments to third parties and (2) service charges. The bill was approved by our

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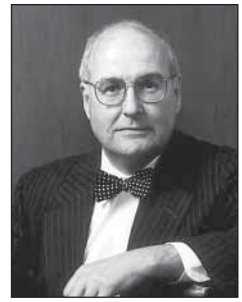
A Message from the Incoming Chair



Peter V. Coffey

I just attended an appellate practice seminar put on by the New York State Bar Association at which all 13 Justices of the Appellate Division, Third Department appeared. One point they made was this—that as soon as you stand up in front of the court, introduce yourself. Well, who am I to challenge the entire bench of the Third Department of the Appellate Division?

My name is Peter V. Coffey and I am a member of a six-person law firm in Schenectady, New York—I am married and have been for forty (40) years and we are the parents of six children (boys) and **one** grandchild.

First of all, the thank yous. Great thanks and warm praise go to Karl Holtzschue, who has chaired the Section for the past year. His initiative regarding legislation is one of the better accomplishments I have seen in the Real Property Law Section.

Thanks also to Joel Sachs, Second Vice-Chair, who has planned a great outing in Hershey, PA—as in chocolate and great things for children to do. Thanks to Anne Copps, our Secretary (if you have an enemy make him or her Secretary). The new year which begins June 1st has Joel as First Vice-Chair, Anne as Second Vice-Chair and Ed Baer as Secretary (who doesn't like him?). Ed was the former Budget Officer—a new position for the Section and something we very much needed. He will be replaced in that capacity by Spencer Compton.

If you are a member of the Executive Committee or have been otherwise substantially involved with the Section, you understand what is going on. This message is addressed to the rest of you. The goal of this year is to bring as many of you as possible into active involvement in the Section—to bring you the benefit of in-person interaction with some of the best real estate practitioners in the state—and the nation in many instances.

Let me tell of a couple of examples of recent activity to show you what I am talking about. Karl Holtzschue has established a great initiative as I mentioned before in that we have become actively involved with the legislature. This has resulted in our visiting and conferring with several legislators every year. Because of this involvement and our actively monitoring legislation affecting our area, we focused on the Property Condition Disclosure Act. As initially passed by the legislature, the Act would have

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Introduction

By Peter V. Coffey

A core act of any real estate attorney is the rendering of a title opinion. The concept is simple, its service complex. In the normal residential real estate closing today conflict is at the heart of the complexity. For whom is the attorney rendering a title opinion? If it's for only one party to the transaction, then we have a simple concept. But once parties are added to the representation, conflicts and complexity compound. And all the while we as real estate attorneys must keep in mind one of the essentials of our profession—subordinate at all times of course to ethical considerations—the making of money. There is nothing tawdry about this aspect of the profession. Thomas Jefferson, when he left the profession wrote a letter to a newspaper stating he was leaving because clients did not pay their bills (a significant number of Thomas's clients unfortunately were his relatives).

We identify four parties generally to a real estate transaction: the seller, buyer, lender and the title company. What about the situation where there is a combination of entities at the closing represented by a single attorney excluding the representation of a buyer and seller (not to be done)? The issue had been discussed before but came to the forefront with the issuance by the New York State Bar Association Committee on Professional Ethics of Opinion 576: "Real estate attorney: agent for title insurers; multiple representation." The opinion was quickly perceived by our Section indicating an inappropriate restriction on the attorney's ability to function in the standard real estate closing. Accordingly, and very quickly, the Chair of the Section appointed the "Tilton Committee," headed by Sam Tilton. Sam as always energetically undertook the work and persuaded the Ethics Committee to reconsider N.Y. State 595, which resulted in Opinion 621 stating, "at the request of the Real Property Law Section of the New York State Bar Association (upon which 1986 report we relied heavily in fashioning N.Y. State 595 [1988]), our committee has reconsidered N.Y. State 595 1988." However, this opinion did not change the conclusion that had been reached earlier. The issue continued to ferment and there followed a series of ethics opinions issued by the New York State Bar Association Committee on Professional Ethics. In addition to the ethics opinions issued by the New York State Bar Association, the Chief Judges of the Appellate Divisions formulated a new Disciplinary Rule, DR 1-106 which, depending upon your opinion, did or did not impact on the ethics opinions of the New York State Bar Association.

This issue is essentially a report on the presentation of the topic at the 2008 Annual Meeting of our Section in New York City and, as seen above, is itself a culmination of years of significant involvement by our Section concerning this issue. Participating was Steven Wechsler, an outstanding ethics authority in the State of New York, a Professor at Syracuse University, a member of the Committee on Professional Ethics and an Associate Reporter of COSAC. In addition to Steve three leaders of the Section served on the panel: Tom Hall, Co-Chair of the Title and Transfer Committee; George Haggerty, Co-Chair of the Unlawful Practice of Law Section (a Committee which is of increasing importance to our Section) and Jerry Antetomaso, Co-Chair with Tom Hall of the Title and Transfer Committee of the Section. It should be noted that Sam Tilton, mentioned previously, is a former Chair of the Title and Transfer Section as is Karl Holtzschue, our immediate past Chair. The panel's presentation itself is the result of an intense effort by the group for several months prior to the presentation of the issue. I chaired the panel.

There was much discussion at the presentation and a lively and (as they say) heated debate. It is my position that DR 1-106 overrides the previous ethics opinions regarding this issue, holding there is a nonconsentable conflict. The Ethics Committee takes the position these conflicts are nonconsentable, that is, even if informed of every aspect of the conflict, the client still cannot consent. It is my opinion that DR 1-106 removed that aspect. As you can see from the exposition of the matter by Steven Wechsler, he disagrees with that. That being said, Steve's clear and thorough analysis sets forth the prevailing opinion on the subject. We are both in agreement that model Rule 5.7 as proposed by COSAC does in fact overrule the previous opinions.

A driving force behind this symposium, in fact a driving force behind the entire Real Property Law Section for the last year, has been Karl Holtzschue. He took a particular interest in this subject and Karl felt the report as presented at the Annual Meeting should be submitted to the entire Section in the *Journal*. One aspect requires statement: Karl was adamant that if the issue were to be presented, it would be presented with some clear advice to Section practitioners. The RPLS Title and Transfer Committee is drafting a model disclosure and consent form for use where the attorney is acting as a title agent for a title insurer insuring the attorney's client. Once approved, it will be published in the *Journal*.

Peter Coffey is a partner in the law firm Englert, Coffey, McHugh & Fantauzzi, LLC in Schenectady, New York.

The History of Title Insurance

By Gerard G. Antetomaso

The genesis of the following series of articles and the presentation of their contents at the Annual Meeting this past January was the apparent confusion and differing views on what an attorney can and cannot do ethically with respect to writing title insurance in a client's real estate transaction. There are many who seem to misinterpret the New York State Bar Association's ethics opinions on the topic.

We thought it may be useful to our Section members to address some of these issues and provide some suggested guidelines to implement in our practices. We must stress that there are strong differences of opinion regarding this subject. You will see that the proposed rule changes from the Committee on Standards of Attorney Conduct (COSAC) differ from the opinions. You will also read that in cases decided in disciplinary proceedings, the courts seem—if not expressly, often tacitly—to acknowledge the propriety of an attorney placing title insurance in transactions involving one's clients.

This article will provide an introduction to the origin of title insurance and examine how the title insurance industry has evolved in the United States to a point where most real estate transactions include title insurance. We will explore some of the differences between title practices here in the United States as compared to other common law countries and how attorney title opinions rather than title insurance are still widely used even in large transactions overseas. In other articles accompanying this issue, George Haggerty will write on the various relationships among attorneys and title underwriters, Professor Steven Wechsler will discuss his interpretation of the current state of the Bar's position on the subject as well as changes that have been proposed and Karl B. Holtzschue will write on COSAC's new proposed rules.

When reduced to its simplest form, title insurance is an opinion as to the history and current status of the title of real property (something that has always been the domain of attorneys), backed by the financial wherewithal of an insurance company. The history of title insurance dates back to a Pennsylvania case decided in 1868 named *Watson v. Muirhead*, 57 PA 161. The system for transferring interests in real estate during the time of the *Watson* case involved individuals known as "conveyancers" who often were responsible for searching title and identifying encumbrances or objections. In *Watson* the plaintiff employed defendant, a conveyancer, to ascertain the title of the vendor of certain ground rents and whether such title was free of encumbrances. Upon review of title, there was found a default judgment against a predecessor in interest to the seller. The judgment was to be vacated subsequent to the payment of costs. The conveyancer, as well as an attorney, had opined the judgment was not a lien against the real estate, and the conveyancer suggested the purchaser go forward with the purchase of the ground rents. Some time after the completion of the transaction, the sheriff executed on the ground rents and sold them at auction. The conveyancer and the attorney were mistaken in their opinions. The plaintiff thereafter commenced an action against the conveyancer.

With respect to the standard of care of conveyancers the Court held "the rule of the liability for errors of judgment as applied to them [conveyancers] ought to be the same as in the case of gentlemen in the practice of law or medicine." *Id.* at p. 167. Therefore, in the opinion of the Court, the Conveyancer had no less responsibility than an attorney with respect to conveyances of real property. The Court in *Watson* ultimately held that the conveyancer's action would not result in liability to the conveyancer. *Id.* at p. 168. In so holding the Court stated "to hold him responsible would be to establish a rule, the direct effect of which would be to deter all prudent and responsible men from pursuing a vocation environed with such perils." *Id.* at p. 168.

The rules governing professional liability clearly were different in 1868 than they are today. Reacting to the *Watson* case, the real estate community in Pennsylvania sought and had passed a bill that permitted corporations to insure titles and in 1876 the *Real Estate Title Insurance Company* was formed. The Pennsylvania statute allowed a corporation to insure title, but the more common practice was for trust companies to insure title and in many cases guarantee payments under bonds and mortgages. Several states followed Pennsylvania's lead and title companies began proliferating, especially in the major cities.

The first New York statute authorizing corporations to insure title was passed in 1909. The earlier laws also entitled trust companies that were incorporated under the Banking Law to provide insurance in real estate transactions. After several revisions of the law, we have finally come to Article 64 of the New York Insurance Law which now governs all title insurance corporations in New York. The Banking Law no longer allows trust companies to offer such insurance.

Once title insurance companies became authorized in New York, there has been little controversy as to their role as insurers. However, early on there were many cases involving title insurance companies that dealt primarily with the interpretation of sections of the Penal Law that classified as misdemeanors certain acts that constituted the practice of law. The cases were decided on the basis of whether individuals or corporations held themselves out as practitioners or whether certain acts they performed on behalf of clients constituted the practice of law. As an example, in *People v. Title Guaranty and Trust Company*, 227 N.Y. 366 (1919), the defendant, at the request of a client, undertook the preparation of blank forms of a chattel mortgage and a bill of sale. *Id.* at p. 370. At the time Section 280 of the Penal Law prohibited the rendition of legal services by a corporation but excepted out certain activities by corporations "lawfully engaged in the examination and insuring of titles to real property, . . ." N.Y. Penal Law § 280 (1916). The Court held the defendant's actions were not considered the practice of law, as they were commonly performed by individuals in other parts of the state who were not licensed to practice. See *People v. Title Guaranty* at p. 375.

In a subsequent case, the Court of Appeals considered a situation where a corporation undertook to assist a developer in procuring purchasers, securing FHA mortgages for such purchases, overseeing the execution of those mortgages and transferring the premises to such mortgagors. The Court found the activities clearly fell within the proscriptions of former Section 270 of the Penal Law and the defendant was found guilty. *People v. Lawyers Title Corporation*, 282 N.Y. 513 (1940). The *Lawyers Title* case differed somewhat from the *Title Guaranty* case in that the court specifically considered former Section 270 of the Penal Law and found inapplicable Penal Law Section 280, which excepted actions of companies engaged in the practice of insuring mortgages and title to real property.

"Title insurance, the underwriters and the agents for such underwriters have become integral parts of the practice of real estate law in the United States and are increasingly involved with such transactions in other areas of the world."

Since both such cases were decided, the provisions of the Penal Law has been repealed and a description of the practice of law and the proscription against non-lawyers advising clients has been codified in the Judiciary Law, specifically §§ 484 and 495. Those sections of the statute make it a crime for individuals or corporations to receive directly or indirectly compensation for "preparing deeds, mortgages, assignments, discharges, leases or any other instruments affecting real estate. . . ." N.Y. Judiciary Law § 495(3) (McKinney's 1965). The Judiciary Law, however, now provides in § 495(5) an exemption from these provisions for title insurance companies that prepare such documents if they are "necessary to the examination and insuring of titles, and necessary or incidental to loans made by any such corporation . . ." As we do not intend this issue to be a discussion of the unauthorized practice of law, we will leave that topic for another time. It is, however, instructive to note that since title insurance companies became authorized in New York, there has been tension between what constitutes the pure insurance function that is authorized, and the practice of law which is not.

In the United States there are over 100 licensed title insurance companies. As our experience tells us, nearly every residential transaction involves the purchase of title insurance. Most commercial transactions also include title insurance in this country. In fact one title company claims to be involved in 90 percent of all real estate transactions in the United States. However, we have not found such widespread use of title insurance in our sister countries. Other common law countries have not yet engaged in the practice of insuring the majority of their real estate transactions. One example brought to my attention by another member of the Executive Committee is the Canary Wharf Project in London. The site was an old abandoned dock area that has been redeveloped. There have been tens of billions of dollars spent already on the redevelopment and there are plans for billions more to be spent on 2 new towers, one of which is already under construction. Upon completion of the latest phase over 100,000 people will work at the site and currently over 500,000 visit weekly to shop and otherwise transact business. The entire project and its financing have been accomplished by attorney opinion letters and without the issuance of any title insurance whatsoever.

In Australia, the first title insurance company wasn't even licensed until 1996. That market is growing, however. Title insurance companies are now doing business in over 65 countries around the world at last count. Title insurance, the underwriters and the agents for such underwriters have become integral parts of the practice of real estate law in the United States and are increasingly involved with such transactions in other areas of the world.

Gerard G. Antetomaso, Gerard G. Antetomaso, P.C. in Webster, NY. He is co-chair of the NYSBA Real Property Law Section Title and Transfer Committee.

Ancillary Attorney Compensation from Title Services

By George Haggerty

Unlike the majority of other states, in New York, income paid to or retained by attorneys in the form of consumer-paid title premiums as a result of law firm-generated title work is the subject of a hotly contested ethical debate. In an effort to better understand the development and background of this type of ancillary legal income in New York, a thorough examination of the basic "lawyer as title agent" economic structures is appropriate.

Law firm income derived from client-paid title insurance premiums, earned in connection with the delivery of title services in real estate transactions, has been a common component of the legal and economic fabric of our practices in upstate New York for generations. Despite its rarity in southern New York, it is a generally accepted practice that purchaser's counsel in the upstate reaches of our state are more deeply "involved" in the title process as an issuing agent of a title underwriter.

Members of the Bar and now others, notwithstanding the northern ancestral origins of "attorney as title agent," are engaged in a focused examination as to the complex underpinnings of client-paid supplementary legal income. Recent developments, both internal and external, have also come together to elevate the discussion concerning ancillary legal income. Perhaps the debate is being advanced as a result of the political or economic agenda of competing trade organizations; nonetheless, it is clear that *de facto* and largely artificial demarcation of "participating" attorney title agents along New York State Insurance Department title rate "zones" is no longer a discussion controlled by geography.

The political and economic winds of change in this sensitive area seem to be driven by several competing interests. Notwithstanding the historical counsel connection to the development of the title industry, competing non-lawyer title agents, through their lobbying efforts, have advanced an ethically based challenge to ancillary attorney income, presenting a substantial threat to real estate attorney practices in many regions.[1] As a direct result of challenges to their industry by lenders, underwriters and assorted joint-venture-style operations, non-lawyer title agents have formalized their attempts to preclude counsel from participating in this area. The title agents' lobby has seen fit to legislatively advance a limited ethical analysis of select Ethics Opinions and Disciplinary Rules to justify preclusions to earned ancillary attorney compensation in an effort to reduce competition from lawyers. The ethically based objections to supplementary attorney income from the title agent industry formed a large part of the strategy advanced by the lobbyists employed by the New York State Land Title Association (NYSLTA) in the 2006 version of the Title Agent Licensing Bill,[2] since modified.[3]

Despite the title agents lobby's political spin upon the applicable legal and ethical prohibitions, the legal profession has consistently and traditionally looked inwardly via our own self-governing rules and considerations, and at times to the court for ethical guidance. Accordingly, compelling judicial interpretations and grievance committee determinations have failed to conclusively establish a *per se* prohibition of attorney participation in this area. In fact, when presented with the "relationship" as impermissible ethical conduct charge in a grievance committee complaint, the Appellate Division, Third Department, in *In re McKinnon*, stated, "an attorney may perform abstract work for a real estate client without necessarily becoming involved in impermissible conflicts of interest."[4] When subsequently analyzing a similar case on the issue of an alleged potential conflict of interest, the Appellate Division, Third Department, again stated, in *In re Ford*, "however, we decline to find that respondent engaged in a conflict of interest by referring real estate clients to his title abstract company."[5]

The issue of attorney participation in the area of earned ancillary income may also have become more focused as a consequence of the lack of perceived protection and support of the Bar by prosecutors and politicians relative to incursions of illegal or unlawful practitioners. There is a growing sense of disillusionment by the Bar as a result of virtually non-existent Judiciary Law enforcement actions by prosecutors. It is seen by many at the Bar that the lack of such action has actually promoted or encouraged the unlawful delivery of traditional professional services by non-legal entities. The lack of coordinated prosecutorial action to date has served to permit the erosion of real estate counsel's role to the point of economic invisibility in certain regions of the state.

It is universally acknowledged that legal ethics rules are not designed to promote lawyers' own selfish economic interests. It is also understood that ethics rules should not be modified merely in light of economic challenges to lawyers' incomes. At the same time however, there is mounting frustration amongst practitioners caused by confusing interpretations of preclusionary rules and opinions, which in some quarters has effectively prevented lawyers from competing with the non-lawyer settlement entities that have taken away their practices. The current state of affairs is now lamented by many at the Bar as lawyers stand by, economically and ethically handcuffed, while they bear witness to the rise of the combinational, non-legal, title agent-controlled "settlement company." These factors understandably serve to give counsel pause to reconsider the relevance of universal ethical preclusions to earned ancillary income from disclosed title insurance placement.

Practitioners are now openly deliberating the contemporary relevancy of existing ethics rules designed to regulate or omit attorney involvement in the delivery of title services and its ancillary legal income. Many proponents of attorney involvement in title policy issuance point to the example of our neighboring state, Connecticut, which in 1984 adopted a compulsory attorney-run delivery system for title insurance-related products.[6] It is informally noted that Connecticut has not witnessed any spike in legal, ethical or moral abandonment by counsel, despite its decision to require new title agents to be "Commissioners of the Superior Court" (i.e., attorneys). The primary motivation behind the statutory change was the protection of consumers from unlicensed or unscrupulous title operations.

Modernization of traditional ethical positions is now being considered by the organized Bar in New York. The re-examination, in part, is being brought about by the proposed adoption of the American Bar Association-based model rules by the organized Bar in the State of New York.[7] The New York embodiment of the ABA model rules has been carefully debated, adjusted and advanced by the Committee on Standards of Attorney Conduct (COSAC).[8] In light of growing national acceptance and intellectual analysis, as well as economic reality, the recently proposed COSAC rules permit attorney participation under strict guidelines requiring disclosure and consent in supplemental income from title services. [9]

It is observed that this combination of external and internal factors has moved the Bar to begin an intensive examination of the historical and ethical restrictions in this area. In anticipation of the potential modification of traditional restrictions on earned ancillary legal income, a review of the assorted economic structures under which attorneys have been compensated for title services is warranted.

Attorney as Title Agent and the Assorted Relationships

The regional practice conventions of the Northern, Western and Southern Tier regions of New York State (collectively referred to as "Northern variations") serve to provide the predominant models of attorney-agency "arrangements" that have existed between counsel and the major title underwriters. The particulars of the Northern variations—their duties, roles and remittances—are illustrative in that they demonstrate the legal and ethical development in attorney practices in this arena over the last 30 years.

The title underwriters in New York have remitted fees or allowed retention of title premiums in various arrangements, which range from loosely stated "appointments" to increasingly complex and negotiated "attorney agency agreements." In New York, there have been three recognized arrangements under which title underwriters have memorialized their relationship to counsel who render title services in connection with the representation of their clients. The relationships fall into three categories: 1) "Approved Attorneys," 2) "Examining Counsel," and 3) the "Attorney Title Agency."

"Approved Attorney"

"Approved Attorney" was the traditional label applied to counsel by a title underwriter which had a strictly percentage-based referral business relationship with counsel. Its place in history is relevant to this discussion in that it essentially involved the payment of unearned fees to referring counsel for the mere placement of title insurance with a participating underwriter. Approved attorneys, generally speaking, did little or no work in return for a small percentage of the title premium or a straight referral fee. Under this arrangement, merely placing a call to the underwriter for title insurance gave rise to an unearned payment. As an Approved Attorney, there was no expectation of independent abstract review, clearance work or any economic accountability. A distinguishing feature of the Approved Attorney was its lack of authority to bind the title underwriter. No books, accounts or records needed to be maintained by referring counsel and there was no audit component. Clearly, under this model of operation, there was no core title service provided by counsel. This type relationship has been deemed illegal at least since institution of the Housing and Urban Development Real Estate Settlement Procedures Act (hereinafter "HUD RESPA") enacted in 1975.[10] Parallel state regulation concerning illegal kickbacks and referral fees can be found under the New York State Insurance Law Section 6409(d).[11] The inappropriateness of such attorney conduct not only violates state and federal regulation, but recent disciplinary action demonstrates the acceptance of *unearned* title fees by counsel in the context of a regulated transaction is also considered a "serious crime," which can permit disbarment.[12]

The two controlling sections of HUD RESPA and its amplifying regulations that sought to prohibit pure referral-fee arrangements in the context of federally regulated transactions seem to have been enacted to directly address the New York-style Approved Attorney relationship.[13] RESPA Section 8(a) prohibits paying or accepting any "fee, kickback, or thing of value" for the simple referral of settlement services.[14] Even more to the point is RESPA Section 8(b), which prohibits payment or acceptance of any portion of a fee or price paid by the borrower for settlement services "other than for services actually performed."[15] It is obvious the federal regulators intended to eliminate the *unearned* distribution or sharing of portions of the closing fees paid by borrowers to attorneys and others who merely placed the order for title insurance or any other settlement service.

It is critical to this discussion that RESPA Section 8(c) provides the notable exceptions to the general prohibitions preventing payments to others from the settlement costs paid by consumers.[16] Specifically, it permits sharing fees or direct payment to service providers, such as counsel, and others who actually render "*core title services*."[17] Thus the payment is permitted for services rendered and not for the mere referral of business. In the Approved Attorney context it is clearly seen, without more, the mere operation of a telephone is no longer sufficient to justify a fee of any kind, legal or otherwise. An obvious but very important distinction is that the applicable statutes require actual separate title-oriented services be expended by counsel in order for any payment to be legally earned and therefore exempt from the prohibitions of RESPA Section 8(a) and (b).

"Examining Counsel"

"Examining Counsel" is a negotiated relationship between counsel and the applicable title underwriter that permits a significant payment or retention of consumer-paid title premiums to counsel for the performance of a defined group of core title services. While the designation of an Examining Counsel generally requires that counsel perform certain well-defined title services, it does not usually require an intense accounting or auditing-control component. In terms of contractual agreement, the underwriter generally designates Examining Counsel by written agreement between the carrier and the attorney. Despite diminishing popularity, the Examining Counsel structure survives to this day and is not uncommon in Western and Northern New York State.

In view of the increased amount of specific responsibility and actual effort expended by counsel, the remittance or retention paid to Examining Counsel is typically greater than to the ill-fated Approved Attorney. The Examining Counsel relationship appears to be in accordance with federal and state legislative mandates that require fees received in connection with the placement of title insurance, or settlement services, be paid only as a result of *actual efforts* rendered on behalf of the title company or the client.

The typical Examining Counsel structure described above seems to satisfy much of the "core title services" requirements as stated under the HUD RESPA federal regulations.[18] However, the final analysis in determining if counsel's ancillary fee has been properly earned may be best determined by reference to related regulations that address payments to settlement service providers who wear several hats in the same transaction.

HUD RESPA Regulation X Sec. 3500.14(g)(3) reads as follows:

> (3) **Multiple Services—** When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person. For example an attorney of the buyer or seller to receive compensation as a title agent, the attorney must perform core title services (for which liability arises) separate from attorney services, including the evaluation of the title search to determine the insurability of title, the clearance of underwriting objections, the actual issuance of the policy or policies on behalf of the title insurance company, and where customary, issuance of the title commitment and the conducting of the title search and closing.

As per the regulation, being counsel for a party in a real property transaction establishes a primary service role, i.e., being in a position to refer settlement service business. In the event Examining Counsel seeks to undertake a secondary role relative to title insurance placement and premium retention, HUD RESPA Section 8(c) along with its amplifying regulation (HUD RESPA Regulation X), must be observed in order to determine the legitimacy of any fees earned pursuant to such secondary role. Said examination must conclude in the finding that counsel is providing "core title services," most importantly for which "separate liability" (as a title officer as opposed to counsel) would arise.[19] Therefore, it is clear under federal regulation that counsel already having a role in a real estate transaction can lawfully earn ancillary payments from title services if their actions are seen as being actual, necessary and distinct from the efforts undertaken in their primary role. If such distinctions cannot be made, the monies paid, retained or earned cannot be justified.

"Attorney or Law Firm as Authorized Agent" (Attorney Title Agency)

The third and most common agency-style structure permitting counsel to participate in title premium retention is the full-blown, attorney-run title agency. Note for clarity, I do not refer to a separately incorporated title agency owned by an attorney; I refer to the traditional law firm operating as the authorized title agent. In this example, the firm, through its own lawyers, is the responsible party or agent. All aspects of complete professional liability are maintained and are applicable to its endeavors. Under the Judiciary Law, non-lawyers, corporations, or joint ventures cannot be partners or shareholders in this operational model.[20]

The core title services provided and income derived from these efforts are indistinguishable from any other non-attorney-based title agency except here the law firm's client transactions form the basis of the revenue stream. The requirements to become an authorized law firm title agent are the same as for non-attorneys—they must be good credit risks, have a high level of experience and maintain adequate errors and omissions coverage for agency operations separate of their legal malpractice coverage. Presently, no additional license is required and the structural relationship between the carrier and attorney agent are governed by a strictly enforced "agency agreement."

The heart of the agency agreement requires substantial effort of counsel in connection with the placement of coverage and issuance of the policy. As with any other title agency, Attorney Title Agents are subject to separate audits by the underwriter. They can effectively bind coverage and assume responsibility consistent with the regulations under HUD RESPA Section 8(a), 8(b) and 8(c). Attorney Title Agents earn all the income that the paid premiums provide consistent with the formal agency agreement. Attorney Title Agents must assume responsibility for their actions separate of the responsibility they have as counsel to a buyer or borrower in the same transaction. Although Attorney Title Agents can earn as much as their non-counsel title agent counterparts, it is critical to note a key distinction—counsel who perform such ancillary services are bound by the Ethical Considerations and Disciplinary Rules that not only require full and complete disclosure of the ancillary role and income, but further require the application of attorney client privileges, confidentiality, client rights, financial disclosure, malpractice exposure, and most importantly, fiduciary duties, to name a few.[21] In a recent disciplinary case of some relevance, *In Re Drysdale*, the Appellate Division, Second Department sustained a charge that counsel failed in her ethical obligation to disclose her economic relationship to a wholly owned title abstract company in which she placed her clients' title orders.[22] There was no issue presented as to whether core title services were provided. Interestingly, the Court in that case did not address any conflict of interest concerns of the ancillary title services provided by counsel's corporate, wholly owned agency.

The rate of ancillary compensation for counsel title work seems to be driven by two factors. First, the specific arrangement or contract between counsel and a title underwriter (Examining Counsel or Attorney Title Agent), and second, the depth of the efforts expended and the level of responsibility undertaken by the attorney seeking compensation. The deeper the level of participation and responsibility assumed by counsel, the greater the permissible reimbursement under most agency agreements. Analysis of controlling regulatory framework seems to skew along the same lines. The payment of a fee for the delivery of core title services by counsel in the context of a real estate transaction in which he or she serves as the consumer's attorney is expressly permissible under current federal and state law, provided said services were legal in nature, appropriately consented to, adequately disclosed, and the income obtained did not result in an excessive overall fee.[23]

As discussed previously, assorted judicial decisions and relevant grievance committee determinations have declined to sanction attorneys for having an income-producing relationship with a wholly owned title agency. Courts have rightly sanctioned counsel involved with owned or controlled title agencies for their failure to provide any real service for the fees extracted, for the lack of prior disclosure of the relationship and the failure to obtain the consent of the client. It is also apparent under federal and state regulation that *earned fees*, meaning income derived from the *actual delivery or performance of title services*, are permissible despite counsel's primary service role as attorney. The compelling "core title services" performance standard found in RESPA, combined with the obligations of client disclosure and consent cited in the proposed COSAC rules, moves one to conclude ancillary legal income may be supportable, defend-able and appropriate under certain conditions.

Endnotes

1. Lawrence M. Litwack, *Two Masters—Ethics for Real Estate Lawyers*, The Bulletin, Summer 2007, at 3.
2. N.Y.S. S. 8132, 229th Sess. (2006).
3. N.Y.S. S. 877-A 230th Sess. (2007) (S. 8132 was modified in part as a consequence of meetings and negotiations with select NYSBA RPLS members, NYSLTA leadership and Senator George Winner (R Elmira) to permit the continuation of attorney involvement in title insurance issuance.).
4. *In re MacKinnon*, 223 A.D.2d 807 (1996).
5. *In re Ford*, 287 A.D.2d 870 (2001) (counsel had been accused of engaging in an impermissible action by a referral of his real estate clients to a title abstract service entity he controlled).
6. Conn. Gen. Stat. § 38a-402(13) (No person may act as a title agent unless he is a commissioner of the Superior Court in good standing, except any individual who held a valid title insurance license on or before June 12, 1984.).
7. Center for Professional Responsibility, American Bar Association Model Rules of Professional Conduct (2004).
8. New York State Bar Association, Proposed Rules of Professional Conduct (2008).
9. Proposed Rule 5.7(c) states a lawyer may provide both legal and non-legal services to a client in the same matter so long as: "the lawyer or law firm complies with Rule 1.8(a) regarding the provision of the non-legal services, (ii) the lawyer or law firm reasonably believes it can provide competent and diligent representation to the client, and (iii) the client gives informed consent, confirmed in writing."
10. Real Estate Settlement Procedures Act § 8, 12 U.S.C.A. §§ 2601–2617 (1974).
11. N.Y. Ins. Law § 6409(d) (McKinney 2008) states:

    No title insurance corporation or any other person acting for or on behalf of it, shall make any rebate of any portion of the fee, premium or charge made, or pay or give to any applicant for insurance, or to any person, firm, or corporation acting as agent, representative, attorney, or employee of the owner, lessee, mortgagee or the prospective owner, lessee, or mortgagee of the real property or any interest therein, either directly or indirectly, any commission, any part of its fees or charges, or any other consideration or valuable thing, as an inducement for, or as compensation for, any title insurance business. Any person or entity who accepts or receives such a commission or rebate shall be subject to a penalty equal to the greater of one thousand dollars or five times the amount thereof.

12. See *In re Stall*, 31 A.D.3d 39, 2006 N.Y. Slip Op. 03788 (2006) (attorney was disbarred for receiving payments from an abstract company, without providing any services in exchange for the payments).
13. In HR Rep. No. 1197, 93d Cong., 2d Sess. 7 (1974), to accompany the House's version of RESPA (HR 9989), the following appeared:

    In a number of areas of the country, competitive forces in the conveyance industry have led to the payment of referral fees, kickbacks, rebates and unearned commissions as inducements to those persons who are in a position to refer settlement business. Such payments may take various forms. *For example, a title insurance company may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application*. (emphasis added)

14. RESPA § 8(a).
15. RESPA § 8(b).
16. RESPA § 8(c).
17. RESPA Reg. X 24 C.F.R. § 3500.14(g)(3).
18. RESPA Statement of Policy 1996-4. 61 Fed. Reg. 49,398 to 49,400 (1996) states as follows:

    2. "Core title services" are those basic services that a title insurance agent must actually perform for the payments from or retention of the title insurance premium to qualify for RESPA's section 8(c)(1)(B) exemption for "payments by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance." In performing core title services, the title insurance agent must be liable to his / her title insurance company for any negligence in performing the services. In considering liability, HUD will examine the following types of indicia: the provisions of the agency contract, whether the agent has errors and omissions insurance or malpractice insurance, whether a contract provision regarding an agent's liability for a loss is ever enforced, whether an agent is financially viable to pay a claim, and other factors the Secretary may consider relevant.

    "Core title services" mean the following in Florida:

    a. The examination and evaluation, based on relevant law and title insurance underwriting principles and guidelines, of the title evidence (as defined below) to determine the insurability of the title being examined, and what items to include and / or exclude in any title commitment and policy to be issued.

    b. The preparation and issuance of the title commitment, or other document, that discloses the status of the title as it is proposed to be insured, identifies the conditions that must be met before the policy will be issued, and obligates the insurer to issue a policy of title insurance if such conditions are met.

    c. The clearance of underwriting objections and the taking of those steps that are needed to satisfy any conditions to the issuance of the policies.

    d. The preparation and issuance of the policy or policies of title insurance.

    e. The handling of the closing or settlement, when it is customary for title insurance agents to provide such services and when the agent's compensation for such services is customarily part of the payment or retention from the insurer.

19. RESPA Reg. X 24 C.F.R. § 3500.14(g)(3).
20. N.Y. Jud. Law § 484 (McKinney's 2008).
21. DR5-101 (22 N.Y.C.R.R. 1200.20(a)); DR 1-106(a), (a)(7) (22 N.Y.C.R.R. 1200.3(a)(7)).
22. *See In re Drysdale*, 27 A.D.3d 196, 2006 N.Y. Slip Op. 01483 (2006) (attorney's failure to disclose her interest in an abstract company to her real estate clients was a violation of Code of Professional Responsibility DR 5-101(a) (22 N.Y.C.R.R. 1200.3 (a)) and DR 1-102.
23. Karl B. Holtzschue, *Holtzschue on Real Estate Contracts and Closings*, §§ 2:2.7(c) 3d ed. 2007.

George Haggerty is a partner in the law firm George Haggerty & Associates, P.C. Tina Munz, Esq. and John Rowland, Esq., Associate Attorney, assisted immeasurably in connection with this project.

The Real Estate Lawyer and the Title Insurance Policy Ethics Status Report

By Steven Wechsler

From the point of view of a legal ethics professor, the question of the propriety of a lawyer for a party to a real estate transaction being involved in the procurement of title insurance for that party starts with a close look at the various actors in the matter and their relationship to one another. For purposes of this discussion, I am assuming the following (admittedly oversimplified) paradigmatic situation, with two alternative scenarios:

> Lawyer represents Buyer of property. As a condition of the loan, Lender requires Buyer to procure a policy of title insurance protecting its interest; Buyer is responsible for the expense of obtaining the insurance. On advice of Lawyer, Buyer also procures a title insurance policy protecting Buyer's own interest.
>
> In Scenario 1, Lawyer has a relationship with an insurance underwriter, XYZ Title, as "Attorney Closer," "Approved Attorney," "Examining Counsel," or "Agent." Lawyer does all of the work needed for issuance of the title policy.[1] This includes some or all of: ordering the County Clerk's search, tax search, building violation search, fire search and certificate of occupancy search; reviewing the survey and personal inspection where required; clearing title objections; preparing title report and title policy; recording all closing documents; and paying and discharging liens. Scenario 2 is the same, except that instead of an "Agent" or similar relationship with XYZ Title, Lawyer has an ownership interest in ABC Abstract Company, which in turn deals with the underwriter.
>
> Buyer pays for both of the title insurance policies. In Scenario 1, a portion of that payment (the "split") is paid to Lawyer[2] and the balance is retained by XYZ Title; the payment to the lawyer is a single lump sum, part of which relates to the work done in connection with the mortgage policy and part of which is compensation for additional, non-duplicative work needed for the owner's policy. In Scenario 2, the insurance premium, less the necessary payment to XYZ, goes to ABC Abstract, in which Lawyer has an ownership interest.

With this as our background, the ethicist asks three questions:

- Are there present or potential conflicts of interest inherent in this situation?
- If so, are those conflicts of interest consentable?
- If they are consentable, what steps must be taken to obtain a valid consent?

Are there present or potential conflicts of interest inherent in this situation?

To answer the first question, we have to reach some conclusions about what it is the lawyer is doing and for whom he or she is doing it. When done by a lawyer, the examination of title and the preparation of a Title Report is the practice of law. This is so even though non-lawyers may sometimes perform the same services without being engaged in the practice of law.[3] The issuance of a policy of title insurance is a contractual business transaction between an entity authorized to issue such a policy and the Insured. Issuing a policy of title insurance is not the practice of law and has significant differences from the legal work which must be done in order for the policy to issue.[4]

The insurance aspect of title insurance is a profitable business. When the transaction proceeds as outlined above, Buyer pays a lump sum for both the mortgage title policy and for his own policy. In Scenario 1, Lawyer, who has done all of the title work, ultimately receives a portion of this payment. It may be that this compensation is simply for doing the title work. However, prior to RESPA's[5] prohibition on kickbacks and commissions, lawyers were routinely compensated by title companies for "bringing in the business."[6] It is at least possible that after RESPA, the "split" continues to include some reward for delivering a customer, even if it is lumped in with the title examination work. In Scenario 2, where the profit on the insurance aspect of the policy goes to ABC Abstract, the lawyer–owner of ABC Abstract is clearly enjoying a profit beyond the compensation for title services provided.

With this background we can see two possible conflicts of interest in this arrangement. First of all, since Lawyer makes more money if Buyer procures the owner's policy in addition to the mortgage policy, Lawyer has a DR 5-101 conflict with his own financial interest. This conflict could affect Lawyer's independent professional judgment on behalf of the client in several ways. First, there is the question of whether Buyer should obtain the owner's policy at all. If so, there is the question of from whom to get the policy. Although the cost of insurance is regulated, title companies are not necessarily fungible; differences may include reputation, reserves and willingness to negotiate exceptions.[7] Lawyer's independent professional judgment on each of these questions might be affected by his or her own financial interest in the transaction.

Second, there is the question of multiple representation of current clients with differing interests under DR 5-105. Plainly, Lawyer represents Buyer in the underlying transaction. When Lawyer performs the work previously described, culminating in the Title Report, it appears that Lawyer is representing the Title Insurer that will issue the policy based on Lawyer's examination of title. Though it may well be that both the Insurer and the Buyer have a common interest in title being free of defects, it is inescapable that Buyer is buying a product from Insurer and that any title problems could be a source of disagreement and negotiation. Thus, if Lawyer represents XYZ Title or has an ownership interest in ABC Abstract, when Lawyer negotiates exceptions to the policy, he is negotiating with himself and representing potentially conflicting interests.

Are these present or potential conflicts of interest consentable?

Now that we have identified some conflicts or at least potential conflicts, the next step in our analysis is to ask whether those conflicts are consentable or not. In addition to requiring full disclosure and consent of the client or clients affected, each of the conflicts rules implicated here has a separate threshold test. DR 5-101 requires "a disinterested lawyer would believe that the representation of the client will not be adversely affected." DR 5-105 uses a similar test: Multiple representation is allowed "if a disinterested lawyer would believe that the lawyer can competently represent the interest of each."

How is a real estate lawyer to know what a disinterested lawyer would conclude? One way is to consult the Ethics Opinions of the New York State Bar Association and other bar associations, which have considered the question in a large variety of situations. An examination of those opinions shows there are some conflicts that are usually consentable, at least under certain circumstances;[8] some conflicts that are generally not consentable, but may be cured by consent in extreme and limited circumstances;[9] and some that are *per se* conflicts—not consentable under any conditions.[10]

Bar Opinions Prior to DR 1-106

New York bar opinions dealing with title insurance go back at least 35 years. The earliest opinions predate RESPA and focus on the compensation received by the lawyer from the title company; using agency principles, N.Y. State 320[11] and N.Y. State 351[12] conclude the "discount" the lawyer receives from the title company must be credited to the client unless express consent for the lawyer to retain it is obtained. After the passage of RESPA, the bar association returned to the issue in N.Y. State 576.[13] That opinion continued to countenance the practice, at least in certain forms. An attorney for a party to a real estate transaction could also act as "Attorney Closer," "Approved Attorney," "Examining Counsel," or "Agent" for a title insurance company in the transaction. The opinion seems to rest on the understanding that the compensation the attorney receives from the title company in such a role is for "substantial services" performed for and on behalf of the title company.[14] If that condition is satisfied, presumably there is no violation of RESPA, and the possible conflicts[15] might be satisfied with full disclosure and consent. The opinion states the disclosure to the client must include the amount the lawyer will receive from the title company and the lawyer must obtain the client's consent to retain any amount received from the title company. The bottom line of the opinion was the practice was at least suspect, but a lawyer might meet the "heavy burden" of justifying it if there were no actual conflicts, full disclosure was made, and the client was not overcharged for the total package received.

My reading of N.Y. State 576 is the conflicts that might arise are understood to be fairly minor and that, in any event, the attorney is not being improperly influenced in the choice of title company or in dealing with the company, because his compensation is essentially just for doing the necessary title work. Thus he is earning whatever he receives, not being compensated for steering business to a particular title company. Whether this is strictly accurate or not, it at least passes the straight-face test: The attorney does necessary work, is compensated for that work and does not receive any obvious commission for the "sales" part of the transaction.

Note however that N.Y. State 576 is premised on an attorney who is "outside" of the title company; here one may feasibly argue the compensation received is just for doing the work. But recall our earlier postulate: Selling title policies is a profitable business and the premium paid includes a profit for the seller. That brings us to a series of later opinions that look at the same transaction, but with the difference the attorney now has an ownership interest in ABC Abstract.

Opinion 595 contemplates a situation in which the attorney is a principal in the title company and therefore will share in any profits derived from the sale of policies. With this change in the situation from an "outside" attorney to an "owner" attorney, the conflicts were immediately perceived as being much more serious. The opinion concludes if the lawyer's company provides only the ministerial function of title abstraction or title searching, the conflict is consentable; even in this situation, the opinion continues the obligation to obtain the client's consent for the lawyer to retain any non-service-related fee earned by the title company.[16]

If, however, the lawyer-owned title company goes beyond performing a ministerial act and prepares the title report or serves as an agent for the underwriter, the opinion concludes the practice raises a *per se* conflict that is not consentable. The ownership interest was said to involve more serious conflicts, such as the lawyer negotiating with himself over exceptions to the policy;[17] moreover, the DR 5-101 conflict was much more apparent in this circumstance.

It is fair to ask whether the move from an "outside" lawyer to an "owner" lawyer deserves such different treatment. It can be argued there is little or no difference in principle, only in form.[18] I would suggest the real motivation for the different result is the increased difficulty of passing the "smell" test when the lawyer actually owns the company that sells the insurance to his own client. When the transaction is done in this form, the argument that the attorney is only being paid for the title work becomes impossible to sustain. The attorney-owner very plainly benefits from the *sale* of the insurance policy, which we have assumed is profitable.

After the issuance of N.Y. State 595, the Real Property Section of the New York State Bar Association requested reconsideration of the opinion's *per se* conclusion. The Committee on Professional Ethics took the unusual step of holding a day-long hearing, during which it received testimony concerning the merits of N.Y. State 595 and its consistency or lack thereof with N.Y. State 576. The result was N.Y. State 621,[19] which adheres to and reaffirms the *per se* result of N.Y. State 595. The opinion emphasized "the attorney who is a part owner of an abstract company has an obvious business interest in the success and profitability of the company." The fact that the abstract company is a separate legal entity served to distinguish this result from the attorney-agent opinions and put the attorney-owned abstract company in the non-consentable group along with lawyer-brokers,[20] lawyer-life insurance agents,[21] and lawyer-estate planners.[22] There was a strong dissent by four members of the committee.[23] A series of later opinions essentially reaffirmed the result where the details of the arrangement were slightly varied.[24] Shortly after the last of those opinions (and ten years after N.Y. State 621), the Appellate Divisions adopted DR 1-106 dealing with lawyers providing non-legal services to clients and others.[25] In some quarters, this new Disciplinary Rule was welcomed in the hope it would change the result in N.Y. State 595 and N.Y. State 621. Those hopes were quickly dashed.

DR 1-106 and Subsequent Bar Opinions

DR 1-106 recognized that lawyers had long provided some non-legal services to clients and that this was not necessarily a bad thing. "Non-legal services" is defined in DR 1-106(C) as "those services that lawyers may lawfully provide and that are not prohibited as an unauthorized practice of law when provided by a non-lawyer." Certainly this sounds as if it should include the provision of title insurance, which is often done by non-lawyers.

DR 1-106, however, did not change the underlying rules on attorneys providing non-legal services—it is, rather, a special kind of disclosure provision. The specific change wrought by DR 1-106 was to make clear that "distinct" non-legal services were subject to the strictures of the Code "if the person receiving the services could reasonably believe that the non-legal services are the subject of an attorney-client relationship." That belief is presumed unless the recipient was given a written disclosure to the contrary. The thrust of DR 1-106 was simply to clear up any confusion clients and others might have concerning the applicability of the lawyer-client relationship to non-legal services.[26] In any event, DR 1-106 worked no change on the provision of legal services, which are always subject to the Code.[27]

Still, the question was whether DR 1-106 should change the result in the prior opinions regarding lawyer-owners in a title insurance situation. The Committee on Professional Ethics quickly concluded the answer was "no."[28] The effect on the lawyer's legal judgment of the lawyer's personal interest in the provision of the non-legal services continued to act as a *per se* bar just as it did before DR 1-106. N.Y. State 753[29] referred back to N.Y. State 621 and N.Y. State 738 and specifically reaffirmed the result regarding the lawyer-owned abstract company providing insurance or performing other non-ministerial tasks. The Committee has not changed its position since.[30]

Proposed New York Rule 5.7

In March 2008, the New York State Bar Association sent its Proposed Rules of Professional Conduct to the Appellate Divisions. Proposed Rule 5.7 is identical to existing DR 1-106, except for the addition of a new paragraph (c). That new paragraph provides:

> (c) A lawyer or law firm shall not, whether directly or through an affiliated entity, provide both legal and nonlegal services to a client in the same matter or in substantially related matters unless (i) the lawyer or law firm complies with Rule 1.8(a) regarding the provision of the nonlegal services, (ii) the lawyer or law firm reasonably believes it can provide competent and diligent representation to the client, and (iii) the client gives informed consent, confirmed in writing.

The Reporter's Notes to this Proposed Rule make clear that this new language was specifically meant to reject the prior bar opinions interpreting DR 1-106 as imposing a *per se* ban on the provision of legal and non-legal services in the same transaction.[31] Comment [5B] amplifies this rejection of the categorical ban, stating:

> Whether providing dual services gives rise to an impermissible conflict must be determined on a case-by-case basis, taking into account all of the facts and circumstances, including factors such as: (i) the experience and sophistication of the client in obtaining legal and nonlegal services of the kind being provided in the matter, (ii) the relative size of the anticipated fees for the legal and nonlegal services, (iii) the closeness of the relationship between the legal and nonlegal services, and (iv) the degree of discretion the lawyer has in providing the legal and nonlegal services.

Thus, if this Rule is adopted by the Appellate Divisions as proposed, there would no longer be a flat ban. The sale of title insurance by an attorney-owner to his client might be appropriate, depending on the application of the factors above. If the resolution was that the dual transaction was consentable, that consent would still be subject to the very stringent standards of Proposed Rule 1.8, as well as the requirements of Proposed Rule 1.7.[32] Thus, consent, if possible at all, would require:

> (1) the transaction is fair and reasonable to the client and the terms of the transaction are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;
>
> (2) the client is advised in writing of the desirability of seeking, and is given a reasonable opportunity to seek, the advice of independent legal counsel on the transaction; and
>
> (3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.[33]

What About DR 5-104?

Finally, we must recall there is a commercial transaction involved here: Buyer is paying a premium in return for the issuance of an insurance policy. Where Lawyer is a paid agent of the underwriter or has an ownership interest in ABC Abstract, Lawyer is entering into a business transaction with his client. DR 5-104, governing transactions between lawyers and clients, has especially strict requirements, including that "[t]he lawyer advises the client to seek the advice of independent counsel in the transaction." Does DR 5-104 apply here?

First, it should be noted that the numerous bar opinions discussed above do not raise DR 5-104 as part of their analysis. The opinions that approve of the practice under certain circumstances require disclosure and consent, but make no mention of DR 5-104 and its special requirements.[34] The later opinions, both before and after DR 1-106, which conclude that under the lawyer-owner scenario the transaction is non-consentable, bottom their analysis on DR 5-101 and do not raise DR 5-104.[35]

Second, if the opinions which continue the *per se* ban after DR 1-106 are wrong and the transaction is consentable, N.Y. State 755[36] makes clear the provision of non-legal services pursuant to DR 1-106 does *not* require the application of DR 5-104; the Opinion specifically mentions title insurance as one non-legal service which would not invoke DR 5-104, assuming the transaction was consentable at all.

There is some authority for applying DR 5-104 to this transaction. As discussed above, the Bar Association's proposed Rule 5.7, governing consent where legal and non-legal services are provided in the same transaction, does require compliance with proposed Rule 1.8(a). That rule is the analog to DR 5-104 and does include the requirement of advising the client to seek independent counsel. The Bar Association of Nassau County, in an opinion concluding the lawyer-owner has an unconsentable conflict, states the transaction does implicate DR 5-104.[37] Finally, the Restatement of the Law Governing Lawyers gives the sale of title insurance as an example of a transaction which would come under DR 5-104.[38]

On balance, I would be prepared to defend the position that under the current Disciplinary Rules, where an attorney is allowed to seek consent to the title insurance transaction, there is no need to comply with DR 5-104. Nevertheless, if an attorney wanted to be especially cautious, I would suggest it does no harm to include the extra language about seeking independent counsel in the disclosure and consent the attorney is already making.

Conclusion and Practical Advice

Whether the bar opinions discussed above are right or wrong is something reasonable people could disagree on. Nevertheless, there they are. Admittedly, these opinions are just that—opinions; they are not binding authority. We cannot say that a lawyer who does not follow them will be disciplined. In fact, there are two Third Department discipline cases in which the Court did not impose discipline on attorneys for referring clients to title agencies they owned.[39] It is quite possible that an attorney-owner might provide a real estate client with title insurance and not be disciplined, provided there was adequate disclosure and consent.

For those attorneys who are more conservative, we can say that a lawyer who *does* follow these bar opinions will almost certainly *not* be disciplined. Therefore, as we await action on the proposed Rules, my own advice is that real estate lawyers should avoid providing title insurance to clients through lawyer-owned abstract companies, but may safely do so as independent agents or closers. Whenever lawyers provide title insurance to clients, whether as attorney-agents or attorney-owners, disclosure and consent should be thorough, rigorous and in a writing signed by the client.

The RPLS Title and Transfer Committee is drafting a model disclosure and consent form for use where the attorney is acting as a title agent for a title insurer insuring the attorney's client. Once approved, it will be published in this *Journal*.

Endnotes

1. The exact scope of the work Lawyer will perform will depend on the details of the transaction and on whether Lawyer is "Attorney Closer," "Approved Attorney," "Examining Counsel," or "Agent." See George Haggerty's article on p. 8 for a discussion of the different relationships.
2. The amount paid to Lawyer may differ depending on whether Lawyer's relationship with XYZ is as "Attorney Closer," "Approved Attorney," "Examining Counsel," or "Agent."
3. "This Committee has recognized there are a number of services that can be performed appropriately by both lawyers and non-lawyers, such as tax return preparation, N.Y. State 557 (1984), financial planning, N.Y. State 633 (1992) and legal research done for lawyers, N.Y. State 721 (1999) (outside research service required by an insurance company may be staffed by lawyers or non-lawyer personnel), but we have also consistently held that "'when such services are performed by a lawyer who holds himself out as a lawyer, they constitute the practice of law and the lawyer, in performing them, is governed by the Code.' N.Y. State 662 (1994) (quoting N.Y. State 557 (1984)." N.Y. State 779 (2004).
4. A lawyer who examines title and prepares a Title Report will be liable to his or her client in tort only if the lawyer is negligent. That potential liability is limited by the three-year statute of limitations and does not include any liability for a forged deed. The issuer of a title insurance policy, on the other hand, has a contractual duty to the Insured to cover any defects in title; there is no need for the Insured to show negligence in the preparation or issuance of the policy and no statute of limitations. Moreover, unlike the lawyer's malpractice liability, the title policy covers the Insured in the event of a forged deed.
5. Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 2601 *et seq.*
6. N.Y. State 576 (1986).
7. "Those attorneys who believe that a title insurance policy is a fungible product, and that all title insurance companies are fungible, have a real need to learn more as to what title insurance is really all about." N.Y. State 621 (1991), quoting comment by James M. Pedowitz, "a highly regarded expert on title insurance," *id.*
8. *See, e.g.*, N.Y. State 802 (2006) (dual representation as bond counsel and borrower's counsel consentable); N.Y. State 778 (2004) (representation of general contractor and owner where claims exceed insurance limits); N.Y. State 753 (2000) (representation of seller and lender), accord N.Y. State 611 (1990).
9. *See* N.Y. State 611 (1990) (dual representation of buyer and seller of real estate in "extreme and unusual circumstances"); *see also* N.Y. State 38 (1996).
10. *See* N.Y. State 761 (2003) (consent not possible because disclosure would require other client's confidential information); N.Y. State 753 (2002) (mortgage broker has unconsentable conflict with representing buyer, seller or lender).
11. (1973).
12. (1974).
13. (1986).
14. RESPA refers to these as "core services."
15. The opinion discusses such potential conflicts as what risks will be insured, but acknowledges these potential conflicts rarely rise to the level of actual conflicts. It also points out that if there is any duplication of services to the title company and the client, the lawyer would have to reduce the fee charged to the client to avoid an excessive fee.
16. *See also* N.Y. State 626 (1992) ("Lawyer representing lender in transaction where fee is paid by borrower must disclose to borrower that lawyer also will receive

compensation from title insurer for representing its interests at closing; lawyer may retain total fees paid by borrower and title insurer so long as lender-client consents and total amount is not excessive.").

17. "An abstract company seeks, at the highest profit, to provide the least service . . . consistent with good business practices in the trade. On the other hand, the law firm's client . . . requires and seeks greater liability protection at a lower price." N.Y. State 595 (1988).
18. Indeed, this was essentially the position taken by four dissenting members of the Committee on Professional Ethics in N.Y. State 621. See note 23 *infra*.
19. (1988).
20. N.Y. State 208 (1971).
21. N.Y. State 516 (1980).
22. N.Y. State 619 (1991).
23. The dissenters pointed out the same ethical considerations should apply to the attorney-owner as to the attorney-agent and argued DR 5-101 incorporated a less stringent test than the "obviousness" test then found in DR 5-105(C). They also thought the lawyer's personal performance of the title work (as opposed to it being done through the separate lawyer-owned agency) was an irrelevant distinction.
24. *See* N.Y. State 626 (1992); N.Y. State. 731 (2000); N.Y. State 738 (2001). *See also* Bar Association of Nassau County, Opinion 2003-3 (2003).
25. Adopted effective Nov. 1, 2001.
26. "The lawyer must avoid confusion on the part of the client as to the nature of the lawyer's role so that the person for whom the nonlegal services are performed understands the services may not carry with them the legal and ethical protections that ordinarily accompany an attorney-client relationship." Ethical Consideration 1-9.
27. Ethical Consideration 1-12.
28. See Simon's New York Code of Professional Responsibility Annotated (Thomson West 2007) at page 133.
29. (2002).
30. *See also* New York State 755 (2002).
31. "Rule 5.7(c) prohibits lawyers from providing both legal and nonlegal services to a client in the same matter (or in two substantially related matters), unless the lawyer complies with the general rules regarding conflict of interest waivers in Rule 1.7 with respect to the legal services, and also complies with the stringent provisions of Rule 1.8(a) (governing business transactions between lawyers and clients) regarding the *nonlegal* services. "This change . . . constitutes a rejection by the NYSBA House of Delegates of contrary interpretations of . . . DR 1-106 [22 N.Y.C.R.R. § 1200.5-b] by the Committee on Professional Ethics (*see, e.g.*, N.Y. State Formal Ops. 752, 753 and 755)." Reporters Notes to Rule 5.7, Proposed Rules of Professional Conduct, New York State Bar Association.
32. *See* Comment [5A] to Proposed Rule 5.7.
33. Proposed Rule 1.8(a).
34. N.Y. State 320 (1973); N.Y. State 321 (1974); N.Y. State 576 (1986).
35. N.Y. State 595 (1988); N.Y. State 621 (1988); N.Y. State 626 (1992); N.Y. State. 731 (2000); N.Y. State 738 (2001); N.Y. State 753 (2002).
36. (2002).
37. Bar Association of Nassau County, Opinion 2003-3 (2003).
38. Section 126, Comment c. Restatement of the Law Governing Lawyers (3d Ed.), American Law Institute.
39. *In re MacKinnon*, 223 A.D.2d 807, 637 N.Y.S.2d 321 (3d Dep't 1996) ("An attorney may perform abstract work for a real estate client [by an agency owned by the lawyer] without necessarily becoming involved in impermissible conflicts of interest."); *In re Ford*, 287 N.Y.S.2d 870, 732 N.Y.S.2d 115 (3d Dep't 2001) ("On this record . . . we decline to find that respondent engaged in a conflict of interest by referring real estate clients to his title abstract company."). These two discipline cases should be relied on with some caution; neither case mentions any ethics opinions nor gives any discussion or analysis on this point. Moreover, in each of these cases there was plenty of other misconduct to support discipline without dealing with the title insurance question. *See also In re Drysdale*, 27 A.D.3d 196, 811 N.Y.S.2d 97 (2d Dep't 2006) (attorney's failure to disclose an ownership interest in a title agency to which she referred numerous real estate clients, along with other misconduct, resulted in public censure).

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COSAC Proposes to Make it Consentable for an Attorney to Refer a Client to the Lawyer's Title Abstract Company

By Karl B. Holtzschue

1. Ethics Opinions

NYSBA Ethics Opinions 595 and 621 state it is improper for an attorney to refer a client to an abstract company in which the attorney has an *ownership interest*. A vigorous dissent in Opinion 621 argues, however, this should be consentable, as Opinion 576 says with respect to the attorney acting as a title-insurance *agent* for a client. Opinion 738 says it is improper for an attorney to refer a client to an abstract company owned by the attorney's spouse, referring to Opinions 595 and 621. Opinion 753 repeats that such a referral is non-consentable and expressly refers to Opinions 595, 621 and 738.

2. Cases

Two Third-Department cases have stated such a referral is not a conflict: *In re MacKinnon*, 223 A.D.2d 807, 637 N.Y.S.2d 321 (3d Dep't 1996) (not an impermissible conflict); and *In re Ford*, 287 A.D.2d 870, 732 N.Y.S.2d 115 (3d Dep't 2001) (declining to find it was a conflict of interest).

Failure to disclose an ownership interest in a title agency has been held to be an impermissible conflict of interest under DR 5-501(a). *In re Drysdale*, 27 A.D.3d 196, 811 N.Y.S.2d 97 (2d Dep't 2006) (failure to disclose interest in company that provided title abstract services and title insurance and failure to obtain former client's permission to represent opposing party warranted *public censure*).

3. COSAC Proposed Rules

NYSBA's Committee on Standards of Attorney Conduct ("COSAC") is finalizing Proposed Rules of Professional Conduct.

Rule 5.7, which covers all nonlegal or ancillary services, brings forward DR 1-106, with one important change. Rule 5.7(d) is new and has no equivalent in the existing Code of Professional Responsibility. It addresses a situation where a law firm is *simultaneously providing both legal and nonlegal services to a client in the same matter*. It provides the law firm shall **not** (whether directly or through an affiliated entity) simultaneously provide legal and nonlegal services to a client in a matter *unless* (i) the law firm complies with Rule 1.8(a), (ii) the law firm *reasonably believes* it can provide competent representation to the client, and (iii) the client gives *informed consent, confirmed in writing* (the latter two as required by Rule 1.7(b)). *Official Comment [5A]* says when a lawyer or law firm provides both legal and nonlegal services in the same matter, a conflict with the lawyer's own interest will nearly always arise, including whether to recommend nonlegal services and which provider to recommend or oversee such services. However, a client may consent to such a conflict if the lawyer complies both with Rule 1.8(a) and Rule 1.7(b). *Comment [5B]* says whether providing dual services gives rise to an impermissible conflict must be determined on a *case-by-case basis*, taking into account all of the facts and circumstances, including factors such as (i) the experience and sophistication of the client; (ii) the relative size of the anticipated fees for the legal and nonlegal services; (iii) the closeness of the relationship between the legal and nonlegal services and (iv) the degree of discretion the lawyer has in providing the legal and nonlegal services.

The *COSAC Commentary* says Rule 5.7(d) and accompanying Comments "are meant to overrule NYSBA Ethics Opinions 752, 753 and 755 and to make clear that the provision of legal and nonlegal services in the same or substantially related matters (i) requires compliance with Rule 1.8(a); and (ii) is subject to Rule 1.7(a)(2) and (b) *on a case-by-case basis* [emphasis added]; that is, there may be cases where a conflict in this situation is non-consentable, but *there are not entire categories of transactions (such as a lawyer acting also as a broker) in which the conflict is non-consentable*." The *Reporter's Note* says the effect of 5.7(d) would be to "legislatively overrule a series of NYSBA Committee on Professional Ethics Opinions that have prohibited the provision of legal and nonlegal services by a lawyer in the same transaction (See N.Y. State 752; 753; 755). After considerable debate, COSAC concluded that the necessity for the lawyer to comply with Rule 1.8(a) and Rule 1.7(a) and (b) is a sufficient safeguard to permit the proposed practice in most cases." (Author's note: The reference to overruling a "series" of prior opinions would include those referred to in Opinion 753, that is, Opinions 595, 621 and 738.)

Rule 1.8(a), governing *business transactions between lawyer and client*, retains much of DR 5-104(A) but expands the requirement the lawyer advise the client to seek independent counsel and give the client a reasonable opportunity to do so. Rule 1.8(a)(3) reinforces this requirement by mandating the lawyer obtain the client's informed written consent not only to the terms of the transaction (as in DR 5-104) but also to "the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction." *Comment [1]* states the Rule applies to "lawyers engaged in the sale of services related to the practice, such as the *sale of title insurance*," adding a cross-reference to rule 5.7. (Author's note: This appears to assume that acting as a title agent and issuance of title insurance are nonlegal services, but it does not seem necessary to question that assumption to analyze the ethical issues.]

Rule 1.7(b), which governs *conflict between a client and the lawyer's other clients or the lawyer's own financial interests*, permits a representation despite a concurrent conflict if, among other things, the lawyer "reasonably believes" the lawyer can provide "competent and diligent" representation to the client and the client gives "informed consent, confirmed in writing." *Comment [10]* states a lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an *undisclosed* financial interest. (Author's note: Note the use of "the lawyer reasonably believes" as the test, which seems to be easier to satisfy than the "disinterested lawyer" test used in DR 5-101 as to a conflict with the lawyer's own interests.)

Rule 1.0(g) states "*informed consent* denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated information reasonably adequate to make an informed decision and has adequately explained the material risks of the proposed course of conduct and reasonably available alternatives. *Official Comments [6] and [7]* amplify the meaning of "informed consent." The lawyer must make reasonable efforts to ensure the client possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes (1) a disclosure of the facts and circumstances, (2) any explanation reasonably necessary to inform the client of the material advantages and disadvantages of the proposed course of conduct and (3) a discussion of the client's options and alternatives. In some circumstances it may be appropriate for a lawyer to advise a client to seek the advice of other counsel. In determining whether the information and explanation provided are reasonably adequate, relevant factors include whether the client is experienced in legal matters generally and in making decisions of the type involved, and whether the client is independently represented by other counsel in giving the consent. Obtaining informed consent will usually require an affirmative response by the client. In general, a lawyer may not assume consent from a client 's silence. Consent may be inferred, however, from the conduct of a client who has reasonably adequate information about the matter. *See also Rule 1.0(b)* "confirmed in writing" and *Rule 1.0(u)* "writing" (which includes e-mail).

4. Conclusion

It seems clear COSAC intends to make the referral of a client to an abstract company in which the attorney has an ownership interest a consentable event, on a case-by-case basis, if the required steps are taken.

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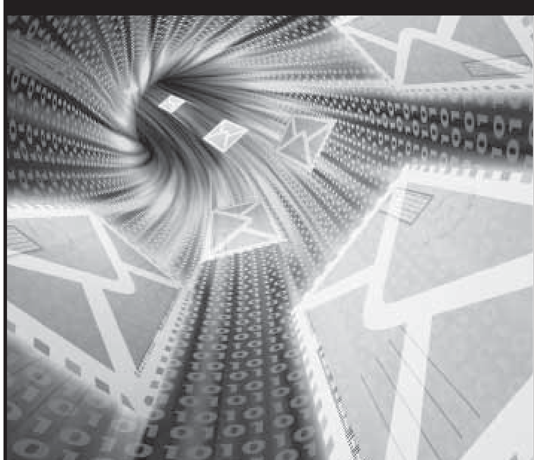

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Single Room Occupancy Law in New York City

By Marti Weithman and Gerald Lebovits

For over half a century, single room occupancy (SRO) units have been a staple of New York's housing supply for low-income residents. These residents, among them society's most marginalized, include the elderly, the disabled, the working poor, and people who would otherwise be homeless. SROs began as housing to serve the temporary needs of individuals with instability in their lives. Decades ago they became a necessary part of New York City's permanent affordable housing stock. SROs are housing of last resort for many in a City that has long been experiencing an affordable-housing crisis of critical proportions.

This article covers some aspects of New York City's rent-regulation system applying to SROs in contrast to apartment units.

What is an SRO?

New York City's SRO housing stock consists of several different types of buildings, each with its own legal classification in New York State or City law. This varied housing stock includes hotels, rooming houses, middle-sized or larger single room occupancy buildings, and lodging houses. Generally, but not always, SRO tenants share a bathroom or kitchen, or both, living only in a single room that might vary in size depending on the type of unit and building.

The Multiple Dwelling Law (MDL) defines a single room occupancy as "the occupancy by one or two persons of a single room, or of two or more rooms which are joined together, separated from all other rooms within an apartment in a multiple dwelling."[1]

SRO buildings are classified as class A, "permanent residence," or class B, "transient housing."[2] The MDL defines class A buildings as "a multiple dwelling which is occupied, as a rule, for permanent residence purposes. This class shall include . . . apartment hotels, bachelor apartments, . . . and all other multiple dwellings except class B multiple dwellings."[3] MDL § 248(1) deems a dwelling occupied for single room occupancy use a class A multiple dwelling.

The MDL defines a class B multiple dwelling as one "occupied, as a rule transiently, as the more or less temporary abode of individuals or families who are lodged with or without meals. This class shall include hotels, lodging houses, rooming houses, [and] boarding houses. . . ."[4]

Both class A and class B dwelling units in SRO buildings—including hotels, single room occupancy buildings, rooming houses, and lodging houses—are rent-stabilized if erected on or before July 1, 1969; contain six or more units; charged no more than $88 a week or $350 a month as of May 31, 1968; and are occupied by a permanent tenant.[5]

A "rooming house" and a "furnished room house" are defined as having fewer than 30 sleeping rooms.[6] The majority of rooming houses are in brownstone-like buildings in Harlem and Chelsea in Manhattan.

A "hotel" is defined as having more than 30 sleeping rooms.[7] Not all hotels are SROs. New York City's higher-end hotels are not SROs and do not contain rent-stabilized apartments. For example, the Ritz Carlton is not an SRO. Among other reasons, on May 31, 1968 the weekly rate charged at the Ritz Carlton exceeded $88 a week or $350 a month.

One unique form of SRO is the lodging house, defined as "a multiple dwelling, other than a hotel, a rooming house or a furnished room house, in which persons are housed for hire for a single night, or for less than a week at one time, or any part of which is let for any person to sleep in for any term less than a week."[8] Lodging houses, sometimes pejoratively called "flophouses," were built around the turn of the twentieth century and are concentrated primarily on the Bowery in Manhattan. Lodging house units, often referred to as cubicles, are generally 4' x 6' in size arranged dormitory-style. The plywood walls do not extend to the ceiling. Atop the cubicle's four walls is chicken wire for ventilation and to stop trespassers from entering the cubicle.

SRO Tenancies

How an individual becomes a tenant in a rent-stabilized hotel building is different from how an individual becomes a tenant in a rent-stabilized apartment building. A permanent tenant is defined under the Rent Stabilization Code as "an individual or such individual's family members residing with such individual, who have continuously resided in the same building . . . for a period of at least six months. In addition, a hotel occupant who requests a lease of six months or more . . . shall be a permanent tenant even if actual occupancy is less than six months."[9] Based on the way SRO tenancies are created, SRO tenants typically are statutory tenants under oral rental agreements and do not have written leases.

An individual, or a family member living with that individual, may obtain permanent tenancy status in one of two ways. The most common way for an individual to become a permanent tenant in an SRO building is to reside in the same building continuously for at least six months as a principal residence. Individuals may also obtain rent-stabilized tenancy rights by requesting a lease for a period of six months or longer. The act of requesting a lease gives the individual tenancy rights.

Hotel owners are required under the Rent Stabilization Code to provide an occupant with a Notice of Rights at the time of registration.[10] The Notice of Rights sets forth the rights and duties of hotel owners, occupants, and tenants, including the "occupant's right to become a permanent tenant at a legal regulated rent by requesting a lease for a term of at least six months at any time during his or her occupancy."[11] Despite this requirement, hotel owners rarely, if ever, provide this notice.

Upon requesting a lease, "the owner must, within 15 days after such request, grant a lease commencing on the date such request was made at a rent which does not exceed the legal regulated rent, for a term of at least six months."[12] Even though the owner is required to grant a written lease to an individual upon request, the tenant is not required to execute the written lease.[13] It benefits SRO tenants to not sign a written lease. Not signing a lease allows them to avoid being bound by the standard lease provisions such as jury-waiver clauses and attorney- and late-fee clauses.

SRO tenancies also differ from apartment tenancies in that an SRO tenant's tenancy rights attach to the building and not an individual unit, as is the case with apartment tenancies. Individuals who continuously reside in an SRO building, regardless whether they have lived in more than one unit for periods less than six months each in the building, become permanent tenants under the Rent Stabilization Law.[14] This is significant because SRO owners sometimes move individuals in a "relocation pattern" from one room to another in hopes the tenants will forfeit or not acquire rent-stabilization protection. These SRO owners incorrectly analogize a loss of rent regulation to the Administrative Code's provision regarding unlawful eviction, which prohibits a landlord from removing an individual from a unit without court order after that person has been in possession for more than 30 days.[15]

SRO tenants' family members also obtain succession rights differently from family members of apartment tenants. The definition of "permanent tenant" allows individuals and their family members to gain tenancy rights by continuously residing in the building for six months or by requesting a lease. By operation of the definition of "permanent tenant" of an SRO building, family members of a permanent tenant may themselves become permanent tenants if they reside in the building for six months as their primary residence or if they request a lease.

For example, if the sister of an individual who has rights as a permanent tenant moves in with that person, the sister may become a permanent tenant upon residing with her family member continuously for six months or upon requesting a lease. This is quite different from how family members of apartment tenants obtain succession rights. Immediate family members of apartment tenants obtain succession rights by proving they lived with the family member in the subject unit as a primary residence for a two-year period before the permanent tenant's vacatur. Further, based on the definition of "permanent tenant," any family members may become permanent tenants; the list of family members is broader than the list of family members permitted to claim succession rights as an apartment tenant.

The Rent Stabilization Code defines a "hotel occupant" as "[a]ny person residing in a housing accommodation in a hotel who is not a permanent tenant. Such person shall not be considered a tenant for the purposes of this Code, but shall be entitled to become a permanent tenant. . . ."[16] Any person residing in a hotel may become a permanent tenant of the building as set forth under the definition of permanent tenant. A tenant's advocate could argue that a roommate of a permanent tenant, as identified by the owner, could also obtain rights as a permanent tenant under this definition if the roommate has lived in the building continuously for six months or by requesting a lease.

SRO Rents

Just as the regulatory system differs between SRO tenants and apartment tenants, the way rent is set for SROs also differs. Each year the New York City Rent Guidelines Board (RGB) adopts a Hotel Order setting forth what increase, if any, applies to rent-stabilized hotels, rooming houses, single room occupancy buildings, and lodging houses.[17] Increases for SROs are generally much lower than increases for apartments and on occasion are 0%. As part of its Hotel Orders, the RGB normally forbids any vacancy increase allowances for SROs, whereas owners of apartment buildings are currently permitted vacancy allowances of 20% when a tenant leaves the unit.[18] This helps maintain SRO units as affordable housing stock and slows, given SRO tenants' turnover, what would otherwise be a rapid course to decontrol.

Also unique to SROs is that in some years when the RGB authorizes a rent increase, the RGB has included a proviso that the increase for SROs shall be 0% if the building is occupied by fewer than 80% of rent-stabilized or rent-controlled tenants.[19] Granting rent increases to SRO building owners provides an incentive to rent the majority of units in their building to permanent tenants.

Services in SROs

Unlike rent-stabilized apartment units, some SRO hotels and rooming houses give, or are required to give, hotel services to tenants if the services were provided to the tenant on applicable base dates set forth under the Rent Stabilization Code.[20] Some of these services include maid and linen services; furniture, including a bed, lamp, clothing storage facilities, chair, and mirror; and one employee present in the lobby 24 hours a day, seven days a week.[21] Division of Housing and Community Renewal (DHCR) rent registrations include the applicable services for a particular unit. Tenants entitled to receive services but who are not receiving them may file an application with the DHCR for a rent reduction based on decreased services.

Harassment in SROs

SRO tenants have historically been subjected to extreme forms of harassment by SRO building owners, who occasionally try to empty their buildings of permanent tenants. The owners' goal is to force SRO tenants out of their homes. These owners want to convert their buildings into apartments with rents set at market rates or to rent them to tourists on a nightly basis to make their ownership more lucrative. The harassment takes various forms, including threats or acts of physical violence, withholding essential services like heat and hot water, and unlawful evictions.

To address this problem, in 1983 the City enacted Local Law 19 of the City of New York, now codified as Administrative Code Section 27-198(b), to ensure that SRO tenants are not forced from their homes at the hands of unscrupulous owners looking to empty their buildings for greater profit.

Before an owner may obtain permits from the Department of Buildings (DOB) to demolish an SRO multiple dwelling or to change its configuration, such as altering the number of rooms in the building, reconfiguring an SRO unit into an apartment, or adding or taking away a bathroom or kitchen facility, the owner must, under Administrative Code Section 27-2093, first apply for and obtain from the Commissioner of the Department of Housing Preservation and Development (HPD) a Certificate of No Harassment (CNH) or apply for an exemption from the requirement.[22]

Before it issues permits to owners based on applications to do this type of work, the DOB requires a CNH from the owner. Once the owner applies to HPD for a CNH, HPD requests comment from tenants of the subject building and from tenant-advocacy organizations about the preceding three-year period, known as the inquiry period. HPD will investigate to determine whether there has been any harassment. "Harassment" is defined in the Administrative Code as conduct causing or intended to cause a person to waive or surrender occupancy right by use or threatened use of force, interruption or discontinuance of essential services, failure to comply with vacate orders, or other conduct that prevents or is intended to prevent a person to surrender or waive any occupancy rights.[23]

If HPD finds reasonable cause to believe harassment occurred during the inquiry period, HPD will commence a proceeding against the owner.[24] Usually, a settlement conference will be held between HPD and the owner and, if no settlement is reached, a hearing is held to determine whether harassment actually occurred. CNH hearings are administrative proceedings that take place at the Office of Administrative Trials and Hearings (OATH).

Effective March 13, 2008, legislation enacted by the New York City Council, signed into law by the Mayor, amends the Administrative Code to give tenants a cause of action of harassment against their landlords.[25] Tenants may now commence an action against their landlord in Housing Court or interpose an affirmative defense and counterclaim for harassment. Harassment is defined to include acts or omissions that cause a lawful occupant to vacate or waive or surrender any rights of the unit by one or more of the following: use of force or express or implied threats of force and repeated interruptions or discontinuances of essential services.[26]

Illegal Conversion of Buildings into SROs

Under Administrative Code Section 27-2077, it has been illegal to build SRO buildings since the mid-1950s. There are few exceptions to this rule, including SROs owned and operated by a non-profit organization or government agency, which may still build new SRO buildings.[27]

When a multi-family house containing fewer than six units, and thus not subject to rent stabilization, is broken up into multiple single rooms without first obtaining the proper permits, the building is not in compliance with the certificate of occupancy. In these situations, a tenant's advocate will argue the tenants who move into these units become "de facto" rent stabilized. The courts have issued conflicting opinions on this issue.

Favoring rent stabilization are these principles. A multiple dwelling containing six or more units when the tenant moves into the unit is subject to rent stabilization.[28] Additionally, even if a landlord were to convert the building back to its original configuration by reducing the number at a later date, any existing units would continue to be rent stabilized.[29]

A recent Kings County Housing Court decision has, however, held differently on this issue.[30] In its decision, the court in *Arrow Linen Supply Co. Inc. v. Cardona* likened the illegal conversion of multi-family buildings into SRO units to the conversion of loft units to residential units and cited the public policy concern of safety.

Policy arguments favor both sides in this unresolved question. Tenants argue an owner who converts a multi-family home into SRO units and reaps the benefit of collecting rent from the tenancies, often over years, should not be rewarded by being permitted to reduce the number of units and deprive the tenants of their rights simply because the owner has found a new way to gain profit from the building. The tenant advocate would argue, therefore, an owner who has illegally converted a building be required in a Housing Part (HP) repair proceeding to legalize the building and conform it to a valid certificate of occupancy rather than evict innocent tenants.

The main exception to the rule reducing the number of units below six leaves the existing units rent stabilized is if the landlord can show the lower number of units resulted from the landlord's "substantial rehabilitation" of the premises.[31]

Current Trends in SROs

Along with the high-pressure housing market in New York City has come new and increasing pressure on tenants living in SRO buildings. Over the past several years, the City's Human Resources Administration (HRA), through the Department of Homeless Services (DHS) and the HIV and AIDS Services Administration (HASA), has been placing people in rent-stabilized SRO buildings. HRA pays the SRO owner up toward $2,000 per month for a single room on behalf of the placement. If the person placed is logged out of HRA's system or, for whatever reason, stops receiving benefits under HRA, the SRO owner may seek to evict the occupant in a no-grounds holdover and argue the tenant is not rent-stabilized and has no rights. Because there are no written contracts between HRA and the SRO owner memorializing their relationship, the court has difficult questions to decide concerning what are the legal rights of the person placed in the unit.

There has also been a trend over the last five years of the illegal use of SRO and apartment buildings being used as tourist hotels, or renting rooms on a nightly basis. This use is improper in class A multiple dwellings which are designed, as a rule, for permanent residence and not transient use, like nightly rentals. SRO buildings are conducive to nightly rentals to tourists because of their configuration.

This has the effect of taking away affordable housing units from the already-depleted housing stock and creates difficult living conditions for New Yorkers. This also creates problems for tenants of buildings illegally renting to tourists, for tourists themselves, and for the City's image. Tourists who visit the City and stay in one of the many illegal hotels advertised on Internet sites as budget hotels or hostels arrive only to find that they are staying in an SRO building where the conditions are below those of most commercial hotels.

To address the problem, a city-wide effort of tenants, community tenant-advocacy groups, and elected officials is trying to tackle the illegal use of SROs. The Mayor created a city-wide Office of Special Enforcement in 2006 to combat illegal hotels. The City has undertaken strategic investigations of buildings where illegal hotel activity has been prominent. As a result of these investigations, some violations have been issued for operating buildings in violation of their certificates of occupancy.

The City recently began litigation in Supreme Court, New York County, against three SRO buildings on Manhattan's Upper West Side for operations contrary to the certificates of occupancy.[32] The Supreme Court granted the City's request for preliminary injunction, finding the operating of these buildings for transient use violates the certificates of occupancy. The court enjoined the defendants from using or permitting the use of the buildings as transient hotels or making any new reservations to tourists for less than 30 days. The decision is currently on appeal before the Appellate Division, First Department.

Conclusion

SRO units are a long-standing component of New York City affordable housing stock. The law concerning SROs is as complex as the relationship between SRO owners and SRO tenants—that is, very complex indeed.

Endnotes

1. Mult. Dwell. L. § 4(16) (West 2001).
2. *Id.* at § 4(8)(a) & § 4(9).
3. *Id.* § 4(8)(a).
4. *Id.* § 4(9).
5. 9 R.C.N.Y. § 2520.11(g); *see generally Gracecor Realty Co., Inc. v. Hargrove*, 90 N.Y.2d 350, 683 N.E.2d 326, 660 N.Y.S.2d 704 (1997), *aff'g* 221 A.D.2d 237, 634 N.Y.S.2d 1 (1st Dep't 1995) (mem.), *aff'g* 160 Misc. 2d 963, 615 N.Y.S.2d 213 (App. Term 1st Dep't 1994) (per curiam) (finding Rent Stabilization Law may cover class B multiple dwellings); *Tegreh Realty Corp. v. Joyce*, 88 A.D.2d 820, 820, 451 N.Y.S.2d 99, 100 (1st Dep't 1982) (mem.) (finding rent control and stabilization statutes cover class B multiple dwellings); *Friedman v. Marx*, N.Y.L.J., Oct. 29, 1990, at 25, col. 6 (Sup. Ct., N.Y. County, Ciparick, J.) ("SRO units are subject to rent stabilization."); *Yohanes v. McKeathen*, N.Y.L.J., June 15, 1994, at 31, col. 2 (Hous. Part Civ. Ct., N.Y. County) (subjecting class B buildings and SRO units to rent stabilization if building has at least six units).
6. N.Y. Mult. Dwell. L. § 4(13) (West 2001).
7. *Id.* § 4(12).
8. *Id.* § 4(14).
9. 9 R.C.N.Y. § 2520.6(j).
10. *Id.* § 2522.5(c)(2).
11. *Id.*
12. *Id.* § 2522.5(a)(2); *accord Nutter v. W & J Hotel Co.*, 171 Misc. 2d 302, 304–05, 654 N.Y.S.2d 274, 276 (Hous. Part Civ. Ct., N.Y. County 1997).
13. *Beverly Hotel Assocs. LLC. v. De Almeida*, 194 Misc. 2d 538, 539, 754 N.Y.S.2d 818, 818–19 (App. Term 1st Dep't 2003) (per curiam).
14. *See 143 E. 30th St. Corp. v. Shankman*, 10 Misc. 3d 1269(A), 809 N.Y.S.2d 482, 2005 N.Y. Slip Op. 51883(U), *1, 2005 W.L. 3115205, at *1 (App. Term 1st Dep't 2005) (per curiam).
15. *See* N.Y.C. Admin. (Housing and Buildings) Code § 26-521(a).
16. 9 R.C.N.Y. § 2520.6(m).
17. For a summary chart of the RGB Hotel Orders, access http://www.housingnyc.com/html/guidelines/hotels.html (last visited Mar. 26, 2008).
18. *See, e.g.*, Hotel Order #37, access http://www.housingnyc.com/html/guidelines/orders/horder37.html (last visited Mar. 26, 2008).
19. *See, e.g.*, Hotel Order #36, access http://www.housingnyc.com/html/guidelines/orders/horder36.html (last visited Mar. 26, 2008).

20. *See* 9 R.C.N.Y. §§ 2520.6(r)(4) & 2520.6(r)(1).

21. *Id.* § 2521.3(a)(1)-(4).

22. *See* N.Y.C. Admin. (Building) Code § 27-198(b).

23. *See* N.Y.C. Admin. (Hous. Maintenance) Code § 27-2093(a)(1)-(4).

24. *See id.* § 27-2093(d)(3)(iii).

25. *See id.* § 27-2004. For a copy of the new law, see http://webdocs.nyccouncil.info/textfiles/Int%200627-2007.htm?CFID=707591&CFTOKEN=30905140 (last visited Mar. 28, 2008).

26. *Id.*

27. *See id.* § 27-2004(a)(1)-(4).

28. *See App. of Shubert v. N.Y. St. Div. of Hous. & Comm. Renewal*, 162 A.D.2d 261, 261, 556 N.Y.S.2d 618, 618 (1st Dep't 1990) (mem.); *McAllister v. Winters*, N.Y.L.J., Mar. 13, 1987, at 12, col. 1 (App. Term 1st Dep't 1987) (per curiam); *Samit Tobacco Corp. v. Fromentin*, N.Y.L.J., June 27, 1984, at 6, col. 2 (App. Term 1st Dep't 1984) (per curiam); *Fleur v. Croy*, 137 Misc. 2d 628, 629, 520 N.Y.S.2d 1010, 1011–12 (Hous. Part Civ. Ct., N.Y. County 1987), *aff'd without opinion*, 139 Misc. 2d 885, 531 N.Y.S.2d 761 (App. Term 1st Dep't 1988) (per curiam).

29. *See supra* note 28.

30. *See Arrow Linen Supply Co. Inc. v. Cardona*, 15 Misc. 3d 1143(A), 841 N.Y.S.2d 818, 2007 N.Y. Slip Op. 51128(U), 2007 W.L. 1597984 (Hous. Part Civ. Ct. Kings County, June 4, 2007).

31. *See Wilson v. One Ten Duane St. Realty Co.*, 123 A.D.2d 198, 201, 510 N.Y.S. 603, 605-06 (1st Dep't 1987) (per curiam); *Fleur*, 137 Misc. 2d at 630–31, 520 N.Y.S.2d at 1012–13.

32. *See City of N.Y. v. 330 Continental LLC*, 2007 N.Y. Slip Op. 27443, 18 Misc. 3d 381, 845 N.Y.S.2d 705 (Sup. Ct., N.Y. County).

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On Expanding the Concept of Brownfields Restoration

By Jeffrey Kleeger

> "to ensure the protection of human health and the environment, and to promote economic development, or the preservation of green spaces . . ."[1]

I. The Brownfield Alternative

It may come as no surprise or as great surprise, but the fact remains: brownfields are increasingly attractive as a land source for new development. If anything is to be learned in the reading of this article, it should be that brownfields are the "way of the future." Apparently, both economic and social forces support this newer trend. The liability provisions in new legislation have eased developer hesitance to invest in brownfield projects. Restoration and redevelopment costs of previously developed land (PDL) are oftentimes less expensive than the costs to develop in greenfields.[2] The cost differential between the more expensive greenfields and the more efficient brownfields may be apportioned to existing infrastructure or the lack thereof. Government support by way of grants and loans to encourage PDL restoration is now more common and increasingly available. Moreover, PDL is likely strategically better situated in comparison with not previously developed land (NPDL), because the original investment will have been in more desirable locations. Greenfields are distinguished from PDL in that they tend to be located in more distant, suburban regions, where infrastructure may be undeveloped or insufficient to support growing populations. Additionally, greenfields (because naturally remote) tend to generate greater costs overall when factors such as urban sprawl are considered. The concept of new urbanism,[3] which favors higher-density building structures, supports brownfield restoration. In an era of increasingly scarce land availability, brownfields are more attractive as a financially viable and environmentally friendly alternative for land use development than ever before.[4]

One may reasonably wonder whether the trend in support of brownfield restoration will maintain its popularity and the interest of public opinion. Some of the credit rightfully belongs to the government,[5] but only insofar as the government has responded appropriately to pressure from the community of developers and environmentalists to support environmentally friendly land use development. Interestingly, on this issue of brownfields restoration, developers and environmentalists, who are normally opposed to one another, share a common interest. Those interested parties, we can label them "stakeholders" for purposes of this analysis, expressed concerns to the government agency tasked with environmental protection, the EPA, respecting problems associated with brownfields across the country.[6] In 1994, the EPA responded to those calls for action by introducing an environmental protection approach which aimed to both solve scarce resource concerns and health and safety protections. The favored approach is considered "locally based, encourag[ing] [of] strong public-private partnerships, and [which] promotes innovative and creative ways to assess, clean up, and redevelop brownfield sites.[7] The approach permits local government control over local social and economic problems, and pledges to detoxify the natural environment in the process. Government funding provides the opportunity for economic benefits to be derived from brownfield revitalization. Financial benefit is to result from environmental restoration.

This article is to be the first of several planned efforts to examine and consider some of the most significant and pressing issues concerning brownfield restoration and redevelopment. This first article will propose a conceptual framework for the restoration of brownfield sites. I will begin the analysis by introducing a basic model for expanding the concept of brownfields which I believe is necessary to promote social and economic benefit. I will provide a clear definition of what brownfields are, and offer an introductory survey of the current legal and regulatory structure surrounding brownfield restoration. A greater degree of public support for these efforts is needed to enhance its potential to achieve its stated goals and objectives. Subsequent notes, comments, and articles will review statutory construction and juridical decisions based upon this new regulatory framework.

II. Brownfields Defined

A useful starting point to gain a better understanding of how federal government brownfield restoration funding support operates may be found in the definitional language of the Brownfields Law.[8] The law essentially amended pre-existing environmental legislation by expanding original provisions for site restoration to include redevelopment of brownfields. Language added to Section 101 of the CERCLA[9] was:

> (39) Brownfield Site—(A) IN GENERAL—The term "brownfield site" means real property, the expansion, redevelopment, or reuse of which may be complicated by the presence or potential presence of a hazardous substance, pollutant, or contaminant.

This definition is significant for two reasons. First, it neatly inserts the brownfields' concept within existing environmental law regulations[10] and by that process it broadens the very scope of the concept. The expanded classification also transforms the environmental law regime for managing brownfields into one that is applicable for all real property, thereby including in the mix, residential, commercial, and industrial properties. Secondly, and perhaps more importantly, the expansion separates the types of degraded sites into two distinguishable forms, in both economic and environmental terms. This process of separation helps to narrow the definition of brownfields. On the one hand there are the highly toxic and costly-to-restore lands which are not normally considered brownfields.[11] And on the other hand, there are the lesser dangerous, minimally contaminated or polluted PDLs, which are capable of more easy treatment, restoration, and revitalization. This is the type normally classified as brownfields: where investment efficiency generates investment effectiveness.[12]

As a matter of public policy this distinction is extremely important. There occurs social and economic loss when PDL is unavailable for community and organizational use. This is especially so when particular land is strategically located. In an era of scarcity in land resources such disuse may arguably be characterized as a form of "waste." The fundamental purpose of brownfield restoration funding (in response to community need) is to eliminate identifiable "waste" offering to promote accomplishments which include

> transforming brownfields into thriving new centers of commerce and industry; creating jobs through cleanup and reuse; formatting innovative partnerships among federal, state, and local governments and private-sector stakeholders such as developers and lenders; training residents of brownfields communities for high-wage environmental careers; and countless other examples of how brownfields restoration [may] positively impact[] local economies and the quality of life for neighboring communities.[13]

Yet certain locations eligible for Superfund treatment cannot be considered safe in terms of human health for immediate live, work, and play,[14] and so treatment for immediate reuse is not a viable option for those sites. The Brownfields Law details limitations on applicability of grants and loans to exclude particular properties from categorization as brownfields. This is due primarily to the policy decision of eliminating parcels already the subject of an ongoing removal action under CERCLA, or those containing highly toxic hazardous wastes necessitating Superfund application. Moreover, protection from liability provisions of the law does not apply to hazardous waste sites.[15] It is important to recognize that brownfields represent social and economic legislation as well as environmental purpose. Treatment and cleaning are secondary in importance, in practical business terms, when compared with economic and social revitalization.

How the brownfields approach is intended to facilitate economic revitalization and improve upon social and economic conditions is a multi-faceted and complex political and legal matter. Essentially, the law expands potential federal financial assistance for brownfield revitalization inasmuch as it creates a funding program directed toward awarding grants for assessment, cleanup, and job training of PDL, which may be relatively quickly tested, treated, and redeveloped for quasi-immediate economic use. The law also includes language with legal purpose to limit the liability of certain property owners and prospective purchasers of brownfield properties. This limitation of liability is critically important because it has historically been a major obstacle to redevelopment to the degree that the cost to redevelop increases by exposure to this form of liability. Because the law clarifies the innocent landowner defenses to litigations, developers and purchasers are better able to calculate their costs and risk, and to that degree, the cost of redevelopment is thereby lessened, and developers are more likely to proceed with those types of projects.[16]

III. The Legal and Regulatory Framework of Brownfield Restoration

The U.S. Congress crafted a broad definition of brownfields which goes far to increase the scope, breadth, and number of covered properties eligible for grant and loan funding support. The full measure of economic and environmental benefit possible is more easily achieved where the brownfields definition is expanded. Environmental protection and social and economic benefit are better served when greenfields remain untouched and brownfields are restored to productive economic capacity. This brownfield definition applies to real property, the reuse of which may be complicated by the presence or potential presence of a contaminant, pollutant, or hazardous substance. The definition supports a general policy for establishing limitations on funding of particular classes of sites considered too dangerous for inclusion, while it also excludes altogether other classes of sites, either for the same reason or to further alternative policy objectives.[17] The limitations and exclusions reflect policy choices for equitable allocation of finite funding resources for site restorations under CERCLA Section 104(k).[18]

The economic reality remains that there are limited resources with which to fund the grant and loan program. According to the EPA, the foundational purpose of the legislation is to establish guidelines for the making of property-specific determinations.[19] These types of determinations permit funding where parcels would not otherwise explicitly qualify for support due to there being minimal levels of exposure to contaminants. In this manner land that would have been left to lie fallow—contaminated but not contaminated enough, a lost resource in an environmental "no-man's land" status of waste—is by this policy and legislation now to be reclaimed. This regulatory framework provides the funding needed to fill a gap in environmental restoration, to promote economic revitalization, and to safeguard the public welfare—in all, beneficial public policy objectives.

In the application of this socioeconomic public policy, in the process of reviewing applications for funding, the EPA considers factual information specific to particular parcels to identify whether property owners satisfactorily indicate "that brownfields funding at such sites will ensure protection of human health and the environment and promote economic development or the creation or preservation of greenspace or recreational areas,"[20] as the statute does require. These are the critical qualifying criteria.

The law clearly identifies three types of properties specifically eligible for restoration funding. These types include (1) sites contaminated by controlled substances; (2) sites contaminated by a petroleum product; and (3) mine-scarred lands.[21] Other sites are either not eligible for funding support at all, or if they are eligible for financial funding it is only by means of a property-specific determination which may be had only under limited circumstances following a careful property-specific determination consistent with the basic purpose of the legislation.[22]

The property owner-applicant must fulfill particular requirements for demonstrating the site meets prerequisite criteria for funding to qualify for funding eligibility by means of a property-specific exception.[23] Applicants must indicate within their request for financial support whether the subject property may be classified within an eligible category.[24] In the event no category is applicable to a particular parcel of land, then a property-specific determination for funding may be requested, in which case submitted evidence should indicate "that brownfields funding at such sites will ensure protection of human health and the environment and promote economic development or the creation or preservation of greenspace or recreational areas."[25]

This issue of eligibility is where land-use attorneys may be most helpful to their clients, because where the subjective characteristics of any particular parcel are sought to be measured by objective criteria there is clearly room for a measure of interpretation, and likely some form of error will occur. Land use attorneys may better serve client interest by educating themselves toward full awareness of how the EPA may interpret the law. Such awareness will permit the attorney to better predict possible EPA decisions, and therefore better advise clients on how to proceed most effectively to secure grant or loan approval, or avoid disqualification from eligibility for funding if such avoidance is possible. The eligibility of any property for brownfields funding is dependent upon whether the EPA is satisfied the particular site meets the necessary criteria for funding eligibility; or if not, whether a permissive exception is appropriately applied. The EPA will receive proposals for funding under CERCLA Section 104(k), and will exercise its authority to award funds under the Section 104(k) grant program.[26]

Thus, diligent oversight by a knowledgeable land-use attorney can provide invaluable guidance to the wary applicant for funding. In follow-up comments in this series of articles, case studies will be analyzed to determine whether the scope and breadth of conflicts over classification of parcels are easily, promptly, and fairly resolved within the administrative process as it currently functions. To be certain, administrative efficiency may always be improved upon, but appropriate framing of administrative requests in the first instance goes far toward eliminating any potential for error.

The dividing line between either Superfund or brownfields classification eligibility is not absolute. While it does not appear the existence of a planned or ongoing Superfund enforcement action will necessarily disqualify a site from receiving brownfields-type funding, the fact of Superfund classification will likely result in brownfields disqualification. As a result, and to promote full disclosure of all funding sources, the EPA will investigate to evaluate whether a site is, or will be subject to, an enforcement action under CERCLA or other federal environmental statutes. Applicants for grants or loans are asked to identify in their applications whether there are any ongoing or anticipated environmental enforcement actions related to the brownfields site for which funding is sought.[27]

A. Brownfield Assessment, Loans, and Grants

Of the three types of properties specifically eligible for funding, one is that of any site contaminated by controlled substances. An example of this type of site may include a private residence once used for the manufacture and or the distribution of illegal drugs and where there is a presence or potential presence of controlled substances or pollutants, contaminants, or hazardous substances still remaining in, on, or about the land.[28]

A second type of site specifically eligible for funding is one where property was contaminated by petroleum or a petroleum product, unless the particular site is already receiving LUST[29] trust funding for restoration purposes, in which case that site would not be eligible for further financial assistance. Petroleum-contaminated sites or portions of properties contaminated with petroleum are characterized eligible for brownfield classification by statutory provision.[30] Applicants who may seek funding support must provide evidence the contamination on the subject parcel is of the contamination type according to CERCLA definition: "crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under that section."[31]

Petroleum-contaminated sites must be of lesser risk than would require their categorization and treatment as Superfund cleanup subjects. The law restricts eligibility for brownfield funding to petroleum-contaminated sites that authorities determine (1) are of "relatively low risk" compared with other "petroleum-only" sites; and (2) for which there is no viable responsible party, and will be assessed, investigated, or cleaned up by a person who is not potentially liable for cleaning up the site. Moreover, petroleum-contaminated sites must not be subject to a corrective action and enforcement order under a Resource Conservation and Recovery Act (RCRA) Section 9003(h) order.[32]

In the case of proposals that include requests for an assessment or direct cleanup grant to address petroleum-contaminated sites, properties contaminated with petroleum or petroleum products may be considered to represent a relatively low risk. As not all petroleum-contaminated sites will be classified as low risk, land-use attorneys must be careful to properly distinguish between categories of risk. Clearly dangerous and highly toxic contamination would be considered high risk. In fact, high-risk sites would obviously include properties treated by use of LUST trust fund monies or petroleum-contaminated sites subject to a response under the Oil Pollution Act (OPA) simply because the level of significant and immediate risk to the environment is imminently high. These scenarios of risk and treatment exclude brownfield locations by definition because brownfields are not normally high-risk propositions. Thus, a useful yardstick for brownfield eligibility may very well be to determine objectively whether the site is considered of relatively low risk.[33] Certainly these classifications are subjective and so great care must be given to the selection of site. Also significant to note is determination that a site is of "relatively low risk" has meaning solely for purposes of determining eligibility for brownfield funding. Such a determination would have no effect on potential liability under RCRA Section 9003(h) for costs of corrective action, or liability under other federal statutes such as Section 311(c) of the Clean Water Act (CWA) and Section 1002 of OPA for removal costs and damages that result from the discharge of oil into navigable waters.[34]

The third type of site specifically listed as eligible for brownfield funding is that of property considered to be mine-scarred lands. "Mine scarred lands" are "lands, associated waters, and surrounding watersheds where extraction, beneficiation, or processing of ores and minerals (including coal) has occurred." Mine-scarred lands include abandoned coal mines and lands scarred by strip mining.[35] Some examples of coal mine-scarred lands may include but are not limited to the following types of abandoned mine areas: surface and / or deep coal mines; coal processing; coal refuse; acid or alkaline mine drainage; and associated waters affected by abandoned coal mine (or acid mine) drainage or runoff, including stream beds and adjacent watersheds. Some examples of non-coal rock mine-scarred lands may include but are not limited to: abandoned surface and deep mines; waste rock or spent ore piles; roads constructed of waste rock or spent ore; tailings, disposal ponds, or piles; ore concentration mills; smelters; cyanide heap leach piles; dams constructed wholly or partially or waste rock, tailings, or spent ore; dumps or dump areas used for the disposal of waste rock or spent ore; acid or alkaline rock drainage; and waters affected by abandoned metal mine drainage or runoff, including stream beds and adjacent watersheds.[36]

B. Generally Excluded Properties

Particular types of property or facilities are generally excluded from funding eligibility unless there is a clear indication the request demonstrates the site meets requisite criteria for a property-specific determination.[37] Applicants requesting brownfields grant and loan assistance must indicate whether any property to be treated is within a category of sites eligible for property-specific funding. When requesting such a determination, applicants should express how the requested brownfields funding support "will ensure protection of human health and the environment and promote economic development or the creation or preservation of greenspace or recreational areas."[38]

There are three particular types of properties excluded from brownfield funding eligibility even with a property-specific determination. These types of properties include:

> (1) sites listed or proposed for listing on the NPL; (2) facilities subject to unilateral administrative or court orders, or orders on consent or judicial consent decree issued to or entered into by parties under CERCLA; and (3) facilities that are subject to the jurisdiction, custody or control of the US government.[39]

A facility or a property subject to a CERCLA removal action[40] may not receive brownfields funding unless a property-specific determination of funding eligibility is approved.[41] A removal may be initiated by the occurrence of one of the following events: "EPA issues an action memo; EPA issues an approval memo; EPA mobilizes onsite; or EPA issues a notice of federal interest to one or more potentially responsible parties (PRPs), which in emergencies may be made verbally."[42] Applicants who do apply for brownfield funding for sites at which removal actions are complete must include documentation evidencing the completion of treatment. Section 3.4.1 goes on to explain that:

> For purposes of eligibility to receive brownfields funding, . . . a removal is complete when, i.e.,

> actions specified in the action memorandum are met, or when the contractor has demobilized and left the site (as documented in the "pollution report" or POLREP). Once a removal action is complete, a property is eligible for brownfields funding without having to obtain a property-specific funding determination.[43]
>
> Properties not affected by removal action may be eligible for brownfields funding on a property-specific basis. Property-specific funding decisions will be made in coordination with the on-scene coordinator (OSC) to ensure that all removals and cleanup activities are conducted safely and to ensure that the OSC retains the ability to address all risks and contamination.[44]

In the event a site assessment results in identifying the need for continued removal action, "the grantee may continue to expend assessment grant funds on additional assessment activities provided any such additional expenditure or site assessment activities are conducted in coordination with the OSC for the site."[45] Eligible entities may receive funding to support assessment or cleanup on a property-specific basis where removal actions are in progress if a grant or loan applicant can demonstrate the funding would ensure the protection of human health and the environment, and promote economic development or the preservation of greenspace.[46]

The following are not eligible for brownfield funding: (1) land subject to administrative or court orders, and consent or judicial consent decrees issued or entered into by parties under provisions of the CERCLA, even if on a property-specific basis; (2) CERCLA sites listed or proposed to be listed on the NPL; (3) instances where statutory provisions mandate a particular parcel or site or type of permitted facility may not receive funding unless the EPA makes a property-specific determination to provide funding.[47] Where portions of a property are not eligible for funding support, other portions may still be eligible. In this type of scenario, the specific permit and situation causing exclusion should be identified and documentation included verifying federal brownfield funding for the assessment or cleanup of the property will further the goals established for property-specific funding determinations. A property or site with a properly issued permit under the federal environmental statutes may be eligible for brownfield funding if it can be documented brownfield funding will ensure protection of human health and the environment and promote economic development, or the preservation of greenspace.[48] Thus, funding may be approved for an eligible entity for assessment or cleanup activities, on a property-specific basis, provided a showing of sufficient evidence documenting eligibility for property-specific funding determinations is presented.[49]

RCRA-permitted facilities, including facilities under agency or court corrective action orders, may not receive funding without a property-specific determination. This rule applies to:

> (1) RCRA-permitted facilities; (2) RCRA interim status facilities . . . ; (3) facilities under court or agency order on consent or judicial consent decree under RCRA or CERCLA that require the facility to conduct corrective action or otherwise address contamination; and (4) land disposal units that have notified EPA or an authorized state of their intent to close and have closure requirements specified in closure plans or permits.[50]

Notwithstanding constraints inherent in the above regulations, funding assistance for excluded property may still be approved if the application demonstrates funding will ensure the protection of human health and the environment and promote economic development or the preservation of greenspace.[51] This objective basis for review of applications permits funding assistance for assessment or cleanup activities on a property-specific basis. Moreover, the following listed types of RCRA facilities are reviewed under less rigorous standards, do not fall within the scope of any exclusion, and consequently are funding-eligible. They are:

> (1) RCRA interim status facilities not subject to any agency or judicial order or consent decree; (2) RCRA interim status facilities subject to administrative or judicial orders that do ***not*** include corrective action requirements or any other cleanup provisions; and (3) parcels of RCRA facilities not under the scope of a RCRA permit or agency or judicial order.[52]

Also relevant is that:

> any property or site that has been issued a permit under RCRA may be eligible for brownfields funding if [it can be clearly shown] that brownfields funding will ensure protection of human health and the environment and promote economic development, or the preservation of greenspace. The EPA will consider providing funding to an eligible entity for assessment or clean up activities at the site, on a property-specific basis.[53]

In a case where closure notification has been filed,[54] an RCRA hazardous waste landfill site will not be funded for brownfields restoration purposes. This form of disqualified site may include permitted facilities that have filed notification for which final closure requirements are in progress.[55] For interim status facilities a closure plan is submitted along with closure notification; for permitted facilities the facility will request a modification to the permit at the time of closure notification.[56] In any event,

> RCRA hazardous waste landfills that have submitted closure notifications may be eligible for brownfields funding if a grant or loan applicant can demonstrate that brownfields funding will ensure protection of human health and the environment and promote economic development, or the preservation of green space. EPA will consider providing funding to an eligible entity for assessment or clean up activities at the site, on a property-specific basis, [where appropriate documentation of eligibility for property-specific funding determinations is provided.][57]

Properties not eligible for brownfields funding—even on a property-specific basis—include those owned by or under the custody / control of the federal government. Still, the following lands remain eligible for funding: "privately-owned, Formerly Used Defense Sites (FUDS); privately-owned, Formerly Utilized Sites Remedial Action Program (FUSRAP) properties; other former federal properties that have been disposed of by the U.S. government."[58]

Moreover, land held in trust by the U.S. government for Indian tribes is eligible; and "eligibility for brownfields funding does not alter a private owner's ability to cost recover from the federal government in cases where the previous federal government owner remains liable for environmental damages."[59]

Properties previously exposed to PCB release and currently subject to remediation under the TSCA are normally excluded from brownfield funding eligibility. Properties are eligible for site assessment grants except where the EPA has initiated an involuntary action, or there is an ongoing action against a disposer to address PCB contamination. "Therefore, portions of properties excluded from funding eligibility include those where: there is a release (or disposal) of any waste meeting the definition of 'PCB remediation waste'"[60]; and an involuntary action to address PCB contamination has been initiated. "[I]nvoluntary actions could include: enforcement action for illegal disposal; [agency] order to characterize or remediate a spill or old disposal; penalty for violation of TSCA remediation requirements; Superfund removal action; or remediation required under RCRA."[61]

In any portion of a property where the EPA has initiated an involuntary action, or where the EPA has an ongoing action against a disposer to address PCB contamination, brownfield funding is only available if a grant or loan applicant can demonstrate that such funding "will ensure protection of human health and the environment and promote economic development, or the preservation of greenspace."[62] "The EPA will consider providing funding to an eligible entity for assessment or clean up activities at the site, on a property-specific basis" as long as there is satisfactory documenting of the eligibility for property-specific funding determinations.[63]

The law excludes from funding eligibility those portions of land for which assistance for response activity is obtained from the LUST trust fund, unless the EPA makes a property-specific determination for funding.[64] Therefore UST sites will be ineligible for funding support "where money is spent on actual assessment and / or cleanup of UST / petroleum contamination."[65] However, support is permitted in cases where a UST site is located in a region where the local authority

> has used LUST trust fund money for program oversight activities but has not expended LUST money for specific assessment and / or cleanup activities . . . . Such sites may receive brownfields support on a property-specific basis, if it is determined that brownfields funding will protect human health and the environment and will promote economic development or enable the creation of, preservation of, or addition to greenspace[66]

consistent with appropriate documentation of eligibility for property-specific funding determinations.[67]

The following property sites receiving LUST monies would nevertheless still be considered eligible to receive brownfields grants or loans: (1) all 50 UST field pilots; (2) portions of properties where an assessment was completed using LUST monies and the site is determined a low-priority UST site. In this scenario brownfield support is permitted because additional LUST money cannot be provided for the cleanup of petroleum contamination, but the site still needs cleanup, and is otherwise a good candidate for economic revitalization; and (3) portions of properties where LUST money was spent for emergency activities, but then the site was determined ineligible for further expenditures of LUST funds, yet the site needs additional funding for continued assessment and cleanup to promote economic revitalization of the site.[68]

IV. Concluding Thoughts on Brownfield Restoration Projects

The restoration of brownfields is an appropriate framework for managing the dilemma of allocating scarce resources equitably. The equity in the allocation is enhanced by the expenditure of common-pool resources in the form of government grant and loan funds for the purpose of increasing the supply of the available land resource for land-use development. This increased supply will permit a more equitable distribution of the land resource. The federal Brownfields Law expands the eligibility for brownfield funding by broadening the categories and classifications of those entities deemed eligible for such funding.[69] In this manner, government expenditures promote the public health, safety and welfare through a program of environmental restoration and improvement. While the federal Brownfields Law defines a brownfield site broadly, it also excludes certain sites from funding eligibility unless a property-specific determination to fund is approved.[70] This determination is normally based on "whether or not awarding a grant will protect human health and the environment and either promote economic development or enable the property to be used for parks, greenways, and similar recreational or nonprofit purposes."[71]

In this manner, government spending produces economic revitalization coupled with environmental protection. This strategy of environmentally responsible financial investment is an economic, political and social win-win-win. It comprises a morally unassailable objective purpose and cleverly conjoins environmental sensitivity with economic pragmatism. To the degree the result has the practical consequence of substituting a policy of brownfield redevelopment for one of transforming greenfields into built spaces, the representational image of good government supporting environmental purpose has honest validity and legitimate effect.

Endnotes

1. A general-purpose objective of the Small Business Liability Relief and Brownfields Revitalization Act of 2001 Pub.L.No. 107–118, 115 stat. 2356 (the "Brownfields Law" or the "Law"); (amending the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 42 U.S.C. § 9601 § 101(39), (CERCLA) as amended).
2. Greenfields following layman's terms and the conventional wisdom is the label commonly applied to "not previously developed land" (NPDL).
3. *See New Urbanism: Creating Livable Sustainable Communities* (*available at:* http://www.newurbanism.org/) (describing the "project of suburbia [a]s the greatest misallocation of resources in the history of the world. [Concluding that] America has squandered its wealth in a living arrangement that has no future."); (Citing James Howard Kunstler in the documentary, **The End of Suburbia** (*available at* http://www.endofsuburbia.com)*; See also Sustainability* (*available at*: http://www.newurbanism.org/sustainability.html) (promoting as the solution "rebuilding our existing cities, and densifying our suburbs into compact, walkable towns and cities connected by extensive train systems. This form of development is known as a Transit Village, or Transit Oriented Development (TOD), and provides a higher quality, sustainable living environment. This gives us the choice of getting around by a number of different means including trains, bicycles, walking, rollerblading, and scooters.); and *Transit Oriented Development* (*available at:* http://www.transitorienteddevelopment.org) for further information.
4. *See Brownfields Brochure* (*available at:* http://www.epa.gov/brownfields/pdf/bflawbrochure.pdf) (describing the benefits of brownfield restoration as providing "communities with the tools to reduce environmental and health risks, reuse abandoned properties, take advantage of existing infrastructure, create a robust tax base, attract new businesses and jobs, create new recreational areas, and reduce the pressure to develop open spaces.").
5. The United States (U.S.) Environmental Protection Agency (EPA) manages a program for providing grant and loan assistance to support brownfield restoration. The authorization is pursuant to congressional delegation under the National Brownfields Program within the Brownfields Law. The EPA additionally publishes guidance and guidelines to assist applicants in preparing grant proposals. The guidelines instruct on successful navigation through the many and complex requirements and prerequisites for qualification for federal assistance in assessment, revolving loan fund, and cleanup grant support.
6. *See Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants—The National Brownfields Program and the New Brownfields Law § 1* (*available at*: http://www.epa.gov/brownfields/html-doc/10902jt1.htm) (discussing the fact over half a million properties once used for industrial or commercial uses were abandoned or underused due to suspicion of hazardous substance contamination, and fear a threat to human health and safety. Brownfield areas, "particularly those in city centers, were contributing to blight and joblessness in surrounding communities. Unknown environmental liabilities were preventing communities, developers, and investors from restoring these properties to productive use and revitalizing impacted neighborhoods.").
7. *Id.*
8. The Small Business Liability Relief and Brownfields Revitalization Act (H.R. 2869, Pub. L. No. 107–118, 115 stat. 2356 "the Brownfields Law") was enacted in 2002. The Brownfields Law amended the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund) by authorizing funding to qualify and restore brownfields. This legislation addressed CERCLA liability protections relating to brownfields by reducing liability in some instances in order to promote brownfield restoration, as the liability issue has been a concern for property owners and lending institutions; the law also provided funds to enhance state and tribal response programs. It is significant to note there are other related laws and regulations which may impact brownfields restoration and reuse by means of financial incentives and regulatory requirements. For more useful information, see Brownfields (*available at:* http://www.epa.gov/brownfields/gdc.htm).
9. The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601) (CERCLA) is congressional legislation authorizing the cleanup of hazardous waste sites across the nation. In 1980, Congress established financial support commonly known as "the Superfund" for that purpose; for a history of relevant environmental legislation, see Timeline (*available at*: http://www.epa.gov/superfund/action/20years/timeline.htm).
10. *See* CERCLA, RCRA, CRA, and SARA (citing various federal statutes which together comprise the foundation for the regulatory regime for public health, safety, and welfare legislation within which the Brownfields Law is inserted. For the CERCLA, which taxed the chemical and petroleum industries and established federal authority to respond to threatened releases of hazardous substances posing a risk to public health or the environment, see 42 U.S.C. § 9601; for the Resource Conservation and Recovery Act of 1976 (RCRA), which established "cradle-to-grave" requirements for hazardous waste from generation to disposal, set

forth less restrictive requirements for non-hazardous solid waste, and in 1984 amendments established additional waste-management requirements and added requirements for underground storage tanks (USTs) that contain petroleum or hazardous substances and which apply to any company that transports, treats, stores, or disposes of hazardous waste, see 40 C.F.R. 260-279, *Amending the Solid Waste Disposal Act;* for the Community Reinvestment Act of 1977 (CRA), which promotes small business lending by depository institutions in local communities, see 12 U.S.C. 2901 and 12 C.F.R. parts 25, 228, 345, and 563(e); and the Superfund Amendments and Reauthorization Act of 1986 (SARA) for legislation reauthorizing CERCLA to continue cleanup activities see 42 U.S.C. Chapter 103.).

11. These include hazardous waste sites, dangerously contaminated, not suitable for human use, and eligible for Superfund classification and placement on the National Priorities List (NPL) for treatment.

12. Basically, the theory goes something like this: Investment dollars spent in PDL will be more likely to realize greater and faster returns than dollars spent in NPDL simply because population-centers are pre-existing in urban areas and population is available to make immediate use of the new services. Moreover, population density is greater in urban-zoned locations, resulting in more efficient utilization of resources.

13. *See Brownfields Cleanup & Redevelopment Success Stories* (*available at:* http://www.epa.gov/swerosps/bf/success.htm).

14. "Live Work & Play" is a popular smart-growth concept and the term lends itself to the name of several business entities devoted to supporting a community redevelopment concept of eliminating commuting by promoting all of one's life activities in a single environmentally conceptualized concentrated area.

15. Brownfields by this definition have been linked to polluted or contaminated sites but the definition also includes mine-scarred land and lands not necessarily contaminated by hazardous substances. For further information see generally *Brownfields* (*available at:* http://www.epa.gov/brownfields/glossary.htm).

16. *See Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants—The National Brownfields Program and the New Brownfields Law* (*available at:* http://www.epa.gov/brownfields/html-doc/10902jt1.htm).

17. Reasons for funding or denial of funding are the result of policy decisions usually based upon the severity of the waste contamination or decisions respecting equitable allocation of financial resources.

18. *See Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grant—(Appendix 3.) Guidance on Sites Eligible for Brownfields Funding Under CERCLA §104(k), §§ 3.2 & 3.3*; (*available at:* http://www.epa.gov/brownfields/html-doc/10902a3.htm).

19. See *EPA Brownfields* (*available at: http://www.epa.gov/brownfields/html-doc/10902a3.htm*) for further information on the general purpose of the legislation.

20. *See the Brownfield Revitalization and Environmental Restoration Act of 2001, § 211 amending 42 U.S.C. 9601 § 101 adding C Site By Site Determinations* (permitting the President to authorize financial assistance under § 104(k) to an eligible entity "if the President finds that financial assistance will protect human health and the environment, and either promote economic development or enable the creation of, preservation of, or addition to parks, greenways, undeveloped property, other recreational property, or other property used for nonprofit purposes").

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *See generally* Proposal Guidelines for Brownfields Assessment: Appendix 3, *available at:* http://www.epa.gov/swerrims/docs/grants/epa-oswer-obcr-07-09.pdf.

27. *See generally id.*

28. *Id.* at § 3.3.1.

29. The Leaking Underground Storage Tank (LUST) Trust Fund was established in 1986 by amendment to Subtitle I of the RCRA. The purpose of the fund is to enforce corrective action taken by the responsible party and or provide a source for funding cleanups at UST sites where the owner/operator is unknown or unable to respond to the need for corrective action. *See* Underground Storage Tanks, http://epa.gov/OUST/ltffacts.htm (last visited Feb. 13, 2008).

30. *See supra* note 26, at § 3.3.1.

31. *See* CERCLA, 42 U.S.C. § 9603 (2000), describing the

> term "pollutant or contaminant" to include, but not be limited to, any element, substance, compound, or mixture, including disease-causing agents, which after release into the environment and upon exposure, ingestion, inhalation, or assimilation into any organism, either directly from the environment or indirectly by ingestion through food chains, will or may reasonably be anticipated to cause death, disease, behavioral abnormalities, cancer, genetic mutation, physiological malfunctions (including malfunctions in reproduction) or physical deformations, in such organisms or their offspring; except that the term "pollutant or contaminant" shall not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of paragraph (14) and shall not include natural gas, liquefied natural gas, or synthetic gas of pipeline quality (or mixtures of natural gas and such synthetic gas).

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* (defining "mine scarred lands" and related terms in the context of solid wastes which are not hazardous wastes for purposes of applying the brownfields classification in lands that have been exposed to prior use by extraction, beneficiation, and processing of minerals using the statutory basis found at 40 C.F.R. 261.4(b)(7)).

36. *Id.*

37. *See* DRAFT Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 4, § 4.2, *available at* http://www.epa.gov/brownfields/html-doc/0902jta4.htm.

38. Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm (requiring that in providing funding for brownfields sites, the general policy is no funding shall be awarded where EPA has a planned or ongoing enforcement action already in place for the particular property. The existence of a planned or ongoing enforcement action for a particular property will not necessarily disqualify a site from receipt of brownfields funding, but because resources are finite, equitable allocation of support and funding dictates at minimum that EPA consider whether other treatment action is already planned or ongoing in making brownfields funding support decisions).

39. *Id.* (listing sites not eligible for funding without a property-specific determination: (1) Facilities subject to planned or ongoing CERCLA removal actions; (2) Facilities subject to unilateral administrative orders or court orders, or to which a permit has been issued by authorities under the Solid Waste

Disposal Act (as amended by the RCRA), the Federal Water Pollution Control Act (FWPCA), the Toxic Substances Control Act (TSCA), or the Safe Drinking Water Act (SDWA); (3) Facilities subject to corrective action orders under RCRA and to which a corrective action permit or order has been issued or modified to require the implementation of corrective measures; (4) Facilities that are land-disposal units that have filed a closure notification under RCRA and to which closure requirements have been specified in a closure plan or permit; (5) Facilities where there has been a release of polychlorinated biphenyls (PCBs) and are subject to remediation under TSCA; (6) Portions of facilities for which funding for remediation has been obtained from the LUST Trust Fund.

40. *See id.* at § 3.4.1.
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.*
46. *See id.* at § 3.4.1.
47. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at §§ 3.4.2–3.4.4, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.42 (describing guidelines for facilities subject to unilateral administrative orders, court orders, administrative orders on consent, or judicial consent decrees issued to or entered into by parties under CERCLA, facilities listed or proposed for listing on the National Priorities List, and facilities to which a permit has been issued by the United States or an authorized state under the Solid Waste Disposal Act (RCRA), the Federal Water Pollution Control Act (FWPCA), the Toxic Substances Control Act (TSCA), or the Safe Drinking Water Act (SDWA).
48. *See* Appendix 3, *supra* note 47.
49. *See* Appendix 3, *supra* note 47 (stating funding support is denied where a facility lacks a permit or order because it fails to be in compliance with federal or state environmental laws requiring a permit or the facility may have failed to notify EPA of its regulatory status. Such facilities are disqualified for brownfields funding where there is failure to comply with a basic regulatory requirement.).
50. *See* Appendix 3, § 3.4.5 RCRA Sites for further information.
51. *See* Appendix 3, *supra* note 47.
52. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at § 3.4.5, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.45.
53. *See id.*
54. *See* 40 C.F.R. 264.112(d); *see also* 40 C.F.R. 265.112(d).
55. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at § 3.4.6, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.46.
56. *Id.*
57. *See id.*
58. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at § 3.4.7, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.47.
59. *See* Appendix 3, *supra* note 55 (clarifying the manner for handling land disposal units that have filed a closure notification under Subtitle C of RCRA and to which closure requirements have been specified in a closure plan or permit); *see also supra*, note 58 (setting forth the manner for handling facilities subject to the jurisdiction, custody, or control of the US government).
60. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at § 3.4.8, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.48.
61. *See id.* (noting the definition of PCB remediation waste found at 40 C.F.R. 761.3; authority for agency order to remediate found at 40 C.F.R. 761.50(b)(3); and note RCRA remediation would proceed under the corrective action authority of § 3004(u) or § 3004(v)).
62. *See* Appendix 3, *supra* note 47.
63. *See* Appendix 3, *supra* note 60 (noting the definition of PCB remediation waste found at 40 C.F.R. 761.3; authority for agency order to remediate found at 40 C.F.R. 761.50(b)(3); and note RCRA remediation would proceed under the corrective action authority of § 3004(u) or § 3004(v)).
64. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants: Appendix 3, at § 3.4.9, *available at* http://www.epa.gov/brownfields/html-doc/10902a3.htm#3.49.
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*
69. *See* Proposal Guidelines for Brownfields Assessment, Revolving Loan Fund, and Cleanup Grants—The National Brownfields Program and the New Brownfields Law, *available at* http://www.epa.gov/brownfields/html-doc/10902jt1.htm (providing the example of permitting awards of cleanup grants to nonprofit organizations that own the property they wish to clean; the expanded definition adopted by the EPA of nonprofit organizations includes universities and other educational institutions. In addition, "coalitions," or groups of eligible entities are permitted to form a hybrid entity for the limited purpose of brownfields restoration to pool their revolving loan capitalization grant funds. A coalition involves grouping two or more eligible entities under one grant recipient. The grant recipient is responsible to EPA for administering the grant, accounting to EPA for proper expenditure of the funds, and is the organizing force for the other coalition members).
70. *See* Appendix 3, *supra* note 38.
71. *Id.* (providing information on "eligibility for funding"); *See also*, Appendix 4, *supra* note 37 (providing information on "property-specific determinations").

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Revised § 216 Lets Corporations with Unlimited Non-Member Income Be "Cooperative Housing Corporations"

By Joel E. Miller

The following is an article that appeared in the March 5, 2008 issue of the *Tax Management Real Estate Journal* published by Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc., Arlington, VA 22202.

If a corporation qualifies as a "cooperative housing corporation" as defined in § 216(b)(1), each of its shareholder-lessees who qualifies as a "tenant-stockholder" as defined in § 216(b)(2) is eligible for certain otherwise unavailable income tax benefits. For the "tenant-stockholder" who uses his dwelling unit purely for personal purposes, those benefits are chiefly the possibility of deducting that portion of his rent that represents his proportionate share of certain real estate tax and interest charges incurred by the corporation,[1] the possibility of deducting interest on certain indebtedness secured by his ownership interest,[2] and the possibility of excluding up to $500,000 of gain on the sale of his ownership interest.[3] For the "tenant-stockholder" who uses his dwelling unit for income-seeking purposes, those benefits are chiefly the possibility of depreciating his ownership interest[4] and the possibility of deferring gain on an exchange of his ownership interest for real property of any kind.[5]

Section 216(b)(1) sets forth four separate requirements that a corporation must satisfy in order to qualify as a "cooperative housing corporation," one of which is, and since the beginning has been, a percentage requirement, evidently designed to separate *cooperative* apartment-owning corporations from other apartment-owning corporations that were able to satisfy the statute's other three requirements. It is that percentage requirement that has been changed. Until December 20, 2007, the statute's percentage requirement was satisfied only if at least 80% of the corporation's gross income was "derived from tenant-stockholders."[6] That is no longer the case. For a corporation that is unable to satisfy the pre-2007 gross income requirement, the law now provides two alternatives,[7] and satisfying any one of three different percentage tests is now sufficient to the statute's percentage requirement.[8] One of the two new alternative tests has to do with the nature of the square footage of the corporation's property. The other has to do with the nature of the corporation's expenditures. For convenience, we shall sometimes refer to those three alternative tests as "the 80% income test," "the 80% footage test," and "the 90% expenditures test."

Over the years, some—not all, of course—corporations wishing to qualify as "cooperative housing corporations" were experiencing what might be described as a growing embarrassment of riches. The amounts and kinds of non-tenant-stockholder income available were constantly increasing. There were stores and garages that could bring in multiples of their former rentals. Advertising companies were willing to pay handsomely for the privilege of placing signs on roofs and walls. Developers of neighboring properties were willing to pay huge sums for easements or so-called "air rights." Film-makers offered tempting so-called "location fees." Portions of roofs could be rented out to cellular telephone companies. Defaulted apartments could bring in very attractive rents.

Corporations presented with such opportunities had to consider whether it made sense to forgo "cooperative housing corporation" status. Quite a few employed one of several strategies that, they hoped, would, without creating substantial income tax or other problems, allow their shareholders to enjoy such income while maintaining qualification. Many corporations simply—and ruefully—turned their backs on very large amounts of income that were available to them. It is small wonder, then, that the owners of cooperative apartments have long sought a modification of the statute's former gross-income-only percentage requirement.[9] As indicated above, those efforts bore fruit at the end of last year. Before we look more closely at the revised § 216, we shall review some of the major steps in the development of that section.

The Usual Cooperative Housing Arrangement

Cooperative apartments have been with us for well over a hundred years, and their usual form has not changed significantly over that time span. In the prototypical cooperative apartment venture, the following steps occur: a building containing apartments of varying values is located by a group of persons who desire to make their homes in those apartments; a corporation is formed; that corporation draws up a list associating a number of its shares with each apartment in the building, in accordance with their respective values; each participant purchases a block of shares from the corporation and at the same time enters into a long-term lease (commonly called a "proprietary" lease) with the corporation for the apartment associated with those shares; and the corporation uses the bulk of those stock-sale proceeds, along with borrowed funds secured by a mortgage on the building, to purchase the building. Each proprietary lease requires the shareholder-lessee to pay to the corporation on an ongoing basis his proportionate share of the amounts needed by the corporation to own and operate the building, including, of course, the funds needed to pay real estate taxes and interest on the mortgage.

"Why," the reader may ask, "did the originators of this scheme use a corporation as the owner of the building rather than, for example, a partnership or a tenancy in common?"[10] There were two principal reasons. One of those reasons (and, it seems likely, the lesser of the two) was that use of the corporate form simplified administration of the venture, particularly in connection with sales and testamentary transfers. The other reason for use of the corporate form was that it served to insulate the participants from personal liability.[11] In considering the wisdom of the choice of vehicle made by the early cooperative apartment owners, it must be borne in mind that, at that point in time, there existed either no income tax, or at most a negligible one.

Early Income-Tax Efforts

But that circumstance changed. More and more burdensome income taxes were imposed, and, as that happened, the owners of cooperative apartments[12]—who only indirectly paid real estate taxes and interest on their building's mortgage—began to look enviously at the owners of one-family houses. In stark contrast to the situation of cooperative apartment owners, house owners were allowed deductions for the real estate taxes and mortgage interest that they paid. "We are homeowners, too," the apartment owners said, "albeit in a different form." They began to lobby Congress for relief from what they regarded as an inequity. In the 1920s, congressional hearings were held on the matter, and at the end of 1927 the advocates for the cooperative apartment owners persuaded the House of Representatives to include in the proposed Revenue Act of 1928 a provision reading as follows:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions: ***
>
> (q) COOPERATIVE APARTMENTS.—Amounts paid by an individual taxpayer during the taxable year to a corporation which owns or leases an apartment building and operates it under the cooperative plan if—
>
> (1) Such amounts are bona fide expended by the corporation in the same taxable year, in payment of taxes allowable as deductions under subsection (c) of this section or in payment of interest on its bonds or on other indebtedness incurred by it in the acquisition, construction, or maintenance of such apartment building or the land on which the building is located, and
>
> (2) Such individual is the owner or lessee of an apartment in the building under a lease the term of which is twenty years or more, or under an agreement with the corporation, is entitled, by reason of stock ownership, to the use and occupancy of such apartment for a like period, and
>
> (3) No part of the net earnings of the corporation inures to the benefit of any private shareholder or individual other than as an owner or lessee of an apartment in such building or one entitled by reason of stock ownership to the use and occupancy of any such apartment.[13]

The Ways and Means Committee report accompanying the bill included the following:

> SEC. 23(q). Cooperative Apartment Owners.
>
> The bill provides for a new deduction in section 23(q) of taxes and interest paid by the owner (or long-term lessee or other occupant as specified in the bill) of a cooperative apartment, which payments are made through the medium of a corporation holding the title to or a long term lease on the entire building. *** The general purpose of these provisions is to place the owner or long-term lessee of a cooperative apartment in the same position as the owner of a dwelling house so far as deductions of interest and taxes are concerned.[14]

However, the Senate refused to go along, and no cooperative apartment provision was enacted at that time.[15]

Notwithstanding that defeat, some cooperative owners, arguing substance over form, nevertheless claimed deductions for their shares of the corporation's real estate tax and mortgage interest payments. Their position was not accepted by the Internal Revenue Bureau, which pointed out that, under the law as it then stood, only the owner of the property—not a lessee of a part of it—could be entitled to such deductions. The courts agreed with the Bureau.[16]

The 1942 Statute

The cooperative apartment owners then went back to Congress. Their principal spokesperson was J. Frederick Eagle, who appeared on behalf of the Tenant-Owned Apartment Association, Inc. Mr. Eagle submitted memoranda to both the House Committee on Ways and Means[17] and the Senate Finance Committee.[18] He and Henry Foster of Brown, Wheelock, Harris, Stevens, Inc. also testified before the Senate Finance Committee.[19] They submitted a proposed statutory provision (modeled on a New York statute that had been adopted in 1931) that read as follows:

> In the case of any taxpayer who is the owner of shares of stock in a corporation organized and existing primarily for the purpose of owning and operating a cooperative multiple dwelling no part of the net earnings of which inures or is calculated or intended to inure to the benefit of any stockholder or individual, and all the expenses of which (less an amount equal to rentals received by it from tenants other than stockholders) are paid annually by the stockholders in proportion to their ownership, a deduction shall be allowed to such taxpayer as to the share of his payments for all taxes, paid or accrued by such corporation during the taxable year, and all interest paid or accrued by such corporation during the taxable year on its indebtedness.

This time the cooperative apartment owners were successful. Significantly, though, Congress chose not to use the language that the witnesses had suggested. Rather, the federal statute limited the new benefit to "tenant-stockholders" (a defined term) of "cooperative apartment corporations" (also a defined term).[20] Two aspects of those definitions are noteworthy. First, doubtless in response to the 1928 Senate Finance Committee's 'ordinary renter' objection,[21] the definition of "tenant-stockholder" contained language obviously designed to ensure that a cooperative apartment owner had in fact made a real investment.[22] Of particular interest for present purposes, the definition of "cooperative apartment corporation" contained several elements (essentially the same ones that existed until the recent revision), one of which denied that status to any corporation that, for the taxable year in question, derived more than 20% of its gross income from sources other than its own "tenant-stockholders."[23] As explained by the Senate Finance Committee (which had added the provision to the House bill):

> The definitions of the terms "cooperative apartment corporation" and "tenant-stockholder" prescribe certain standards which are designed to safeguard the revenue by assuring that the apartment corporations involved are bona fide cooperative apartment corporations and that the individuals entitled to deductions under section 23(z) are bona fide tenant-stockholders of such corporations.[24]

The 2007 Revision

It thus cannot be doubted that Congress in 1942 was of the opinion that an apartment corporation with too much non-tenant-stockholder gross income should not be eligible even if it met all of the statute's other requirements. As noted above, that remained the law until December 20, 2007, when the President signed the very popular and swiftly enacted Mortgage Forgiveness Debt Relief Act of 2007,[25] which included a virtually unnoticed provision[26] that makes it no longer necessary for a corporation to pass the original 80% income test in order to qualify as a "cooperative housing corporation."[27] Passing any one of three alternative tests—the original 80% income test, the new 80% footage test, or the new 90% expenditures test—will now suffice to satisfy the statute's percentage requirement.

Before looking at the two new alternative tests, let us note the sole reason for the change as stated by the House Ways and Means Committee (wherein the Act originated):

> Under present law, tenant-stockholders of a cooperative housing corporation are allowed to deduct their proportionate shares of the cooperative's deductible real estate taxes and mortgage interest only if the cooperative's nonmember income is no more than 20 percent of its total gross income. To satisfy this rule, some cooperative housing corporations have made rentals to commercial tenants at below-market rates. The Committee believes that the tax rules should not create an incentive to charge below-market-rate rents. Accordingly, the Committee's bill provides two non-income-based alternatives to the 80-percent requirement of present law.[28]

We may also note that, the day before the President signed the new law, the office of Congressman Charles B. Rangel of New York, the committee chair as well as the § 216 revision's author and prime mover, issued a press release quoting Mr. Rangel as follows:

> I am extremely pleased that the tax code will treat people who live in co-operative housing the same as homeowners and condo owners are treated when it comes to their renting out part of their property. I hope that this will provide relief from [*sic*] for some from the high housing costs in New York. *** Thanks to the hard work of many, the federal government will be able to provide some relief to families as they struggle with the rising living costs.

The 80% Footage Test

Under the revised § 216, neither the original 80% income test nor the new 90% expenditures test need be passed for a taxable year if:

> (ii) At all times during such taxable year, 80 percent or more of the total square footage of the corporation's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use.[29]

A number of interpretive questions spring to mind, some of which are mentioned below. Preliminarily, though, an important point must be noted. Some of the writings describing this test have, for no apparent reason, overlooked the words "by the tenant-stockholders." As a striking, but by no means only, example, Mr. Rangel's above-mentioned press release included the following paragraph:

> Co-ops would be allowed to pass through applicable tax benefits if they meet one of three requirements:
>
> 1) If 80 percent or more of the co-op's gross income is from the tenant stockholders[.]
>
> 2) If 80 percent of the total square footage of the building is used or [*sic*] for residential purposes.
>
> 3) If 90% of the costs of operating the building are for the benefit of the tenant stockholders.

The quoted language obviously contains a number of significant inaccuracies, thus making it clear enough that it is only a rough approximation of the law. Even so, the second numbered subparagraph's omission of the "by the tenant-stockholders" phrase—which was picked up and quoted elsewhere—has an especially high potential to be seriously misleading. Under the law, it is not enough if 80% of the total square footage is used *by someone* for residential purposes. If that were the test, a corporation could pass this particular test (and thereby satisfy the statute's percentage requirement) even if a great many of its apartments had no shares allocated to them and were rented out to non-evictable persons who were not "tenant-stockholders." And that is not a rare situation. There are many housing cooperatives whose buildings contain quite a few apartments as to which no shares are outstanding—commonly because defaulting shareholder-lessees surrendered their shares and leaseholds to the corporation and the corporation took no further action. Such a corporation might well meet the misstated 80% footage test but not the actual 80% footage test, and, of course, it is the actual test that would count. It would be a shame if such a corporation were lulled into a false sense of security by such erroneous reports.

Among the questions to be considered in connection with the 80% footage test are the following:

- It is to be noted that there is no apparent limitation to normal floor space within buildings.[30] If no such limitation is held to be implied, what portions of the corporation's property are to be taken into account? Basements? Roofs? Lawns?
- Is property leased to—as opposed to owned by—the corporation part of its "property"?
- If the corporation has a property-owning subsidiary, is this test to be applied on a combined basis? [See Miller, "TAMs Wave Warning Flag for Housing Coops Relying on Subsidiaries to Pass 80/20 Test," 20 *Tax Mgmt. Real Est. J.* 318 (2004).] If the answer is no, can the corporation drop some property into a subsidiary in order to achieve the required percentage? If the answer is yes, can the corporation acquire a property-owning subsidiary in order to achieve the required percentage?
- What does "available for use" mean? It seems clear that it must mean as against the corporation; it is unthinkable that the square footage of an apartment rented out, even long term, by a "tenant-stockholder" would be 'bad' square footage for this purpose. But there are less tractable issues. Are non-shareholder apartments rented out by the corporation "available for use by the tenant-stockholders" simply because the corporation has the power to issue shares allocated to them? What of a commercial establishment—say, a gymnasium, a movie theater, a parking garage, or a supermarket—that the "tenant-stockholders" are free to patronize? Should the answer turn on the permissibility or extent of use by non-occupants?
- What are "residential purposes"? Suppose the corporation's property includes professional offices, a travel agency, or the back office of a major construction company. How about hotel rooms?[31]
- Boiler rooms, lobbies, elevators, and so on, are obviously "available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use," but is an allocation required if they also serve persons who are not "tenant-stockholders"?

In applying the 80% footage test (as well as both the original 80% income test and the 90% expenditures test about to be discussed), it must always be borne in mind that not every shareholder-lessee of a "cooperative housing corporation" is necessarily a "tenant-stockholder." As noted above, qualification as such has its own requirements, and a shareholder-lessee does not qualify as a "tenant-stockholder" unless his shares were paid for to the corporation in a sufficient amount.[32] This can be a real problem in some circumstances. For example, a number of "affordable housing" programs require—either by law or as a practical matter—that an appreciable percentage of shareholder-lessees be permitted to purchase their shares from the corporation for a nominal amount. It is unlikely that such purchasers or their successors would qualify as "tenant-stockholders," so that such programs may not be able to benefit from the § 216 revision.

The 90% Expenditures Test

1. Under the revised § 216, neither the original 80% income test nor the new 80% footage test need be passed for a taxable year if:

> (iii) 90 percent or more of the expenditures of the corporation paid or incurred during such taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the corporation's property for the benefit of tenant-stockholders.[33]

Three questions immediately present themselves:

- What expenditures are "for the acquisition, construction, management, maintenance, or care of" the relevant property (whatever that property may be)? This list of purposes (hereinafter referred to as "the qualifying list") will be discussed below.
- What property is "the corporation's"? As under the 80% footage test, there can be doubt about property leased by the corporation or owned by its subsidiary.
- If a particular expenditure on the qualifying list benefits both "tenant-stockholders" and others, it would seem that an allocation would be required.[34] But how is that to be done? By actual use? By square footage? By income? Also, in making such an allocation, is the corporation bound by an allocation made for a different purpose?[35]

When we look closely at the qualifying list, we see something odd. Section 216(b)(1)(D)(iii) contains only the following five entries:

- "acquisition,"
- "construction,"
- "maintenance,"
- "management," and
- "care."

Yet, another portion of § 216—which sets forth certain purposes for which indebtedness was incurred by the corporation in respect of certain of its property and which also contains five entries—has a different list, namely:

- "acquisition,"
- "construction,"
- "maintenance,"
- "alteration," and
- "rehabilitation."[36]

We can easily conclude that the drafters of the § 216 revision meant to add "management" and "care," but why did they omit "alteration" and "rehabilitation"? Were expenditures for such purposes not meant to be 'good' expenditures for purposes of the 90% expenditures test?

What about refinanced debt? One would think that the purpose for which the original debt was incurred should control, but it must be remembered that the IRS has taken the position that the proceeds of a loan taken to refinance indebtedness incurred to purchase a residence "were used for purposes other than purchasing or improving the residence, and thus the indebtedness was not 'incurred in connection with the purchase or improvement of' that residence as that language is used in section 461(g)(2)."[37] Also, Congress, when enacting § 163(h)(3)(B)(i), which contains a sentence defining the term "acquisition indebtedness" with reference to a "qualified residence," saw fit to specify that "[s]uch term also includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of [the defining] sentence."

Another question is whether certain large expenditures made by virtually every housing cooperative—for example, real estate taxes and casualty insurance premiums—fit on the list. In view of the fact, presumably known to the Congress, that the 90% expenditures test would be of precious little use if such items were not included, it seems fairly certain that they will be squeezed in somewhere. In this connection, it may be observed that the qualifying list was undoubtedly copied, word for word, from a somewhat similar expenditures requirement found in the homeowner associations section of the Code,[38] so that interpretations of that section may be relevant in construing the qualifying list in § 216. And the regulations under the homeowners' association section, which applies to expenditures in connection with "association property," include the following:

> Qualifying expenditures may include . . . expenditures for—
>
> (1) Salaries of an association manager and secretary; ***
>
> (4) Security personnel;
>
> (5) Legal fees;
>
> (6) Upkeep of tennis courts;
>
> (7) Swimming pools;
>
> (8) Recreation rooms and halls; ***
>
> (10) Insurance premiums on association property;
>
> (11) Accountant's fees; *** and
>
> (13) Real estate and personal property taxes imposed on association property by a State or local government.[39]

Some Comments

A few observations may be made. First, if we take the House Ways and Means Committee at its word,[40] much narrower "fixes" for the perceived problem were available. One possibility might have been to provide special rules where a housing cooperative's building contains commercial space, in effect separating the for-profit activity from the cooperative function (and taxing appropriately the profits of the former). An even better possibility might have been to allow the corporation to split itself—tax-free[41]—into two separate entities that are thereafter free to go their separate ways, one entity owning the commercial space (and not being a "cooperative housing corporation") and the other being able to qualify under former § 216. There was no need to allow unlimited income of any kind from any source whatever, possibly even from the operation of an extensive business having nothing whatever to do with the corporation's building.

In view of the breadth of the new law, it is now possible for the shares of a "cooperative housing corporation" to have value that is due mostly to the ownership of income-producing assets other than those held in connection with the provision of housing. Under such circumstances, it is hard to justify treating such shares as a residence for purposes of § 121 or as real estate for purposes of § 1031.

Other Issues

The new law may turn out to be a mixed blessing. Housing cooperatives may find themselves now paying income tax on amounts that have heretofore gone untaxed. Notwithstanding that the law has always been clear that, in the case of cooperatives of all kinds, net non-member income (unless otherwise exempted, as, for example, municipal bond interest) is supposed to be taxed at the corporate level (and, if distributed in any form, taxed again at the shareholder level), the fact is that it was a very rare housing cooperative that paid any income tax[42] (and, it is a safe bet, no shareholder-lessee ever reported a constructive dividend on being furnished housing at less than a market rent due to non-member earnings). One can understand why, when such untaxed amounts were relatively small—held in check by the necessity of complying with the pre-2007 80% gross income requirement—the IRS might have chosen not to devote precious resources to such matters. However, now that "cooperative housing corporations" are free to engage in any business and earn untold amounts of non-member income, that may change. It will scarcely be surprising if the attention of the IRS is caught by the appearance in the press of reports that some "cooperative housing corporations" are expecting to reduce enormously the rents that they will collect from their shareholder-lessees in the future, while at the same time providing greater amenities.[43]

Moreover, it may well be that organizations meeting the new definition of "cooperative housing corporation" will no longer automatically be deemed to be operated "on a cooperative basis."[44] To quote from a Tax Management portfolio:

> Cooperatives commonly transact business with or for nonmembers. One question raised by nonmember business is how much of such business may be conducted without violating the requirement that a cooperative be operated on a cooperative basis. ***
>
> In contrast to exempt cooperatives [i.e., those within § 521, which would not include housing cooperatives], nonexempt cooperatives are not subject to express statutory limitations on the transaction of nonmember business. *** The volume of nonmember business that would cause a nonexempt cooperative to lose its cooperative status is unclear.[45]

The point is significant. In determining its currently allowable deductions, a corporation that is not operated "on a cooperative basis" is subject to the stringent deduction-limiting rules of § 277(a) rather than having the benefit of the comparable but much more liberal rules that presently obtain under Subchapter T, which are available only to organizations so operated.[46] More than a dozen years ago, the IRS announced that it would "continue to assert in litigation that the limitations of section 277 apply to cooperative housing corporations that do not qualify as subchapter T cooperatives. *** Only [where] the housing corporation is a subchapter T cooperative will section 277 not be applied."[47] It is thus quite likely that in the future some housing cooperatives, even ones clearly satisfying the statute's revised percentage requirement, will be called upon to demonstrate that they are operated "on a cooperative basis "if they wish to escape the rigors of § 277(a).

Tax practitioners can expect to be kept busy and to have to work in new fields. For example, in addition to having to classify receipts as 'good,' 'bad' or neutral for purposes of the 80% income test, tax practitioners may now be called upon to classify physical areas as 'good,' 'bad' or neutral for purposes of the 80% footage test and to classify disbursements as 'good,' 'bad' or neutral for purposes of the 90% expenditures test. Also, the proper allocation of deductions—whether under § 277(a) or under the Subchapter T rules—for "cooperative housing corporations" with significant amounts of non-member income will assume much greater importance. Other questions will have to be answered as well. Should arrangements that were set up to comply, or at least try to comply, with the pre-2007 80% gross income requirement be unwound? For example, should a wholly owned subsidiary be folded into the parent? If a sibling entity was employed and the memberships are no longer the same, should efforts be made to bring them into line? If a particularly shaky stratagem was employed, should it be allowed to run for a while, thereby not calling attention to it but at the same time exposing more years to challenge by the IRS? In the case of a housing cooperative that has just qualified as a "cooperative housing corporation" (due to its ability to pass one of the two new alternative tests despite its inability to pass the 80% income test), can those of its shareholder-lessees who have become "tenant-stockholders" exclude gain on an immediate sale or exchange of their apartments, or does § 121(d)(4) require two years of qualification before the transaction? There may be interesting times ahead as housing cooperatives and their tax advisers work with the revised § 216.

Endnotes

1. IRC § 216(a).
2. IRC § 163(h)(3).
3. IRC § 121.
4. IRC § 216(c).
5. IRC § 1031.
6. IRC § 216(b)(1)(D), before amendment by the Mortgage Forgiveness Debt Relief Act of 2007, P.L. 110-142.
7. IRC § 216(b)(1)(D), as amended by the Mortgage Forgiveness Debt Relief Act of 2007, P.L. 110-142, § 4(a). The change is effective for taxable years ending after the date of enactment. P.L. 110-142, § 4(b). As indicated, the President signed the bill (H.R. 3648) on Dec. 20, 2007.
8. It is important to note that, despite published reports to the contrary, a corporation still must satisfy the other three requirements as well. As before, satisfying the statute's percentage requirement is only part of qualifying as a "cooperative housing corporation."
9. *See, e.g.*, Miller, "The Impact of a Housing Cooperative's 'Bad' Income on Its Members' Section 216(a) Deductions, Now and Under Proposed Legislation," 10 *J. Real Est. Tax'n* 99 (1983).
10. It must be recalled that condominiums were essentially unknown in this country until the 1960s, decades after the appearance of cooperative apartments.
11. See the following colloquy from hearings held in the fall of 1927 by the House of Representatives Committee on Ways and Means in connection with the 1927–28 Revenue Act revision:

    Mr. COLLIER [one of the committee members]. They always form a corporation, do they not?

    Mr. [Nathan William] MACCHESNEY [general counsel of the National Association of Real Estate Boards]. Not always. I may say that that is the safe and best way of doing it. It is sometimes done through a trust and sometimes by a partnership, but it is a very risky thing for a person to go into a partnership of that kind.

    Mr. COLLIER. The general custom is to have a corporation.

    MR. MACCHESNEY. Yes. [page 216]

    Mr. MacChesney had previously described the usual cooperative apartment venture to the committee members, emphasizing that he was talking about "corporations . . . organized for the sole purpose of providing homes for the people who are going to live in them." [page 215].
12. As has been indicated, it is somewhat misleading to refer to the participants in a cooperative apartment venture as the owners of apartments. What each actually owns is a block of corporate shares and an associated long-term leasehold; the apartments themselves are actually owned by the shareholder-lessees' corporation.
13. H.R. 1, 70th Cong., 1st Sess. (1927).
14. H. Rep't No. 2, 70th Cong., 1st Sess., at 14 (1928).
15. S. Rep't No. 960, 70th Cong., 1st Sess., at 14 (1928). One of the reasons that the Senate Finance Committee gave for striking the House's provision was that "this deduction . . . is not given to the great number of individuals who lease apartments by the year."
16. *See, e.g., Wood v. Rasquin*, 21 F. Supp. 211 (E.D.N.Y. 1937), *aff'd without op.*, 97 F.2 1023 (2d Cir. 1938).
17. Hearings on the Revenue Revision of 1942, House of Representatives Ways and Means Committee, 77th Cong., 2d Sess., vol. 3, at 3433–35 (1942).
18. Hearings on the Revenue Revision of 1942, Senate Finance Committee, 77th Cong., 2d Sess, vol. 3, at 171–73 (1942). He sought to respond to the 1928 committee's 'ordinary renter' point (*see* n.15, *supra*) by stating that "it should be borne in mind that the proprietary lessee has an investment whereas the ordinary tenant has no investment."
19. *Id.* at 164–70 and 173–74.
20. Internal Revenue Code of 1939, § 23(z). The full text of the 1942-added provision may be found in I.T. 3664, 1944 C.B. 141, 143. The term was changed to "cooperative housing corporation" when § 23(z) of the 1939 Code was re-enacted as § 216 of the 1954 Code.
21. *See* notes 15 and 18, *supra*.
22. His stock had to be "fully paid-up in an amount not less than an amount shown to the satisfaction of the Commissioner as bearing a reasonable relationship to the portion of the value of the corporation's equity in the building and the land on which it is situated which is attributable to the apartment which such individual is entitled to occupy." Internal Revenue Code of 1939, § 23(z)(2)(B). The current provision is essentially the same. See IRC § 216(b)(2).
23. Internal Revenue Code of 1939, § 23(z)(2)(A). The current provision is essentially the same. See IRC § 216(b)(1).
24. S. Rep't No. 1631, 77th Cong., 2d Sess., 1942-2 C.B. 504, 577.
25. P.L. 110–142.
26. In extensive discussions on and off the floor of Congress of the then-proposed law, which included provisions of much more importance and wider interest, the § 216 revision was mentioned in only the briefest and non-informative terms or, more often, not mentioned at all. For example, when the bill was first introduced and briefly described by the chairman of the House Ways and Means Committee, his entire discussion of the § 216 revision was the following: "Finally, the bill makes it easier for taxpayers to form housing cooperation co-ops [sic]." Remarks of Charles B. Rangel of New York, Cong. Rec., Oct. 4, 2007, p. H11289. When an elaborate bill signing ceremony was staged to highlight the benefits the new law would provide, the cooperative housing provision was not mentioned.
27. Two things should be noted. First, an apartment corporation need not pass either of the two new alternative tests if it can pass the original 80% income test. Second, notwithstanding erroneous published reports to the contrary, the two new alternative tests do not replace all of the requirements that a corporation must satisfy in order to be a "cooperative housing corporation"; they are permissible substitutes for only the 80% income test.
28. H. Rep't No. 110-356, 110th Cong., 1st Sess., p. 8 (2007). It should be noted that a housing cooperative whose problem was caused by valuable commercial space had a ready means of escaping its dilemma. It could—by means of a 'condopping,' for example—sell off that space and thereafter qualify under the old § 216. Such an approach was typically rejected for a number of stated more-or-less valid reasons, but in all likelihood mostly because the shareholder-lessees believed

that the space might in the future become even more valuable and to some extent because they were unwilling to pay the income tax that might result from such an action.

29. IRC § 216(b)(1)(D)(ii).

30. *Cf.* Regs. § 1.528-4(b), which, for a roughly comparable purpose having to do with condominiums, casts its test in terms of "at least 85% of the total square footage of all units within the project."

31. *Cf.* Regs. § 1.528-4(d), which provides that "a unit, or building will not be considered used for residential purposes, if for more than one-half of the days in the association's taxable year, such unit, or building is occupied by a person or series of persons, each of whom so occupies such unit, or building for less than 30 days."

32. IRC § 216(b)(2).

33. IRC § 216(b)(1)(D)(iii).

34. See Regs. § 1.528-6(b) ("Where expenditures by an organization are used both for association property as well as other property, an allocation shall be made between the two uses on a reasonable basis. Only that portion of the expenditure which is properly allocable to the acquisition, construction, management, maintenance, or care of association property, shall constitute qualifying expenditures.").

35. For example, if a corporation for patronage / nonpatronage purposes under Subchapter T allocates 30% of its real estate taxes to commercial space (based on income), can it for purposes of the 90% expenditures test allocate only 10% to the commercial space (based on square footage)?

36. IRC § 216(a)(2)(A).

37. Rev. Rul. 87-22, 1987-1 C.B. 146.

38. IRC § 528. There is, of course, a significant difference between § 216 and § 528 in that, in order to qualify under the latter, an organization must (among other things) pass an income test *and* a square footage test *and* an expenditures test. § 528.; Regs. §§ 1.528-4, -5 and -6.

39. Regs. § 1.528-6(c). *But cf.* Regs. § 1.528-9(b), which separately lists "[m]aintaining association property" and "[p]aying real estate taxes on association property."

40. *See* text at n. 28, *supra*.

41. *See* n. 28, *supra.*

42. This was generally accomplished by either (i) taking aggressive positions in allocating deductions for purposes of § 277(a) or the rules under Subchapter T or (ii) more commonly in this author's experience, simply ignoring such provisions altogether.

43. *See, e.g.*, Vivian S. Toy, "Co-ops Reap Unexpected Bonanza," *The New York Times*, Jan. 20, 2008, real estate section, p. 1; Bradley Hope, "Bush Sets Windfall for Co-Ops in City," *The New York Sun*, Jan. 17, 2008, p.1. Indeed, this author has already been consulted by housing cooperatives that are planning on cash distributions to their shareholders.

44. The Tax Court did hold that all § 216 "cooperative housing corporations" were perforce within Subchapter T (*see, e.g.*, *Thwaites Terrace House Owners Corp. v. Comr.*, T.C. Memo 1996-406), but that was under the former version of § 216, and it may be that the same result would not be reached under the new version.

45. Carla Neeley Freitag, Tax Management Portfolio No. 744-2nd, *Taxation of Cooperatives and Their Patrons*, at II, B, 2.

46. IRC § 1381(a).

47. AOD 1995-011.

Bergman on Mortgage Foreclosures:
More on Service of Process Woes

By Bruce J. Bergman

In a judicial foreclosure state like New York, it is no mystery that slippery borrowers can abuse the legal system and delay mortgage foreclosure cases for what seem to be interminable durations. Of the many opportunities such borrowers have to slow the process down, perhaps one of the most fertile is in the area of process service.

Borrowers might not live at the mortgaged premises; they might not ever give accurate information to the lender or servicer. Or, they may pretend not to be home and might even go into hiding. They can in these ways stretch a process service period, sometimes for many, many months. Even assuming the slippery parties are ultimately pinned down, the sharp borrowers retain in their arsenal the ability to pounce (and how often is that on the eve of sale?) with an order to show cause alleging they were never served. Although most often that posture is utterly false, many borrowers are perfectly willing to swear about not being served so as to require a hearing (a traverse). That then takes time to schedule, time to conduct and time to wait for a decision, although it could be rendered by the court on the day the witnesses are heard.

But even courts inclined to afford borrowers the benefit of the doubt have come to recognize that often these last-minute thrusts are too frequently delay tactics disguised as requests for justice. Accordingly, from time to time courts have imposed conditions upon stays or the right to be heard. In one case [*Apple Bank for Savings v. Georgatos*, 228 A.D.2d 459, 643 N.Y.S.2d, 670 (2d Dep't 1996)] a judge was (understandably) not so impressed by the borrowers' claim of lack of service. He was willing, however, to set the matter down for a hearing, but only upon condition that the borrowers tendered $6,000 to the mortgagee. When the borrowers failed to make the payment (surprise), the hearing was cancelled and the motion to vacate the judgment of foreclosure and sale was denied.

(Counsel for lenders would be heartened by this enlightened approach.)

But upon appeal, the court said where a sworn denial claiming lack of service has been submitted, there is an entitlement to a hearing on the propriety of service without any conditions being imposed. [Citing *Dime Savings Bank v. Steinman*, 206 A.D.2d 404, 613 N.Y.S.2d 945; *Copeland v. Gross*, 39 Misc. 2d 619, 241 N.Y.S.2d 481.]

The trial level judge had the right idea—why tolerate what appears to be transparent without some demonstration of good faith and some compensation to the already battered lender? But good ideas don't always make good law and this is an example of that. No relief here from the borrowers who enjoy distorting legal avenues.

Mr. Bergman, author of the three-volume treatise *Bergman on New York Mortgage Foreclosures* (Matthew Bender & Co., Inc., rev. 2004), is a Partner with Berkman, Henoch, Peterson & Peddy, P.C., Garden City, New York; an Adjunct Associate Professor of Real Estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course; and a special lecturer on law at Hofstra Law School. He is also a member of the USFN and the American College of Real Estate Lawyers.

Guide to Hudson River Sights from the Train

On a train trip to Albany from New York City for a bar association activity, I said to my colleague, Spencer Compton, that I wished I could identify the sights we were seeing from the train as we rode up the beautiful Hudson River Valley. When we arrived at the Albany train station, I searched for a guide, but could only find a map (Hudson Valley Map by JIMAPCO). On line I found www.hudsonriver.com, but did not find a guide.

So I decided to make my own guide, which is on the following pages. First, there is a three-page chart showing the approximate mileage from New York City to Albany, the eight bridges, sights on the west bank and in the river and sights on the east bank. Principal sights are in bold type [those in brackets are not visible from the train]. Bridges and many train stations are underlined. Next, there are short descriptions of the principal sights that are visible from the train, including many of the seven lighthouses. My personal favorites are West Point, Bannerman Arsenal Island (castle ruins very close to the train), Saugerties Lighthouse (a bed and breakfast) and the Hudson-Athens Lighthouse (a beautiful brick structure). Next, there are short descriptions of sights not visible from the train. Finally, there is a code for train whistles that you may hear, supplied by Terry Brooks of NYSBA.

Bring this Guide along on your next train trip along the Hudson River and enjoy the sights! Say hello for me to my favorites.

Karl Holtzschue
Chair, NYSBA Real Property Law Section, 2007–2008

Mile	West Bank/In River	East Bank
		[sites not visible from train]
7.5	<u>George Washington Bridge</u> (Routes I-95 / U.S. 1)	<u>George Washington Bridge</u> (Routes I-95 / U.S. 1)
	****St. Peter's College***	
		****Spuyten Duyvil (Harlem River)***
	****Palisades***	<u>Yonkers Station</u>
	Hudson River widens	<u>Irvington Station</u>
22.5	<u>Tappan Zee Bridge</u> (Routes I-87 / I-287)	<u>Tappan Zee Bridge</u> (Routes I-87 / I-287)
		<u>Tarrytown Station</u>
		****Tarrytown Lighthouse; [Kykuit]*** ****Sunnyside; [Lindhurst]***
		<u>Philipse Manor Station</u>
		****Sing Sing Prison***
		<u>Ossining Station</u>
		<u>Croton-Harmon Station</u>
		[Van Cortland Manor]
	[Stoney Point Lighthouse]	****Indian Point Nuclear Power Plant***
		<u>Peekskill Station</u>

Mile	West Bank/In River	East Bank
42	Bear Mountain Bridge (U.S. Route 6)	Bear Mountain Bridge (U.S. Route 6)
		Manitou Station
	Highland Falls	***Osborne Castle**
		Garrison Station
	****West Point: U.S. Military Academy***	
	****Storm King Mountain***	
		Cold Spring Station
		[Boscobel Mansion]
		Breakneck Ridge Station
	****Pollopel Island / Bannerman Arsenal***	
56	Newburgh-Beacon Bridge (Route I-84)	Newburgh-Beacon Bridge (Route I-84)
		[sites not visible from train]
		[Locust Grove]
68	Mid-Hudson Bridge (Routes U.S. 44 / N.Y. 55)	Mid-Hudson Bridge (Routes U.S. 44 / N. Y. 55)
		Poughkeepsie Station
		[Springhill at Hyde Park and Vanderbilt Mansion]
	****Esopus Island Lighthouse***	
		[Staatsburgh Mills Mansion]
		[Wilderstein Mansion]
	****Roundout Lighthouse (Kingston)***	Rhinecliff Station
87	Kingston-Rhinebeck Bridge (N.Y. Route 199)	Kingston-Rhinebeck Bridge (N.Y. Route 199)
	****Catskill Mountains***	Montgomery Place (from north)
		Bard College (arcade)
		Cruger Island (track crosses over)

Mile	West Bank/In River	East Bank
	Saugerties Lighthouse	
	Catskill Mountains	***[Clermont Mansion]***
	Hunter Mountain (Elv. 4,050 feet)	
106	Rip Van Winkle Bridge (N.Y. Route 23)	Rip Van Winkle Bridge (N.Y. Route 23)
		[Olana Mansion]
	Hudson-Athens Lighthouse	*Hudson Station
126	Castleton Bridge (NYS Thruway Berkshire Connector)	Castleton Bridge (NYS Thruway Berkshire Connector)
137		Albany-Rensselaer Station
		[sites not visible from train]

***Spuyten Duyvil**: Where the Harlem River meets the Hudson, a swing bridge opens for boats, and legend says a trumpeter drowned warning the Dutch of an English attack.

***Tarrytown Lighthouse**: Obsolete due to Tappan Zee Bridge, this "spark plug" survives as a museum, viewable from Kingsland Point Park.

***Sing Sing Prison**: Maximum-security prison built of marble by inmates, opened in 1828, who were "sent up the river." From 1914 to 1971, the electric chair was used. See the film "The Big House."

***Indian Point Nuclear Power Plant**: Two operating Westinghouse pressurized water nuclear reactors built in 1974 and 1976 produce electricity for 2 million homes.

***Osborne Castle**: A/k/a "Castle Rock." Built of stone topped by red roof and conical orange turret in 1881 by William H. Osborn, patron of Frederic Church, owner of Olana.

***West Point: U.S. Military Academy**: Founded in 1802, the motto is "Duty, Honor, Country." "Much of the history we teach was made by people we taught."

***Storm King Mountain**: The battle to create Storm King State park resulted in seminal environmental law decision in U.S. Supreme Court. Many hiking trails, closed in 1999 due to unexploded artillery shells from West Point, were reopened in 2002. Founded in 1960, the Storm King Art Center is one of the best-loved outdoor sculptural parks.

***Bannerman Island Arsenal**: Built on Pollopel Island in 1900 by Frank Bannerman VI as a warehouse for an immense collection of Civil and Spanish American War surplus weapons. Showroom at 501 Broadway. Famous catalog 1880–1966 (KBH has one).

***Esopus Island Lighthouse**: The "Maid of the Meadow," the last of the wooden lighthouses. The black cat is still in the window.

***Roundout Lighthouse (Kingston)**: Still an active aid to navigation; centerpiece of the Hudson River Maritime Museum; "Haunted lighthouse" program.

***Saugerties Lighthouse**: The only lighthouse as a bed and breakfast, beautifully restored.

***Hudson-Athens Lighthouse**: Beautifully restored brick lighthouse is still an active aid to navigation, with working fog bell.

***Hudson Station**: Beautifully restored brick train station.

Hudson River Valley Sites Not Visible from the Train (south to north):

***Sunnyside (Tarrytown)*:** Washington Irving's Dutch Plantation-style home, with a fanciful and eclectic touch. Grounds landscaped in the Romantic style.

Lyndhurst (Tarrytown): Gothic castle home of railroad magnate Jay Gould, built in 1838 and remodeled several times. Now a National Trust Historic Site with estate landscaping.

Kykuit (Sleepy Hollow): One of the Rockefeller family homes, an imposing granite Georgian mansion rising above a series of stone terraces and formal Beaux-arts gardens. Home to Nelson Rockefeller's extensive collection of 20th-century sculpture.

Van Cortlandt Manor (Croton): Early American stone manor flanked by a rebuilt tavern and restored tenant house. Demonstrations of period activities.

Boscobel Mansion (Garrison): Federal Domestic style mansion built in 1804 by statesman Morris Dyckman, a British Loyalist. Reassembled in its current location, with American Federal period antiques and art and well-appointed grounds.

Locust Grove (Poughkeepsie): Home of Samuel F.B. Morse, converted in 1847 from Georgian style to a Tuscan Villa with 150 acres of grounds and spectacular river views.

Springwood (Hyde Park): Birthplace and early 1800s Georgian Colonial style home of Franklin D. Roosevelt. Burial site of Franklin and Eleanor.

Vanderbilt Mansion (Hyde Park): Neoclassical style "Gilded Age" mansion completed in 1899 for Frederick Vanderbilt. Majestic river views.

Mills Mansion (Staatsburgh): 65-room Beaux Arts neoclassical Autumn Residence of the Ogden Mills (and Ruth Livingston) family.

Wilderstein Mansion (Rheinbeck): Remodeled to a Queen Anne house in the 1880s. Circular tower soars five stories above a landscape by Calvert Vaux.

Montgomery Place (Annandale-on-Hudson): Federal mansion built in 1804 by widow of Revolutionary War hero General Richard Montgomery; architect was A.J. Davis.

Clermont Mansion (Germantown): Built in late 1770s, remodeled in 1920s as a Colonial Revival. Occupied by seven generations of the Livingston family, including Robert R. Livingston, Jr., one of the five authors of the Declaration of Independence.

Olana Mansion (Hudson): Hudson River painter Frederic Church's magnificent Persian palace stands as one of his greatest works of art. Landscaping in the Romantic style.

Primary Reference Sources: www.hudsonriver.com; http://en.wikipedia.org

Whistle code

Train whistles are used to communicate to other railroad workers on a train or to railroad workers in the yard. Different combinations of long and short whistles each have their own meaning. They are used to pass instructions, as a safety signal, and to warn of impending movements of a train. Despite the advent of modern radio communication, most of these whistle signals are still used today:

One short: Stop or stopping; apply the brakes

One long: Approaching railroad station or junction (if moving), or apply air brakes and equalize pressure (if standing)

Two short: A general answer signal or acknowledgement; identical to the "roger" or "10-4" radio terms

One short, one long: Inspect the train

One long, one short: Visibility obscured

Two long: Train is about to proceed forward; release the brakes

One long, two short: Additional section follows signaling train

Two long, one short or ***two short, one long***: Train is approaching a meeting or waiting point

Two long, one short, one long: Train is approaching a grade-level crossing (i.e., a road crossing). This is a widely used safety signal used to warn motorists and is blown at every grade level crossing, except where local noise ordinances prohibit it. Known in railroad rulebooks as rule "14L."

Three short: Train is about to proceed in reverse (if standing), or train is about to stop at the next station (if moving)

Three long: Train cars have come unhooked; train has come apart

One long, three short: Flagman, go protect the rear of the train

One short, three long: Flagman, go protect the front of the train

Four short: Request for signals

Four long: Flagman, return to the train from the west or north

Five long: Flagman, return to the train from the east or south

Four short, one long: Fire alarm; fire on the train

Multiple short: Danger, get off the tracks! Used to warn pedestrians or livestock who are on the tracks in front of the approaching train.

Supplied by Terry Brooks of NYSBA

Executive Committee and has been sent to the NYSBA Executive Committee for approval.

3. **Lawyer as Title Agent**. At my request, the speakers at the January CLE have written articles for this issue of our *N.Y. Real Property Law Journal* (Peter Coffey, Professor Steven Wechsler, Jerry Antetomaso and George Haggerty). My article on COSAC is also included. The Title and Transfer Committee is working on a model disclosure and consent form for use where the attorney is acting as a title agent for a title insurer insuring the attorney's client. When approved, it will also be published in the *Journal*.

4. **Third Annual Trip to Albany to Meet with Legislators**. Harry Meyer (Immediate Past Chair), Joel Sachs (2nd Vice-Chair) and I met with legislators on April 29, accompanied by Kevin Kerwin (NYSBA Associate Director, Government Relations). We met with Senators Winner and Little and Assemblyman Bradley, staffs of Senator DeFrancisco and Assemblywoman Weinstein and Amanda Hiller, Assistant Counsel to the Governor. Topics included our bills on adverse possession (S7915; Sen. Little's is S7917) and disclosure of title insurance service charges, problems with the restrictive covenant modification document bill (A10355), registration of title agents, unauthorized practice of law and not granting discretion to county clerks on recording of mortgage documents.

5. **Mortgage Foreclosure**. Our Task Force on Mortgage Foreclosure is analyzing various mortgage foreclosure bills. It is drafting legislative memoranda on A10083 (Foreclosure Prevention Act), A9695 (one year foreclosure moratorium) and A10817/S8143 (Governor's Program Bill #44). It will also be analyzing the impact of the Home Equity Theft Prevention Act and will consider proposing legislation to correct any problems (e.g., with deeds-in-lieu of foreclosure).

6. **Discretion of County Clerks on Recording Mortgages**. The Real Estate Financing Committee has drafted memos in opposition to A9295 and A9491, which would grant discretion to County Clerks to reject mortgage documents.

7. **Offensive Restrictive Covenants**. In response to a request for comment from Assistant Counsel to the Governor Amanda Hiller, we drafted a memo in opposition to the bill (A5182/S5727), vetoed by the Governor, that would have required title companies to record a document removing racial and other offensive covenants. Our memo suggested that existing laws and practices by title insurers in not reporting such restrictions appear to be effectively addressing the concern. It is the opinion of the Section that existing federal and state Laws that prohibit the enforcement of such restrictions effectively address the issue. We are currently drafting a memo to oppose the latest bill (A10355), which would allow an owner to file a modification document but has many substantive and mechanical defects.

8. ***N.Y. Real Property Law Journal* on Lexis and Westlaw**. Articles from our *Journal* are to be published on Lexis and Westlaw, with a time delay (intended to not discourage membership in the Section).

9. **Section Website**. Our RPLS website at www.nysba.org/realprop has several useful features: *N.Y. Real Property Law Journal* issues (www.nysba.org/realpropertyjournal) back to 1998; committee rosters and mission statements; minutes of Executive Committee meetings; schedule of RPLS CLE and committee meetings (Upcoming Events); Real Property Forum discussion group (Section Listserve); RPLS Blog; listing of bills of interest in the Senate and Assembly (Status of Pending Legislation); and 2007–2008 Legislative Memoranda prepared by the RPLS (19 and counting—a new record for the Section). Go to our website to keep up with the latest developments.

10. **Summer Meeting**. The summer meeting of the Section will be held in Hershey, PA from July 24–26, featuring CLE and lots of family fun. Come join in!

Looking back on my year as Chair, I think we have made a good deal of progress toward the goal I stated in my incoming message: Be The Best We Can Be!

Karl B. Holtzschue

exposed the seller to liability for what the seller knew and what the seller could have known. If the case law of the State of New York regarding knowledge applied to the Statute as initially passed, the seller would in effect have become a guarantor of the condition of the premises. We successfully persuaded the Governor to veto the Act. When the Act was passed the next year, sellers' disclosure responsibility was limited to the "actual knowledge" of the seller. We were also able to convince the Governor to veto the recent Adverse Possession Law, which would have had serious adverse consequences to the law in the State of New York. It was clearly an overreaction to the Court of Appeals decision of *Walling v. Przybylo*. Bob Zinman, a long-time member of our Executive Committee, Bob Parella, a fellow Professor with Bob at St. John's Law School whom Bob recruited, and an energetic Task Force composed of members of the Executive Committee proposed our own statute and presented it to relevant legislators.

We presented a program in New York City on the ethical considerations involved with lawyers representing multiple parties in closings. This is an extremely serious pocketbook issue and there are several forces in the state taking positions which would result in the prohibition of lawyers representing multiple parties at closings—in short, you could not perform your client's title services. The New York State Land Title Association-proposed legislation—named the Title Insurance Agent Licensing Bill—and its definition of controlled business would have controlled us right out of the business. We have worked extensively with the Land Title Association—Karl attended their meeting in Nova Scotia—and have managed to modify the legislation so as to limit its application to attorneys.

Former Chair Harry Meyers established an Unlawful Practice of Law Committee which is headed by George Haggerty. There has been tremendous involvement particularly by members in Buffalo regarding this issue. I spoke with George on the afternoon I dictated this Message; the day before he had just spoken to one of the lead attorneys in Washington with the Federal Trade Commission regarding lawyers. The Federal Trade Commission in conjunction with the Justice Department has constantly opposed any attempt by lawyers to define the practice of law which if legislatively enacted would restrict non-lawyers' ability to do what we do. The Federal Trade Commission and the Justice Department have this idea that the really important factor in providing these services to the public is for people to get the cheapest price possible. I am not making this up. They have said this specifically in letters to the American Bar Association and various state legislatures. Many organizations, including realtors and non-lawyer title agents, press the lawmakers to pass legislation which would have a serious adverse impact on our ability to continue representing clients as we historically have. It is for these reasons I believe you should become actively involved in our Section.

Another reason for substantial involvement is our committees. Take a look at the back of the issue and look at the list—are there not at least two committees seriously relevant to your practice? Of course there are. These committees are chaired and peopled by, as I have said, some of the best real estate practitioners anywhere. They are wonderful people—friendly and so interested in helping all of us. They would not be there if they were not; and they are ready to work—with your help. They constitute a resource that cannot be tapped through any other organization or medium. The address for each Chair or Co-Chair is there—simply drop him or her a note and ask to join the committee and you will be on it.

If all goes well, next month I hope to announce a program this year that will make the talent and expertise of the members of these committees available to every one of you. When the program is announced, please take advantage of it.

Shortly before Thomas More had his head cut off, he stated, "I am commanded to be brief"—a thought echoed by the Justices of the Appellate Bench of the Third Department.

Thank you for reading this far—we are going to have a very exciting year.

Peter V. Coffey

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N.Y. Real Property Law Journal

Submission Guidelines

The *Journal* welcomes the submission of articles of timely interest to members of the Section in addition to comments and suggestions for future issues. Articles should be submitted to any one of the Co-Editors whose names and addresses appear on this page.

For ease of publication, articles should be submitted via e-mail to any one of the Co-Editors, or if e-mail is not available, on a disk or CD, preferably in Microsoft Word or WordPerfect (pdfs are NOT acceptable). Accepted articles fall generally in the range of 7-18 typewritten, double-spaced pages. Please use endnotes in lieu of footnotes. The Co-Editors request that all submissions for consideration to be published in this *Journal* use gender-neutral terms where appropriate or, alternatively, the masculine and feminine forms may both be used. Please contact the Co-Editors regarding further requirements for the submission of articles.

Unless stated to the contrary, all published articles represent the viewpoint of the author and should not be regarded as representing the views of the Co-Editors, Board of Editors or the Section or substantive approval of the contents therein.

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