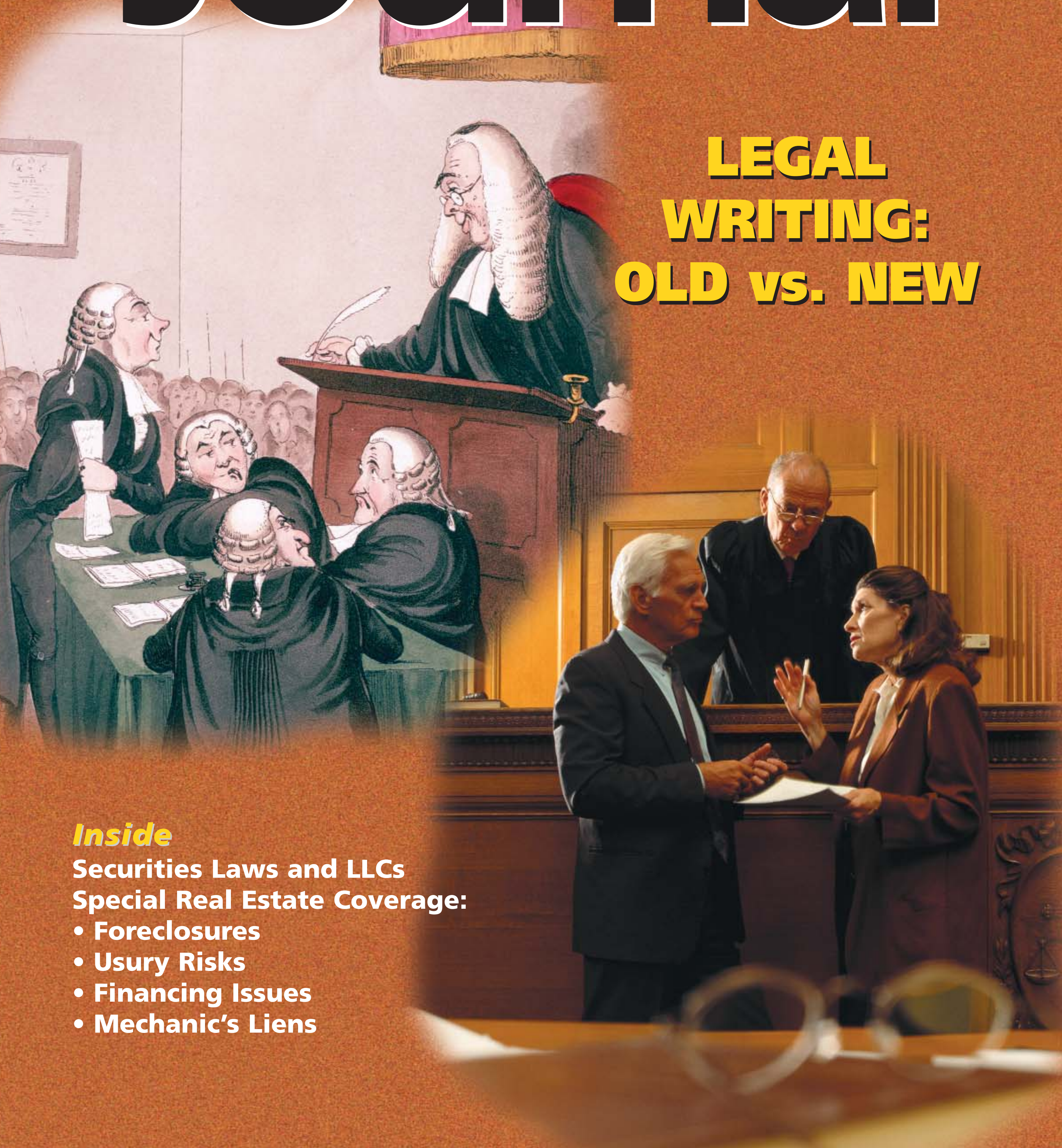
NEW YORK STATE BAR ASSOCIATION

JULY/AUGUST 2001 | VOL. 73 | NO. 6

Journal



LEGAL WRITING: OLD vs. NEW

Inside

Securities Laws and LLCs

Special Real Estate Coverage:

- **Foreclosures**
- **Usury Risks**
- **Financing Issues**
- **Mechanic's Liens**

Editorial Offices
One Elk Street
Albany, NY 12207
(518) 463-3200
FAX (518) 463-8844

ON THE WORLD WIDE WEB:
http://www.nysba.org

Contents

The *Journal* wishes to thank Prof. Robert Zinman of St. John's University, William Colavito of Bedford Hills and Harry Meyers of Buffalo for their assistance in developing the articles on real estate matters in this issue.

Departments

On The Cover

This month's cover illustration of an Elizabethan courtroom is from Historical Picture Archive/Corbis. The cover was inspired by a statement in the new *Legal Writer* column: "Some rules will help lawyers get out of Elizabethan courts and into American courts of the twenty-first century."

Cover design by Lori Herzing.

 The *Journal* (ISSN 1529-3769), official publication of the New York State Bar Association, One Elk Street, Albany, NY 12207, is issued nine times each year, as follows: January, February, March/April, May, June, July/August, September, October, November/December. Single copies $12. Periodical postage paid at Albany, NY with additional entry Endicott, NY. POSTMASTER: Send address changes to: One Elk Street, Albany, NY 12207.

President's Message

Steven C. Krane

Meet the Gundersons

"Well, if that doesn't beat all." Effie Gunderson dropped her magazine to her lap.

If there was another person in the room, he wasn't letting on.

"BOB? You listening?"

"I hear you, Effie. What did those bar fellows do now?" Bob Gunderson scarcely looked away from the television set. But then, if he had, he would have had a hard time finding Effie, who had created a fortress of stacked magazines on the tables surrounding her ancient rocking chair.

"Did you know that over there in New York State the attorney disciplinary system is closed to the public?"

Bob was in no hurry to respond. Bob was happy to kick back and watch his "stories" after 41 years of raising durum wheat. Now that the government was paying him not to grow his crops, he made an easy transition into the world of daytime television.

Effie became impatient. "BOB!"

"Whaddya want?" Bob finally shifted his gaze from the television's gray glow (low signal strength in northwestern North Dakota) to the piles of publications surrounding his wife.

Effie leaned forward and peered over the rim of magazines piled on the table that separated her from Bob. "I said, did you know that over there in New York State the attorney disciplinary system is closed to the public?"

Bob hesitated for a moment, as if genuinely trying to remember whether he did in fact know anything at all about attorney discipline in New York or any other state.

"No, Effie, I did not know that." This time he wasn't going to bite. If he engaged her in conversation he'd miss several key plot elements and would have to buy the digest over at the convenience store to catch up. He was going to say no and leave it at that.

Effie was prepared for this stratagem and allowed the silence to grow. She remained almost motionless behind her barricade, knowing full well that Bob would not survive the lull in conversation and that he eventually would be compelled to join. Bob remained resolute, trying to reinsert himself into the plot of the soap-of-the-moment. Why couldn't Effie have a normal hobby, like the other ladies her age in Winston? Other ladies hooked rugs, took up needlepoint, played cards, became ham radio operators, collected decorative spoons (one even using the Internet to do it). But not Effie. She had to be different. After the kids left home and the farm shut down, Effie Gunderson had taken out subscriptions to every lawyer magazine in the country, and read those bar journals cover to cover every month. And today she was fixated on the President's Message from the June 2001 New York State Bar *Journal*.

Effie was not a lawyer, nor were any of her kin. She had limited contact with lawyers in her lifetime. Effie had a lawyer draw up her will, and had seen the same lawyer (Mr. Andersen, rest his soul) when she and Bob decided to put the Lundegaard family farm into both their names, but otherwise hadn't ever had the need. So whatever she knew about lawyers and lawyering came from those journals she devoured on an hourly basis.

"They make such a big secret about it," Effie muttered as if to herself but in a perfectly audible tone.

Bob relented after another prolonged silence, figuring he would have to engage in this conversation sooner or later. Effie could be very patient while lying in wait. "Well, they must make *some*thing public *some*time, don't they?"

"Well, sure, once it's all over with, and it's been through the grievance committee and through the courts, they announce the result. You can't disbar or suspend a lawyer in secret, Bob. And you surely can't have a private public censure!" Effie broke into peals of laughter the likes of which Bob hadn't heard from her in years.

Bob saw the humor, but wasn't quite ready to "bust a gut" with his wife. Yet, having joined in the talk, he jumped in with both feet. As was his pattern, he usually started by baiting her. "Well, why should they?"

"Should they what, dear?"

"Make anything public."

"Don't you know *any*thing?" Effie leaped from her seat, now towering over the parapets of her bar journal fortress, and strode to the bookshelf that held the family Bible and other important volumes. "Remember the McKay Report?"

Steven C. Krane can be reached at 1585 Broadway, New York, N.Y. 10036

PRESIDENT'S MESSAGE

"Not more MDP! Please!"

"Not *MacCrate,* but *McKay*!" Effie began to recite. "Dean Robert McKay, chairman of the ABA Commission on Evaluation of Disciplinary Enforcement, report adopted by the ABA House of Delegates in 1992."

Bob didn't remember. He must have still been riding the tractor back when this report came out.

"Here. Page 33. Here's what the McKay Report says: 'The Commission is convinced that secrecy in discipline proceedings continues to be the greatest single source of public distrust of lawyer disciplinary systems. Because it engenders such distrust, secrecy does great harm to the reputation of the profession.' You listening?"

"Yes, Effie."

She cleared her throat. Effie was not done. "'The public's expectation of government and especially of judicial proceedings is that they will be open to the public, on the public record, and that the public and media will be able to freely comment on the proceedings.'"

"Well, Effie, what do you know about what other states do?"

"About two-thirds of the states open their attorney disciplinary proceedings somewhere along the line, usually after there has been an initial complaint, some sort of investigation, and a determination that probable cause exists to believe that the lawyer has committed a violation of the rules of ethics. Some states open the process completely, so every complaint is available to the public, but that is not what is being proposed in New York."

"So what's the big issue, if most other states do it this way? Have there been problems in other states caused by opening the process?"

"That's just it!" Effie had obviously done her homework on this topic. "I've contacted people all over the country and asked them about their experiences with open disciplinary proceedings—"

"How've you managed that?" Bob interrupted.

"On the Internet, of course. And there's no evidence, anecdotal or otherwise, that opening the process has had a negative effect on lawyers or on their reputation, and the feedback from the public and the press has been very positive."

"So why the resistance?"

"The opponents are concerned that if charges are filed against a lawyer who is later cleared, the lawyer's reputation will have been damaged for no good reason."

On first hearing, this sounded reasonable to Bob. He switched back into baiting mode. "So if they have that protection, why should they agree to give it up?"

"Well, here's what the McKay Report said about that: 'The public does not accept the profession's claims that lawyers' reputations are so fragile that they must be shielded from false complaints by special secret proceedings. The irony that lawyers are protected by secret proceedings while earning their livelihoods in an open system of justice is not lost on the public. On the contrary it is a source of great antipathy toward the profession.'"

"And on what did they base that conclusion?"

"They held nationwide public hearings, then circulated a draft report for comment to all sorts of groups, including bar associations around the country, client protection funds, consumer groups, and so on. It was a big deal, Bob. And remember the Craco Report in New York?"

Bob did remember. The Craco Report had come out just as Effie had begun her new hobby, and that was all Bob heard about at dinner for a week. He could see its frayed blue cover peeking out from the bottom of one of Effie's stacks. "Was that part of it?"

"Yes, and they held public hearings, too, and did all sorts of research on the subject. The public doesn't trust the system because it's all so secret. They think problems are being swept under the rug, in private."

"Well, do they have anything to hide?"

"No, that's just it. The system works well. They catch the bad ones and discipline them in a fair system in which judges, lawyers and laymen all take part. It's really quite good. Could use some uniformity within the system, but overall it works."

"All right, then, Effie, how do you go about balancing the public interest in having access to attorney disciplinary proceedings against the need to avoid unnecessary harm to lawyers' reputations?"

"Well, what if you couldn't file formal disciplinary charges until a Justice of the Appellate Division made a determination, based on presentations by the prosecutor and by the respondent, that probable cause existed to support a finding of a disciplinary violation? And what if at the same time the Justice was required to determine whether there were any special circumstances that warranted keeping this particular proceeding closed to the public? And what if you raised the standard of proof in attorney disciplinary proceedings from a preponderance of the evidence, where it is now, to clear and convincing evidence, which is what the standard is almost everywhere else in the country?"

Bob nodded. Effie was on to something. "Sounds like a lot of protection for the lawyer." Bob looked thoughtful.

CONTINUED ON PAGE 42

Dress for Success: Be Formal But Not Inflated

Editor's Note: Gerald Lebovits is the author of Advanced Judicial Opinion Writing, *a handbook for New York State's trial and appellate law clerks and court attorneys. The* Journal *has asked him to adapt, in the coming months, portions of his 328-page work to the needs of practicing attorneys, applying his principles to briefs, position papers and client memorandums.*

His first column addresses an issue of tone applicable to all legal writing. Future columns will explore the philosophy of style, usage, persuasive legal writing, legal-writing myths, citation and other issues.

By Gerald Lebovits

Lawyers must dress for court. No ripped jeans, but no top hat, tails, and spats, either. A well-dressed lawyer is formal but not inflated. Clothes do not make the lawyer. But they get the lawyer into court.

Just as lawyers must dress appropriately, lawyers must write appropriately. Lawyers who write must do more than shape law, apply fact, and organize coherently. They must do more than master grammar and usage. They must also adopt an effective style and tone. Whatever the legal writer's goal—to persuade, to inform—the right tone is formality without inflation.

Some rules will help lawyers get out of Elizabethan courts and into American courts of the twenty-first century.

No contractions or ampersands. They aren't formal & shouldn't be used. But use ampersands in names of businesses and professional associations that use ampersands. The law firm: "Dewey, Cheatem & Howe."

No slang. You betcha bottom dollar! In legal writing, "[s]lang often deformalizes, thereby deemphasizing the seriousness of a situation."[1] Fad words are groovy—not! And trendy writing is flaky.

No recent back-formations. They enthuse no one. It is hard to orientate people to new back-formations. A back-formation is formed by subtracting an affix from a longer word. Older back-formations such as *diagnose* from *diagnosis* are acceptable. Readers find new back-formations grating. A friendlier relative of the back-formation is the functional shift. Through shifts in parts of speech, a verb may become a noun (*to run* may shift to *a run*) and a noun may become a verb (a *blacklist* may become *to blacklist*).

The "ize" sometimes have it. No one objects to old *-ize* suffixes that turn nouns or adjectives into verbs: *criticize*, *rationalize*. All disfavor recent *-ize* formations: *concretize*, *prioritize*.

No implied intransitives. In an implied intransitive, the object is indeterminate. What do waiters mean when they serve food and tell you to "enjoy"? To enjoy the food? To enjoy yourself while you digest? Implied intransitives are acceptable in conversation but not in formal writing.

No de-transitivizing. A verb may be transitive ("I need you") or intransitive ("I need"). A de-transitivized verb is neither. Safire's examples of what not to write: "[P]lease wait while your credit card is *authorizing*" and "[T]his book usually *ships* in three days."[2] The problem with de-transitivized verbs is lack of clarity, not merely informality. What subjects of Safire's sentences are authorizing and shipping? What objects are the verbs' action being done to?

Do not "verb" nonverbs. Parts of speech evolve into verbs called "changelings," which in time function as nouns and verbs: *calendar*, *chair*. But do not overnight nonverbs overnight.

No colloquialisms. Go 'round the barn to avoid 'em.

No abbrev. in your text unless nec. OK? Eliminate the following: *i.e.* (*id est—in other words*, *that is*); *e.g.* (*exempli gratia—for example*); *re*: (*about*, *concerning*, *in the matter of*, *regarding*—except as a reference in a letter); *etc.* (*et cetera—and so forth*, *and so on*, and the like); *N.B.* (*nota*

Gerald Lebovits, a principal court attorney in Supreme Court, Criminal Term, New York County, is also an adjunct professor of law and the Moot Court Faculty Advisor at New York Law School. His e-mail address is gerald.lebovits@law.com.

bene—note well); *q.v.* (*quod vide—which see*; *see also* has replaced *q.v.*); *viz.* (*videlicet—namely*).

N.B.: Use commonly abbreviated titles such as Mr., Ms., and Dr. Do not abbreviate less common titles. Prefer *Officer A* to *P.O. A*, *Professor X* to *Prof. Y*. *Q.V.*: Acronyms you have already defined are permitted: FBI.

No parenthetical remarks. (They are informal and (usually) easily avoided.)

No strong interjections. "Good grief!" Interjections express emotion too strong for legal writing.

No shortened words. Whether you write on a p.c. in your auto or dictate over your phone on a plane, go the max: Write words in full. "ET, phone home" becomes "ET, telephone home."

Quibble over quotation marks. Avoid quotation marks except to quote, define a term of art, or reference a word or phrase. Not following this rule marks you a "paranoid" or an "egocentric."

Forget figures. Prefer words to figures when giving lists, for 1 reason: Words are more formal than figures.

No pontificating or high-falutin language. Write like a person, not a personage. Those who use inflated language are, well, full of hot air.

Big words are bad. Never use a gargantuan, humongous, or capacious (*big*) word when an infinitesimal, lilliputian, or diminutive (*small*) one will suffice, be adequate, and satisfy your requirements (*do*). Big words impress no one. Perhaps your sixth-grade teacher taught you to use $10 words. Perhaps you learned big words for the SAT. Perhaps big words brought you high grades in college. Perhaps you paid big money for a big thesaurus to learn big words. If so, your writing can use a big adjustment.

Here is an authoritative guide from Professor Rozakis's fun book: "[A]cademic writing is all-too-often verbose and didactic for the sake of mere pedantry. After you graduate and enter the business world, your task shifts from writing to impress to writing to communicate . . . . Much of the time . . . big words just set up barriers between you and your audience."[3]

Besides, big words can mean big mistakes. Incorrectly using a big word turns pretense into buffoonery—a perception a legal writer can ill afford to create. Recall the times you have heard people confuse *subsequently* with *consequently*. These people should have preferred *later* to *subsequently*.

Strive for balance in formality. Be neither impenetrable nor casual. (That would be a tummy-wrenching experience.) Be neither inhibited nor egocentrically breezy. (Which reminds me of an interesting story . . .). Be neither gratuitously judgmental nor opinionated. (Nobody asked me, but . . .). The goal in legal writing is not to be conversational, as one would be in an informal, relaxed setting. The goal, however, is to use words you would use in polite conversation.

Good legal writing is planned, formal, noninflated speech. If you want to write the Queen's English, make sure the Queen is not Elizabeth I. Clothes do not make the lawyer. But writing well does.

1. George D. Gopen, Writing from a Legal Perspective 56 (1981).
2. William Safire, *On Language*, N.Y. Times Magazine, Oct. 22, 2000, at 38 (emphasis in original).
3. Laurie E. Rozakis, The Complete Idiot's Guide to Grammar and Style 233 (1997).

Courts Apply Investment-Contract Test to Determine When LLC Membership Interests Are Securities

BY PETER A. MAHLER

Can a membership interest in a limited liability company (LLC) be considered a security for purposes of federal and state securities laws? Yes and no, depending, sums up the collective wisdom of the handful of reported cases to answer the question so far.

LLCs are authorized in all 50 states and the District of Columbia. New York was one of the last states to join the LLC bandwagon in 1994; Wyoming was the first in 1977. The attraction of the LLC business form comes from its hybrid nature, combining the pass-through tax treatment of partnerships, the limited liability of corporations and some of the organizational attributes of limited partnerships. LLCs can be member-managed or managed by one or more managers who need not be members. LLC statutes, including New York's, generally give organizers broad freedom contractually to tailor ownership, management and economic rights and duties to the needs and aspirations of the individual enterprise, and to alter or negate the statutory default provisions, by adopting comprehensive operating agreements.

The great flexibility and variability of the LLC's organizational structure suggest *caveat emptor* as the suitable credo for any prospective, non-controlling LLC member. And perhaps that is as it should be, in the greater interest of fostering capital formation and entrepreneurial activity.

The securities laws, however, embody a more paternalistic approach to achieving the same ends, with an emphasis on protecting investors by compelling full and fair disclosure relative to the issuance and transfer of the many types of financial instruments covered by the statutes. When securities regulators or a disappointed LLC member seek relief under the securities laws, the courts must reconcile, on the one hand, the opacity that freedom-of-contract engenders under the LLC laws and, on the other hand, the transparency sought by the securities laws.

Investment Contract

The term "security" is defined in § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(a)(1), and § 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10). The U.S. Supreme Court has observed that the definitions "are virtually identical and will be treated as such in our decisions dealing with the scope of the term."[1] The definition of "securities" in New York's Blue Sky Law generally tracks the federal definition.[2]

The statutory definition specifies a number of financial instruments, such as stocks, bonds and debentures, that traditionally are recognized as securities but clearly do not encompass LLC membership interests. Attempts to apply the securities laws to such interests have focused on the statute's reference to "investment contract" which, as construed by the Supreme Court in *SEC v. W.J. Howey Co.*[3] requires (1) an investment of money or other consideration (2) in a common enterprise (3) with an expectation of profit (4) to be derived "solely" from the efforts of others.

Howey's analysis "embodies a flexible rather than a static principle, one that is capable of being adapted to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits."[4] The *Howey* decision also stressed that, in defining an investment contract, form should be disregarded for substance and emphasis should be placed upon economic reality.[5]

Howey's first three elements usually will not pose an obstacle to classification of an LLC membership interest as a security. The key factor is whether the profit expectation is derived "solely" from the efforts of others. Al-

CONTINUED ON PAGE 11

PETER A. MAHLER is a partner at Derfner & Mahler, LLP, in New York City (e-mail mahlerlaw@aol.com). He practices in the area of business litigation, including shareholder, partnership and LLC membership disputes. A graduate of U.C. Santa Barbara, he received his J.D. from New York University School of Law.

CONTINUED FROM PAGE 10

though the Supreme Court post-*Howey* has not confronted the issue directly, the Second Circuit and other federal courts (in cases not involving LLC membership interests) have concluded that *Howey*'s use of the word "solely" is not to be taken literally, and that the test is met when the investor's prospective returns hinge primarily on the essential managerial efforts of others.[6]

> ***The first reported cases to grapple with the application of the securities laws to LLC membership interests were enforcement actions.***

In *Williamson v. Tucker*,[7] which involved joint venture interests in real estate, the Fifth Circuit further refined this aspect of the *Howey* test, holding that a general partnership or joint venture interest can be designated a security on one of three alternative grounds:

> (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Regulatory Enforcement Actions

The first reported cases to grapple with application of the securities laws to LLC membership interests were enforcement actions brought by state and federal securities regulators. In two cases, the courts held that the LLC membership interests were securities and granted relief against promoters. In a third case, the court found questions of fact and denied the promoter's motion for summary judgment.

The first case, *SEC v. Parkersburg Wireless LLC*,[8] decided in 1997, involved the sale of LLC memberships in a Nevada company to more than 700 individuals in 43 states, many of whom were unemployed or retired or elderly, and each of whom made a required minimum investment of $10,000. The SEC alleged that the defendants sold unregistered securities in violation of the 1933 Act and failed to register as broker-dealers in violation of the 1934 Act.

The court found that the first three elements of the *Howey* test for an investment contract were readily satisfied. As to the fourth element, the defendants contended that the members' hoped-for profits in the company's wireless cable operations were not to be derived from the efforts of others because the members exercised "the ultimate power" over the company by virtue of Nevada's LLC law and under the terms of the operating agreement. The court disagreed, finding that one of the defendants exercised near-total control over the LLC's management; that management had submitted only one issue to the membership involving the purchase of a wireless cable operation; and that "[w]hile the investors theoretically may have possessed a right to manage the affairs of [the LLC] under the terms of the Operating Agreement, the inexperience and geographic diversity of the 700-odd investors essentially precluded this from ever coming to pass."[9]

A second SEC enforcement action the following year, *SEC v. Shreveport Wireless Cable Television Partnership*,[10] also involved the sale of LLC membership interests, as well as general partnership interests, in several wireless cable operations, allegedly in violation of the 1933 and 1934 Acts. The defendant promoters raised almost $18 million through the sale of full and partial membership units in a Louisiana LLC to almost 1,500 investors located in all 50 states and abroad. The defendants moved for summary judgment, arguing that the partnership and LLC membership interests did not meet the *Howey* test of an investment contract because, based on the partnership and operating agreements, the investors "agreed to participate significantly in the management and operation of the cable entities in which they invested" and therefore did not purchase units with the expectation that the efforts of others would generate the profits.[11]

In denying summary judgment, the court examined the language of the agreements as well as the degree of operational control exercised by the promoters. The agreements contained various provisions for majority or super-majority voting by the membership concerning management decisions, allocations, composition of the management committee and major decisions regarding the sale, ownership or indebtedness of the company. The court found that these provisions did "not appear to confer managerial responsibilities on the . . . members beyond those of a limited partner or a voting shareholder in some corporations." The court also found that the sale of such large numbers of membership interests could result in the investors having "such limited input that their ownership interests constitute securities deserving of the protection of federal securities laws." Finally, citing an investor's affidavit stating that the mem-

CONTINUED ON PAGE 12

CONTINUED FROM PAGE 11

bers were precluded from participating in "essential managerial decisions" made before the management committees took control, the court found a triable issue whether the "investor's profits after the time of sale are primarily dependent upon the promoter's efforts."[12]

Two weeks after *Shreveport* was decided came *Nutek Information Systems, Inc. v. Arizona Corporation Commission*.[13] *Nutek* was an appeal from an administrative determination by Arizona securities regulators that the promoters of LLCs formed under Texas law to operate a network of dispatch communications systems violated Arizona's Blue Sky Law. The promoters collected more than $10 million from 920 investors from Arizona and elsewhere. The articles of organization of each LLC specified that the company was member-managed, thereby giving the members "legal control." Applying the *Howey* test and the *Williamson* factors, the court nonetheless found that several circumstances negated the members' ability to exercise "effective control" over the LLCs and that the membership interests therefore were investment contracts covered by Arizona's Blue Sky Law. The circumstances included long-term construction and management agreements that turned over all principal management functions to a separate company wholly owned by the promoters, which agreements were in place before most members invested in the LLCs; the dilution of member power resulting from the large number of geographically dispersed investors; the investors lacked the technical expertise to manage the LLCs and relied on the skills of the promoters and their management company; and the financial success of the individual LLCs depended largely on the management company's ability to establish networked operations.

In three cases the courts ruled that the LLC membership interests were not securities and dismissed the complaints.

Subsequent Private Actions

In the wake of *Parkersburg*, *Shreveport* and *Nutek* came four reported decisions in private litigations asserting federal securities law violations arising from LLC membership interests. The scorecard in the private actions looks quite different—in three cases the courts ruled that the LLC membership interests were not securities and dismissed the complaints; in the fourth the court ruled that the complaint adequately alleged a security but dismissed the complaint on other grounds.

In *Keith v. Black Diamond Advisors, Inc.*,[14] decided in 1999, the plaintiff and a second owner of a mortgage-lending business entered into an agreement with the defendant venture capital firm to form a member-managed New York LLC. The plaintiff and the other owner each received a 25% interest in the LLC in exchange for transferring to it their interests in the mortgage lender. The defendant contributed cash and financing expertise in exchange for a 50% interest in the LLC. Plaintiff's complaint alleged that the defendant subsequently diluted his interest and squeezed him out of the business through various means, and asserted claims under §§ 10(b) and 29(b) of the 1934 Act. The defendant sought dismissal on the ground that the alleged fraud was not in connection with the purchase or sale of a security.

District Judge Shira Sheindlin agreed with the defendant and dismissed the claims, finding that the plaintiff's LLC membership interest was not an investment contract under the *Howey* test because the plaintiff "intended to maintain some degree of control" in the LLC at the time he made his investment. The court primarily looked to the provisions of the LLC agreement as supplemented by the New York LLC Law, which on the face of it gave the plaintiff broad management and voting rights that the court found "antithetical to the notion of passivity" required under *Howey*. In rejecting the plaintiff's contention that the economic realities of the defendant's squeeze-out measures should trump the plaintiff's formal rights, Judge Sheindlin noted that "although the degree of control [plaintiff] actually exercised was less than he expected to exercise, that fact does not convert his interests into securities."[15]

The defendant in *Great Lakes Chemical Corp. v. Monsanto Co.*,[16] decided last year, also won a pre-answer motion to dismiss a complaint alleging securities law violations arising from the purchase and sale of a 100% membership interest in a manager-managed Delaware LLC. The LLC was formed and owned by Monsanto Co. and one of its wholly owned subsidiaries to market certain pharmaceutical compounds. The LLC's operating agreement specified that the members had no authority to directly manage the LLC's business and affairs, over which a board of managers had sole authority. The defendants, accused of making financial misrepresentations to induce the plaintiff's acquisition, argued that the LLC membership interest was not an investment contract under *Howey* because the plaintiff did not invest in a "common enterprise" and because its profits in the enterprise were not "solely from the efforts of others."

The court agreed with the defendants on both counts. First, the plaintiff acquired the entire LLC membership interest without pooling its contributions with those of other investors, as is required for horizontal commonality. After the sale, the sellers (*i.e.*, the LLC's original promoters) retained no interest in the LLC, hence the plaintiff's fortunes were not linked to those of the promoters, as is required for vertical commonality. Second, even though the operating agreement gave all management authority to a board of managers, it also gave the members the power to remove any manager with or without cause, and to dissolve the company. Such authority, according to the court, gave the plaintiff "the power to directly affect the profits it received" from the LLC. The court also cited as evidence of such power the complaint's allegations that, prior to the sale, the sellers controlled the managers' actions by prohibiting them from speaking directly with the plaintiff regarding certain sales and customer data.[17]

In *KFC Ventures, LLC v. Metaire Equipment Leasing Corp.*,[18] also decided last year, the corporate plaintiff paid $250,000 to acquire a 15% membership interest in a manager-managed LLC providing medical imaging services. A year later, the plaintiff sued the 85% owner on various claims including securities fraud for failing to make certain capital contributions and other acts of mismanagement. The LLC's operating agreement named the 85% owner as the initial manager with the full and exclusive power to acquire property, sell assets in the ordinary course of business, enter into contracts and "to manage, control, administer, and operate the business and affairs of the Company." The operating agreement expressly limited member authority to voting on extraordinary matters such as dissolution and admission of additional members.[19]

The defendant's argument for dismissal under *Howey*, that the plaintiff had adequate opportunity to engage in the LLC's business affairs, carried no weight with the court. The court relied entirely on the express provisions of the operating agreement in holding that the plaintiff did not have the capacity to exert essential managerial efforts, making it "possible" that the plaintiff's interest in the LLC "may be a security."[20] The court nonetheless dismissed the complaint with leave to replead for failure to allege fraud with particularity.

In a case decided earlier this year by the South Dakota Supreme Court, *Tschetter v. Berven*,[21] the four individual plaintiffs invested approximately $100,000, combined to purchase minority membership interests in a South Dakota LLC formed to construct and own a franchise restaurant, the operations of which were to be managed by the franchisor. The business quickly failed and the plaintiffs, along with the promoter, were sued by the LLC's lender on their personal guarantees. The plaintiffs then sued the promoter for fraud under South Dakota's Blue Sky Law, which defines "security" consistent with federal law.

The LLC's operating agreement vested authority for day-to-day decisions in two managers who were required to be members and who were selected by the other members. The agreement also permitted the members to call membership meetings, authorize company loans and incidental expenses up to $12,500, engage counsel, select officers, remove the LLC's accountant with or without cause, and gave all members access to LLC records. The minutes kept by the LLC also showed that the plaintiffs were "informed and active" in the LLC.[22]

On these facts, the court had little trouble concluding that the plaintiffs' LLC membership interests did not constitute investment contracts under the *Howey* test. The LLC's operating agreement established that "substantial power and responsibility was vested in its members" and that the plaintiffs in fact exercised the powers. In so ruling, the court specifically rejected the plaintiffs' main argument, that the LLC's management agreement with the franchisor established their dependence on the efforts of others. This argument failed, wrote the court, because the relevant inquiry "is the [plaintiffs'] role in the [LLC]" and because the LLC retained the ability to terminate the management contract for non-performance. The court also observed that only in "unusual circumstances" would an investor in a member-managed LLC be able to establish reliance on the entrepreneurial efforts of others, especially where, unlike a case such as *Nutek* involving advanced technology enterprises, the investment is in an uncomplicated business such as the restaurant in *Tschetter*.[23]

The result has been a fact-intensive, case-by-case approach that yields few if any bright-line rules. Nonetheless, it is safe to say that the decisions thus far suggest several emerging principles.

Nutek, Redux

In April of this year, Maryland securities regulators won a $178,000 fine for violation of that state's securities laws against the organizers and promoters found liable for violating Arizona securities laws in *Nutek*, discussed above.

In *Ak's Daks Communications, Inc. v. Maryland Securities Division*,[24] the Maryland Court of Special Appeals applied the *Howey* test to the investors' LLC interests in mobile communications networks, essentially tracking the analysis in *Nutek*. What makes *Ak's Daks* interesting is its criticism of *Tschetter* and *Shreveport* for starting "from the premise that an interest in a limited liability company is not a security and apply[ing] the factors set out in *Williamson* to determine whether that presumption is overcome." According to the Maryland court, the better approach is the one taken in *Great Lakes* and *Nutek*, where the courts recognized that, because LLC interests lack the unlimited liability associated with general partnerships, the "*Williamson* presumption" against investment contracts should not apply.[25]

Conclusion

The few courts that have examined whether LLC membership interests are securities have sought guidance primarily from case precedents applying *Howey* to interests in general and limited partnerships. As the court in *Great Lakes* pointed out, the different presumptions developed for those kinds of interests, predicated on the presence or absence of limited liability as an incentive or disincentive to be involved in enterprise management, do not apply to LLCs, members of which can be active managers yet still retain limited liability.[26]

The result has been a fact-intensive, case-by-case approach that yields few if any bright-line rules. Nonetheless it is safe to say that the decisions thus far suggest several emerging principles that provide at least some guidance for practitioners and their clients, as follows:

- LLC membership interests are likely to be classified as securities, even in an LLC that is nominally member managed, when they are mass marketed and sold to numerous, geographically dispersed investors who lack the business acumen and expertise to participate in management in any meaningful way, regardless of their actual expectations.
- In a member-managed LLC with more concentrated membership, where the operating agreement endows all members with management authority, under a reasonable expectations standard the courts are highly unlikely to treat such interests as securities even if a member effectively is excluded from management.
- In a manager-managed LLC, a member's power to remove the managers may be enough to preclude application of the securities laws.
- Acquisition of a 100% membership interest likely will be treated as a non-stock sale of the business outside the protections of the securities laws.
- A member who invests in a manager-managed LLC whose operating agreement expressly limits the members' authority to voting on extraordinary matters, such

CONTINUED ON PAGE 15

CONTINUED FROM PAGE 14

as dissolution and admission of new members, likely may seek relief under the securities laws.

The courts undoubtedly will have much more to say on the subject as new refinements and permutations of the LLC form of business enter the picture.

---

1. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 n.1 (1985).
2. *All Season Resorts, Inc. v. Abrams*, 68 N.Y.2d 81, 87, 506 N.Y.S.2d 10, 16 (1986).
3. 328 U.S. 293 (1946).
4. *Id*. at 299; *see SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943) (investment contract defined broadly to reach "[n]ovel, uncommon, or irregular devices, whatever they appear to be").
5. 328 U.S. at 298.
6. *See SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 582 (2d Cir.), *cert. denied sub nom., Hecht v. SEC*, 459 U.S. 1086 (1982); *Williamson v. Tucker*, 645 F.2d 404, 418 (6th Cir.) (*en banc*), *cert. denied*, 454 U.S. 897 (1981); *Aiena v. Olsen*, 69 F. Supp. 2d 521, 534 (S.D.N.Y. 1999).
7. 645 F.2d 404, 424 (5th Cir.) (*en banc*), *cert. denied*, 454 U.S. 897 (1981).
8. 991 F. Supp. 6 (D.D.C. 1997).
9. *Id.* at 9 n.3.
10. 1998 WL 892948 (D.D.C. Oct. 20, 1998).
11. *Id.* at *5.
12. *Id.* at *6-7.
13. 194 Ariz. 104, 977 P.2d 826 (Ct. App. 1998), *cert. denied sub nom., AKS Daks Communications, Inc. v. Arizona Corp. Comm'n*, 528 U.S. 932 (1999).
14. 48 F. Supp. 2d 326 (S.D.N.Y. 1999). *Keith* is one of the earliest cases to decide that the citizenship of an LLC for purposes of diversity jurisdiction is based on the citizenship of the LLC's individual members. *See* P. Mahler & D. Gillett, *Limited Liability Companies as Litigants*, N.Y.L.J., Oct. 22, 1999, p. 1, col. 1.
15. *Keith*, 48 F. Supp. 2d at 332-34.
16. 96 F. Supp. 2d 376 (D. Del. 2000).
17. *Id.* at 390-92.
18. 2000 WL 726877 (E.D. La. June 5, 2000).
19. *Id.* at *2.
20. *Id.* at *3.
21. 2001 S.D. 11, 621 N.W.2d 372 (2001).
22. *Id*. at 377.
23. *Id*. at 377-78.
24. 138 Md. App. 314, 771 A.2d 487 (2001).
25. *Id*. at 332.
26. *Great Lakes Chem. Corp. v. Monsanto Co.*, 96 F. Supp. 2d 376, 392-93 (D. Del. 2000).

Mortgage Foreclosures Involve Combination of Law, Practice, Relationships and Strategies

By Bruce J. Bergman

For some practitioners, the intricacies and unending nuance of major commercial mortgage foreclosures are of great interest. But for most attorneys, certainly those who do not practice regularly in the field, a broader picture of what a mortgage foreclosure action is about, and what the respective goals of plaintiffs and defendants are, may be more captivating.

Why, for example, was your client named in the foreclosure? Or, what are the unique compulsions from a plaintiff's point of view? Then too, experience suggests that genuinely appreciating the underpinning of the proceedings helps unlock the mysteries of what is often viewed as an arcane pursuit. Yes, the novel details can be stimulating, but for many, something more akin to a primer might just be in order.

Ultimately, foreclosure is a startling combination of law and practice, the chemistry of the relationships and the strategies.

The Goal of a Foreclosure

The goal is not as obvious as it might first appear. Aside from the plaintiff's desire to be made whole, the technical (although ultimately practical) goal of a foreclosure action is to cause the secured property to devolve through the foreclosure in the same legal condition it was when the mortgage was delivered. To more readily appreciate the portent of this stolid pronouncement, observe that at the inception, a mortgage lender motivated by commercial considerations makes two decisions—one business, one legal. (This is in contradistinction perhaps to an elderly couple moving to Arizona who must take back a purchase money mortgage to facilitate the sale).

The former examines the prudence of the loan. Thus, if someone has $100,000 to spend and is buying a house assertedly worth $300,000, the need is to borrow $200,000 to complete the transaction. The question the lender asks is, would someone at a foreclosure sale pay $200,000 to buy a house worth $300,000? The answer is "yes," suggesting that the business question has been satisfied.

In regard to the legal inquiry, assume that the lender expects to be in a first position. (Second or even more junior mortgage loans can be made, but for this example, contemplate a first mortgage.) A title search will be obtained and if there are any extant liens or encumbrances on the property—such as mortgages, mechanics liens, judgments, life estates, among a host of others—the lender will require that all be satisfied or disposed of as a condition of granting the loan.

Suppose that after the mortgage is executed, delivered and recorded, the owner-borrower (more precisely, the mortgagor) persuades some other lender to take a mortgage on the property for $100,000. The aggregate burden of debt on the property is now the equivalent of the property's value, $300,000. Does the original lender care? To the extent that such a quantum of debt portends the borrower's inability to remit mortgage installments, yes. But in a more compelling procedural sense, no. Should the borrower default, the original lender recognizes that the subsequent, junior, subordinate, mortgage holder will be named and served with process in the resultant foreclosure action. Presuming the efficacy of the service, one consequence of the foreclosure will be that the interest of the second mortgagee will be extinguished.[1] The purchaser at the foreclosure sale will own the property free and clear of the junior mortgage. In

Bruce J. Bergman is a partner at Certilman Balin Adler & Hyman, LLP in East Meadow, N.Y., where he heads the mortgage foreclosure department. He is the author of the three-volume treatise *Bergman on New York Mortgage Foreclosures* (Matthew Bender & Co., Inc. 2001), a member of the USFN, the American College of Real Estate Lawyers, an adjunct associate professor of real estate at New York University's Real Estate Institute and a special lecturer at Hofstra Law School. A graduate of Cornell University, he received his J.D. from Fordham University School of Law.

short, the goal of the foreclosure will have been achieved—the property emerged from the foreclosure action in the same pristine legal condition it was when the first mortgage came into being, free of all liens and encumbrances. Conveniently, the business decision is also confirmed. Someone *would* pay $200,000 for a house worth $300,000. Conversely, the business contemplation would not have been fulfilled *unless* all subsequent lienors would be wiped out by the foreclosure action.

Unlike most other litigation, which has few defined stages beyond initial pleadings and ultimate judgment, the foreclosure case has specific plateaus, each of which must be achieved in order.

And the scenario of eliminating the peril imposed by later encumbrances applies to most later interests. So, if the borrower sells the property, the grantee takes subject to the mortgage and if named and served in the foreclosure action, that title is lost. Junior judgments are extinguished; likewise tenancies and so on. The only exceptions are real property taxes and certain municipal "super liens," the latter particularly of concern in New York City.

The issue of taxes is dealt with by the lender assuring payment by escrowing for taxes. Alternatively, the lender would procure tax searches, becoming thereby armed to insist that the borrower pay delinquent taxes, failing in which the lender can advance those sums, add them to the debt and foreclose for the tax default.[2]

Steps in the Foreclosure Action

The prevalent method of foreclosure in New York[3] is *judicial* foreclosure, governed by N.Y. Real Property Actions and Proceedings Law article 13 (RPAPL), although any attorney who could prosecute the case in sole reliance upon the desultory statutory provisions is worthy of deification. (*Non-judicial* foreclosure in this state is new and of much narrower application.[4])

Unlike most other litigation, which has few defined stages beyond initial pleadings and ultimate judgment, the foreclosure case has specific plateaus, each of which must be achieved in order. Inclusive of the internal procedures of mortgage servicers—which as a practical matter need to be recognized—these stages are as follows.

Collection Procedures In part because professional mortgage servicers want to preserve performing loans and avoid foreclosure, they initiate various calls and letters to the borrower, designed to elicit payment of arrears and reinstatement of the mortgage. Even though there is no firm rule, traditionally the duration of collection efforts typically does not exceed three months.

Acceleration Most mortgages require periodic payment installments, usually monthly and most often of both principal and interest. Any marginally well-drafted mortgage will also provide that upon the happening of certain events of default—such as failure to pay principal, interest or taxes, neglect to maintain insurance, among many others—the lender has the option[5] to declare due the entire outstanding balance of principal and interest.[6] If in our example the monthly mortgage payments were $1,500, after three months, the lender might prefer to refrain from pursuit of the $4,500 in arrears (plus applicable late charges[7]) and instead accelerate the full balance of some $200,000. Acceleration is almost invariably the final act of the mortgage holder before the file is conveyed to counsel to foreclose.

Foreclosure Search Achieving the foreclosure goal necessitates naming all those with junior interests. Knowing who those potential parties are is revealed by analysis of a title search, the variety particularly tailored for a foreclosure action referred to, not surprisingly, as a foreclosure search.[8]

Pleadings Possessed with a listing of all junior interests, counsel prepares the summons, complaint[9] and, most often, the notice of pendency, commonly, the *lis pendens* (discussed, *infra*).

Filing of Pleadings An action in New York is instituted by the filing of the initial pleadings. Because it is possible that interests could attach to the mortgaged premises between the time the foreclosure search is completed and the pleadings filed, plaintiff's counsel is best advised to direct the title company to continue the search to the moment of filing.

Service of Process Litigators recognize the burdens of this endeavor. CPLR article 3 generally and CPLR 308(1), (2) and (4) and the service by publication dictates of CPLR 316 engender an extraordinary volume of intertwined case law. This is a particular problem in the foreclosure case both because there are often multiple defendants (all those junior lienors) and because an infirmity in service may not emerge—that is, may not be raised by a chagrined defendant—until the eve of the foreclosure sale. If service *was* defective, the ritualistic foreclosure process can be banished to the inception of the action.

Appearance and Answer[10] In addition to a CPLR 3211(a) motion to dismiss (which will only seldom have legitimate application) a defendant has four basic choices of response to the foreclosure complaint: default, notice of appearance and waiver, general notice of appearance and answer. Default is the least desirable of course. It forgoes notice to a defendant of any proceedings in the action. Even plaintiffs tend to be ill at ease with a default because it presages a defendant's eve of sale claim of lack of service.

The notice of appearance and waiver imposes minimal delay (thereby reducing case duration and accrual of interest) while still preserving notice of the most crucial stages, perhaps referee's computation and definitely notice of sale and notice of proceedings to obtain surplus monies.

The general notice of appearance which, like the notice of appearance and waiver can be interposed at *any* time, creates greater delay and entitles the party to notice of all subsequent proceedings.

An answer engenders the greatest delay and serves to contest the case, thereby putting the plaintiff to its proof either via a motion for summary judgment or a trial. Because an answer is also an appearance, even after it is stricken, the party who interposed it remains entitled to notice of all proceedings.

Appointment of Referee to Compute (Order of Reference)[11] Once the time has passed for the last defendant to appear or answer (and when any answer which may have been interposed has been stricken by motion for summary judgment),[12] an application is made for a referee to compute. If there has been neither general notice of appearance nor answer, the order is obtainable *ex parte*. Where there is an appearance or a stricken answer, the application is by notice of motion.

Referee's Computation The referee is to file an oath and report of amount due. In practice, these are prepared by plaintiff's counsel. Duties of the referee are strictly constrained by the order of appointment and are almost invariably confined solely to computation of the sum due and determination of whether the property is to be sold in parcels.[13] If any party has appeared and not waived it, or has answered, the formality of a referee's hearing is required.[14]

Judgment of Foreclosure and Sale[15] The judgment decrees that the mortgaged premises can finally be sold. Because it is unnecessarily time-consuming to do so, the referee's report should not be confirmed separately but should be part of the judgment, sought either *ex parte* or by motion under the same standards as the order of reference. The judgment also (among other things) appoints a referee to sell the property and adjudges deficiency liability.

Foreclosure Sale[16] After statutory advertising requirements are fulfilled (approximately four weeks), the foreclosure sale is conducted as an auction under the direction of the referee, typically at the Supreme Court building (although in Suffolk County the venue is the town hall) where the property is situated.

Closing[17] If the plaintiff is the successful bidder, the deed and its related papers can be signed (or executed) at the moment of the sale. When there is a third-party bidder, the usual terms of sale schedule a closing 30 days after the sale. The grantor of the property is the referee and the closing is usually held at the referee's office.

Role of the Notice of Pendency[18]

A predicate to obtaining judgment of foreclosure and sale is a *lis pendens* on file 20 days before issuance of the judgment.[19] Although such is the mandate, there are significant advantages to filing the *lis pendens* at the inception of the action, and it is often done.[20]

As noted, the foreclosure search suggests to plaintiff's counsel who the necessary defendant parties should be. These are the persons and entities who are then served with process. Suppose that, after being served, a clever defendant borrower "sells" the mortgaged premises to a friendly cousin. Because, obviously, the cousin is unknown to the plaintiff, that new owner is not served. Upon the assumption that an owner not served will retain an interest not extinguished by the foreclosure, a plaintiff might be compelled to periodically update the search to ferret out holders of these later interests. But with what frequency should the search continuations be obtained?

Even if such an update timely unearths the cousin, what is to prohibit a new conveyance to yet another compliant relative—or any other cooperative friend or a corporation created for the very purpose of owning the property? And each time a new defendant is unearthed, a motion to amend the caption of the action would be required. Worse, a new defendant could be discovered a day before the sale. If that person has to be added to the case, then served and empowered to answer the complaint, it makes the point that no foreclosure would ever end.

Borrowers would instantly discover this procedural glitch and could effectively cripple the mortgage foreclosure process. But it doesn't happen that way—because of the *lis pendens*. Anyone acquiring an interest in real property after the filing of the *lis pendens* is bound by the action as if they had been served.[21] So, if someone protests that they were never served in the foreclosure, observing the filing date of the *lis pendens* may be dispositive of any issues.

Special Consequences of Time

Legal matters rarely proceed with the dispatch that clients and their attorneys would prefer. To some extent, however, this is built into the process and accepted in advance with some modicum of equanimity. In the negligence case, for example, there are investigations and depositions susceptible to multiple adjournments, followed by lengthy trial calendars. But in the foreclosure case, interest upon the obligation accrues every day, often at a default rate in excess of the note rate. *Eventually*, with enough delay, mounting interest will create a debt greater than the value of the property. It is apparent, then, that time bears a relationship to generation of a surplus (a circumstance amenable to all) or a deficiency (an unwelcome occurrence for all).

A surplus emerges when the sum bid at a foreclosure sale exceeds the sum decreed due in the judgment to the foreclosing lender. A deficiency is a shortfall in recovery that may be viewed as the converse of a surplus, although the reverse correlation is not so exact. The deficiency is the difference between the sum due the foreclosing lender, inclusive of interest (to which is added the amount owing on all prior liens and encumbrances, also with interest, plus costs and disbursements of the action), and the greater of the market value of the foreclosed property on the date of the foreclosure sale or the proceeds of the foreclosure sale.

All parties to a foreclosure should be to some degree concerned about whether either a surplus or a deficiency will result. One way to gauge the importance of these possible events is to note the effect upon parties when there is neither a surplus nor a deficiency.

Suppose for illustration a mortgage loan of $400,000 on a property worth $500,000. (The concept would be the same for a $40,000,000 loan on a property worth $50,000,000.) Assume that the mortgage bears interest at 10% and that the borrower defaults upon the initial payment. Presume further that the foreclosure consumes one year of time to reach the juncture of a sale. The judgment of foreclosure and sale will have decreed that the sum due the foreclosing lender totals $450,000, consisting of $400,000 in principal and $40,000 in interest, with the remaining $10,000 consisting of accrued late charges, an escrow overdraft to pay taxes, together with legal fees, costs, disbursements and allowances.

On the final assumption that the value of the property had remained stable at $500,000 during the course of the foreclosure, there is some likelihood that the highest price bid at the foreclosure sale will be that sum of $450,000 due the lender. If the lender receives all the money due to it, it has neither necessity nor legal grounds to seek recompense from anyone liable for the debt—most often the borrower. Hence, there is no deficiency.

Nor is there a surplus. So long as the amount bid is no higher than the amount due the lender, no money is "left over." All proceeds go to the lender, so nothing remains against which anyone can claim.

Since most—but certainly not all—mortgage loans are designed at the inception to be prudent, there is often a "reasonable" relationship between the quantum of the loan and the value of the property it secures. The foreclosure sale *should* make the lender whole. The greater the positive disparity between the sum due the lender and the value of the property, the greater is the likelihood of a surplus. Only when the property is worth less than the amount due the lender can there be a possibility of a deficiency.

That the usual can readily become unusual should be immediately apparent. For example, if the foreclosure under discussion raced ahead in six months (unlikely though that is) and the property precipitously increased in value by 10% during that time, the numbers would clearly be different. Then, the sum due the lender would be $430,000 (10% interest for six months instead of a year would total $20,000 rather than $40,000). With a 10% increase in value, the property would be worth $550,000. Under these circumstances, the difference between the total owed the lender ($430,000) and the market value of the property ($550,000) is a whopping $120,000. This suggests a considerable probability that any number of bidders would be most anxious to bid higher than the upset price. Every dollar bid above $430,000 then becomes surplus.

Although surplus is of no consequence to the foreclosing party (who cannot receive more than the debt), or to senior encumbrances (whose liens remain attached to the property), surplus is meaningful to the owner of property (usually, but not always, the borrower) who was divested of title by the foreclosure, as well as the holders of all interests of record *junior* to the foreclosed mortgage. Each of these persons or entities shares in the surplus in the order of their respective priorities.[22]

Returning to the converse—the deficiency—different assumptions in the scenario could reverse the result. Suppose that instead of taking one year, the foreclosure is contested and takes two years to complete. Now the interest component of the debt increases from $40,000 to $80,000. Assume also that the litigation adds $10,000 in additional legal fees and that the property declined in value by 10% rather than remaining stable or increasing.

Given the newly recited facts, the sum due the mortgage holder aggregates $500,000. With the property now worth $450,000, it is apparent that no one will bid a sum sufficient to make the lender whole at the foreclosure sale. The probability is that the lender will simply succeed to title by bidding a nominal sum at the sale. The lender will be deemed to have received $450,000—the value of the property. Having been owed $500,000, however, the loss, or deficiency, is $50,000. Whoever is personally liable for the mortgage debt can then be subjected to a motion to obtain a deficiency judgment.[23]

Personal Liability for the Debt

Inherent in the concept of mortgage foreclosure is sale of the property to satisfy the debt. But what if the property is worth less than the sum due to the mortgage holder? That, of course, is the noted deficiency situation, which then leads to contemplation of who the parties might be who are liable to the mortgagee.

Although it is a more expansive subject than this, anyone who has promised to pay the debt is a person so liable. Conspicuous in this category are signers of the mortgage note (or bond) and guarantors. They must be made defendants in the foreclosure action if that shortfall is to be assessed against them.

Notwithstanding that the mortgagee's counsel is armed with all the techniques to solve the early problems in a foreclosure, a mortgagor could choose nevertheless to litigate.

That such people or entities could be in jeopardy suggests that a mortgage holder might choose to forego a lengthy and possibly tortuous foreclosure, opting instead for an action at law on the note or guarantee. That could be a faster route to success and, if the obligors have the proverbial deep pockets, maybe the most efficacious way to proceed.[24]

One thing mortgagees most often cannot do is foreclose and pursue the monetary obligation simultaneously. New York, like most states, has a one-action rule or an election-of-remedies statute that prohibits such an oppressive dual assault.[25]

How Much Is Due the Lender?

The quantum of peril to those liable for the mortgage debt is a critical item in the process. Of course, the debt consists of principal and interest. Interest is generally a more momentous category than might first appear. If a mortgage is silent on the subject, upon default the principal bears interest at the contract or note rate—which is in essence the expected rate of return. If, however, the mortgage provides for some *other* rate to apply on default, that different and almost inevitably *higher* percentage will apply. That might be 15%, or 20%, or 24% or, as is so in New York, *any* rate of interest. Because interest on default is deemed neither to be a loan nor a forbearance, it cannot run afoul of usury proscriptions.[26]

But there is still more to it, some of consequence, some of less importance. Typically, a lender is entitled to recoup sums in a number of categories. Disbursements is one. Actual out-of-pocket expenditures in the foreclosure process—*e.g.*, index number, process service, foreclosure search, legal advertising, referee's fees—can be added to the foreclosure judgment. So too can late charges, but only up to the time the mortgage balance was declared due.[27] Among other sums are what various statutes may refer to as costs and allowances.

Of usually greater significance are legal fees.[28] Although no statute authorizes recoupment of legal fees in a foreclosure action, the contract (the mortgage) can so provide and typically does. Then, reasonable legal fees as determined by the court (not the referee) can be added to the judgment. Especially in a heavily litigated case, these sums can be quite substantial.

Also in the category of meaningful items are advances made by the plaintiff to protect the lien of the mortgage, such as taxes, insurance and payments to senior mortgagees. Depending on the nature of the property, these can be weighty amounts. And then there is the matter of interest on those advances. Here, the same concept controls as with interest on the principal. If the mortgage is silent, the note rate applies. But if a separate provision is made, a higher rate can prevail. It is therefore easy to observe how a mortgage debt can precipitously rise well past expectations of the uninitiated.

Receiverships in Foreclosure

Notwithstanding that mortgagee's counsel is armed with all the techniques to solve the early problems in a foreclosure, a mortgagor could choose nevertheless to litigate. This situation can then be exacerbated by physical deterioration of the property, resulting in diminution of the mortgage security to the point where the mortgagee will sustain a loss.

A permutation of this idea relates to a commercial property, for example, a shopping center or an apartment building. The mortgagor subjected to a foreclosure, knowing the case will ultimately be lost, embarks on a course of action to "bleed" the property. He collects all the rents and profits but neglects repairs, payment of taxes, insurance and every other possible cost. This turns a handsome profit for the mortgagor and funds a protracted defense to the foreclosure. Under these circumstances, one need not expound at length upon the expected deteriorated value of the mortgaged property at the conclusion of the foreclosure.

In response to this very real dilemma, the mortgagee has a great asset in the ability to appoint a receiver.[29] In a foreclosure action, when the lender believes that the property may decline in value during the progress of the case or that the mortgagor or some occupant may allow the property to depreciate or be vandalized, the appointment of a receiver is available to preserve the premises for the ultimate benefit of the mortgagee.

The receiver stands in the shoes of the owner. Once appointed and qualified, the receiver has the right to collect all rent due or to become due arising out of the premises. The receiver collects the income, maintains insurance, pays taxes and makes repairs. The property is, therefore, preserved. In addition, any excess income is applied to reduce the mortgage debt, and consequently a twofold purpose is served. Still further, the mortgagor's interest in delaying the foreclosure is greatly diminished, if not entirely eliminated.

Conclusion

How does one adequately sum up a subject as expansive as mortgage foreclosure? The ready answer is that it is not achievable. Even a delineation of but a few of the topics excluded exposes the futility of the endeavor: settlement strategies and devices, defenses to foreclosure, parties to the foreclosure action, venue of the case, deed in lieu of foreclosure, partial foreclosure, strict foreclosure, the upset price, foreclosure sale procedures and infirmities, condominium issues, co-op foreclosures and eviction after foreclosure.

Living with foreclosure every day, however, reveals that it is much like every other area of the law—when it is understood viscerally, it is not so mysterious. Maybe this will serve as a beginning.

---

1. How, in turn, a junior mortgagee assesses and protects its position is in itself a worthy subject. For a further review, see 1 Bergman on New York Mortgage Foreclosures § 2.16, (Matthew Bender & Co., Inc. 2001) (hereinafter "Bergman"). *See also*, *Foreclosure of the Second Mortgage—The Nuances of Default on a Second Mortgage are Worthy of Note*, 11 Servicing Mgmt., 32 (Dec. 1999); *Are You Really Junior?—It Sure Matters!*, Equity, Oct., 1998, at 24; *Assault On The Second Mortgage*, 7 Servicing Mgmt., 15 (Mar. 1996); So, *What's Your Position, Junior?*, 6 Servicing Mgmt., 68 (Feb. 1995); *A New Look at RPAPL Section 1351 Relief—A Treat for Lenders*, N.Y. St. B. Ass'n Real Prop. L. Sec. Newsl. Vol. 19, No. 4 at 7 (Oct. 1991).
2. What represents an actionable mortgage default is an expansive subject. For a lengthier analysis, see *Default and Acceleration*, in 1 Bergman ch. 4.
3. *See generally Overview and Guide to the Basics of Mortgage Foreclosure Concepts and Strategies*, in 1 Bergman ch. 2.
4. Non-judicial foreclosure—actually "power of sale" foreclosure in New York—became effective on July 7, 1998 with creation of a new RPAPL article 14. It sunset on July 1, 2001 with the reasonable prediction, however, that it would be extended. While designed to reach a sale within about three months of initiating the procedure, it is confined essentially to non-residential properties, does sometimes require court intervention, and has a number of infirmities which diminish its efficacy. For a further discussion, see *Non-Judicial Actions—Statutory Ambiguities Could Cause Delays in Default Cases*, N.Y.L.J., Feb. 10, 1999, p. 5, col. 2; *Non-Judicial Foreclosure*, in 1 Bergman ch. 8.
5. *See* 1 Bergman § 4.03.
6. *See Default and Acceleration*, in 1 Bergman ch. 4.
7. *See* 1 Bergman § 1.10.
8. *See Ordering and Analyzing the Foreclosure Search*, in 1 Bergman ch. 11. Who precisely those parties are to be is another major topic, for which reference is invited to *Parties to the Foreclosure Action*, in 1 Bergman ch. 12.
9. There is, of course, much to preparation of the complaint in a mortgage foreclosure action. For details, see *The Foreclosure Complaint*, in 2 Bergman ch. 16.
10. For a complete discussion of this subject, see *Responses to the Complaint: Law and Strategies for Plaintiffs and Defendants*, in 2 Bergman ch. 19.
11. *See Role of the Referee*, in 2 Bergman ch. 20. *The Prickly Referee's Hearing—If You Stumble*, N.Y. Real Prop. L.J. Vol. 24, No. 1 at 36 (Winter 1996).
12. As a practical matter, a motion for summary judgment in the foreclosure case would also seek the appointment of a referee.
13. *See* 2 Bergman § 20.03.
14. *See* 2 Bergman § 20.06.
15. *See Judgment of Foreclosure and Sale*, in 2 Bergman ch. 27; *Foreclosure Sales—Unlocking The Bidding 'Mystery': There Shouldn't Even Be One*, N.Y.L.J., Nov. 29, 1995, p. 5, col. 2.
16. *See The Foreclosure Sale—Process and Elements*, in 3 Bergman ch. 30.
17. *See The Foreclosure Closing and Distribution of Sale Proceeds*, in 3 Bergman ch. 31.
18. *See* CPLR article 65; *Notice of Pendency in the Foreclosure Case*, in 1 Bergman ch. 15.
19. RPAPL § 1331.
20. For a discussion of practice tips relating to the filing of a *lis pendens*, see 1 Bergman, § 15.08[1].
21. CPLR 6501; 1 Bergman § 15.02.
22. For a full discussion of surplus monies in the foreclosure case, see *Surplus Money Proceeding*, in 3 Bergman ch. 35.
23. *See generally Deficiency Judgments*, in 3 Bergman ch. 34.
24. *See* 1 Bergman § 7.13.
25. *See Election of Remedies*, in 1 Bergman ch. 7.
26. *See* 1 Bergman § 6.02[3][g].
27. *See* 1 Bergman § 1.10. *Confirmed at Last—Yes, Virginia, There are Late Charges, and in New York Too*, N.Y.L.J., Jan. 26, 1994, p. 5, col. 2.
28. *See Legal Fees*, in 2 Bergman ch. 26.
29. For more on this subject, see *No Scamming This Time—Protecting Receiver and Foreclosing Plaintiff from Deception*, N.Y.L.J., Sept. 25, 1996, p. 5 col. 2; *The 5 Percent Question—Receiver's Commission: Confusion Reigns Over "How Much*," N.Y.L.J., May 24, 1995, p. 5 col. 2; *Appointing and Paying Receivers in the Mortgage Foreclosure Action*, N.Y. St. B.J. Vol. 62, No. 1, at 34 (Jan. 1990); *Receiverships in the Foreclosure Action*, in 1 Bergman ch. 10.

Confusury Unraveled: New York Lenders Face Usury Risks In Atypical or Small Transactions

BY JOSHUA STEIN

New York's usury law consists of a scrambled collection of statutes, most of which appear in the New York General Obligations Law.[1] Combined with federal preemption in certain areas described below, these statutes exempt most substantial commercial lending transactions from any usury restrictions.[2]

"Usury" remains a potential trap only for the unwary loan shark (who probably does not care, because the judicial system is not highly relevant to his activities anyway) and participants in a few other atypical or small lending transactions.[3]

In the occasional weird case where usury restrictions do apply, a violation can invalidate the entire loan and constitute a felony.[4] A practitioner must be alert to this risk whenever considering any loan transaction that is small or involves a borrower other than a corporation or limited liability company.[5]

As in any other area, the practitioner should always refer to the most current version of the applicable statutes and other law before rendering any advice on New York usury law.

The following discussion of New York usury law does not cover any loan restrictions beyond usury and compound interest, such as prepayment, attorneys' fees, discount points, prepaid interest, and late charges. Adjustable-rate residential mortgages are subject to their own interacting federal and state limitations and disclosure requirements, which are beyond the scope of this article.[6] Exemptions for broker-dealer loans are also not addressed.[7] For ordinary mortgage loan transactions, the most common escape hatches from usury include those discussed below.

The flowchart accompanying this article is designed to summarize New York's usury maze. The flowchart analysis begins on page 28, with the oval marked "START." It continues down the page. Lines indicate the sequence of issues to consider. Diamond boxes indicate decision points, each with a question that can be answered "YES" or "NO." Depending on the answer, the analysis continues down one path or the other.

The paths of analysis sometimes lead to more diamond boxes, each another decision point. Eventually, all roads lead to rectangles, representing conclusions. Some of these rectangles represent incomplete conclusions. In those cases, the rectangle has a second path leading out of it, and the analysis continues down that path because one must ask more questions.

Most boxes on the flowchart contain small reference number(s). Each such number refers to a footnote in the following discussion, directing the reader to the text and footnotes where a discussion of the particular issue begins. That discussion contains citations, details, qualifications, and more information to consider. The flowchart should be considered only in the context of this article as a whole.

Do not take this flowchart too literally. It merely summarizes information in a way that many people find practical and interesting. An attorney considering a particular set of facts may find that by using some other order or approach instead, the attorney will achieve the best possible result and the most appropriate analytical basis for it.

Maximum Rate

In the rare factual circumstance where New York's usury ceiling actually applies and federal law does not preempt it, a lender usually cannot charge interest higher than 16% per annum.[8] The Banking Law contains similar provisions.[9] "Interest" includes certain other charges payable to the lender on account of the loan.

JOSHUA STEIN is a real estate and finance partner in the New York office of Latham & Watkins (e-mail joshua.stein@lw.com). A member of the American College of Real Estate Lawyers, he serves as chair of the Practising Law Institute annual seminar on commercial real estate financing. This article will be a chapter in the author's forthcoming book, *New York Commercial Mortgage Transactions* (Aspen Law & Business). The author is a graduate of the University of California at Berkeley and received his J.D. from Columbia University.

The usury ceiling rises by 150 basis points to 17.5% per annum for loans secured by cooperative apartments.[10]

Floating-rate loans and loans that contemplate future advances create a few special complications of their own, which are beyond the scope of this article.[11]

The courts have established some rules for calculating just how much interest a lender is actually collecting on a loan (such as the effect of prepayment of interest). These rules can be crucial in close cases but are outside the scope of the present discussion.

Compound Interest

Independent of the usury restrictions, New York limits a lender's ability to collect compound interest. Even if a loan is not usurious, the lender may be barred from charging interest on the borrower's unpaid interest. In general, New York prohibits compound interest on any loan of $250,000 or less, except in the following cases:

- *Certain Business Loans.* Business loans of $100,000 or more secured under the Uniform Commercial Code with a rate at or below prime plus 8% percent per annum;[12]
- *Certain UCC Loans.* Demand loans of $5,000 or more secured by certain Uniform Commercial Code documents;[13] and
- *Other.* Statutory exceptions enacted for particular industries.[14]

New York prohibits compound interest on any loan, regardless of amount, secured by a "one or two family owner-occupied residence," including a cooperative apartment.[15]

If a lender illegally charges compound interest and the net effective interest rate after compounding is at or below the usury ceiling, he or she must refund the "compounded" part of the interest but not the other interest already paid. In that case, the lender faces no other forfeiture risk. If the effective interest rate, after compounding, exceeds the usury ceiling, then the severe penalties for regular "usury" will apply.[16]

Until 1989, New York courts had, for almost two centuries, invalidated compound interest in a number of cases, as if interest payable on unpaid dollars of "interest" was something completely different from interest payable on unpaid dollars of "principal." Although in recent years courts have sometimes apparently struggled to find exceptions to the general New York rules against compound interest, New York has retained its common law rule against compound interest. The Legislature solved the problem in 1989 primarily at the urging of Martin E. Gold, formerly director of corporate law in the New York City Law Department and now with Sidley Austin Brown & Wood in Manhattan.[17]

If a mortgage loan that provides for "compound" interest does not run afoul of New York's rules in this area, the lender must still confront another old friend, the mortgage recording tax. If the loan documents provide, or the parties ever agree, that unpaid interest shall be added to principal (for example, as part of a workout), then the loan thereby incurs additional mortgage recording tax on the resulting new "principal indebtedness." Moreover, the Department of Taxation and Finance takes the view that as soon as interest starts to accrue on previously accrued interest, the previously accrued interest becomes principal and hence itself subject to mortgage recording tax.[18]

Penalties for Usury

If a loan is usurious, it becomes wholly void.[19] The lender forfeits all principal and interest[20] (the loan becomes a gift) and the borrower can also recover the usurious portion of the interest previously paid.[21] If the lender is "a savings bank, a savings and loan association or a federal savings and loan association" or within certain other categories of institutional lender, the statute provides a different penalty: the lender forfeits all interest (not just the usurious part of the interest), but not principal, and may also be required to repay the borrower twice the interest actually paid.[22]

Criminal Usury

New York has a separate criminal usury ceiling of 25% per annum on nonexempt loans. Any lender that knowingly collects criminally usurious interest commits a felony.[23] The criminal usury ceiling applies to some loans that are not subject to civil usury restrictions at all: loans of $250,000 or more; and certain secured loans of $5,000 or more that are payable on demand.

In these cases, however, New York law does not appear to give the victim of usury any express civil remedy against the lender.[24] A few cases say that banking institutions are exempt from criminal liability for usury.[25] The only penalty available against them would thus appear to be forfeiture.

Federal Preemption for Residential First-Mortgage Loans

Federal law preempts all state interest-rate restrictions, presumably both "usury" and "compound interest" restrictions, for residential first-mortgage loans (including first-lien co-op loans) made to any borrower by any federally insured institution, federally regulated lender, federal government agency, lender approved by the Federal Home Loan Mortgage Corporation (Freddie Mac), any other lender that regularly makes residential mortgage loans totaling more than $1,000,000 a year, or a number of other lenders regulated by or connected with the federal government.

Although Congress allowed the states to override the federal usury preemption for residential first-mortgage loans, New York did not. To the contrary, New York affirmed the federal override.[26] As a result, virtually all residential first mortgages[27] are exempt from New York usury restrictions.[28] Federal law also supersedes state usury restrictions for certain other categories of loans, but these miscellaneous exemptions generally will have no practical effect given the other exemptions and preemptions available and today's rate environment.[29]

Junior Mortgages; Other Institutional Lender Exemptions

A New York state-chartered bank or trust company or licensed mortgage banker may make junior mortgage loans to individual borrowers at whatever interest rate is "agreed to by the [lender] and the borrower."[30] By implication these loans are exempt from the usury ceiling in the New York General Obligations Law.[31]

Similar exemptions-by-implication would probably apply to certain "personal loans" made by a state bank or trust company, foreign bank, or other licensed lenders.[32] Other state banking-related statutes may permit specific regulated lenders to charge interest above the usury ceiling.

Loans of $2,500,000 or More

Any loan of $2,500,000 or more (including obligatory future advances) is exempt from all usury restrictions, including criminal usury.[33] This simple provision of New York law basically solves the usury problem for all substantial commercial loans and is a major part of the reason that multistate loan transactions are often governed by New York law.

If, however, the loan is secured by a "one or two family owner-occupied residence," including a cooperative apartment,[34] the lender still cannot collect compound interest.[35] For most residential first mortgages, however, as previously described, federal law would preempt even the restriction on compound interest.

Limited Liability Company and Corporate Borrowers

A limited liability company (LLC) or corporate borrower cannot "interpose the defense of usury in any action,"[36] nor can a guarantor of a corporation's debt.[37] The same logic would suggest that a guarantor of a limited liability company's obligations should also not be able to raise a usury defense. The courts do not seem, however, in any reported case to date to have addressed the implications for a guarantor.

Some very old cases suggest that a corporation also cannot affirmatively commence an action to invalidate a usurious obligation.[38] No recent New York case has considered this question. The courts' general attitude in this area would indicate, however, that a corporation (presumably also an LLC) probably could not assert usury even as an affirmative claim. A New York corporate or LLC borrower can still assert the invalidity of compound interest on loans of $250,000 or less.[39] The usury exemption for loans made to a corporate or LLC borrower does not apply to entities formed to own a one- or two-family dwelling.[40] Finally, a corporate loan remains potentially subject to criminal usury restrictions, as described elsewhere in this article, although these restrictions are enforceable solely by the state.

A commentator on New York usury law recently described the remaining usury restrictions on corporate loans as being much like "the appendix in humans and wings on flightless birds," and as an economic matter "not only useless, but unsound as well."[41]

Loans of $250,000 or More

Any loan of $250,000 or more not "secured primarily by an interest in real property improved by a one or two family residence" is treated the same as any loan of $2,500,000 or more, except that criminal usury restrictions still apply.[42]

Various additional statutory exemptions sometimes also come into play.[43]

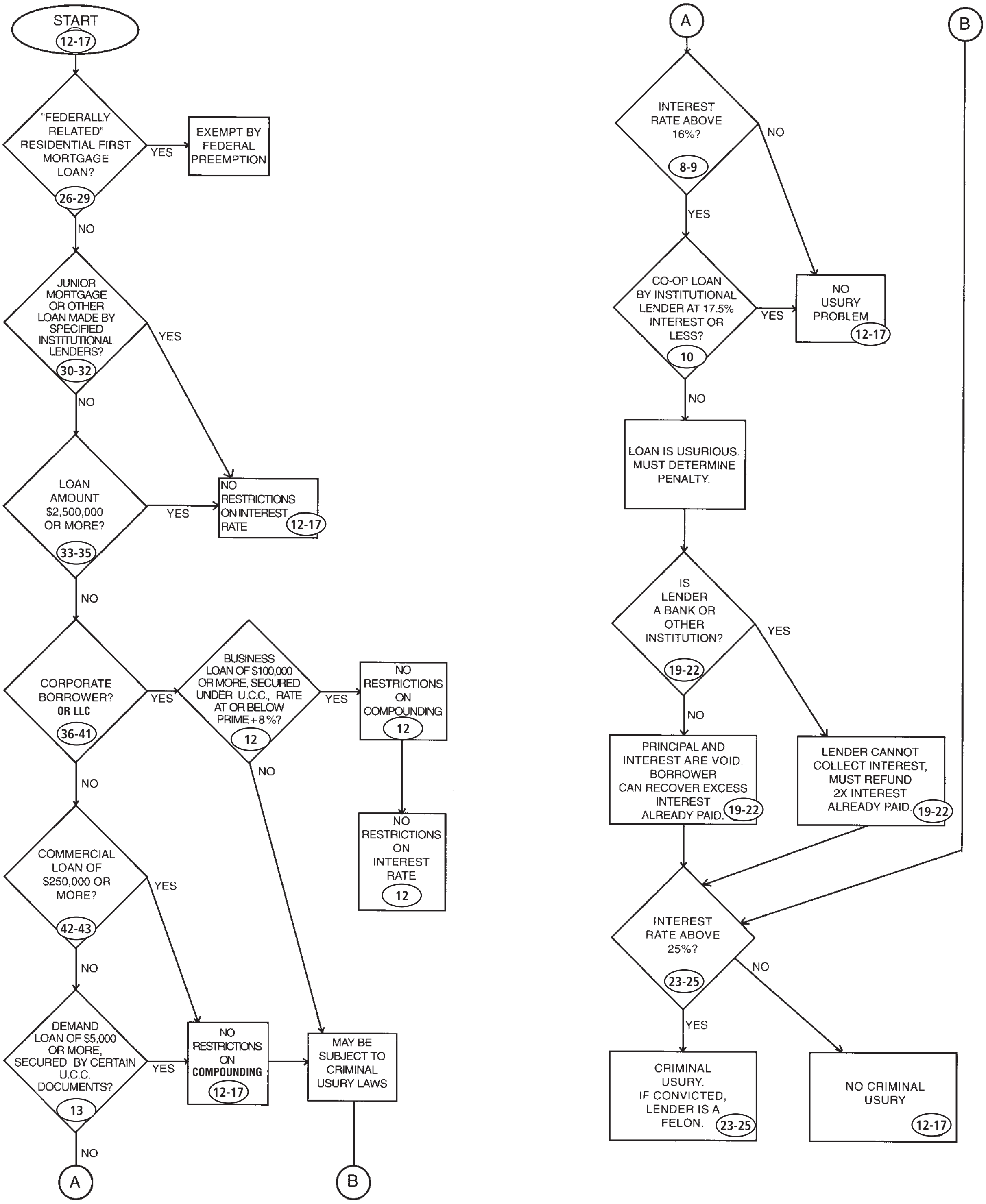
Usury Savings Clauses

Lenders will often include in their documents "usury savings clauses," language saying that if the loan turns out to be usurious, then any payments by the borrower above the allowable rate shall be retroactively recharacterized as repayments of principal. In the few cases that have considered the validity and effectiveness of such clauses, the results were not encouraging for lenders.

The decision in *Federal Home Loan Mortgage Corp. v. 333 Neptune Avenue Limited Partnership*[44] offers an interesting, though typically unilluminating, example.[45] There, a bankruptcy court applying New York law initially found that the loan, although usurious, was saved by the "usury savings" clause. The District Court for the Eastern District of New York rejected that reasoning, concluding instead that the "'usury-avoidance' provision does not save the otherwise usurious loan. Since the loan is usurious, it is void."[46] The court followed by analogy an old and well-established line of New York cases holding that a lender cannot cure an otherwise usurious loan by simply returning to the borrower (or alternatively, allowing credit for) interest payments above the usury cap.[47]

On appeal of the *333 Neptune Avenue* case, the Second Circuit explicitly refused to adjudicate the issue, saying that the "usury savings" provision raises "knotty and undecided questions of New York state law that are best avoided by federal courts."[48] The appellate court vacated and remanded the decision of the District Court. No published opinion was available at the time of this research.

FLOW CHART



The numbers in the ovals indicate the endnote references where these topics are covered in the text.

A few years earlier, the Appellate Division in a memorandum decision ignored a "usury savings" provision. Although the loan documents in that case said that if the interest rate were found to be usurious it would drop to the legal rate, the court decided this was not enough to make the loan nonusurious.[49]

The court cited its own 1965 decision, *Durst v. Abrash*,[50] where it had concluded that even if the parties agree to arbitrate any disputes over the interest rate, the courts can still examine whether a loan is usurious and impose appropriate remedies.[51] Over a dissent that implied the usury statutes may be second- or third-class citizens in the statute books,[52] the *Durst* majority concluded that usury statutes are to be taken seriously and the parties should not be able to sidestep them.[53] By citing the *Durst* case in its 1994 case on usury savings clauses, the court suggested that it regards usury savings clauses as the functional equivalent of using arbitration to avoid usury issues.

The question of the enforceability of usury savings clauses has not been resolved by the New York Court of Appeals. The reported cases to date suggest serious skepticism regarding such clauses, though they would appear to do no harm.

In contrast, it is the author's sense that practitioners in this area do place some weight on usury savings clauses. Practitioners may assume that usury savings clauses work, based perhaps on the general theories that (a) the courts don't like usury law very much; and (b) words in a document usually mean what they say. The preceding discussion demonstrates, however, that neither assumption is necessarily correct in the area of usury savings clauses. Practitioners should place little or no reliance on usury savings clauses. In particular, if counsel is asked to opine that a loan is not usurious, counsel should reach that conclusion based on something other than a usury savings clause.

Usury Summary and Conclusion

Considered as a whole, the usury exemptions and preemptions summarized above virtually assure that any significant commercial loan, and almost every residential mortgage loan, will be exempt from New York usury restrictions. Aside from the exemptions and preemptions discussed above, particular factual situations may suggest other usury defenses and definitional exclusions found in the cases but not discussed here.

Common escape hatches from usury include: (1) interest after default or after maturity; (2) deferred purchase price;[54] (3) waiver; (4) burdens of proof; (5) standing (the usury defense is available only to the original borrower); (6) application of another state's law; (7) estoppel (including the borrower's delivery of an estoppel certificate[55]); and (8) other equitable defenses.

Does title insurance solve any possible usury problem? No. The American Land Title Association 1992 standard loan policy of title insurance expressly excludes any coverage for usury.[56] And the New York title insurance industry's rate manual does not allow title insurance companies to insure against usury risks, such as by issuing a usury endorsement.

Given how easy it is to steer clear of usury problems in New York commercial transactions, however, the lack of title insurance protection against New York usury rarely causes much concern in this area of practice.

---

1. For more on New York usury law, see Bruce J. Bergman, 1 *Bergman on New York Mortgage Foreclosures*, § 6.01, (Matthew Bender & Co., Inc. 2001).
2. Although this work generally disregards residential transactions, they must be taken into account to provide a reasonable summary of New York usury law.
3. This article is based in substantial part on the author's previous article on New York usury law. *See* Joshua Stein, *Confusury Unraveled: A Road Map of New York's Usury Law*, N.Y. St. B. Ass'n Real Prop. L. Sec. Newsl., Vol. 21, No. 4, at 17 (Fall 1993). That article was extensively updated and expanded for this republication.
4. *See* N.Y. Penal Law §§ 190.40, 190.42 (hereinafter "Penal Law").
5. Thus New York, which prides itself on being more practical and business-like than California, ends up with a usury law functionally the same as California's, which one article described as follows:

   > [U]sury law [in California] does not seriously inconvenience most lenders and offers very little protection to most borrowers. The law in this area has a loud bark but rarely bites. However, its rare bite can be painful indeed. This may be good politics, but it makes for complex law.

   E. Rabin & R. Brownlie, *Usury Law in California: A Guide Through the Maze*, 20 U.C. Davis L. Rev. 397, 440 (1987).
6. *See* 12 U.S.C. § 3803(c) (1998); 12 C.F.R. § 226.19 (1999); N.Y. Banking Law §§ 6-f, 6-g (hereinafter "Banking Law").
7. *See* N.Y. General Obligations Law § 5-525 (hereinafter "GOL").
8. *See* GOL § 5-501(1) (maximum usury rate 6% unless otherwise provided in Banking Law § 14-a); Banking Law § 14-a(1) (16% maximum usury rate for purposes of GOL § 5-501). GOL § 5-501(3)(b) sets special rules for most residential loans where the annual interest rate exceeds 6%. In these cases, the borrower has the statutory right to prepay at any time. The lender cannot collect a prepayment fee unless the prepayment occurs in the first year and the documents expressly provide for such a fee. *See* GOL § 5-501(3)(b). This statute expressly provides for federal preemption.
9. *See* Banking Law § 14-a(1); *see also, e.g.,* Banking Law §§ 108(1) (state bank or trust company), 173(1) (private bankers), 202(1) (foreign banks), 510-a (investment companies); Comp. Codes R. & Regs. tit. 3, § 4.1 (hereinafter "N.Y.C.R.R.").
10. Banking Law §§ 103(5), 235(8-a), 380(2-a).
11. GOL § 5-501(4), (4-a); Banking Law § 14-a(1)-(2); 3 N.Y.C.R.R. §§ 4.1, 4.2 (regulations adopted by Banking Board).
12. GOL § 5-526. The prime rate means "the average prime rate on short term business loans which is published by the board of governors of the federal reserve system for the most recent week which was publicly available from the board of governors of the federal reserve system on the previous business day." GOL § 5-526(4).
13. GOL § 5-523.
14. *See, e.g.*, N.Y. Insurance Law § 3203(a)(8)(G); Martin E. Gold, *New York Approves Law Legalizing Compound Interest*, N.Y. St. B. J., Vol. 62, No. 6, at 26 (Oct. 1990) (citing other industry-specific statutory exceptions).
15. *See* GOL § 5-527(2). The statute defines "residence" to "include" a cooperative apartment, but says nothing about condominiums. A court would probably say "residence" also includes a condominium apartment.

16. *Giventer v. Arnow*, 37 N.Y.2d 305, 372 N.Y.S.2d 63 (1975).

17. The history of compound interest in New York and the 1989 legislation are described in two articles by Mr. Gold: *Compound Interest: Legalization Wins Approval*, N.Y.L.J., June 15, 1989, p. 1; and *New York Approves Law Legalizing Compound Interest*, N.Y. St. B. J., Vol. 62, No. 6, at 26 (Oct. 1990).

18. *See* Op. N.Y. State Dep't of Taxation & Fin., *Ticor Title Guarantee Company*, N.Y. St. Tax Rptr. (CCH) & 401-177 at 46,171 (June 25, 1993) (mortgage recording tax imposed on capitalized interest "as if the interest had been actually paid to the mortgagee and the mortgagee then loaned the same amount back to the mortgagor"). Goldberg asks whether the parties might avoid this result by recharacterizing the "compound interest" as simple interest calculated using a different formula.

    > If interest has become due, and the lender then agrees to defer payment of that interest in return for the borrower's agreement to pay interest on the deferred interest, or if the borrower exercises an option to capitalize interest, then it would seem that the deferred interest has become principal. However, if the initial loan agreement provided that interest would be compounded, then it would seem, although this is not the present state of the law, that the compounding is merely the means of calculating the cost of borrowing the original principal.

    David M. Goldberg, Transfer and Mortgage Recording Taxes in New York Title Closings § 6-13(a) (Lexis Law Publishing). In *Cosmopolitan Broad. Corp. v. State Tax Comm'n*, 78 A.D.2d 475, 435 N.Y.S.2d 804 (3d Dep't 1981), the court required payment of mortgage recording tax on the total amount of principal indebtedness when the documents failed to distinguish between principal and interest. If unpaid interest is added to principal, the logical extension of this case would require payment of mortgage recording tax on the additional principal indebtedness.

19. GOL § 5-511(1) (unless lender is a savings bank, savings and loan association, or federal savings and loan association). *See Eikenberry v. Adirondack Spring Water Co.*, 65 N.Y.2d 125, 126, 490 N.Y.S.2d 484 (1985).

20. GOL § 5-511.

21. GOL §§ 5-511, 5-513. *But see* GOL § 5-519 (granting partial relief if lender repays excess interest).

22. GOL §§ 5-511(1), 5-513; *see, e.g.*, Banking Law §§ 108(6), 202(7), 235-b, 380-e, 510-(a)(1).

23. Penal Law §§ 190.40, 190.42.

24. *See American Express Co. v. Brown*, 392 F. Supp. 235, 238 (S.D.N.Y. 1975) (discussing the inability of the victim "to personally enforce the criminal usury law of the state") (dictum).

25. *See Flushing Nat'l Bank v. Pinetop Bldg. Corp.*, 54 A.D.2d 555, 387 N.Y.S.2d 8 (2d Dep't 1976) (citing *Franklin Nat'l Bank of Long Island v. DeGiacomo*, 20 A.D.2d 797, 248 N.Y.S.2d 586 (2d Dep't 1964); *Reisman v. Hartman & Sons, Inc.*, 51 Misc. 2d 393, 273 N.Y.S.2d 295 (Sup. Ct., Queens Co. 1966). *See also Tides Edge Corp. v. Central Fed. Sav., F.S.B.*, 151 A.D.2d 741, 542 N.Y.S.2d 763 (2d Dep't 1989).

26. Banking Law § 14-a(7).

27. The term "first mortgage" would probably not include a wraparound mortgage. *See Mitchell v. Trustees of U.S. Mut. Real Estate Inv. Trust*, 375 N.W.2d 424, 430 (Mich. Ct. App. 1985). This type of mortgage arises where the parties want to preserve an existing mortgage, probably with a below-market interest rate. The borrower signs a new mortgage, part of which is "new money" and part of which just replicates the principal indebtedness secured by the old underlying mortgage. The borrower makes payments only to the holder of the "wraparound," who is supposed to pay the "underlying" mortgage. Typically the holder of the wraparound mortgage benefits from the difference between a low interest rate on the underlying mortgage and a higher rate on the entire wraparound mortgage. These transactions are less common today than they once were, for several reasons. First, interest rates are relatively low. Second, most existing mortgages categorically prohibit any further mortgages. Third, wraparound mortgages create substantial risks for all parties except the holder of the wraparound—risks that were not adequately identified, analyzed, and dealt with during the last wave of wraparound financing. Finally, those risks created unique problems for cooperative apartment corporations, which were often left as potential bagholders in the early 1990s when a sponsor took back a wraparound mortgage, assigned it to "Wrap, Inc." (literally, in at least one case), then defaulted on maintenance payments for the unsold apartments, yet continued to collect payments on the wraparound mortgage. The "wraparound mortgage" structure is not highly favored today, but is still occasionally seen.

28. Common exceptions include mortgages involving unusual lenders and careless lenders taking a mortgage on a "residential manufactured home" that fail to comply with certain consumer protection requirements. *See* 12 U.S.C. § 1735f-7a(c), (d), (e)(4); *Quiller v. Barclays American/Credit Inc.*, 764 F.2d 1400 (11th Cir. 1985) (construing the transaction as nevertheless complying with federal regulations because language allowing borrower a right to cure implied borrower would receive notice of default), *aff'g en banc* 727 F.2d 1067, 1072 (11th Cir. 1984) (denying protection of federal preemption because a contract term allowed lender to commence foreclosure without notice upon default); 12 C.F.R. § 590.1-4 (implementing regulations for consumer protection).

29. *See, e.g.*, 12 U.S.C. § 1735f-7a (loans insured under Titles I and II of National Housing Act); 38 U.S.C. § 3728 (Veterans Administration guaranteed loans); 12 U.S.C. § 85 (national banks not subject to states' discriminatory rate caps or caps below discount rate plus 1%); 12 U.S.C. § 1831d (preempting state usury ceilings below discount rate plus 1%); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 511(a), 94 Stat. 132 (certain business and agricultural loans made between 1980 and 1983); GOL § 5-501(5) (loans insured by "federal housing commissioner" or pursuant to "Servicemen's Readjustment Act of 1944"). The foregoing does not purport to list all banking-related statutes that could preempt New York usury laws.

30. *See* Banking Law §§ 103(4-a) (state bank or trust company), 591-a(1) (licensed mortgage bankers, limiting security to residential real property on mortgage that is not a first lien).

31. *See Novelty Textile Mills, Inc. v. Hopkins*, 145 Misc. 2d 583, 547 N.Y.S.2d 516, 517 (Sup. Ct., Bronx Co. 1989).

32. *See* Banking Law §§ 108(4)(b), (5)(b), 202(4)(b), 352(a). These "exemptions-by-implication" might not avoid criminal usury problems.

33. *See* GOL § 5-501(6)(b).

34. The statute does not expressly refer to condominium apartments. One would expect a court to treat condominium apartments the same as cooperative apartments, as they would seem to be functionally equivalent at least for purposes of usury and consumer protection.

35. *See* GOL § 5-527(2).
36. GOL § 5-521(1); N.Y. Ltd. Limited Liability Company Law § 1104.
37. *See First Nat'l Bank of Amenia v. Mountain Food Enter., Inc.*, 159 A.D.2d 900, 553 N.Y.S.2d 233, 234 (3d Dep't 1990). The documents in this case were vague about whether the corporation or the individual guarantor was the true borrower. The court decided that the availability of the usury defense hinged on "whether the loan was made to repay personal obligations or to further a profit-oriented enterprise." *Id*. at 235. If the latter, then neither borrower nor guarantor could raise a usury defense.
38. *See, e.g.*, *Atlantic Trust Co. v. Proceeds of the Vigilancia*, 68 F. 781, 782 (S.D.N.Y. 1895) (stating that the usury statute is, in effect, repealed as to corporations, *citing Merchants Exch. Nat'l Bank v. Commercial Warehouse Co.*, 49 N.Y. 635 (1872); *Rosa v. Butterfield*, 33 N.Y. 665 (1865); *Curtis v. Leavitt*, 15 N.Y. 9 (1857)).
39. Although loans to a borrower of this type remain subject to "criminal usury" limits, that statute is a criminal one enforceable only by the state.
40. *See* GOL § 5-521(2).
41. Paul Golden, *Evolution of Corporate Usury Laws Has Left Vestigial Statutes That Hinder Business Transactions*, N.Y. St. B. Ass'n J., Vol. 73, No. 4, at 20 (May 2001). Mr. Golden is right on all counts.
42. *See* GOL § 5-501(6)(a).
43. These include the following: Any loan of $5,000 or more, payable on demand, secured by a pledge of documents of title or negotiable instruments under Article 3, 7, or 8 of the Uniform Commercial Code, is exempt from all restrictions on interest rates and interest compounding, except criminal usury. *See* GOL § 5-523. The Banking Law contains similar provisions. *See, e.g.*, Banking Law § 510-a(2) (loans by investment companies). In general, no usury restrictions apply, not even criminal usury, when a corporation borrows $100,000 or more (not including future discretionary advances) for business purposes, at a rate of up to prime plus 8% per annum, granting a UCC security interest as security. *See* GOL § 5-526.
44. 1999 WL 390837 (E.D.N.Y. 1999).
45. The usury savings clause at issue stated in relevant part:

    > Under no circumstances shall Mortgagor be charged under the note or this Mortgage, more than the highest rate of interest which lawfully may be charged by the holder of this Note and paid by the Mortgagor on the indebtedness secured hereby. . . . Should any amount be paid to Mortgagee in excess of such legal rate, such excess shall be deemed to have been paid in reduction of the principal balance of the Note.

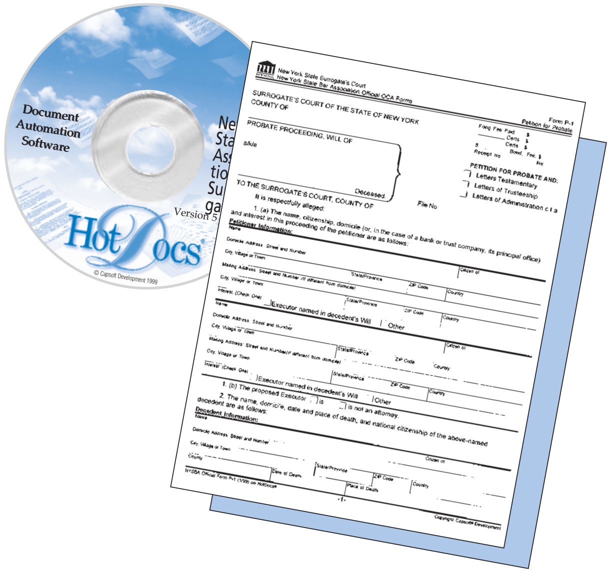
    Federal Home Loan Mortgage Corp. v. 333 Neptune Ave. L.P., 201 F.3d 431 (2d Cir. 1999) (as quoted in an unpublished Second Circuit opinion).
46. *333 Neptune Avenue*, 1999 U.S. App. LEXIS 32056, at *5.
47. *See Babcock v. Berlin*, 123 Misc. 2d 1030, 475 N.Y.S.2d 212 (Sup. Ct., Suffolk Co. 1984); *Bowery Sav. Bank v. Nirenstein*, 269 N.Y. 259 (1935). *See also Yakutsk v. Alfino*, 43 A.D.2d 552, 349 N.Y.S.2d 718 (1st Dep't 1973) (giving credit for excess interest will not cure a usurious loan).
48. 201 F.3d 431 (2d Cir. 1999).
49. *See Simsbury Fund, Inc. v. New St. Louis Assocs.*, 204 A.D.2d 182, 611 N.Y.S.2d 557 (1st Dep't 1994).
50. 22 A.D.2d 39, 253 N.Y.S.2d 351 (1st Dep't), *aff'd*, 17 N.Y.2d 445, 266 N.Y.S.2d 806 (1965).
51. *Id*. at 44 ("[If] usurious agreements could be made enforceable by the simple device of employing arbitration clauses the courts would be surrendering their control over public policy in a way in which the Court of Appeals . . . made very clear could not happen.").
52. This is a characterization with which the author would agree, at least in the world of commercial mortgage loans.
53. *Durst,* 253 N.Y.S.2d at 356 ("The welter of legislation in this area makes clear that the concern is one of grave public interest and not merely a regulation with respect to which the immediate parties may contract freely.")
54. *See, e.g.*, *Mandelino v. Fribourg*, 23 N.Y.2d 145, 295 N.Y.S.2d 654 (1968); *Christopher v. Gurrieri*, 238 A.D.2d 299, 655 N.Y.S.2d 654, 655 (2d Dep't 1997) (mem.) (where promissory note arose from purchase of business, it "was neither a loan nor a forbearance . . . but was in the nature of a purchase money mortgage which is not subject to the usury laws"). *Compare C&M Air Sys., Inc. v. Custom Land Dev. Group II*, 262 A.D.2d 440, 692 N.Y.S.2d 146 (2d Dep't 1999) (upholding an interest rate defined in the documents as "the highest rate of interest permitted," without deciding whether the transaction was an exempt purchase money loan). The usury exemption for deferred purchase price may also be available to a third-party lender that finances an acquisition. *Dallas v. Dallas*, 182 A.D.2d 1039, 582 N.Y.S.2d 835, 836 (3d Dep't 1992) ("[a] mortgage given to secure money, borrowed for the purpose of purchasing real property, is generally held to be a purchase-money mortgage, notwithstanding that the mortgage was given to a person other than the seller," *citing Barone v. Frie*, 99 A.D.2d 129, 472 N.Y.S.2d 119, 121 (2d Dep't 1984)). *But see* Bruce J. Bergman, *Usury and the Purchase Money Mortgage—An Appellate Division Faux Pas(?)(!)*, N.Y. St. B. Ass'n Real Prop. L. Sec. Newsl., Vol. 21, No. 1, at 4 (Jan. 1993) (describing *Dallas* case as "manifestly incorrect"). There is no reason to think that New York's usury exemption for purchase-money mortgages applies only to first mortgages, although the author is not aware of any authority on point.
55. In *Hammelburger v. Foursome Inn Corp.*, 54 N.Y.2d 580, 584, 446 N.Y.S.2d 917, 919 (1981), the Court of Appeals concluded that, based on delivery of an estoppel certificate in connection with an assignment of the loan, the mortgagor "will be estopped from asserting the defense of criminal usury" unless the assignee knew about the problem or knew that the estoppel certificate was obtained under duress. If criminal usury arises whenever the rate exceeds 25% per annum, how could an assignee claim ignorance of the criminal usury problem? Answer: the rate in the documents might have been 24%, but if the original lender had extracted a 10% loan fee, not mentioned in the documents, this would probably bring the effective interest rate above 25%, depending on the term of the loan. Such a loan might be criminally usurious, but the assignee might not know it. If an estoppel certificate can immunize an otherwise usurious loan, can the original holder use this principle protectively, such as by requiring the borrower to deliver an estoppel certificate either at the closing or shortly thereafter to induce the holder to agree to some modification of the loan? Can the original holder rely on such an estoppel certificate?
56. *See* ALTA 1992 Loan Policy "Exclusion from Coverage" No. 5.

NYSBA'S DOCUMENT ASSEMBLY PRODUCTS

SURROGATE'S FORMS ON HOTDOCS®

Generating New York Surrogate's Court Forms Electronically

Now you can electronically produce forms for filing in New York surrogate's courts—both downstate and upstate—using your computer and a laser printer. New York State Bar Association's Surrogate's Forms on HotDocs is a fully automated set of forms which contains all the official surrogate's court forms as promulgated by the Office of Court Administration (OCA). By utilizing the HotDocs document assembly software, this product eliminates the hassle of rolling paper forms into a typewriter or spending countless hours trying to properly format a form.



PN: 6229

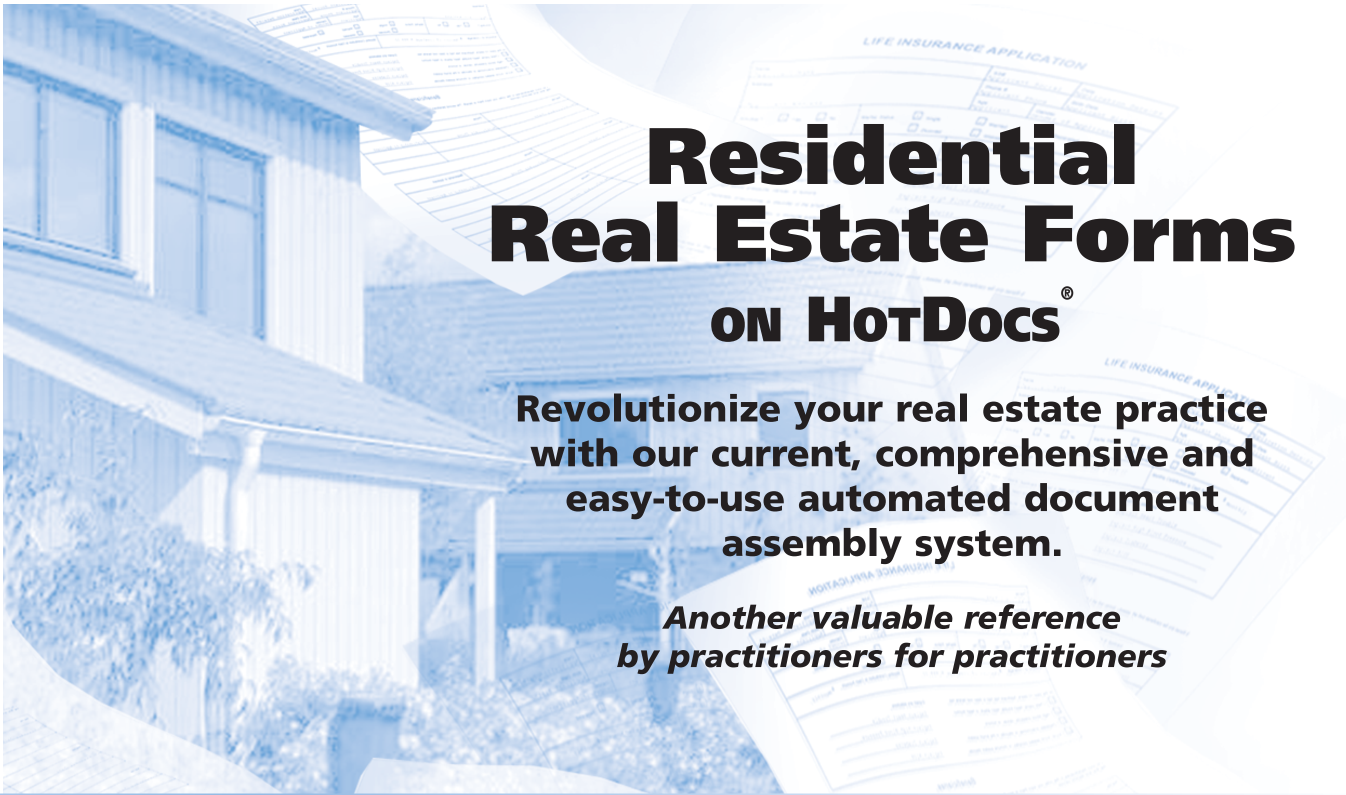
List Price $360*

NYSBA Member Price $300*

*Plus $35 for sales tax, shipping and handling.
Prices subject to change without notice.

Prices include 1 year subscription for updates

Discounted prices for two or more users

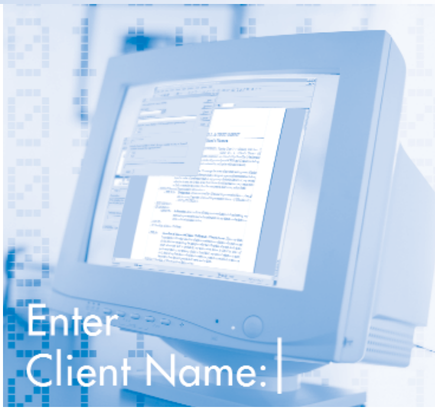


Residential Real Estate Forms

ON HOTDOCS®

Revolutionize your real estate practice with our current, comprehensive and easy-to-use automated document assembly system.

Another valuable reference by practitioners for practitioners



The Quick and Easy Way to Draft Residential Real Estate Forms

Discover how easy it is to electronically produce 200 different residential real estate forms—for both downstate and upstate transactions—by using **New York State Bar Association's Residential Real Estate Forms on HotDocs.**® Quickly prepare clean, crisp, ready-to-file deeds, contracts of sale, clauses for numerous contingencies, various riders, escrow documents and closing agreements for traditional house sales, as well as for sales of cooperative and condominium units.

PN: 6250
List Price $396*
NYSBA Member Price $336*

*Plus $35 for sales tax, shipping and handling.
Prices subject to change without notice.

Prices include 1 year subscription for updates

Discounted prices for two or more users

NYSBA **New York State Bar Association**

Call to Order

1-800-582-2452

Source Code: CL1390

8/2001

Wall Street Remains a Key Player In Commercial Real Estate Financing Despite Capital Market Fluctuations

BY JOSEPH PHILIP FORTE

To better understand the context of real estate finance as we head into the 21st century, it is instructive to understand where we have been, where we are now, and where we are headed.

Historically, real estate finance business was conducted within local markets. The traditional sources of real estate financing for acquisition, development and construction have been the institutional lenders that do business in that local "Main Street" market—the commercial banks, thrifts, and insurance companies.

Until recently, primary market lenders generally did not approach the capital, or "Wall Street," market for funding. Likewise, Wall Street rarely made forays into the local real estate finance markets; when it did, it was to serve an existing investment banking client with corporate real estate needs. Thus, while Main Street lenders focused primarily on the individual real estate project, Wall Street's focus in real estate finance was limited to corporate client relationships. In recent years, however, Wall Street has expanded its real estate focus to become another source of real estate financing.

Background

Residential Mortgage-Backed Securities (MBS)
Wall Street's orientation began to shift when Government Sponsored Entities (GSEs) entered the residential real estate finance markets nationwide in the 1970s.[1] Wall Street discovered and quickly exploited the opportunity to profit from the inefficiency of the fragmented residential real estate finance market.

Although residential mortgage-backed securities (MBS)[2] issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) were not backed by the full faith and credit of the United States, as GNMA's MBS were, the government sponsorship of the GSEs created an implicit government guarantee[3] in the perception of capital markets. This shadow guarantee, coupled with some Federal Housing Administration and Veteran's Administration (FHA/VA) Loan pools, was the equivalent of a two-tier credit enhancement. Without the usual capital markets credit concerns, the MBS issued by GSEs did not have to be structured to minimize the credit risks inherent in real estate finance transactions.

The development of conventional or Private Label MBS residential transactions was, however, hampered by credit risk concerns. While some isolated Private Label MBS issuance occurred in the late 1970s, non-GSE securitization of whole loans did not gain momentum until the thrift industry crises in the high interest rate environment of the early 1980s. Based on its good experience with GSE-issued MBS, Wall Street saw a unique opportunity to profit from the thrift crisis by proffering the securitization exit strategy as the solution to the thrifts' residential portfolio dilemma. Real estate assets, such as mortgages, are inherently illiquid and are not as freely transferable as securities. If the real estate assets serve as a basis for the issuance of securities, however, greater liquidity can be attained through a vehicle separate from the real estate assets.

Without a GSE issuer and the credit enhancement from a government guarantee, the Wall Street market would not consider a Private Label MBS to be equivalent to a GSE-issued MBS. With a Private Label MBS, an investor would need to be concerned with the credit of the issuer as well as with the usual credit risks associated with real estate assets. To assure the market of timely payments on the securities, it became necessary to structure the Private Label transactions to provide credit support.[4] This credit support can be provided by

JOSEPH PHILIP FORTE is a partner at Thacher Proffitt & Wood in New York City and a member of the Steering Committee of the Capital Consortium. He is a past president of the Commercial Mortgage Securities Association and the publisher of its quarterly magazine, *CMBS World.* He is also the co-chair of the Real Estate Financing and Liens Committee of the NYSBA Real Property Law Section. He is a graduate of St. Francis College and received his J.D. degree from St. John's University School of Law.

third party or issuer credit enhancement or by the structure of the transaction.[5] While mortgage loan sellers in the secondary market typically make representations and warranties concerning their mortgage loans and are generally obligated to repurchase the related mortgages in the event of a default, representations and warranties by a seller are not considered to be credit enhancement for a structured transaction in the capital markets.[6]

In determining whether to purchase a particular class of securities, capital markets investors generally place enormous reliance upon the investment grade rating assigned to the issuance by one or more of the national credit rating agencies.[7] Credit enhancement makes the Private Label MBS more acceptable to capital markets investors and substantially increases the possible base of investors because it enables an issuer to obtain an investment grade credit rating for its MBS issuance. Investment grade ratings, therefore, become the key to success in the capital markets by allowing investors to dispense with the in-depth review of the real estate that a primary market lender would undertake in its normal underwriting process.[8]

Commercial Mortgage-Backed Securities (CMBS) Although the Wall Street investor (albeit wrongly) views the real estate collateral pooled for a residential MBS as homogeneous and similar in certain respects to corporate bonds, an investor cannot make the same assumptions in the face of the unique and diverse nature of commercial real estate.[9] The securitization of commercial mortgages had a slower and more deliberate growth than the securitization of residential mortgages.[10]

Although several MBS transactions involving pools of commercial mortgages or a single large CMBS were closed from 1984 to 1985, the strong resurgence of interest by traditional Main Street lenders in commercial mortgages in the mid-1980s stalled any further development of a CMBS market beyond some occasional isolated transactions.[11] The oversupply of traditional Main Street capital, unfettered by market restraints, crowded out the capital markets investors, but the cycle quickly ran its course. A series of events, including the savings and loan crisis and the stiffening commercial bank regulatory environment in the late 1980s, led to a national real estate depression in 1990 that effectively strangled the flow of Main Street capital to commercial real estate. The credit crunch severely affected not only real estate and real estate investors, but also lenders and owners.[12]

In the early 1990s Wall Street again seized the opportunity to provide a counter-cyclical funding source for commercial real estate finance transactions. The task of developing a CMBS market was eased by the Resolution Trust Corporation's (RTC) mandated sell-off of mortgages acquired in the liquidations of the failed savings and loan associations.[13] The RTC's activity had several profound effects on the CMBS market—it significantly increased investor awareness and knowledge of CMBS; it expanded the base of CMBS investors; and it legitimized the CMBS market. With the increased pressure on the management of traditional real estate lenders to tailor their investment portfolios for credit rating agencies, their government regulators, and the financial markets, CMBS began offering a viable solution for risk management and reallocation of institutional assets.[14]

Impetus to Changes in Real Estate Markets

In August of 1998, real estate borrowers were shocked to discover that the collapse of an Asian currency and a Russian bond default adversely affected their ability to seek simple real estate financing in hometown America. As a result of developments in the early 1990s, commercial real estate financing became an integral part of the capital markets. "Conduits" had replaced savings and loan associations as the source of capital and liquidity for many borrowers.

This access to the capital markets was both "good news" and "bad news" for the traditional borrower and the traditional real estate lender. Local real estate was suddenly being affected by events in the world financial markets with an immediacy far different from the traditional real estate lag in a falling economy. Real estate borrowers now had access to capital markets, but also had to cope with the consequences of their fluctuation.

After August 1998, some commentators have questioned whether resecuritization was a financing "fad" or the wave of the future for commercial real estate. As the accompanying article suggests, there "ain't no goin' back."

The Capital Consortium

The converging interests of Main Street and Wall Street lenders in the CMBS market created a unique opportunity for the real estate industry to organize a unified effort to respond to the effects of the credit crunch. To successfully join commercial real estate finance and capital markets, however, it was necessary for Main Street lenders to appreciate and respond to the specific concerns of Wall Street in the CMBS structures and for Wall Street to understand Main Street lender issues.

With the existing residential MBS market as a model of liquidity for single-family properties, three national real estate trade associations joined forces as the Capital Consortium, to pursue the common goal of developing a viable CMBS market to create a secondary market for commercial mortgages. The Capital Consortium is a confederation of the Mortgage Bankers Association of America (MBA), the National Association of Realtors® (NAR) and the Real Estate Roundtable ((RER) formerly known as the National Realty Committee), as its original members, as well as the Commercial Mortgage Securities Corporation (CMSA) and the Bond Market Association.

The CMM uses "borrower" instead of "mortgagor," "lender" instead of "mortgagee," and "security instrument" instead of "mortgage."

To expedite and focus its efforts, the Consortium initially identified certain primary obstacles to the development of the CMBS market that had not hampered development of residential MBS—lack of standard documentation, inconsistency in availability and scope of data on commercial mortgages, and a generally unfavorable regulatory and legislative environment for CMBS investment. The Consortium's goals were to provide greater liquidity to the commercial secondary mortgage market, to bring enhanced market discipline and stability to the commercial mortgage market through efficient secondary market pricing, and to create known rating implications for commercial mortgage portfolios.

The Working Groups Adhering to the Consortium's objectives, the MBA-sponsored Making the Market Working Group developed data elements to establish information reporting guidelines for loans intended for securitization or for sale in the secondary market. To enhance market liquidity and to create efficient pricing, the Consortium promulgated the Data Elements Guidelines, which seek to provide "a comprehensive, uniform data framework for originators issuers, investment bankers, trustees, loan servicers and investors to better manage information at the security, class, pool, loan, property and tenant levels."[15]

The Clearing the Barriers Working Group, headed by the RER, made tremendous progress toward removing regulatory and legislative barriers to commercial mortgage securitization. At the outset, the Consortium identified the following legislative and regulatory goals: (1) to amend the "five or fewer" rule of the U.S. Tax Code governing real estate investment trusts (REITs); (2) to encourage federal preemption of state securities laws with regard to merit review and limitations on investment in CMBS; (3) to change the regulatory treatment of CMBS or portions of loan portfolios sold to others to avoid over-reserving for federally regulated banks; and (4) to create a class exemption in the Employee Retirement Income Security Act's (ERISA) "parties in interest" and prohibited transactions" limitations for CMBS.[16]

The NRC's Creating the Instrument Working Group[17] spent more than three years developing a mortgage template that could be readily and predictably underwritten, originated, rated, and pooled for CMBS transactions.[18] The group chose a mortgage document developed by Thacher Proffitt & Wood, a law firm with a significant real estate finance and capital markets practice, as its initial discussion draft for the ratable mortgage template. The firm's mortgage template had been created 13 years earlier for a national residential lender that regularly pooled its residential loans for securitization. The lender was contemplating a national commercial and multifamily lending program that failed to go forward. Since that time, the form had been used by numerous traditional real estate and Wall Street lenders in the primary and secondary markets, including the first commercial mortgage conduit.

Over time, the firm had substantially revised and expanded the form to reflect the current market issues and reorganized the mortgage from its historical accretion format into a corporate document format with the articles and sections grouped by subject matter. The revised form had been used for years by several commercial mortgage conduit programs, which subsequently pooled and securitized the multifamily and commercial loans based on it.[19] The revised form had also been used in many large single or affiliated borrower pools and in many property-specific single-asset transactions.[20] As a model, it therefore had the benefit of extensive primary market usage and capital markets exposure.

The Working Group delegated the drafting of the mortgage template to a Documents Task Force representing the diverse constituencies within the RER, including owners, advisors, builders, investors, lenders, and managers of commercial real estate investments. The Task Force decided to produce a complete form of a generic mortgage, rather than a skeletal template.[21] After the Task Force completed its final draft of the mortgage template, it was delivered to a Principal Working Group, composed primarily of the non-lender constituency of the RER, for its review and feedback. After nine months of negotiations, the Principal Working Group obtained certain concessions and modifications to the final work product of the Task Force.[22] The CMM was then submitted to the three trade association members of the Consortium for their review and approval. The Consortium approved the CMM and published it on June 25, 1996, as part of its *Capital Markets Initiatives.*[23]

The Capital Markets Mortgage (CMM) To ensure structural consistency and ease of use, the finished product, the Capital Markets Mortgage (CMM), contains a detailed table of contents that enables a document draftsman or due diligence reviewer to locate specific provisions more easily.[24] The CMM also incorporates a list of definitions for greater consistency in negotiating and documenting transactions. It is organized by subject matter with numbered articles and sections that are captioned to proffer a more modern documentary presentation.[25]

To allow the use of consistent terms throughout various loan documents such as promissory notes or assignments of leases and rents, the CMM uses "borrower" instead of "mortgagor," "lender" instead of "mortgagee," and "security instrument" instead of "mortgage." Consistent terminology permits easier substitution of clauses between documents, especially between real estate security instruments in multistate transactions.

The material provisions within the CMM are in standard locations for ease of drafting, modification, or due diligence review.[26] It also contains certain legal and economic concepts universal to all real estate secured loans[27] and identifies certain substantive sections and clauses that may be added or deleted as appropriate in particular transactions, such as transactions based on property type or borrower entity.[28] A Special Covenants article provides for the insertion of special transaction-specific provisions without any disruption of the standard provisions' placement.[29] A separate Local Law article allows modification of the generic template for state-specific law provisions.[30]

Substantively, the Documents Task Force considered the then-recent experience of real estate lenders (from Main Street as well as Wall Street) in the primary and secondary mortgage markets, the current requirements of the various credit rating agencies in pool and as single asset CMBS transactions, and certain issues of particular importance to capital markets investors.

To appreciate the capital markets, it is helpful to keep in mind the three elements essential for any securitization structure to be ratable and, therefore, marketable: (1) the structure must not permit any interruption of the cash flow from the property to the ultimate investor, (2) all information regarding the borrower, principals of the borrower, the property, and the mortgage must be disclosed to the investors, and (3) the structure must disallow or must compensate for the repayment of any principal before its scheduled repayment, whether in installments or at maturity. These elementary principles drive many of the structural considerations that often baffle the Main Street lender, the lender's counsel, the borrower, and the borrower's counsel in looking at a commercial mortgage loan that is being originated for securitization. Knowledge of these basic principles of structured finance provides the real estate lawyer with a better grasp of the perspective of Wall Street, specifically investment bankers, credit rating agencies, and capital markets investors.

Access to and disclosure of information in the capital markets is critical to the securitization process.[31] A growing appetite for property and borrower-specific information spawned by the losses accrued in the last national real estate depression, coupled with the continuing development of sophisticated computer data collection and retrieval systems in loan servicing, has fueled a feeding frenzy for information in commercial real estate finance.[32]

The development of the CMBS market has further accelerated the process of modernizing the information infrastructure with respect to the quantity, quality, scope, and type of information requested.[33] The increased availability of such information has caused the number of parties gathering and reviewing information to grow. In addition to the traditional participants, credit rating agencies, secondary market investors (senior, mezzanine and subordinate), trustees and custodians, due diligence contractors and their respective attorneys, accountants and other agents are involved in various stages of the process, whether the transaction deals with a whole loan, bulk sale, or sale of CMBS in a public offering or a private placement.

Non-investment grade investors, especially holders of the first loss position (the "B" piece buyer[34]), will have an even greater need for critical information regarding borrowers and properties.[35] Without the comfort of an investment grade rating, non-investment grade investors or their due diligence agents are compelled to review the borrower's credit and collateral to assure themselves that their investments are prudent. Because of the inherent risk of the subordinate creditor position, the due diligence that they undertake may be greater than that of a primary mortgage market lender and similar to that of a junior mortgagee. This need for information does not cease after the loan is initially underwritten, closed and funded. A CMBS, by definition, is designed to trade both the senior (the "A" piece buyer) and the B piece buyer. Current information is critical for prudent trading to occur.

Regardless of whether commercial mortgages are sold as whole loans or publicly or privately as securitized pools, representations and warranties must be provided to potential investors; it is the custom of the marketplace. The nature and type of the representations and warranties may have an effect on the pricing of the transaction. For the average capital markets investor, the warranties may serve as an initial disclosure device or, in some cases, a substitute for due diligence.[36] However, as a backup to the representations and warranties it must make or pass through to the capital market, the seller-issuer into the capital market can ultimately look to the representations and warranties of the borrower contained in the mortgage and of any prior seller contained in the mortgage purchase and sale agreement.[37]

Wall Street and Main Street can coexist and mutually profit from real estate finance, and the real estate industry may be the primary beneficiary with access to a larger source of financing.

The CMM is a ratable mortgage, which allows the lender and the borrower to weigh the cost and the benefit of each variation of a transaction provision from the ratable template. When lender and borrower know the cost of a variation from the ratable template, the lender has an enhanced understanding of its pricing and the capital markets value of the loan asset it is creating, and the borrower has an improved understanding of the rate and proceeds the lender is offering.

The CMM is not intended as a standard mortgage for use in all transactions.[38] It may be modified based on differences in property type, lender requirements, borrower characteristics, market considerations, and other factors. It is an evolving document that will be modified occasionally by the Consortium to reflect its acceptance and usage in the market and in response to developments in the CMBS markets generally.[39]

Conclusion

The effects of the CMBS market on the primary mortgage market will be considerable.[40] The benefits should include increased liquidity; avoidance of cyclical credit crunches; increased geographic, borrower, and collateral diversification; evolving market standardization of underwriting; servicing and documentation; and the resulting stabilization of commercial property values. The disadvantages could include the risk that lenders may leave the real estate finance market or consolidate, the risk of poor underwriting and servicing, the loss of portfolio lender discipline, the loss of the personal lender/borrower relationship, the unresponsiveness of investors, and the risk of governmental intervention in the market.[41]

As the lingering specter of the last real estate credit crunch recedes from the institutional memory of the Main Street lenders, the early reports of the demise of Main Street real estate finance and the triumph of Wall Street CMBS may have been greatly exaggerated. With the return of the Main Street lender to real estate finance,[42] the increased competition for a limited number of financing opportunities may wreak havoc on Wall Street's plans to have conduits[43] replace traditional lenders as the principal source of real estate capital.[44] Nonetheless, with the actual decrease in the number of traditional real estate lenders in the Main Street market through liquidation and consolidation and the periodic reduction in appetite of Main Street lenders for commercial mortgages in real estate downcycles, Wall Street and the CMBS market will have a legitimate place in the commercial real estate market as a counter-cyclical source of real estate finance and as an exit strategy for primary market lenders, as well as for commercial mortgage portfolio investors.[45]

Today, many money center banks are exclusively securitized lenders into CMBS pools and hold no significant mortgage portfolios. More life insurance companies have slowly migrated to using securitization as an exit strategy. Whether a business (investment and commercial banks) or a disposition alternative (insurance companies), commercial mortgage securitization is and will continue to be an integral as well as critical factor in real estate finance. One nationally recognized real estate report has noted:

> Investors need to keep in mind that real estate's linkage to the fixed-income universe through CMBS means short-term capital availability will be closely aligned to the overall capital markets. A non-real-estate-related disruption like the 1998 credit crunch would be felt immediately in the real estate world, impacting liquidity without regard to property market fundamentals. Most . . . agree that short-term shocks are tolerable in return for the contribution of public-market efficiencies in helping to smooth out the boom-bust cycles of the past.[46]

Securitized lending now accounts for almost 20% of all outstanding commercial and multifamily mortgages in the United States with a substantially larger percentage originated for securitization each year.[47] In 1999, a majority of all commercial mortgages were originated to be deposited in CMBS pools.[48]

Wall Street and Main Street can coexist and mutually profit from real estate finance, and the real estate industry may be the primary beneficiary with access to a larger source of financing than has been tapped before.[49] The mutual education of the markets to the critical issues confronting them will help assure the successful development of a CMBS market.

---

1. In the early 1970s, the Government National Mortgage Association (GNMA) guaranteed pass-through certificates for pools of Federal Housing Administration insured and Veteran's Administration guaranteed loans (FHA/VA Loans) issued by GNMA-approved issuers. The pass-through certificate represented an undivided ownership interest in the whole loan pool. Like the earlier guaranteed mortgage certificates, the issuers undertook to pass-through the investors' pro rata share of the monthly principal and interest payments due on the whole loan pool, after deduction for servicing and management fees, regardless of whether the underlying mortgages were in default. GNMA's guarantee of full and timely payment was backed by the full faith and credit of the United States.

   Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) followed GNMA into the capital markets in the late 1970s and early 1980s and issued pass-through certificates representing pools of residential whole loans. In 1983, FHLMC issued the first collateralized mortgage obligation. This obligation provided for the distribution of cash flow not to individuals on a pro rata basis, but to specific classes designed to meet specific investor concerns regarding timing of receipt of principal due to mortgage prepayments. Thereafter, a vast array of product variations developed in direct response to investor needs.
2. Briefly stated, the process of mortgage securitization involves the creation of a new financial instrument that represents an ownership interest (a pass-through certificate) in, or an obligation secured (a pay-through bond) by, a pool of mortgage loans. Acquisition of these instruments can be structured either as a sale, with the issuer selling certificates that represent an undivided fractional ownership interest in the issuer's mortgage pool, or as financing, with the issuer issuing debt instruments secured by the issuer's mortgage pool as collateral.
3. The GSE MBS were very attractive to Wall Street because they minimized the credit risk inherent in conventional real estate finance.
4. Hence, MBS are referred to as structured transactions.
5. Credit support can be provided by: (1) a third party credit enhancer issuing a standby letter of credit, a surety bond, a pool insurance policy, or a corporate guarantee; (2) over-collateralization of a mortgage-backed bond; (3) creating separate senior and subordinated classes of securities; or (4) establishing reserves or cash collateral accounts. (Reserve accounts are generally created with equity, cash flow holdbacks, or sales proceeds, while a cash collateral account is financed by an institutional loan. These accounts are pledged to the trustee for the benefit of the investors.) The senior/subordinated structure is a variation on a second mortgage allowing the subordinate class of securities to absorb losses first before the more senior classes take any loss.
6. Eric M. Schwartz, *Representations and Warranties in Commercial Mortgage-Backed Securities: Going . . . Going . . . Gone?*, Structured Finance Special Report (Moody's Investor Services, Inc., New York, N.Y.), Nov. 3, 1995, at 2 (hereinafter "Schwartz").
7. The three credit rating agencies are Standard & Poor's, Moody's Investors Service, Inc., and Fitch Research, Inc. Each company has developed its own criteria and methodology for rating commercial MBS (CMBS) transactions. This criteria is available on their respective Web sites.
8. Investors will rely on a rating because a credit rating agency will perform its own "stress test" of the mortgage pool to determine the rating to assign, using a variety of disparate factors such as debt service coverage, loan-to-value ratios and loan seasoning, balloons or negative amortization, exposure to borrower concentration, geographic diversity and economic risks, pool service experience and creditworthiness, and deal structure and credit enhancement. The credit rating agency will determine the likelihood of timely repayment using historical loan experience for the collateral type and its own statistical database concerning probability of default and severity of the loss. Rating agencies will also consider the physical and environmental condition of the mortgaged property, as well as the tax structure, loan servicing, administration issues, and the mortgage document provisions to determine the rating. *Commercial Mortgage Stress Test,* Structured Finance Special Report (Fitch Research, Inc., New York, N.Y.), Jun. 8, 1992, at 1.
9. Residential and commercial real estate loans differ in many ways. For example, commercial real estate loans have different income property underwriting and appraisal methods, lack standard underwriting and loan documents; lack FNMA/FHLMC loan programs and market guidance; involve different legal and regulatory issues of investment authority, borrower structure and credit, and property zoning; depend on income-producing leases and tenants as well as other interested third parties; and have differing insurance requirements and a variety of different permissible prepayment risks. Joseph P. Forte, *Commercial Mortgages in the Secondary Market,* Mortgage Banking, Oct. 1985, at 37. Of course, multifamily property is residential as well as income producing.
10. In the 1920s, approximately 20 companies issued their own "guaranteed mortgage certificates" to acquire investment capital. Guaranteed mortgage certificates were fractional shares of mortgage loans sold to small (as small as $500) as well as large denomination buyers by the lenders who originated the loans. "Guaranteed" referred to the seller's guarantee of the investor's receipt of its pro rata share of the monthly mortgage payments due from the borrowers. This newly developing market collapsed with the real estate failures that occurred in the wake of the Great Depression. Many guarantors were unable to cover their guarantee payments to investors without the cash flow of borrower payments, and the New York Insurance Department, which regulated these companies, placed all of the issuing companies into rehabilitation. In the 1960s, the development of private mortgage insurance in New York was hampered by the memories of the earlier "guarantor" failures. Louis Perlstein, *What the 1920s Tell Us About Mortgage-Backed Securities Today,* Prop. & Prop., Jan.-Feb. 1987, at 19.

11. *See* Forte, *supra* note 9.

12. "This dearth of capital resulted in a drop in property values, dampened investment returns, increased delinquencies and foreclosures, as well as industry layoffs. In turn, this resulted in an erosion in state and local tax bases, which adversely impacted community services." *The Capital Consortium, Capital Markets Initiatives*, Jun. 25, 1996, at 1 (hereinafter "Consortium").

13. Since 1991, the RTC has issued over $17.8 billion in CMBS with a peak CMBS issuance of approximately $9 billion in 1992. *1995/1996 Commercial Backed Securitization Survey,* Trends and Developments (The E&Y Leventhal Real Estate Group, Los Angeles, Cal.), 1996, at 1, 6 (hereinafter "*Securitization Survey*").

14. Securitization allows real estate investors to

> move assets off their balance sheets, lessen their risk based capital requirements, and/or redeploy their capital in ways more in alignment with their strategic plans. The institution can still generate income from the portfolio by remaining the servicer of the pool of mortgages underlying the CMBS. For buyers of the securities, the tranche structure of most securitizations allows investors to pick an investment that suits their risk and reward criteria, as well as the investment timeframe which facilitates matching their assets and liabilities.

Argante Cappelli & Michael Wirth, *The Securitization of Real Estate Assets,* Real Estate Strategies (Deloitte & Touche LLP, New York, N.Y.), Summer 1996, at 2. The Private Label CMBS market developed significantly from $1.6 billion in 1990 (before any RTC issuance) to about $30 billion in 1996, with more than $100 billion outstanding in total. *See Securitization Survey, supra* note 13, at 1 (discussing statistics regarding market development); Commercial Mortgage Alert, Dec. 23, 1996, at 9.

15. Consortium, *supra* note 12, at 3.

16. "The Omnibus Budget Reconciliation Act of 1993 removed the bias against domestic pension funds' capital investment in REITs. The Riegle Community Development and Regulatory Improvement Act of 1994 authorized Federal preemption of state securities laws, subject to promulgation of regulations by the Office of the Comptroller of the Currency and amended the risk-based capital treatment of CMBS to avoid over-reserving. The Consortium submitted an initial application for exemptive relief under ERISA for investment grade CMBS in March 1995 which was subsequently updated." Consortium, *supra* note 12, at 3-4.

17. Samples of new FNMA and FHLMC revised uniform forms of multifamily note, mortgage, and guaranty were released at the MBA's Commercial Real Estate Finance/Multifamily Housing Conference in February 1997. The new documents are typewritten, rather than pre-printed, and the new mortgage is approximately 40 pages. FNMA and FHLMC will have slightly different versions of their uniform documents regarding the yield maintenance formula, transfers of interest of non-managing general partners under the Due-on-Sale Clause, and the conditions for and mechanics of a loan assumption. For purposes of comparison to the CMM, the FNMA and FHLMC documents hereinafter will be referred to as FNMA/FHLMC Mortgage/Note/Guaranty, and the FNMA/FHLMC sections will be referred to as they appear in these revised documents. Unless the context indicates a reference to the FNMA/FHLMC Mortgage documents, all references to "articles" and "sections" are to the CMM.

18. Consortium, *supra* note 12, at 5. The Working Group was also responsible for due diligence and terminology. It has promulgated the Due Diligence Checklist to assist in identifying in a uniform way the documents and information contained in each loan file. The terminology project was incorporated into the mortgage template definitions. Consortium, *supra* note 12, at 61.

19. *See generally* Michael W. Davis, *Conduits: Market Overview and Rating Process,* Series on CMBS Issues (Duff & Phelps Credit Rating Co., Chicago, Ill.), Jul. 1995, at 2 (hereinafter "Davis") (describing requirements for conduit market securities).

20. *See generally Rating Single-Borrower Commercial Mortgage Transactions,* Structured Finance Special Report (Fitch Research, Inc., New York, N.Y.), Oct. 3, 1994, at 1 (addressing issues concerning single-borrower mortgage transactions).

21. The Capital Consortium *Capital Markets Mortgage*, Feb. 27, 1996, (hereinafter "CMM") (A draft of the CMM is printed in 31 Real Prop. Prob. & Tr. J. 523 (1996)). A generic deed of trust and a deed to secure debt template with terms identical to the CMM have also been developed. The Task Force intended that the mortgage and deed of trust may be modified to reflect state-specific changes. The Documents Task Force intends to develop a Promissory Note and Assignment of Leases and Rents that will correspond to the CMM.

22. The principal obstacle to consensus was a requested confidentiality provision that was sought as a substitute for the delivery of information contemplated by § 18.1. The changes that were incorporated focused on the sections concerning insurance, leasing, defaults, and restoration. CMM, *supra* note 21.

23. A copy of the *Capital Markets Initiatives,* which includes the Executive Summary, the CMM, the Due Diligence Checklist, and the Legislative Initiatives is available from the RER. *See* Consortium, *supra* note 12.

24. CMM, *supra* note 21, at i-iv.

25. CMM, *supra* note 21, at v-vii. For example, all of the grants of security are contained in article 1 including the property mortgaged, an assignment of leases and rents, a security agreement, and a pledge of monies held. In deference to the past, article 1 also contains the historical habendum and defeasance clauses. In the FNMA/FHLMC Mortgage, the grant of security interest is at least as extensive as the CMM.

26. CMM, *supra* note 21, at i-iv. The standard locations will correspond to identical provisions in the generic deed of trust and the deed to secure debt. The deed of trust template will, of course, contain a generic "Trustee" article, which can be modified by state-specific law requirements in the "Local Law" article.

27. *See* CMM, *supra* note 21, at art. 2 (aggregating and delineating the debt and other obligations secured by the CMM and providing for the method of payment).

28. *See, e.g.*, CMM, *supra* note 21, at § 3.3 (discussing "Insurance" subsection (e) concerning blanket policies or (f) regarding policy layering, which may be added or deleted as necessary).

29. *See* CMM, *supra* note 21, at art. 4 (discussing various special covenant provisions).

30. 31 *See* CMM, *supra* note 21, at art. 22 (containing a representative New York Local Law section for illustrative purposes).

31. M. Cathy Anderson, *Divulging Data,* Institutional Investor (1995), at 211.

32. As CMBS issuance and secondary trades continue to develop and expand in the capital markets, investors are only constrained by an industry infrastructure which is outdated and has not developed as quickly as the appetite of the market. The CMBS industry clearly recognizes these shortcomings and is addressing the information crisis in several ways. Several national trade associations, such as the Public Securities Association (now known as the Bond Market Association or "BMA"), the Real Estate Capital Resource Association (RECRA), MBA, the Commercial Real Estate Secondary Market and Securitization Association (now known as the Commercial Mortgage Securities Association or "CMSA"), and the Capital Consortium have each established special working groups to deal with the several different facets of this information revolution. RECRA formed a Disclosure Committee with respect to the release of non-public information. That committee issued Disclosure Guidelines for Commercial Mortgage Backed Securities on December 15, 1995. The CMSA has developed a draft "Minimum Reporting Requirements" for post-CMBS issuance information, which recommends, among other things, quarterly reporting of the following actual property performance information: gross revenue by quarter, last full year's expenses, net operating income, occupancy rates at the end of the quarter, actual capital expenditures in the previous quarter, lease roll-over schedule, and a list of major tenants (greater than 20% of space). In November 1996, CMSA issued standards to "create a market mechanism to facilitate a sufficient level of ongoing information to support a fully functional securities trading market." Commercial Real Estate Secondary Market and Securitization Ass'n, *Standards for the Dissemination of Information on New Commercial Mortgage-Backed Security Issues* (Nov. 11, 1996) (hereinafter "Standards") (unpublished manuscript on file with CMSA (now known as the "CMSA Investor Reporting Package")). The BMA has formed a special committee to examine the liability issues of borrower and property-specific loan data and the release of such data to third parties. In July 1995, a task force was formed by the National Council of Real Estate Investment Fiduciaries, the Pension Real Estate Association, and the National Association of Real Estate Investment Managers to review existing information reporting practices of the real estate industry issued standards for establishing information reporting criteria.

33. In 1993, FNMA/FHLMC expanded their requirements for delivery of financial information in their new multifamily mortgage rider. Those rider provisions have been incorporated into the FNMA/FHLMC Mortgage. FNMA/FHLMC Mortgage, *supra* note 17, at § 31.

34. As distinguished from the "B" rating. *See What Do "B" Ratings Mean?*, Structured Finance Special Report (Fitch Research, Inc., New York, N.Y.), Aug. 5, 1995.

35. Beneficial rating can be achieved in large part through information. Rating agencies have no choice but to rate issues based on the information available to them. Better information usually equates to a better rating because more credit, collateral, borrower and interest rate risks are identified, qualified and quantified. Less information will frequently result in a lower rating to make up for unknown risk. Cappelli & Wirth, *supra* note 14, at 2.

36. *Exhibit B: Representations and Warranties, The Rating of Commercial Mortgage-Backed Securities* (Duff & Phelps, Credit Rating Co., Chicago, Ill.) (1994) at 51; *Standards*, *supra* note 32, at 66; Schwartz, *supra* note 6, at 2.

37. In the capital markets, typical mortgage purchase and sale agreements contain seller representations and warranties that are a contractual derogation of the "nonrecourse" endorsement and assignment of the mortgage loans transferred under the agreement for the purposes of a seller-required cure or buy back upon a breach of any representation of warranty.

38. The CMM was published with the following Preface:

> The capital markets mortgage . . . [is] a generic template to be used in commercial and multifamily real estate transactions to be sold or financed in the capital markets. They should, however, only be used with legal counsel and modified to conform to the requirements of the states where the property is located as well as the credit and risk requirements of the contemplated transaction . . . [and] is not intended for use in large or complex commercial real estate transactions for which traditionally negotiated documents, specifically tailored to the individual characteristics of the type of loan, the property, the borrower and the lender, will continue to be more appropriate.

Consortium, *supra* note 12.

Notwithstanding the caveat in the Preface, the CMM can be used in negotiated transactions because it is readily susceptible to modification. Moreover, from the perspective of the credit rating agencies and investors, especially B-piece buyers, some of the documentary as well as borrower organizational requirements will be more, not less, restrictive for larger loans in pools, affiliated borrower loan pools, and Property-Specific Transactions.

39. Consortium, *supra* note 12, at 7.

40. *See* Joseph B. Rubin, *A Thriving Securities Market*, Mortgage Banking, Jul. 1996; Gregory A. White, *Someone Else's Money,* Real Est. Fin. J. (Fall 1996).

41. For a further analysis of the benefits and disadvantages, see Brian Olason, *Commercial Mortgage Securitization: Capital Markets Fill A Void*, Real Est. Rev., Summer 1994, at 18. The Securities and Exchange Commission is considering proposing formal rules on the disclosures of information in the public offering of CMBS. *CMBS—SEC Mulls Disclosure Rules*, Commercial Mortgage Alert, Sept. 9, 1996, at 3.

42. *Traditional Lenders Re-enter Commercial Real Estate Lending Marketplace,* Special Report (Duff & Phelps Credit Rating Co., New York, N.Y.) (Oct. 1995).

43. A conduit is a process that connects the Main Street and Wall Street markets. A financial intermediary that sponsors the conduit (originally, the investment banks, and now more likely a commercial bank) makes or purchases loans from third-party correspondents on standardized terms, underwriting, documents, and pools those loans for sale to investors in the CMBS market. *See* Davis, *supra* note 19.

44. Michael Higgins, *Banks and Real Estate Securitization: The Time Is Now*, Mortgage Banking, Jan./Feb. 1997, at 34.

45. Jun Han, *To Securitize or Not to Securitize? The Future of Commercial Real Estate Debt Markets*, Real Est. Fin. J., Sum-

mer 1966, at 71. One super regional commercial bank has announced that "[u]nder the new policy, all view commercial mortgages are being underwritten to standards that will make them acceptable for securitization." Sally Gordon, *A Compelling Case for Commercial Real Estate Securitization,* Fixed Income Research Report (CS First Boston, Boston, Mass.), Sept. 7, 1994, at 8. By beginning with the CMM or a lender customized version, a primary market lender with a capital markets sensitive portfolio of commercial loans may enjoy greater liquidity with a more marketable pool of assets. Standard & Poor's announced at its June 1996 Real Estate Finance Conference that it is developing a system to rate whole loans secured by commercial real estate.

46. *Capital Flows: The New World Order, Emerging Trends in Real Estate*, (Price Waterhouse Coopers LLP and Land Lease Real Estate Investments (Oct. 2000)) at 28.

47. *CMBS in 2000 - A Quiet Year*, Commercial Mortgage Backed Securitization Update 2000-2001, Ernst & Young (2000).

48. *CMBS in 1999 - CMBS Market Highlights*, Commercial Mortgage Backed Securitization Update 1999-2000, Ernst & Young (1999).

49. Barbara Rubin et al., *Public Versus Private Markets: Comparing CMBS and Commercial Whole-Loan Yields*, Real Est. Fin. J., Fall 1996, at 39. Steven Bergman, *Banks Pump Life Into the Market for Commercial Mortgage Conduits,* Barron's, Jun. 12, 1995, at 48. *See* Tamara L. Adler, *Senior Housing. Alternatives and Implications,* Real Est. Fin. J., Fall 1996, at 68.

PRESIDENT'S MESSAGE
CONTINUED FROM PAGE 6

"What is it, Bob?"

"Well, I was just wondering how often formal charges are brought against lawyers that *don't* result in public discipline? You wouldn't happen to know that, would you?"

Effie pulled another booklet off one of the piles in front of her. "Hot off the press, Bob. New York State Bar Association Committee on Professional Discipline, Annual Report for 2000. Of the cases that went to formal charges and were processed in the courts last year, 234 resulted in public discipline. Only two resulted in private censures and only three were dismissed."

"That's only about 2% that didn't get public discipline. And that's with them making their decisions regarding formal charges on the assumption that it will all be private until the court rules. I'd assume they'd be even more careful if they're deciding on allowing charges to proceed in the context of public proceedings."

"You're not as dumb as you look, Bob."

"Thanks, Effie."

The sun gradually dimmed and sank over the fallow fields. Somewhere along the way Bob's soap operas made way for the early evening news, although Bob was never quite sure where the borderline was. By six, Bob and Effie Gunderson were at the dinner table, discussing the events of the day. After a few moments, Effie lay down her fork and prepared to speak. All indications were that she planned on saying something significant.

"Bob?"

"Yes, Effie."

"Did you know there are no lawyers in Winston?"

"There are only 85 *people* in Winston, Effie."

"And not one of them a lawyer."

"So?"

Effie walked into the next room and returned with a manila folder. "You know, tuition at the North Dakota law school is pretty reasonable."

Bob nodded and smiled. At that moment he knew that there would soon be a lawyer in the Gunderson family after all.

Businesses Considering Renting In Commercial Condominiums Face Unique Contractual Issues

BY MATTHEW J. LEEDS

In a growing number of circumstances, commercial developments involving both horizontal and high-rise properties are being presented in the form of condominium ownership. There are many reasons for this, including critical matters of financing.[1] Although the condominium form of ownership generally involves fee ownership of real property, where the landlord is a unit owner, the unique legal nature of this form of ownership significantly affects the landlord-tenant relationship.[2]

As the broadest example, in a normal landlord-tenant situation, the landlord who owns and operates the building can promise services and utilities to a tenant, but in the condominium form of ownership the immediate landlord (who is the owner of the condominium unit) may not have dominion over such matters, which are typically governed by the condominium's board of managers. Many other obvious and subtle issues arise in these circumstances. Accordingly, a careful tenant would want to identify the issues in a particular commercial condominium through the appropriate due diligence.

By definition, the owner of the condominium unit, who is the landlord, also needs to be sensitive to the concerns of prospective tenants and would engage in similar examinations. Through negotiation, the tenant would like to obtain both assurances that it will be able to get the benefits it bargains for and realistic mechanisms to enforce its rights against its landlord, or even against the condominium board and all of the unit owners.

A major tenant courted before the condominium is established might have the best chance of actually governing these matters. In such a situation, the tenant has the best opportunity to have its desired protections built into the condominium documents. For a tenant, this is an ideal situation, but the relative bargaining power of tenants will vary. In addition, especially once the condominium is created, the ability to institute a tenant's wish list of protections might be diminished. However, any tenant—large or small—would, theoretically, need to take into account all of the concerns that a highly desirable large commercial tenant would identify. Nevertheless, in any situation, an understanding of the situation the tenant would be stepping into is necessary for the tenant to make a business decision on whether to tolerate the risk if all of its concerns are not addressed perfectly.

Identifying Issues

This article provides a survey of these considerations by identifying the issues that would normally arise for a commercial tenant, suggesting some methods for performing due diligence to identify the special issues that might exist in a particular condominium, and describing some prospective methods of resolving competing interests to address these issues. Again, although the focus of the discussion is on the point of view of a major tenant who can command significant changes, it also reflects the concerns of any commercial tenant in a condominium.

Because condominiums are a creature of statute, state law must be reviewed for special considerations peculiar to the jurisdiction, specifically the New York Condominium Act, article 9-B of the Real Property Law.[3] In dealing with terminology, the common New York formulation is to refer to the space that is actually owned by an individual owner as a "condominium unit," while the entire development is referred to as the "condominium." (In some other jurisdictions these words have somewhat different connotations.)

MATTHEW J. LEEDS is a member of Robinson Silverman, Pearce Aronsohn & Berman in Manhattan. He is second vice president of the NYSBA Real Property Law Section and is past co-chair of its Condominiums and Cooperatives Committee. He is a member of the American College of Real Estate Lawyers. A graduate of New York University, he received his J.D. from the State University of New York at Buffalo and his LL.M. from New York University.

This discussion also assumes that a property has been fully given over to commercial use, as opposed to being a "mixed-use property," which would present many of the same issues with more highly concentrated particulars. The normal paradigm involves a condominium where the units are owned in fee simple ownership, as opposed to a condominium where the entire condominium property is subject to a leasehold. Also covered here is a condominium that is subject to other "umbrella" property owners associations in addition to the condominium regime itself.

The Condominium Form of Ownership

Like all other unit owners in the condominium form of ownership,[4] the landlord in the situations referred to in this article typically owns one or more of the various condominium units in the condominium. Each condominium unit is a separate parcel of real estate,[5] owned in fee simple, and is its own separate tax lot.[6] Each unit is fundamentally like a parcel of air space contained within the inside surfaces of the walls and ceiling (or other boundaries) that usually describe a particular space.

As a separate parcel of real estate, each condominium unit may be burdened by a separate mortgage that will affect no other condominium units, without the consent of those other unit owners.[7] Inextricably entwined with the ownership of a condominium unit would be the ownership of an undivided interest in what are referred to as the "common elements" of the condominium, generally the structural or shared areas of the condominium property. Typical common elements include the land on which the building is built, structural portions of the building, including the walls and the roof, and any common lobbies, hallways and spaces, including those that house building systems serving the condominium units. Each unit owner's proportionate interest in the common elements is frequently referred to as the "common interest" allocable to that unit. The unit owners are thus in many respects like tenants-in-common with respect to the common elements.

The unit owners together constitute a kind of association that is responsible for running the property. This association is managed by a board of managers elected by the unit owners. Although the board is responsible for running the association, it can separately hire professional management to handle much of that function.

To pay the expenses of operating the property, the board normally assesses each unit owner a certain portion of these costs in what are called "common charges." Although common charges are normally split up based on the unit owners' relative common interests, in commercial condominiums it is not unusual for a particular unit owner who uses a greater portion of some common element or taxes building services or facilities to a degree disproportionate to the common interest to be required to pay a greater share of expenses related to that item. Sometimes the condominium documentation calls for a specific allocation of expenses among the unit owners in a manner different than common interests.[8] In addition, some common elements may be allocated as "limited common elements" for the exclusive use of one or more units. Generally, the unit owner who has use of a limited common element has greater responsibility for the expenses and maintenance of those spaces than the unit owners who do not actually use them.

It is always significant to note that the expenses of operating of the condominium association do not normally include two of the most significant expenses of real property ownership: real estate taxes and the repayment of a mortgage. This is incidental to the fact that each condominium unit is itself a parcel of real estate, and it is only the obligation of the unit owner affected by the liens for mortgages and real estate taxes to pay them.

As security for the payment of a condominium unit owner's common charges, it is usual that the association (by the board of managers or otherwise) has a lien against each unit owner's unit with respect to the payment of such common charges.[9] In New York, this lien is generally subordinate to liens for real estate taxes and a first mortgage of record.[10] However, the Condominium Act does permit these priorities to be adjusted in a fully non-residential condominium.[11]

Those who are more familiar with residential condominium situations than with commercial condominium situations may be familiar with a common device by which a condominium association can become involved in the sale or leasing of a unit. That is, many residential condominiums provide that, in order to permit some common control over the unit owners or residents without flouting any common law restriction against unreasonable restraints on alienation, many residential condominiums require that a unit owner seeking to sell or lease its property offer a right of first refusal to the condominium association. Not surprisingly, in commercial condominiums, the business considerations dictate that a right of first refusal is not usually imposed on sales or leases by unit owners.

A property is subjected to the condominium form of ownership (*i.e.*, divided into the separate condominium units, each as a separate parcel of real estate and the common elements and subjected to the governing provisions of the local condominium statute) by recording or filing statutorily required documents. These materials are normally in the nature of a "declaration of condominium" and appropriate floor plan drawings indicating the locations of the separate condominium units and the common elements. The declaration normally incorporates or is accompanied by the by-laws of the condominium, which typically govern management and operation of the condominium.[12]

In the area of consumer protection, such as real estate securities laws in New York,[13] states often require that sale of condominium units be performed pursuant to an information statement or offering plan or memoranda. In some of those jurisdictions, information is merely maintained or compiled by the association or the developer. In New York, the offering statement is the subject of a separate filing with a government agency, the New York State Department of Law Real Estate Financing Bureau.[14] That agency reviews the materials to determine whether they are acceptable for filing. For some projects, when it is deemed upon application that the requirement of an offering plan does not fulfill a necessary statutory or public purpose, the Department of Law has authority to issue a "no-action" or "no-jurisdiction" letter. It essentially states that, based on the application, a full filing is not required. Any offering materials would not normally be required to be provided to tenants, but, if available, they might provide an interesting source of information for a tenant renting a unit.

The expenses of operating the condominium association do not normally include two of the most significant expenses of real property ownership: real estate taxes and the repayment of a mortgage.

The basics of the condominium structure suggest issues that can arise for tenants looking to rent a condominium unit. To identify which generic structures affect the particular condominium, however, and to flush out any idiosyncratic issues that might exist with respect to a particular condominium, a lawyer will normally engage in a certain amount of due diligence.

Due Diligence

In any situation, a tenant will perform certain kinds of physical and business examinations before deciding whether a particular property is appropriate. For example, a tenant and its experts (other than the lawyer) would be expected to conduct a physical inspection of the property, determine whether the building systems purportedly available are adequate to support the tenant's needs, investigate the reputation of the property and the developer (if relevant) and like matters. The lawyer is normally asked to review any requested documentation that might inform issues raised by the tenant. Equally important is the lawyer's review of appropriate documentation to suggest issues that the tenant might have had no reason to expect.

Documentation is rarely standard and is frequently tailored to a particular circumstance. As with many situations, the lawyer can anticipate general categories, but does not know how they will be phrased in a particular instance, nor whether there will be any surprises. Thus, legal review will frequently involve the following documents, to be reviewed provision by provision to determine how a particular condominium structure might affect the client. Specifically, the lawyer might be asked to review:

- *The Condominium Act*. In a profession of increasing specialization, even seasoned leasing lawyers may find it appropriate to engage colleagues who are more conversant in condominium law and practice to review a lease of commercial space. If the property is located in another state, consultation with local counsel is recommended.
- *Certificate of Occupancy*. Although this would normally be a part of the physical inspection conducted by the client and its other experts, there may be occasions when required use issues or local statutes suggest that the lawyer review the certificate of occupancy as it pertains to the contemplated space.
- *The Declaration of Condominium and the Condominium By-laws*. In most instances, an examination of these fundamental documents is the meat of the attorney's due diligence analysis. Together, these documents lay out how the condominium unit is described, the services that will be provided to the unit, and the obligations that will fall on the unit owner. Critically, these documents indicate who is in charge of different aspects of condominium operations and whether the landlord will actually be able to deliver services and other promises made under the lease to the tenant. Even if the initial documents indicate that the landlord will have full rights to perform for the tenant, the documents will also indicate whether the condominium can change its rules and operation in the future in a manner that could subvert matters contemplated by the lease.

In combination with a review of the condominium statute, these documents will also indicate whether the landlord-owner of the condominium unit will be subject to a lien on behalf of the board which, if foreclosed for nonpayment of common charges or other nonperformance, could lead to a cancellation of the lease.

- *Rules and Regulations of the Condominium*. The extent to which these rules affect the tenant, and the extent to which they could be changed by somebody (*i.e.,* the other unit owners) other than the landlord (who is just one of the unit owners), are important considerations for any tenant. Actually, these concerns will often be dealt with by a review of the declaration and by-laws.

• *The Offering Plan, if Any*. These documents normally recite a considerable amount of information. If the particular condominium has been created without an offering plan because of an exemption or administrative permission, it would be of interest to document such consent. Certainly, it is always of interest to determine whether the condominium was properly created (and therefore, among other things, that the landlord actually owns what is being leased to the tenant).

• *Condominium Floor Plans*. Although an examination of the floor plans is normally considered in conjunction with the physical inspection of the property, the condominium floor plans are often the source of the description of the condominium units themselves and the common elements. Regardless of the presentation by business people on behalf of a landlord or the understanding of the tenant's experts, the condominium documentation itself should be checked to make sure that it actually describes the demised premises as part of the condominium unit owned by the landlord. In addition, an examination of the floor plans will indicate whether building facilities exclusively allocated to the tenant are actually within the control of the landlord in its own unit, or are subject to control by the board of managers or the other unit owners, as a common element.

• *Title Insurance.* The issue of title insurance is very similar to the issue of whether a tenant in a conventional landlord-tenant relationship is interested in title insurance, to support its own interests or for reassurance that the landlord is the owner of the anticipated space. In addition, because the space to be leased out as a condominium unit is a separate parcel of real estate, issues regarding existing lienors and other aspects of the landlord's status and well-being can be of great interest.

• *Books and Records of the Condominium*. These include (1) financial statements of the condominium; (2) minutes of meetings of the Board of Managers; (3) minutes of meetings of unit owners; (4) accountant's statements such as certified financials; and (5) miscellaneous correspondence and statements included in the foregoing or maintained separately with the records. Frequently, examination of most of these materials takes place in the office of the managing agent for the condominium. This opens a broad area, where the recital of incidental fact could provide desired insight into a deal. For example, an indication in financial statements of difficulties in collecting common charges from other major unit owners, or references to major work that needs to be performed, could reflect an inadequacy in the physical plant or suggest a forthcoming additional assessment. At the same time, such due diligence frequently allows an opportunity to speak with the individuals actually involved in management to ask them generally about operation of the property. Such casual interviews can sometimes elicit interesting current information or a better overview than would be available from the dry documents themselves. Actually, a typical review of these materials often yields much information that it is not necessary to describe separately to the client. On the other hand, it can reveal important facts.

Any provision allowing the escalation of real estate taxes should be reviewed to make sure that it reflects the appropriate measure of taxes against the units.

• *Review of Unit Owner's Mortgage and Other Due Diligence*. These are matters that would normally be conducted with respect to certain leases. They include the availability of non-disturbance agreements (presumably in conjunction with subordination agreements) and other matters that are routine for the experienced leasing lawyer.

A lawyer's normal review of due diligence materials when the landlord has presented a proposed lease typically raises practical and legal issues. It is usually profitable to identify these ahead of time, particularly when the landlord has not anticipated the tenant's concerns in the draft lease. The organization of negotiation between the parties might begin with a general meeting about these kinds of global concerns. Ideally, this might even precede any drafting exercise. Actually, in some development situations, a large tenant might be involved in planning the entire condominium, and so might have a say in the way the condominium documents are drafted. If not, many of the considerations will be the same and the parties must seek to address the concerns in other ways (subject to bargaining power and other practicalities).

Sample Concerns

Due diligence and a general understanding of the condominium situation are likely to bring out a mix of generic issues and issues particular to a deal.

As an overall matter, it can be interesting throughout a condominium lease review to keep in mind the similarities to a conventional sublease, where the subtenant is not in privity with the person who has actual ownership and control of the property.[15]

Examples of typical concerns and some brief thoughts on how they can be addressed include the following:

• *Services, Use, Rules and Regulations*. In the condominium, the board of managers, acting as the representatives of all of the unit owners, governs the operation of the property, tempered by the provisions of the condominium documents. The tenant must be sure that its landlord can provide everything that is promised in the lease. The tenant and the landlord, in turn, must determine whether the landlord in the first instance has the right to require the board to provide the services the landlord has promised. These can be as direct as the provision of heating, ventilating and air conditioning, provision of parking, use of loading facilities, maintenance of signage on the exterior of the building and the like. One aspect of this examination involves determining whether areas that must be accessible to the tenant are actually technically part of the landlord's condominium unit, or whether they consist of common areas (such as entrance ways and parking). It is often not enough for a tenant if the landlord has an obligation to provide services, but the landlord cannot itself require that they be provided. Rules of operation of the building, such as limits on hours or provisions or heat, or hours during which a loading dock may be used, can significantly detract from the rights that a tenant would normally require in the lease. Another area of critical examination is the permitted use of the property. In particular, a tenant whose lease is by its terms subject to the declarations and by-laws might be told by a landlord that the tenant should have realized that the condominium might not provide services for the unit owner-landlord, so the tenant is out of luck.

• *Obligations of Tenants as Unit Owners*. A typical drafting anomaly in many condominium documents suggests that, for the purposes of the condominium documents, unit owners shall be deemed to mean not only unit owners, but also their tenants, and sometimes their licensees and guests. Presumably, such drafting was meant to suggest that tenants would be subject to the same restrictions as unit owners, and to require unit owners to police the behavior of their tenants. Unfortunately, carrying such logic through a document would mean that a tenant could be asserted to have all of the obligations of a unit owner. This makes sense with regard to day-to-day behavior at the property, but is not necessarily intended to suggest that a tenant has the unit owners' fundamental obligations to pay common charges or would be subject to a lien for such payment.

• *Lien for Non-Payment of Common Charges*. Typical condominium statutes and typical condominium documents provide security for the payment of common charges by establishing a lien against a unit owner's unit in favor of the board of managers. A tenant would be concerned that such a lien would be a superior right to the lease and that foreclosure could wipe out the lease.

• *Insurance, Casualty and Condemnation*. Because of the nature of a condominium, with the fundamental structure of the improvements being owned essentially in common by all unit owners, fundamental casualty insurance is obtained by the board of managers on behalf of the unit owners. Although the general rule under the Condominium Act is that the condominium will be obligated to restore the property in the event of a major casualty, this rule does not apply in catastrophic circumstances. In fact, where loss involves 75% or more of the property, 75% of the unit owners must agree to restore, or the property will be subject to a partition and, presumably, termination of the condominium.[16] Such provisions might contradict the provisions in a lease. In addition, the parties should work to assure that insurance obtained separately by a tenant would not conflict with or be negated by a condominium policy. The parties should determine from insurance experts the necessity for mutual waivers of subrogation, defenses based on acts of the insured, and the like.

• *Rent and Common Charges*. Common charges do not necessarily represent the operating expenses that are strictly relevant to the tenant. A tenant should examine the appropriate lease provisions to determine whether it is appropriate to tolerate a direct pass-through of common charges. In particular, if the lease seeks to require a tenant to assume a portion of increased expenses for the entire property, it should be determined whether there is a way to account for such expenses properly and whether common charges actually serve as a measure of such operating expenses to be passed along.

• *Real Estate Taxes*. Any provision allowing the escalation of real estate taxes should be reviewed to make sure that it reflects the appropriate measure of taxes against the units. Because the unit will have its own real estate tax bill, rather than a fixed percentage of the total tax bill for the entire project, the normal real estate tax escalation provision should be adjusted accordingly. In addition, condominium documents can provide that any grievance of taxes would be coordinated by the board, but a tenant might want to resist such a unified effort, depending upon the circumstances and the jurisdiction.

• *Ability to Finance the Lease*. Concerns of potential leasehold mortgagees should be considered, including concerns about whether the mortgagee would be entitled to copies of notices in the event of a unit owner's default under its obligations to the condominium, and would be extended possible rights to cure.

• *Alterations and Work.* The ability to perform work in the space will be governed by limitations in the documentation and rules and regulations of the condominium, including matters pertaining to work that will affect common areas or building systems, insurance issues, and even questions of when work can be performed.

• *Consents*. It is not unusual for lease provisions to require that a tenant may perform a certain act (such as the performance of work on its space) with the consent of the landlord, with a frequently modified position being that such consent cannot be unreasonably withheld. Similar provisions occur frequently in condominium documents, where such activities can be performed by unit owners with consent of the board, provided that they are within certain reasonable bounds. Regardless of whether the "reasonableness" standard modifies the issue of consent, any tenant must recognize the potential problem of asking for consent from a landlord, who would otherwise give it but is then prohibited from giving such consent by the condominium documents or by the board. Additional problems arise if the landlord cannot unreasonably withhold consent but there is no similar standard of cooperation imposed on the board. Furthermore, even if both the landlord and the board are required to behave reasonably at their respective levels of involvement, there may be instances where the board seeks to withhold its consent for a consideration that is reasonable in the subjective position of the board, but might not be reasonable in the different position of the landlord. There might also be an instance in which an owner of a building would give consent, but the board might have some special concerns because of the condominium form of ownership, such as the objective concerns of other tenants or issues relating to common property.

• *Further Subdivision of the Unit*. The landlord-unit owner might have a right under the condominium documents to cause the unit that is the subject of the lease to be split into one or more condominium units. Because this is just a matter of documentation, it does not necessarily require physical work. However, the landlord would then own multiple pieces of real property, all subject to the lease. Presumably, each unit could end up being owned by a different owner, thus creating issues of multiple ownership for the tenant suddenly occupying the property of more than one owner.

• *Termination of Condominium Ownership*. Either by operation of law or by a vote of unit owners, a condominium can be terminated.[17] In that situation, the landlord who previously owned a discrete parcel of real property that was rented to a tenant no longer is the technical direct owner of the premises. The tenant's position is somewhat unsure, but it would appear that all unit owners would become tenants-in-common for the entire property.

• *Amendments to Condominium Documents*. Condominium documents are normally subject to amendment by a vote of unit owners (sometimes also requiring the vote of mortgagees of unit owners). Naturally, if a tenant evaluated its position in a condominium based upon the condominium documents, its position could be changed by an act of the unit owners amending the provisions previously relied upon for comfort.

The most general principle to be invoked is that a tenant would like to know that it can require the rights it bargained for in the lease can be implemented.

Sample Drafting Mechanisms

The imagination of lawyers can suggest myriad ways to deal with these concerns. Regardless of how clever a strategy might be, its use might be limited by the bargaining positions of parties, their energy and other practicalities affecting a given situation. Still, it is appropriate to suggest some sample approaches to concerns raised above.

The most general principle to be invoked is that a tenant would like to know that it can require that the rights it bargained for in the lease can be implemented. (That is, a tenant should not have a landlord make a hollow promise, which can only be redressed by an action for damages against the landlord). In some instances, this would suggest an attempt to make sure that the landlord-unit owner has a right as against the condominium to obtain the necessary services and rights. The landlord would then agree in the lease to provide the services and give rights to the tenant (thus permitting the tenant recourse against the landlord for failure to provide such services). In other instances, a tenant might seek assurance that the board and other unit owners would respect the rights of the tenant, and might even seek more direct privity with them in the condominium documents or in separate agreements. Not surprisingly, experience has shown that in a major development where the presence of the tenant is a critical component of the success of the project, a tenant might be able to arrange for condominium documents to respect its interest. Such a tenant's "wish list" can inform any tenant's negotiation. In such situations, techniques include:

• *Deal with Specifics*. If a tenant can identify matters that it needs to make sure are provided by the entire building, the condominium documents can provide intensive detail on issues such as the provision of heat to the unit, the number of parking spaces applicable to the unit, the hours of operation and the like. This might create a problem of flexibility in the future, however. In addition, it is important to make sure that the critical provisions cannot be amended subsequently. It would always be worrisome if some specific matter had not been considered by the imagination of the business people and attorneys at the time of drafting the document, only to have it later become an important consideration.

• *"Subordination" of Condominium Documents to the Lease*. One shorthand approach to a tenant's concerns would be to suggest that the operation of the condominium and all condominium documents would be subject to the rights of the tenant and the operation of the property as required pursuant to the lease. Some practitioners express the view that any lease existing before the condominium document is recorded would be in this superior position. (This argument, in part, includes a supposition that all unit owners succeed to the interests and obligations of the original owner of the property, who was the original landlord.) However, an explicit "catch all" statement to this effect in the condominium documents, specifically identifying a particular lease, might express an important governing doctrine for the protection of a tenant. Further, a tenant might seek a provision in the condominium documents recognizing not only the existence of the lease, but explicitly stating that the board and all unit owners recognize that the condominium would operate in such a way as to provide everything required under the lease to the tenant, and not to diminish such rights or to increase any obligations of the tenant.

• *Issue of Consents*. To address the concern of a landlord not giving consent under a lease because the condominium's consent under the condominium documents was withheld, a tenant might seek to have the board limit its rights of consent in certain matters, such as (1) the Board's consent being deemed given if the landlord gives its consent (whether or not it could be reasonably withheld); or (2) the landlord agreeing that it would not be a reason for withholding consent that the condominium did not give consent (thus giving a tenant rights against the landlord, although the tenant might still not be able to perform the act which was requested); or (3) having the board agree that in such a situation it would be required to give consent if a landlord who owned the entire property would be required to give consent, independent of the condominium form of ownership.

• *Restrictions on Amendments*. If specific rights of a tenant are protected in condominium documents, it can only be meaningful if the documents cannot be amended by the unit owners in a way that would diminish those rights. Accordingly, the provisions in the documents that permit amendments might be changed so they would prohibit any amendment that would affect the lease without the consent of either the tenant and/or the owner of the unit which contains the demised premises.

• *Protection Against Board's Lien for Common Charges*. The documents themselves, or a separate agreement with the board, could provide recognition and non-disturbance of the tenant in the event that the unit is foreclosed upon by the board. In addition, the tenant, both on behalf of itself and any mortgagee, might request mortgagee-type protections of copies of the notices of unit owner's default to the condominium and an opportunity to cure such defaults. Some commercial condominium documents recognize the concern of tenants with respect to the lien for common charges and actually have been drafted by developers to provide the automatic recognition, non-disturbance and attornment of leases covering spaces in excess of a certain minimum size.

• *Insurance*. Tenants might seek provisions in condominium documents or separate agreements pursuant to which the parties would agree that (1) any insurance of the tenant, the unit owner and of the board or other unit owners would include appropriate provisions so that their insurance policies would not conflict and/or (2) that the parties would enter into such side agreements as would be necessary so as to keep the scheme of insurance in place (such as an agreement, if necessary, not to sue each other in such a way as to negate a waiver of a claim that a covered act was an act of the insured). These might include waivers of subrogation, defenses for acts of the insured and the like.

• *Restoration*. A tenant would seek to have condominium documents recognize that the portion of the condominium property consisting of the demised premises be restored in accordance with the obligations of the landlord under the lease with respect to casualty. Where the law (on 75% destruction)[18] or condominium documentation might require an affirmative resolution of unit owners to restore, a tenant might seek a power of attorney and proxy from all unit owners in the event of such a vote (whether these run in favor of the tenant or in favor of the tenant's landlord). The condominium documentation itself might provide for these powers of attorney and proxies (presumably to attempt to bind all present and future owners).

• *Multiple Owners*. If the premises are contained in more than one unit, or if there is a prospect of an existing unit being further subdivided into more than one unit, a tenant might seek to require that there only be one party for the tenant to deal with. Otherwise, it would create difficult administrative problems, as well as the possibility of receiving different treatment with respect to different landlords. One sample mechanism would be for the landlord to agree that the owner of a particular portion of the space would be deemed the agent for all of the owners, and that the tenant would only be required to give notice and deal with that one agent, who would be authorized to speak in a binding way on behalf of all of the landlord-unit owners.

• *Termination*. A tenant might seek a provision that, in the event of termination, not only would the lease be deemed to remain in place, the original landlord would be deemed to be the *de facto* owner of the portion of the premises subject to the lease, and would be the agent for all of the other owners with respect to whom the tenant would deal. The tenant would also want all owners to be held responsible jointly and severally for the performance of the landlord's obligations under the lease.

• *Enforcement Rights*. A tenant might seek not only for the condominium documents to provide that its landlord be the unit owner having a right to require the condominium to provide everything which has been negotiated in the lease but the tenant might also seek to have the condominium agree that the tenant, as a person named in the condominium documents, would have a right to claim such benefits. In addition, a tenant might seek to have both the lease and the condominium documents recognize a right of the tenant to pursue enforcement of such rights directly against the board and other unit owners. To the extent that the condominium documents and/or operation of the condominium is subject to the lease, a tenant would like the board and the unit owners to recognize their obligations to provide the landlord's responsibilities to the tenant, although this might be taken as an extreme position in certain circumstances. In fact, in order to mollify other unit owners, it might be appropriate in many situations for a tenant to agree that enforcement of its rights against other unit owners would be limited to equitable remedies to make sure that appropriate services were obtained, at the same time suggesting a limitation on damages which could be sought against the unit owners (but leaving the opportunity to pursue damages from the landlord-unit owner or an obstreperous board).

Conclusion

This survey of the concerns of tenants taking space in condominium units can only be read in light of the specifics of a particular project. In addition, although a major tenant in a development deal might have significant opportunity to negotiate its wish list of protections in condominium documents, many situations will not allow a tenant to protect itself in this manner.

All the same, a discussion of these items raises the concerns that all tenants should consider. In fact, for a developer to be successful, the concerns of prospective tenants might be anticipated and addressed in formative condominium documents. To go full circle, it should be recognized that these deals only start at the beginning of negotiations for such a lease with a statement of general principles and approaches derived from due diligence.

---

1. David Clurman, The Business Condominium (1973).
2. Matthew J. Leeds, *Special Considerations of a Major Tenant Taking Space in a Commercial Condominium*, The ACREL Papers, Fall, 1999.
3. N.Y. Real Property Law § 339 (hereinafter "RPL").
4. *See, e.g.*, David Clurman & Edna Hebard, Condominiums and Cooperatives (1970); Patrick Rohan & Melvin Raskin, Condominium Law and Practice (2001); William Jay Lippman, Condominium and Co-op Closings: A Practical Guide to Residential and Commercial Properties, (3rd ed. 2000); Matthew J. Leeds & Walter Goldsmith, New York Practice Guide: Cooperatives & Condominiums (1986).
5. RPL § 339-e.
6. RPL § 339-y.
7. RPL § 339-l.
8. RPL § 339-m.
9. RPL § 339-z, 339-aa.
10. RPL § 339-z.
11. *Id*.
12. RPL § 339-u.
13. N.Y. General Business Law article 23-A (the "Martin Act") §§ 352-c - 352-k.
14. *See, e.g.*, N.Y. Comp. Codes R. & Regs. tit. 13, pt. 20, (Regulations Governing Newly Constructed, Vacant or Non-Residentials.)
15. Andrew Herz & Russell Wohl, *Subleases: The Same Things as Leases, Only Different*, 35 Real Prop., Prob. & Tr. J. 667 (2000).
16. RPL §§ 339-bb, 339-cc.
17. RPL § 339-t.
18. RPL §§ 339-bb, 339-cc.

Understanding Mechanic's Liens Reveals Approaches to Thwart A Developer's Improper Filing

By Brian G. Lustbader

A mechanic's lien is as easy and inexpensive for a lienor to file as it is costly and time-consuming for the property owner to discharge. All that the prospective lienor need do is file a short (one page) form with the clerk of the county in which the subject property is located. No attorney is required and, until a recent amendment of the New York Lien Law, the lienor could keep his or her lien indefinitely by obtaining one-year extensions each year after the initial filing.[1]

Yet such a simple filing can and often does create significant title and loan problems for the owner of the property subjected to the lien. Lenders often require that the properties be kept "lien-free," and, in addition, title cannot be conveyed without discharging any liens that exist. With this type of leverage available from such a simple filing, a mechanic's lien is a potent weapon in the hands of an unscrupulous individual. For that reason, there clearly is great value to any method that enables a property owner to discharge a meritless lien without waiting for a full-blown lien foreclosure proceeding. This article describes the remedies available to the private property owner, and then focuses on liens asserted not by a contractor or a materialman, but by a developer.

Before analyzing the methods used to discharge a lien, it is important to understand the purposes underlying the Lien Law itself. The statutory scheme was not designed to protect each and every person who performed a role in the improvement of real property. Rather—and undoubtedly in recognition of the cloud on title and the other adverse ramifications of a filing—the law's protection was limited to the class of people who directly perform labor or furnish materials. These include contractors, subcontractors, suppliers, laborers and the like.[2] In recent years, that class has been expanded slightly to remedy perceived abuses against (or simply to provide additional protections for) two additional groups of individuals—architects and real estate brokers.[3]

Methods for Discharging Liens

As the foregoing demonstrates, the class of companies or individuals who may legitimately assert a mechanic's lien on a private (or public) improvement is limited. Even so, if a property owner believes that a lien against the property was wrongly filed, there are few options available to discharge that lien.

There are four basic methods. First, the owner may "bond" the lien, that is, apply to the Supreme Court or the County Court of the county in which the property is located to file a bond, in an amount set by the court, to substitute as security for the debt allegedly owed in the place of the property itself. Such a procedure is not terribly time-consuming (it can be accomplished in a few weeks) and is relatively inexpensive in terms of attorney's fees and court costs. The problem is that the owner often must post collateral in the amount of the bond as set by the court (usually 110% of the amount of the lien), and this collateral must remain in place until the lien is satisfied or litigated, which can take years. When a lien is inflated, this problem can be especially onerous for the owner, as additional collateral will be tied up for the duration of that lien. However, this procedure is always available, regardless of how the owner utilizes any of the other procedures described below.

Another option available to the owner is to counterclaim against the lienor for willful exaggeration of the lien. If successful, the owner may be able to have the lien reduced to the proper amount, or even to have the lien dismissed in its entirety. In addition, the lienor may be required to reimburse the owner for his or her costs in obtaining such an order, including reasonable attorney's fees expended in the owner's effort to establish the

Brian G. Lustbader is counsel to Mazur, Carp & Rubin, P.C. in Manhattan and a member of the Real Property Law Section of the NYSBA. He litigated the referenced case on behalf of the owner. A graduate of Massachusetts Institute of Technology, he received his J.D. from Columbia University School of Law.

amount of the exaggeration.[4] This option may have some *in terrorem* effect on the lienor, that is, it may frighten the lienor into being reasonable with settlement demands, or even may encourage the lienor to withdraw the lien without further litigation.

However, if the lienor is not frightened off by the counterclaim,[5] the owner must then either force the commencement of a foreclosure (discussed below), or wait until the lienor begins the foreclosure action on his own—and the latter may not occur until years after the filing (unless the willful exaggeration can be shown on a summary judgment motion, a difficult task at best).

Few reported cases involve a lien that was stricken under Lien Law § 19(6), and none of them involves a lien asserted by a developer.

A third procedure prevents the lienor from extending his or her lien for years, and allows the owner to obtain an adjudication of the lien's merits as rapidly as possible. This is simply a demand upon the lienor to initiate a foreclosure action within 30 days; if the lienor does not comply, the lien will be discharged.[6] The advantage of this demand, other than the obvious acceleration of the foreclosure proceeding (or, if the owner is fortunate, a lienor default and the resultant lien discharge), is that it requires the lienor to incur significant and immediate expenses in the form of attorney's fees and the like. The disadvantage is that if the lienor does "pick up the gauntlet" the owner must still await the entire legal process, including pre-trial document discovery, interrogatories, and depositions, plus a full trial, before resolution—all while incurring legal fees.

The only other option that allows immediate discharge, without committing funds in the form of a lien bond for discharge, is the rarely-used procedure of petitioning the court to dismiss a lien on its face.[7] The reason that this procedure is rarely used, and cases on the subject rarely published, is that it is typically available only when there is a fatal defect that is apparent from the face of the lien itself, *e.g.*, an incorrectly named owner, or a lien filed beyond the period of limitations set forth in the Lien Law.[8] However, should a particular lien fall within category, the advantages of a Lien Law § 19(6) petition are obvious. In a relatively expedient, cost-effective fashion, an owner can be rid of a nettlesome lien soon after it is filed.

Denying a Developer the Right to Lien

The developer's role is often central to the improvement of real property, but his rights under the Lien Law, and those of the owner whose property he has been "developing," have not been subject to extensive judicial scrutiny.

As indicated above, few reported cases involve a lien that was stricken under Lien Law § 19(6), and none of them involves a lien asserted by a developer. Therefore, a decision last year by Justice Stanley L. Sklar of Supreme Court in New York County addressing this situation is a welcome addition to the case law.[9] The opinion clarifies a number of issues that can arise under Lien Law § 19(6), including the type of services for which a lien may be filed, the class of claimants permitted to file liens, and the circumstances under which a lien may be dismissed because of facial defects.

The case itself dealt with two liens filed by an individual and his wholly-owned company, claiming that they acted as developers of two building renovation projects in lower Manhattan. Each lien contained the following, identical description of the services allegedly provided: "professional services rendered, as developer, in connection with the coordination, supervision and direction of the development of the premises known as and by the street address of . . ."

By way of background, the owner had obtained a loan from a single lender to cover the renovation costs in both premises. The developer's fees were recited as a line-item cost to be paid each month on a proportional basis. A few months into construction, the owner defaulted on the loan and construction ceased. The aggregate value of both claimed liens exceeded $3.5 million. This was the full amount of the development fees recited in the loan documents, even though, as noted above, the project had ceased after only a few months.

The lender then foreclosed against the owner on its loan. In that proceeding, the developer, one of the various mechanic's lienors named in the mortgage foreclosure action, asserted his lien claim. In response, the owner counterclaimed against the developer for willful exaggeration of the lien. New financing was obtained, but because of the magnitude of the liens the owner was required to escrow funds well in excess of what was claimed in order to satisfy its subsequent lender.

Given the adverse impact the lienors were having on the projects, the owner chose to take aggressive action against the liens, and brought a Lien Law § 19(6) proceeding independent of the mortgage foreclosure, as permitted by statute.[10] The owner and initial lender ultimately settled the foreclosure action, and the owner and the developer were left to litigate between themselves regarding the liens that had been filed.

Because there were no prior cases under New York's Lien Law that dealt with the validity of liens filed by developers, the parties argued by analogy. The owner relied on cases that emphasized how the Lien Law's protections are limited to those who perform direct, on-site services (or who furnish materials) that were actually incorporated into the subject real property improvement,[11] except where the Lien Law specifically permits a claim for particular types of off-site services, *e.g.*, architectural or real estate brokerage services.[12] In response, the developer pointed to the leading cases in which construction *supervisors* had been permitted to file liens for their services.[13]

Ironically, however, the cases cited by the developer proved useful to the owner. Justice Sklar noted that these decisions held that liens may not be filed for services such as negotiation of subcontracts, coordinating contractors, etc.—in short, services that do not necessarily need to be performed at the construction site itself. The court struck the liens.

In granting petitioners' application, Justice Sklar emphasized the requirement that the lienor have expended labor *directly* in improving the real property, citing Lien Law §§ 2(4) and 3, together with two cases decided thereunder.[14] Because there was no New York authority directly on point, Justice Sklar also cited leading authorities outside New York: the Supreme Court of Indiana and an intermediate appellate court in Illinois that had ruled developers may not lien for their services.[15]

Justice Sklar held that, "while supervisory services may form the basis for a lien . . . [such supervision] must be of actual, on-site construction work . . . [and the] performance of collateral supervisory functions, such as the negotiation of contracts or the procurement of bids . . . constitute non-lienable work."[16] Justice Sklar indicated, however, that his decision did not affect the viability of any contract claim that the developer might have against the owner, thereby negating any argument that the developer was being denied an opportunity to pursue his claim in court.[17]

Conclusion

This ruling expressly confirms two important points. Developers cannot qualify as "contractors" within the meaning of the Lien Law because they perform executive level services that are, by their nature, essentially off-site and removed from the day-to-day work on the project. This remains true even if those services are extensive, such as arranging for financing, planning and marketing the project, negotiation of contracts and subcontracts, and oversight of contractors. Further, liens for such services are subject to immediate discharge under Lien Law § 19(6). Owners and developers must now be guided accordingly.

---

1. Until recently, N.Y. Lien Law § 17 permitted unlimited extensions of one-year duration, obtained by *ex parte* court order, for private improvements. Under Lien Law § 18, the limit of each extension for public improvements was six months. However Lien Law §§ 17 and 18 were amended by 2000 N.Y. Laws ch. 324, § 1, to provide that effective January 1, 2001, lienors will be entitled to obtain only two such additional one-year extensions for both public and private improvements.
2. "A contractor, subcontractor, laborer, materialman . . . who performs labor or furnishes materials for the improvement of real property . . . shall have a lien for the principal and interest, of the value, or the agreed price, of such labor. . . ." Lien Law § 3. "The term 'contractor,' when used in this chapter, means a person who enters into a contract with the owner of real property of the improvement thereof. . . ." *Id.*, § 2(9). "The term 'laborer,' when used in this chapter, means any person who performs labor or services upon such improvement." *Id.*, § 2(11).
3. *See Robert Plan Corp. v. Greiner-Maltz Co.*, 229 A.D.2d 122, 655 N.Y.S.2d 648 (2d Dep't 1997) (real estate brokerage services).
4. Lien Law § 39 states:

   > In any action or proceeding to enforce a mechanic's lien upon private or public improvement or in which the validity of the lien is an issue, if the court shall find that a lienor has willfully exaggerated the amount for which his claims a lien as state in his notice of lien, his lien shall be declared to be void and no recovery shall be had thereon.

   Lien Law § 39-a states:

   > Where in any action or proceeding to enforce a mechanic's lien upon private or public improvement the court shall have declared said lien to be void on account of willful exaggeration the person filing such notice of lien shall be liable in damages to the owner or contractor. The damages which said owner or contractor shall be entitled to recover, shall include the amount of any premium for a bond given to obtain the discharge of the lien, . . . reasonable attorney's fees for services in securing the discharge of the lien, and an amount equal to the difference by which the amount claimed to be due . . . as stated in the notice of lien exceeded the amount actually due . . . thereon.
5. Only a handful of such cases has resulted in any severe penalty, as it is very difficult to demonstrate that the lienor has acted "willfully."
6. Lien Law § 59 states:

   > A mechanic's lien notice of which has been filed on real property . . . may be vacated and canceled . . . by an order of a court of record. Before such order shall be granted, a notice shall be served upon the lienor. . . . Such notice shall require the lienor to commence an action to enforce the lien, within a time specified in the notice, not less than thirty days from the time of service. . . . Proof of service and that the lienor has not commenced the action to foreclose such lien, as directed by the notice, shall be made by affidavit, at the time of applying for such order.

7. Lien Law § 19(6) states:

   > Where it appears from the face of the notice of lien that the claimant has no valid lien by reason of the character of the labor or materials furnished and for which a lien is claimed, . . . the owner or any other party in interest, may apply to the supreme court of this state, . . . for an order summarily discharging of record the alleged lien. . . . The application must be made upon a verified petition . . . and upon the approval of the application by the court, . . . an order shall be made discharging the alleged lien of record.

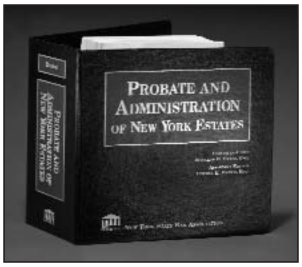
8. For example, in *Atkinson v. Tiscione*, 150 Misc. 2d 971, 972, 571 N.Y.S.2d 189, 190 (Sup. Ct., Schenectady Co. 1991), the court dismissed a lien for financial consultant services. *See also FCZ Corp. v. Blais Deli, Inc.*, 135 A.D.2d 535, 536, 522 N.Y.S.2d 16, 17 (2d Dep't 1987), (lien claim for wrongful termination of employment agreement summarily dismissed under Lien Law § 19(6)).
9. *In re 110 Church LLC, et al.*, (Sup. Ct., N.Y. Co., Sklar, J.), N.Y.L.J., 9/20/00, p. 27, col. 2.
10. *See* Lien Law § 19(6), quoted in note 7, *supra*.
11. See the provisions of the Lien Law quoted in note 2 *supra*.
12. *See* Lien Law § 2(4); *see also Robert Plan Corp. v. Greiner-Maltz Co.*, 229 A.D.2d 122, 655 N.Y.S.2d 648 (2d Dep't 1997).
13. *Goldberger-Raabin, Inc. v. 74 Second Avenue Corp.*, 252 N.Y. 336 (1929); *Carl A. Morse, Inc. v. Rentor Industrial Development Corp.*, 85 Misc. 2d 304, 306, 379 N.Y.S.2d 994, 999 (Sup. Ct., Queens Co. 1976).
14. In this connection the court cited *West-Fair Electric Contractors v. Aetna Casualty & Surety Co.*, 87 N.Y.2d 148, 638 N.Y.S.2d 394 (1995), and *Chas. A. Sells, Inc. v. Chance Hills Joint Venture*, 163 Misc. 2d 814 (Sup. Ct., Westchester Co. 1995).
15. *Premier Investments v. Suites of America, Inc.*, 644 N.E.2d 124 (Sup. Ct., Ind. 1994); *First Bank of Roscoe v. Rinaldi*, 262 Ill. App. 3d 179, 199 Ill. Dec. 850, 634 N.E.2d 1204 (Ill. App. 2d Dist. 1994).
16. Citing *Henry & John Assocs. v. Demilo Construction Corp.*, 137 Misc. 2d 354, 520 N.Y.S.2d 340 (Sup. Ct., Queens Co. 1987); *Goldberger-Raabin*, 252 N.Y. 336; *Carl A. Morse*, 85 Misc. 2d 304.
17. A separate issue that was briefed by the parties, but only indirectly decided by the Court, was whether extrinsic evidence could be submitted to defeat, or sustain, a lien that might otherwise be considered defective. *See DiCamillo v. Navitsky*, 90 Misc. 2d 923, 925, 396 N.Y.S.2d 585, 587 (Sup. Ct., Putnam Co. 1977) (lien summarily discharged and extrinsic evidence rejected where admitting the extrinsic evidence would serve "no useful purpose"). By reviewing the arguments raised by the parties in their supporting affidavits Justice Sklar implicitly ruled that such extrinsic evidence could be considered.

NYSBA**CLE** Publications

Probate and Administration of New York Estates

Editor-in-Chief
Douglas H. Evans, Esq.
Special Counsel
Sullivan & Cromwell
New York City

Assistant Editor
Cheryl E. Hader, Esq.
Paul Weiss Rifkind Wharton & Garrison
New York City



Co-sponsored by the Association's Trusts and Estates Law Section, *Probate and Administration of New York Estates* is an invaluable text of first reference for both the novice and the experienced attorney. Written by veteran trusts and estates practitioners, this comprehensive text covers all aspects of estate administration, from preliminary preparations to filing the accounting.

The editors and the many distinguished authors bring a wealth of practical knowledge, making this a uniquely useful reference.

Contents

Preparing for Estate Administration
Jurisdiction of the Surrogate's Court
Administration Proceedings
Probate Proceedings
Settlement of Small Estates
Right of Election
Miscellaneous Matters Affecting Validity of Wills and Distribution of Assets
Administering the Estate
Federal and New York Estate Taxation
The New York Estate Tax
Fiduciary Income Tax Planning
Preparing the Account
Settling the Account

1995; Supp. 2001 • 978 pp., loose-leaf • PN: 4005
List Price: $140 (incls. $10.37 tax)
Mmbr. Price: $110 (incls. $8.15 tax)
(Prices include 2001 Supplement)

About the 2001 Supplement

The 2001 cumulative supplement brings the extremely well-received first edition up-to-date. The chapter on the federal estate tax has been completely revised and includes a section on the new New York estate tax procedures. The other chapters have been extensively updated to reflect case law and statutory changes that have occurred. Future supplements will cover what are sure to be many more changes to the estate tax.

The 2001 cumulative supplement is again prepared by leading trusts and estates practitioners, who share their many years of practical experience.

2001 • 1,038 pp., loose-leaf • PN: 50059
List Price: $80 (incls. $5.92 tax)
Mmbr. Price: $60 (incls. $4.44 tax)

Contributors

Carl T. Baker, Esq.
Douglas H. Evans, Esq.
Martin Feinstein, Esq.
Charles J. Groppe, Esq.
S. Jeanne Hall, Esq.
Stephen B. Hand, Esq.
Arlene Harris, Esq.
Linda B. Hirschson, Esq.
Prof. William P. LaPiana
John E. MacKenty, Esq.
Gary R. Mund, Esq.
Robert J. Pape, Jr., Esq.
Raymond M. Planell, Esq.
Robert S. Reynolds, Esq.
Sanford J. Schlesinger, Esq.
Charles T. Scott, Esq.
Arthur M. Sherwood, Esq.
Susan B. Slater-Jansen, Esq.
John C. Spitzmiller, Esq.
Richard M. Storto, Esq.
Michael R. Suprunowicz, Esq.
Sharon L. Wick, Esq.

"This is an excellent 'how to' book about estate administration in New York, from probate through final accounting, painstakingly prepared by some of the premier trusts and estates lawyers in the state of New York."

Robert D. Taisey, Esq.
Windels, Marx, Davies and Ives
New York

To Order by Mail, send a check or money order to: CLE Registrar's Office, New York State Bar Association, One Elk St., Albany, NY 12207*

To Order by Telephone, call
1-800-582-2452
(Albany & surrounding areas 518-463-3724)

Source Code: CL1389
8/2001

* Please specify shipping address (no P.O. box) and telephone number

New York State Bar Association NYSBA

EDITOR'S MAILBOX

Child Care in Courthouses

I read, with great interest, your February cover story "Construction Program Provides New Facilities." My hope is that each of the new courthouses and future courthouses to be built around the state will provide child care services for employees, jurors, for members of the bar, and for others who must appear in court. Child care in municipal buildings/courthouses is of great importance. It's an important convenience. This service also enables governments to attract the best employees – people who would like to work near their children. The lack of adequate child care in New York is disappointing. Most child care facilities close after 6 p.m. Employees who might otherwise be willing to work longer hours have no choice but to leave work shortly after 5 p.m., creating productivity problems. Those who are on waiting lists for child care programs must rely on baby-sitters or nannies who are not always very reliable.

Child care makes sense in every courthouse and in every government building.

Paul Feiner
Greenburgh Town Supervisor

Military Law Cases

As a staff judge advocate serving on active duty in the U.S. Air Force, and a New York State Bar member since 1984, I enjoy reading any article that brings the fascinating and diverse practice that is military law to the attention of others. By their article, "Military Cases Present Diverse Array of Vital Issues for Individuals and the Government," in the February issue, attorneys Fidell and Sheldon have succeeded and done the bar a great service. While I differ with some of their characterizations, the "don't ask, don't tell" policy for instance, and regret the omission of the vibrant contract and even environmental law practice, one thing we definitely agree upon is that military counsel are highly motivated.

Although service cultures may be different, the judge advocates serving in the Army, Air Force, Navy and Coast Guard around the globe in places like Bosnia, Southwest Asia, at sea, and yes, even in Washington, D.C., all share a most noble service commitment, to provide their country and their fellow service members the best legal advance they can.

Lt. Col. Wayne Wisniewski, USAF
Peterson Air Force Base, Colo.

The 18-B Experience

I was delighted to see the article in the June issue of the *Journal* on 18-B and law guardian compensation. Coverage of this critical matter is long overdue. The plight of the parties represented by underpaid counsel cannot be overstated. The problem here is how to reach the general public and the powers that be in the state government to underscore the need to improve the pay of those who represent the less fortunate among us.

I hope the article has made some impact on the problem; it was an excellent statement of the issue.

Miriam Null
Holliswood, N.Y.

Defending the Footnote

As an emeritus member of the Fourth Department who was one of those responsible for abolishing the footnote in appellate briefs, I write in response to Paul F. McAloon's interesting defense of the "Lowly Footnote" in the March/April issue.

He is right in pointing out the footnote's literary value and its occasional "pleasant relief" for both writer and reader. However, it can also lead to unintentional error, as in footnote 3 of his appealing exposition, where he refers to Buffalo as the place where the Fourth Department sits. Actually it sits, and always has, in Rochester, which got the better of the bargain. Buffalo got the blizzards and Rochester got the courthouse. You have to watch those tricky footnotes.

David O. Boehm
Harris Beach & Wilcox
Rochester, N.Y.

President's Message

In addition to stirring fond memories of my family's cottage at Crescent Beach in Ontario, I think that Paul Hassett's President's Message in the March/April issue accurately portrays a new direction for the courts in New York State.

The dedication of Chief Judge Judith S. Kaye and the many other forward-thinking jurists throughout our Unified Court System is encouraging. Here at home under the energetic leadership of Hon. Vincent E. Doyle, the Eighth Judicial District has taken a lead role in many pilot projects within our courts.

Not unlike the resolution of the Peace Bridge issue, our problem-solving courts cannot be at their best without community input and involvement. This includes the legal community. Those of us who work within the courts and those of us in private practice would do well to keep an open mind and to participate in making problem-solving courts work.

The first graduation ceremony was held recently at the Jamestown Drug Court. In speaking about the graduates, our district attorney and public defender sounded like the proud parents of a Little Leaguer who just hit one out of the park. One notable graduate who had 70 previous arrests is now drug-free and gainfully employed. He is paying child support for the first time. The mother of his child is also a drug court graduate.

In addition to the apparent societal benefits, there is this side bonus for the bar. With every drug court graduate, with every child who now has a fighting chance, we get to be the good guys. The lawyers are not looked down upon, but are seen as part of the solution to some of society's worst ills.

Kathleen Down Krauza
Chief Clerk
Chautauqua County Courts

NEW MEMBERS WELCOMED

FIRST DISTRICT
Candace Adiutom
Saima S. Ahmed
Michele J. Alexander
Georgia S. Alikakos
Carolyne Gann Allen
Tosha N. Andrews
Anastasia A. Angelova
Melanie Calandra Teresa Ash
Paul M. Atanasio
Patience E. Atkin
Mark Atlee
Paul Austin
Won Bae
Francine M. Banner
Franya G. Barnett
Fredrick T. Barr
Jillian C. Becker
Michael Amos Bedell
Jesus M. Beltran
Christina Bennett
Keith Andrew Berger
Michael F. Beyda
Kenneth Christopher Bibko
Jacqueline C. Bicandi
Rachel S. Blumenfeld
Daniel Matthew Boglioli
Emily J. Boris
Damien Matthew Bosco
Jason R. Boyarski
William Creighton Brashare
Martin Burn
Shinina T. Butle
Jan Osten Bystro
Elizabeth L. Capuan
Mary C. Cart
Christopher Joseph Carus
Antonio Celii
Michele C. Cerullo
Daniel H. Chakrin
Roy Lee Chan
Guy Chayoun
Betty Chen
Lisa Ann Chiarini
Daniel P. Chiplock
Laura G. Ciabarra
Lauri Cohen
Christopher A. Colvin
Christian B. Coppinger
Gerald Coviello
Eric Dannheim
Anthony Lawrence Deluca
John Francis Desantis
Malick Alioune Diop
Kevin Andrew Donohue
Anne Bridget Doohan
Daniel Dovdavany
Nathy J. Dunleavy
Gerald Eichinger
Michael Q. English
Franco Esposito
Kenneth David Faltischek
Dawn M. Fasano
John J. Feeney
Jason A. Finestone
Stephanie E. Fischer
Melanie A. Fitzpatrick
Edward Ryder Flagg
Kathleen A. Flaherty
Kerri B. Folb
Tina Monshipour Foster
Andrew R. Frisch
Jonathan D. Fuhrman
Rodney John Fuller
Sanjay K. Gandhi
Justin Matthew Garbaccio
Harry E. Garner
Rebecca L. Garrett
Sandra A. Garrick
Rafal Gawlowski
Jacob Adam Gelber
Souad Y. Ghosn
Evangelo Gianoukakis
Andrea Michelle Giordano
Brian W. Gottlock
Martha A. Greenough
Mark D. Grimm
Robert Grodd
David Guadagnoli
David V. Gubbini
Nicholas A. Gunia
Keith J. Hand
Brent Hannafan
Norman J. Hannawa
Birch M. Harms
George Robert Hatzmann
Clara Elizabeth Henderson
Krisana Maria Hodges
Stephen B. Holden
Scott Walter Horlacher
Jerome C. Huang
Irene Mary Hurtado
Amy K. Impellizzeri
Nicole Ilyse Isacoff
Alon Israely
Rachel L. Izower
Yeon Wook Jeong
Zheng Jiang
Megan E. Johnson
Matthew Farley Jones
Gregory H. Kahn
T. Quinlan Kato
David G. Katona
Noah Reid Katz
Kristen Margaret Keenan
Weslii V. Khahaifa
Freda M. Khan
Sandra M. Kiersh
Taeman W. Kim
Thomas P. King
Gregory Anthony Kleva
Michael Korsinsky
David Kromm
Julian Ku
Jeremy N. Kudon
Laszlo G. Kulin
Paul D. Lall
Joshua Scott Lamel
Jay S. Lampert
Douglas Todd Landon
Monica V. Langfeldt
Michael Lanzillotta
Eric S. Lasky
Aaron Christopher Lavizzo
Gilbert A. Lazarus
Arnaud Jean Lecoeur
Michael C. Ledley
Beth Lisa Lemberger
Dana Lennon
Antonette Diane Lettman
Sabine C. Leube
Jeffrey Leung
Michael S. Leyden
Hai Liao
Stefanie A. Lindeman
Eric S. Lipman
Naomi T. Liss
Thomas Lookstein
Alison J. Love
Christopher G. Lowe
Dawn Marie Mahoney
Kaye Mahoney
Thomas Robert Makin
Arslan Malik
Saville A. Mallach
Heather Colleen Manley
James Christopher Mantia
Richard Martinelli
Josefina Martinez
Jon Eric Martino
Carlos Mastrapa
Edwin Matos
Jill Heather McClure
Frederick R. McGowen
David Charles Mcgrail
Richard Brian Mcgrath
Glenn Patrick Mcgrory
Lauren Ann Mchugh
Mary Alice Mclaughlin
Vanessa Marika Meis
Jennifer Tabacchi Mitek
Robert Modica
Curtis Lindberg Moner
Kyle W.K. Mooney
Robert E. Moriber
Stuart Anthony Morrissy
Joseph P. Morsellino
Marla Moskowitz
William Denis Motherway
Matthew Francis Musselman
Matthew Leo Mustokoff
Jason Abraham Nagi
Rajni A. Narasi
Roxanna D. Nazari
Bryan Nazor
Messeret Nega
Nahalel Alexander Nellis
Eric W. Nerenberg
David Greg Neustein
Patricia M. Nunez
Colleen O'Loughlin
Sarah Opatut
Steven Howard Ornstein
Jeffrey E. Palker
Laura Rose Palmer
Peter Papagianakis
Youngjoon Park
Samuel Olds Patmore
Stanley Urbano Paylago
Ira M. Pearlstein
David A. Pentlow
Jennifer Taina Perez
Guy Perry
Robin L. Petty
Tara S. Pfeifer
Thomas N. Pieper
Rosa Pietanza
Nicholas J. Pinto
Leigh Heather Pisane
Kimberly Pittman
Mindy Ellen Plotkin
Laura E. Popp
Jennifer M. Pugh
Marnie Helene Pulver
Paul Thomas Qualey
Donya D. Ramsay
Christian Reber
Elliot Resnik
George Joseph Rheault
Christopher Ciro Riccardi
Daniel Rindsberg
Anne Marie Rocco
Jonathan A. Rogal
Joanne J. Romero
Gabriel S. Rosenberg
Laura Rosenberg
John Carten Rothermich
Ryan J. Rovere
Rovin Rajendra Rozario
Vanessa Paola Rubinstein
Alicia Russo
Andreas Kurt Anthony Sahar
Salvador Sanchez
Ronen Sarraf
Nitin S. Savur
Karen Theresa Schiele
Robert Schirtzer
John Erik Schreiber
Jessica Mila Schutzman
Collin Schwartz
Amy R. Sender
Paul V. Seraganian
Andrew Shaffer
Diana R. Shafter
Cheryl Leah Shammas
Stuart R. Shaw
Umar A. Sheikh
Morgan S. Sheinberg
Nanci Ship
Andrea Kamala Shreeram
Howard Frederick Sidman
Jennifer L. Siegal
Pearl Teng Ling Siew
Atul Singh
Deborah A. Sinnott
Paola Siracusa
Kurt A. Skeete
Anna-Marie C. Slot
Jane Alexandra Small
Eric James Smith
Jocelyn A. Smith
June H. Smith
Nadine Smith
Amy Jill Sobotkin
Alan H. Sonnenklar
Alexander Soric
Victoria Prussen Spears
Caryn S. Stein
Joshua Adam Stein
Matthew A. Steinberg
Daniel Alexander Steinbok
Anthony B. Stumbo
Erica E. Sulkowski
Anthony Edward Szydlowski
Hung Gia Ta
Judith Tandon
Christina Dawn Thivierge
Iyana Y. Titus
Wendy T. Topkis
Lenina Chrysalis Trinidad
Stephen Andrew Trowbridge
Stacey A. Usiak
Maysa Vahidi
Gaurav Vasisht
Jeremy Michael Veit
Julie O. Veit
Kamee Beth Verdrager
Jeanette Marie Viggiano
Lisa L. Wallace
Mary Walsh
Lillian Wan
Alex Li-teh Wang
David R. Warren
Elizabeth A. Warren
Nicholas E. Warywoda
Tala I. Washton
Miller Leslie Watkins
Bram D. Weber
Susan E. Weiner
James J. Wenzel
Jeffrey Millard Werner
Ryan J. Whalen
Odette J. Wilkens
D. Forest Wolfe
Adam D. Wolfson
Allison S. Wong
Scott R. Worden
Iyad S. Zawaideh
Victoria H. Zerjav
Dehai Zhang
Fathia Zouiyen

SECOND DISTRICT
Allie Aaron
Nicole M. Ajello
Iddo I. Arad
Justin Bloom
Racquel Delsita Brown
Robert E. Brown
Marjory Cajoux
Caroline Campomanes
Pei Pei Cheng
Christine P. Claffey
Adam Seth Cohen
Bella Cohen
Michele D. Collins
Nia Cross
Thea K. Davis
David W. Denton
Nadia I. Desyatnikova
Elliot M. Elo
Keith D. Elrington
Dawn Falco
Maryann Fede
Marcel Florestal
Penelope J. Flynn
Elsa M. Forbes
Jamie A. Forman
Spencer Brandt Freedman
Harold Gates
Arthur Gershfeld
Jennie Getsin
Victor A. Grossman

Kathleen Higgins
Christopher W. Hoyt
Richard Kipperman
Jonathan Darrell Klein
George Kontogiannis
Moshe Koplowitz
Michelle Lloydene Lawner
Cheryl L. Lewis
Danielle Librizzi
Joseph Lopardo
Marc A. Lowy
Elizabeth Elaina Malang
Ian G. Merrill
Jacques Elwin Michel
Rebecca Morris
Miriam Mosseri
Derefim B. Neckles
Keith A. Nezowitz
Esther C. Noe
Funmi Odegbami
Tara A. O'Rourke
Zvi Ostrin
Sean Patrick O'Sullivan
Tatiana Pahman
Svetlana M. Polyakova
Sharmila Rampersaud
Joel S. Ray
Paul J. Sagiv
Howard J. Schain
Jennifer W. Shon
Steven N. Solomon
Inna Spector
Stacey E. Steinberg
Olga Suslova
Keith Taketo Tashima
Anna Tsirlina
Yevgeny Tsyngauz
Lizette Rios Vallsworth
Thomas Karl Wittig
Craig Edward Young
Peter L. Zanolin

THIRD DISTRICT
Edward Joseph Aluck
Mary Tracey Brooks
Donna Cole-Paul
Jacqueline Conti
Thomas Henry Cragan
John E. Daly
Rebecca Denue
Denise M. DiPace
Michael J. Dutkowsky
April A. Elkovitch
Kirsten E. Fish
Jill Gruben
Stacy Harvey
Kathleen S. Holland
Peng Jiang
Douglas R. Kemp
Denise M. Kim
Traci A. LaVallee
Karen McGrory
Leesa A. Naimo
Candice Panichi
Yiselle Rodriguez
William Proctor Scott
Maura Patricia Walsh
Daniel Werner
Ann Morris Willey
Steven D. Wilson
David C. Zegarelli

FOURTH DISTRICT
Margery C. Eddy
Robert R. Glynn
Scott R. Jones
Karl C. Kranz
Maureen Anne Mangan
John R. Mertz
Glen F. Michaels
Aaron W. O'Brien
Daniel Salvin

FIFTH DISTRICT
Kristen M. Benson
Deborah I. Bice
David A. D'Agostino
Julie L. Giruzzi
Christine M. Heppeler
Amy S. Maloney
Rebecca Mandigo
Elizabeth B. Snyder
Michael D. Steinberg
Annemarie E. Steward
Carissa L. Swavely
Stacey A. Wiley

SIXTH DISTRICT
Edward E. Kopko
Paul Prasarn
Jon J. Sarra
Christopher Schulte
Mary M. Tarantelli
Andrew J. Welch

SEVENTH DISTRICT
Margret Haining Cowles
Elizabeth A. Davies
Joseph S. Dressner
Eileen T. Duggan
Ellen P. Lynch
Karen M. Petote
Melanie Sarkis
Jodie L. Sayers
Shannon Lee Stockwell
Kevin Tompsett

EIGHTH DISTRICT
Joseph A. Agro
Randy G. Attea
Stephanie A. Cole
Troy Flascher
Maureen Flynn
Kevin Graff
Kelly Grear
Vincent A. Hemming
Michael J. Hillery
Anna M. Kobialka
Elizabeth A. Mallory
Cassandra J. Mann
Tiffany R. Martin
Daniel Morse
David Polak
Lisa D. Primerano
Aaron B. Sukert
Susan Fedor Surace
Philip Witzling

NINTH DISTRICT
Debra A. Arena
Jennifer Ashare
Christine Elizabeth Cervasio
William Wyman Cobb
Richard H. Durben
Elizabeth Sack Felber
Joseph A. Ferrigno
Nicole Marie Harris
Douglas Richard Henry
Ian C. Hunter
Rochelle Inger
Yvette M. King
Claire Margaret Lapham
Louise A. Leduc
Christopher N. Lewis
Lynne Mazin
Andrew McLaughlin
Anthony R. Mole
Kristin H. Neuman
Jeffrey Odefey
Jodi Ritter
Elyssa C. Santos-Abrams
Vincent Savino
Brian T. Schmidt
Anuja Shah
Mark A. Smith
Tara E. Smith
Amy Kendra Stoeberl
Adam D. Wadler
Bruce J. Walker
Robert M. Weiner
Galen D. Wilcox
Thomas M. Wilentz
Philip J. Wirzbicki

TENTH DISTRICT
Bruce A. Barket
Meredith Diane Belkin
William Bird
Margaret G. Blascetta
Dennis Buchanan
Jeffrey Philip Campisi
Michele Capetola
Linda Caputo-Friedmann
Lynnette S. Certain
Marilyn B. Chinitz
Lauren Chite
Ricky Collura
Diane Corrigan-Hancock
Shawn S. Cullinane
Richard D'Addario
Michael R. Denkovich
Timothy Feil
Thomas A. Gabriele
Joseph T. Garcia
Ross H. Gould
Michelle L. Gross
Larry Inniss
Adrienne L. Lasaponara
Adam J. Leemon
John R. Lewis
Anthony Michael Makrides
John F. McKinney
Latanya B. McPherson
Maria S. Mitchell
Amy M. Monahan
Pranali M. Patel
Jeffrey I. Peskin
Danielle M. Peterson
Vivien V. Ranada
James D. Reddy
Kim M. Roesch
Beth L. Rogoff
Gerald Rosenberg
Leslie Rutledge
Jessica Grace Schubert
Harold A. Shapiro
Beth Silver
Heather J. Smith
Steven Stern
Vincent Charles Tenety
Avemaria Thompson
William T. Toohey
Arturo Torres
Darlene T. Treston
Andromachi Tsoukalas
Evanthia Voreadis
Nathaniel T. Wallace
Nikolaos Xylas
Andrew Zajac
Kimberly T. Zuckerman

ELEVENTH DISTRICT
Hector Alexiades
Camille Danielle Barnett
Rosemarie P. Boyd
Rocco A. Cavaliere
Allan G. Chambers
David Chan
Blaise U. Chow
Wanda Doening
Gwenevere Corlis Foster
Ethan David Ganc
Gregory Lowell Gliedman
Carol L. Kegler
Jooyun Y. Kim
Shawn Lan
Mayra Ivelisse Lopez
Sabrina Malpeli
Joseph F. McCabe
Carey C. Moore
Nicole Napolitano
Eslyn R. Persaud
Kaisur Rahman
Evelina Rubinoff
Yana Ryzhik
Rita Stark
David R. Swarthout
Hannah M. Tabbara
Michael David Tarbutton
Hafiz Uddin
Tracy Kwai-lan Wong
Feng Xie

TWELFTH DISTRICT
Jennifer L. Budner
Rebecca Hanson Chenard
Richard B. Demas
Vadim Goldshteyn
Idina M. Holmes
Sabrina Jiggetts
Richard P. Kearney
Alla Krupnik
Reagan Lambert
Nhu Phuoc-Anh Nguyen
Robert J. Reid
Suzanne Marie Saia
Peter A. Sell
Hillary Shayne Springel
Licet Tineo
Tae-hoon Charles Won

OUT-OF-STATE
Lisa N. Abad
Christopher L. Abernathy
Sae Ahn
Yuki Akimoto
Maristella Aldana
John Anthony Ammiinato
Michael B. Anastasio
Timothy Andison
Chris Aniedobe
Kwadwo D. Anto
Valentine Chukwuemeka
Anyaibe
Olga King Arthars-Beskrone
Ann Ayers
Jeffrey J. Babcock
Mauricia M.M. Baca
Ronald W. Backes
Marie C. Baker
Robert M. Baratta
Scott C. Barnett
F. Daniel Bell
Relani Belous
Stephanie M. Belser
Ronit Ben-Hur
Michael Paul Benedek
Hector Benitez-Solivan
Kim Jean-Batiste Benjamin
Matthew Berkle
Laure Berthelot
Michael Bertrand
Jessica Blatt
Glen E. Books
Jason Michael Borlinghaus
Mary B. Boyle
Rebecca Brackley
William H. Brammer
Stacey Michelle Brandenbury
Traci Vernita Bransford
Gregg A. Brauneisen
Murry David Brochin
Mark Arthur Brown
Keith C. Buell
Erik J. Burgos
Thomas S. Burke
Caleb Paul Burns
Deborah Ann Burns-Megarr
Christopher Robert Calabrese
Silvio Cappellari
David Cargille
Howard S. Caro
James R. Carroll
Thomas A. Carroll
Edward V. Cattell
Francis Y. B. Chew
Denise Chim
Sang Bhee Choi
Jodie Leith Chusid
Catherine M. Clark
Adauto V. B. Conde
Catherine Conneely
Meredith R. Conway
Alicyn Beth Craig
James Carman Crescitelli
Heather Daly
Paul S. Danner
Kelvin Scott Davis
Stephen H. Dinolfo
Dominick DiRocco
Demetrius J. Djoulia
John J. Donovan
Priya Doraswamy
Shana L. Douglas
Peter Francis Dow
Jonathan Jackson Doyle
Allen Arthur Drexel
Peter Andrew Dub
Charlene D. Dukes
Marc S. Edrich
Kelly Eibs
Pia Manuela Eichberg
Michael Eisenberg
Esteban J. Elias
Robert Epstein
Diana S. Erickson
Rocco F. Errico

Sarah R. Evans
Abdulcadir Farah
Christopher R. Fawcett
Rory Z. Fazendeiro
Barry Richard Feldman
Andrew Guthrie Ferguson
Catherine M. Ferrara-Depp
Lori Ferraro
Toniann J. Ferreth
Jonathan H. Ferry
Tanya W. Fisher
Daniel P. Fitzgerald
David Fleming
Oliver Fontana
Siobhan M. Forde
John Freemyer
Stephen R. Froling
Liam Ge
Mindy Gensler
Ekundayo B. George
Emmanuelle Victoria George
Daniel J. Gerkin
Sibylle Petra Christiane Gierschmann
Lathe Gill
Christina Ann Gleason
Jane Y. Glezin
John Golden
William M. Goldman
Jeffrey H. Goldsmith
Josephine Gonzalez
Gita Gorji
Kenneth Charles Green
Brian F. Guzman
Caryn L. M. Hargrave
Timothy S. Hart
Frank Hess
Heidi E. Hilgendorff
Reiko Hiramatsu
Lauren Thalia Hollander
Sungkee Hong
Takayuki Hori
Robert Joseph Hudock
James T. Hunt
Vanessa Ann Ignacio
Masato Imaizumi
Shigeru Inada
Mehul R. Jani
Anne Marie Janiczek
Jill L. Johnson Schroepfer
Irena Jurasova
Rachel Kagia
Vamsi K. Kakarla
Michael R. Kamen
Preeti Kapoor
Constantina Katsigiannake
Dunniela Kaufman
Amy Hillary Kay
Gavin M. Kearney
Kathleen Marie Kelly
Melaine Mecka Kennedy
Allison D. Kiene
Beth D. Kiesewetter
Jung-hong Kim
Ui-suk Kim
Honey L. Kober
Hiroki Kodate
David P. Kreppein
Ashlie Kropp
Remzi Guvenc Kulen
Maya Christine Kulycky
Ruchika Kumar
John Joon-han Kwon
Charles J. LaDuca
Laurie LaPalme
Laura A. Lattal
Jason B. Lattimore
Chung-l Lee
Donna M. Lee
Hyoung S. Lee
Moosang Lee
Louis P.A. Lehot
Adrienne LePove
Yaniv Levinson
Yachun Lin
Jun Liu
Siew Luan Low
Chu-ching Lu
Wei-ming Lu
Douglas F. MacLean
Mutheu Maitha
Alia Malek
Joseph A. Malfitano
Zertasha Malik
Caryn D. Mark
Jennie L. Markowitz
Matthew E. McGoey
Gulmira McHale
Geoffrey McLaughlin
David Melnih
David Melnik
Richard Steven Meyer
Geoffrey J. Michael
Frederick T. Miller
Francisco J. Mirkow
Elizabeth Lynn Mitchell
Cheston David Mizel
Lokanath Mohapatra
Alfonso E. Moreno
Erik W. Mueller
Heidi E. Murdy
Satoshi Naganuma
Toru Nakahara
Deepak Damodaran Nambisan
Irvin B. Nathan
Kimberly A. Neill
Alicia Michele Nestor
Jennifer M. Norton
Helena E. O'Neal
Olatunde Opaleye
Wendoly Ortiz
Thomas D. O'Shea
Scott C. Pappas
Carletha Parkinson
Michele A. Peters
Leslie A. Pettenati
Glenn S. Pfeiffer
Carol M. Pieper
Reza Pishva
Stephen M. Plotnick
Vasiliki Plytas
Michael Steven Portnoy
Martin Alexander Price
Jeffrey C. Primiano
Kristin Tansey Quick
Hector Virgicio Ramirez
Jay D. Raxenberg
Steven M. Reiness
Jeri Elizabeth Reutenauer
Michael Rizzo
Kim S. Rodriguez
Robert Paul Roesener
Melissa A. Rolland
Brian Ashley Rosenthal
Rosmini Roswijati
Gary M. Rubman
Bernadette Savage
Anne Mercedes Schneiderman
Tania Scivetti
Geoffrey Louis Scowcroft
Stephanie A. Sechler
Stefan Seel
Na Seon Joo
Kristi Lucile Severance
Neel G. Shah
Saleem A. Shareef
Nilay Shastry
Imani Shele
Fincourt B. Shelton
Leon Shenker
John P. Sheridan
Jek S. D. Sim
Edward J. Smeltzer
Matthew A. Sokol
David Spielman
Gerd W. Stabbert
Joshua Randolph Stebbins
Marc Ethan Steinberg
Roman C. Strutynski
Laura A. Stutz
Eugene R. Sullivan
Gilbert M. Swift
Tomoichiro Takayama
Takashi Tanaka
Peter Daniel Tanski
Michael G. Tauber
Andras Paul Teleki
Edward N. Tobias
Jonathan Todres
Saori Tomizawa
Tommaso Tosi
Maria Trabucchi
Yoshiki Uchida
Derek S. Underwood
Saverio Valentino
Eline S. Van Der Vlist
Martha A. Vedder
Manuel Vergan
Lucinda Mary Vette
Roland Vogl
Michael John Wallace
James Walsh
Justin J. Walsh
David R. Weaver
I-lin Wei
Miriam Nathalie Weisbecker
David Wesely
Karen A. Westrick
Rebecca Moffat White
John Williams
Joshua Wong
Richard Wong
Azizah Poy Yasin
Brady Young
Becky Yu
Keisuke Yuzawa
Peter Wolf-Georg Zapf
Andrew Paul Zarnowiecki
Hiroyuki Zetsu
Stephanie M. Zlasney

In Memoriam

Edward A. Baker
Seaford, NY

Gerard R. Boyce
Franklin Lakes, NJ

Mitchell L. Dorf
Rahway, NJ

Malcolm Fein
Brooklyn, NY

John D. LeSeur
Batavia, NY

Joseph E. Lynch
Auburn, NY

Rae Schupack Nathan
Larchmont, NY

HEADQUARTERS STAFF E-MAIL ADDRESSES

Executive Staff
Patricia K. Bucklin, *Executive Director,* pbucklin@nysba.org
John A. Williamson, Jr., *Associate Executive Director,* jwilliamson@nysba.org
L. Beth Krueger, *Director of Administrative Services,* bkrueger@nysba.org
Kathleen R. Baxter, *Counsel,* kbaxter@nysba.org
Lisa Bataille, *Administrative Liaison,* lbataille@nysba.org
Kathleen M. Heider, *Director of Meetings,* kheider@nysba.org

Accounting
Kristin M. O'Brien, *Director of Finance,* kobrien@nysba.org
Anthony M. Moscatiello, *Controller,* tmoscatiello@nysba.org

Continuing Legal Education
Terry J. Brooks, *Director,* tbrooks@nysba.org
Jean E. Nelson II, *Associate Director,* jnelson@nysba.org
Jean Marie Grout, *Staff Attorney,* jgrout@nysba.org
Leslie A. Fattorusso, *Staff Attorney,* lfattorusso@nysba.org
Cheryl L. Wallingford, *Program Manager,* cwallingford@nysba.org
Daniel J. McMahon, *Assistant Director, Publications,* dmcmahon@nysba.org
Patricia B. Stockli, *Research Attorney,* pstockli@nysba.org

Governmental Relations
C. Thomas Barletta, *Director,* tbarletta@nysba.org
Ronald F. Kennedy, *Assistant Director,* rkennedy@nysba.org

Graphic Arts
Roger Buchanan, *Manager,* rbuchanan@nysba.org
William B. Faccioli, *Production Manager,* bfaccioli@nysba.org

Human Resources
Richard V. Rossi, *Director,* rrossi@nysba.org

Law Office Economics and Management
Stephen P. Gallagher, *Director,* sgallagher@nysba.org

Law, Youth and Citizenship Program
Gregory S. Wilsey, *Director,* gwilsey@nysba.org
Emil Zullo, *Assistant Director,* ezullo@nysba.org

Lawyer Assistance Program
Ray M. Lopez, *Director,* rlopez@nysba.org

Management Information Systems
John M. Nicoletta, *Director,* jnicoletta@nysba.org
Ajay Vohra, *Technical Support Manager,* avohra@nysba.org
Paul Wos, *Data Systems and Telecommunications Manager,* pwos@nysba.org
Margo J. Gunnarsson, *Database Services Administrator,* mgunnarsson@nysba.org

Marketing
Richard Martin, *Director,* rmartin@nysba.org

Media Services and Public Affairs
Bradley G. Carr, *Director,* bcarr@nysba.org
Frank J. Ciervo, *Associate Director,* fciervo@nysba.org
Amy Travison Jasiewicz, *Editor, State Bar News,* ajasiewicz@nysba.org

Membership
Patricia K. Wood, *Director,* pwood@nysba.org

Pro Bono Affairs
Diane Burman, *Director,* dburman@nysba.org

THE NEW YORK BAR FOUNDATION

2001-2002 OFFICERS

Richard J. Bartlett
President
1 Washington Street
P.O. Box 2168
Glens Falls, NY 12801-2963

Emlyn I. Griffith
Vice President
225 North Washington Street
Rome, NY 13440-5724

Patricia K. Bucklin
Secretary
One Elk Street, Albany, NY 12207

Randolph F. Treece
Treasurer
375 State Street
Albany, NY 12210

DIRECTORS

John P. Bracken, *Islandia*
Cristine Cioffi, *Niskayuna*
Angelo T. Cometa, *New York City*
Maryann Saccomando Freedman, *Buffalo*
Robert L. Haig, *New York City*
Jules J. Haskel, *Garden City*
Paul Michael Hassett, *Buffalo*
John R. Horan, *New York City*
Susan B. Lindenauer, *New York City*
Robert L. Ostertag, *Poughkeepsie*
Joshua M. Pruzansky, *Smithtown*
Thomas O. Rice, *Garden City*
M. Catherine Richardson, *Syracuse*
Hon. Shira A. Scheindlin, *New York City*
Justin L. Vigdor, *Rochester*

JOURNAL BOARD MEMBERS EMERITI

As a tribute to their outstanding service to our *Journal*, we list here the names of each living editor emeritus of our *Journal*'s Board.

Richard J. Bartlett
Coleman Burke
John C. Clark, III
Angelo T. Cometa
Roger C. Cramton
Maryann Saccomando Freedman
Emlyn I. Griffith
H. Glen Hall
Charles F. Krause
Philip H. Magner, Jr.
Wallace J. McDonald
J. Edward Meyer, III
Robert J. Smith
Lawrence E. Walsh

2001-2002 OFFICERS

Steven C. Krane, President
New York
Lorraine Power Tharp, President-Elect
Albany
Frank M. Headley, Jr., Treasurer
Scarsdale
A. Thomas Levin, Secretary
Mineola

Vice-Presidents

First District:
Mark A. Alcott, New York
Stephen D. Hoffman, New York
Second District:
Edward S. Reich, Brooklyn
Third District:
James B. Ayers, Albany
Fourth District:
Peter D. FitzGerald, Glens Falls
Fifth District:
James F. Dwyer, Syracuse
Sixth District:
Hon. Eugene E. Peckham, Binghamton
Seventh District:
C. Bruce Lawrence, Rochester
Eighth District:
Joseph V. McCarthy, Buffalo
Ninth District:
Joseph F. Longo, White Plains
Tenth District:
A. Craig Purcell, Hauppauge
Eleventh District:
Gary M. Darche, Flushing
Twelfth District:
Lawrence R. Bailey, New York

Members-at-Large of the Executive Committee

Sharon Stern Gerstman
Michael E. Getnick
Matthew J. Kelly
Gunther H. Kilsch
Bernice K. Leber
Susan B. Lindenauer

† Delegate to American Bar Association House of Delegates
** Past President*

Members of the House of Delegates

First District
Alcott, Mark H.
Baker, Theresa J.
Barasch, Sheldon
Batra, Ravi
† Bing, Jonathan L.
Bonner, Thomas J.
Brett, Barry J.
Buckley, Hon. John T.
Cashman, Richard
Chambers, Hon. Cheryl E.
Christian, Catherine A.
* Cometa, Angelo T.
Cuyler, Renaye B.
Davis, Bonni G.
Davis, Evan A.
DeFritsch, Carol R.
Eisman, Clyde J.
Eppler, Klaus
* Fales, Haliburton, 2d
Farrell, Joseph H.
Field, Arthur Norman
Finerty, Hon. Margaret J.
Fink, Rosalind S.
* Forger, Alexander D.
Freedman, Hon. Helen
* Gillespie, S. Hazard
Goldstein, M. Robert
Gross, Marjorie E.
Haig, Robert L.
Handlin, Joseph J.
Harris, Martha W.
* Heming, Charles E.
Hirsch, Andrea G.
Hoffman, Stephen D.
Horowitz, Steven G.
Jacoby, David E.
Jaffe, Barbara
Kilsch, Gunther H.
* King, Henry L.
Kougasian, Peter M.
† Krane, Steven C.
Landy, Craig A.
Leber, Bernice K.
Lieberman, Ellen
Lindenauer, Susan B.
* MacCrate, Robert
Mandell, Andrew
Miller, Michael
Miller, Sonia E.
Minkowitz, Martin
* Murray, Archibald R.
Opotowsky, Barbara Berger
* Patterson, Hon. Robert P., Jr.
Paul, Gerald G.
Pickholz, Hon. Ruth
Quattlebaum, Poppy B.
Raubicheck, Charles J.
Rayhill, James W.
Rifkin, Richard
Robertson, Edwin D.
Roper, Eric R.
Rosner, Seth
Rubenstein, Joshua S.
Safer, Jay G.
Scarborough, Robert H.
Schumacher, H. Richard
* Seymour, Whitney North, Jr.
Silkenat, James R.
Sloan, Pamela M.
Souther, Eugene P.
Stenson, Lisa M.
Vitacco, Guy R., Sr.
Yates, Hon. James A.

Second District
Cerchione, Gregory T.
Dollard, James A.
Doyaga, David J.
Fisher, Andrew S.
Hesterberg, Gregory X.
Kamins, Barry
Lashley, Allen
Morse, Andrea S.
Reich, Edward S.
†* Rice, Thomas O.
Sunshine, Nancy T.
Terrelonge, Lynn R.

Third District
Ayers, James B.
Bauman, Harold J.
Cloonan, William N.
Connolly, Thomas P.
Dorsey, Richard J.
Flink, Edward B.
Friedman, Michael P.
Higgins, Patrick J.
Kelly, Matthew J.
Klein, Frank
LaFave, Cynthia S.
Leistensnider, Ruth E.
Lester, Kelly Mooney
Maney, Hon. Gerard E.
Miranda, David P.
Murphy, Sean
Netter, Miriam M.
Pierro, Louis W.
Samel, Barbara J.
† Tharp, Lorraine Power
Tippins, Timothy M.
Treece, Randolph F.
* Williams, David S.
* Yanas, John J.

Fourth District
Cioffi, Cristine
Clements, Thomas G.
Doern, James E D
FitzGerald, Peter D.
Harper, David A.
Hoye, Polly A.
Keniry, Hon. William H.
Russell, William E.
Tishler, Nicholas E.

Fifth District
Doerr, Donald C.
Dwyer, James F.
Fennell, Timothy J.
Fetter, Jeffrey M.
Getnick, Michael E.
Gingold, Harlan B.
Klein, Michael A.
Kogut, Barry R.
Michaels, Joanne E.
Priore, Nicholas S.
Rahn, Darryl B.
†* Richardson, M. Catherine
Rizzo, James S.
Uebelhoer, Gail Nackley

Sixth District
Beehm, Angelina Cutrona
Denton, Christopher
Drinkwater, Clover M.
Folmer, John B.
Gacioch, James C.
Lewis, Richard C.
Mayer, Rosanne
Peckham, Hon. Eugene E.
Reizes, Leslie N.
Wayland-Smith, Tina

Seventh District
Bleakley, Paul Wendell
Buzard, A. Vincent
Castellano, June M.
Clifford, Eugene T.
Dwyer, Michael C.
Grossman, James S.
Harren, Michael T.
Heller, Cheryl A.
Lawrence, C. Bruce
†* Moore, James C.
* Palermo, Anthony R.
Reynolds, J. Thomas
* Van Graafeiland, Hon. Ellsworth
* Vigdor, Justin L.
Wallace, David G.
†* Witmer, G. Robert, Jr.

Eighth District
Attea, Frederick G.
Doyle, Vincent E., III
Edmunds, David L., Jr.
Eppers, Donald B.
Evanko, Ann E.
Evans, Sue M.
* Freedman, Maryann Saccomando
Gerstman, Sharon Stern
Gold, Michael A.
Graber, Garry M.
†* Hassett, Paul Michael
McCarthy, Joseph V.
Mohun, Michael M.
O'Connor, Edward J.
O'Mara, Timothy M.
Palmer, Thomas A.
Pfalzgraf, David R.
Porcellio, Sharon M.

Ninth District
Aydelott, Judith A.
Fedorchak, James M.
Gardella, Richard M.
Geoghegan, John A.
Golden, Richard Britt
Goldenberg, Ira S.
Headley, Frank M., Jr.
Herold, Hon. J. Radley
Klein, David M.
Kranis, Michael D.
Longo, Joseph F.
Manley, Mary Ellen
* Miller, Henry G.
Mosenson, Steven H.
O'Leary, Diane M.
* Ostertag, Robert L.
Riley, James K.
Stewart, H. Malcolm, III
Walker, Hon. Sam D.

Tenth District
Abrams, Robert
Asarch, Hon. Joel K.
†* Bracken, John P.
Filiberto, Hon. Patricia M.
Franchina, Emily F.
Gutleber, Edward J.
Kramer, Lynne A.
Levin, A. Thomas
Levy, Peter H.
Meng, M. Kathryn
Mihalick, Andrew J.
Monahan, Robert A.
Perlman, Irving
†* Pruzansky, Joshua M.
Purcell, A. Craig
Roach, George L.
Rothkopf, Leslie
Spellman, Thomas J., Jr.
Tully, Rosemarie
Walsh, Owen B.

Eleventh District
Bohner, Robert J.
Darche, Gary M.
Dietz, John R.
Glover, Catherine R.
Nashak, George J., Jr.
Nizin, Leslie S.
Terranova, Arthur N.
Wimpfheimer, Steven

Twelfth District
Bailey, Lawrence R., Jr.
Friedberg, Alan B.
Kessler, Muriel S.
Kessler, Steven L.
Millon, Steven E.
†* Pfeifer, Maxwell S.
Schwartz, Roy J.
Torrent, Damaris Esther
Torres, Austin

Out-of-State
Chakansky, Michael I.
* Walsh, Lawrence E.

Language Tips

By Gertrude Block

Question: This query contains two questions: (1) is the word disirregardless acceptable? Enclosed is a reputable journal article in which it is used instead of irregardless. Which is correct? (2) TV and radio commentators pronounce the adjective long-lived like the verb live. Shouldn't it be pronounced like the adjective alive?

Answer: Both of these questions are relevant, given current misuse of both words. Take the "non-word" *disirregardless*. To the noun *regard* three negatives (*less, ir-* and *dis-*) have been added to create this monstrosity. (The prefix *-ir* is really the negative prefix *in-*, changed to *ir-* by assimilation with the following 'r' sound). Strike out the two unnecessary negatives and the correct adjective, *regardless,* emerges.

Why did the drafter add two unnecessary prefixes? Probably to emphasize his negative remark. It was common and correct in Old English (Anglo-Saxon) and in Middle English to employ double and triple negatives for emphasis. Chaucer's line in his 14th-century poem, *The Canterbury Tales*: "For he that naught n'assaieth, naught n'achieveth" contains four negatives, translating in modern English to "For he that does not try nothing, does not achieve nothing." And Chaucer describes his Knight, whom he greatly admires, by the use of three negatives: a man who "nevere yet no vileyne ne sayde."

The modern rule that it is incorrect to use more than one negative was introduced by 18th century grammarians who argued that English usage should follow a mathematical model. Among the most influential grammarians was Bishop Robert, an Oxford academician, who is responsible for the assertion that two negatives cancel each other, creating a positive, both in mathematics and in language. That assertion, of course, is nonsense. Nobody would interpret the statement, "I didn't do nothing," to mean "I did something."

However, the current use of multiple negatives would be unwise because they have achieved notoriety, now indicating a broader lack of grammatical structure and implying general substandard usage. That's a substantial strike against anyone, implying that ungrammatical English indicates ignorance. Like licking your plate at the end of the meal, double negatives used to be acceptable, but no longer!

The reader's second question, whether the vowel sound in the adjective *long-lived* should rhyme with the noun *life* or with the vowel sound in the verb *live*, can be answered more briefly. Pronounce the adjective with the "long" 'i' sound, as in *life*. The adjective derived from the noun *life*, and indicating that the subject has a long life. The 'f' sound often changes to 'v' before a voiced ending, as in the 'd' sound that follows. Compare the statement, "We bring you Joe Schmoe, live, from the scene of the fracas."

It's true that many commentators mispronounce the adjective *long-lived*, but don't assume they are authoritative. How many of these people also pronounce *nuclear* as if it were spelled *nucular*?

Question: Correspondent Felicia Buebel writes that she has just read the column in the September 1999 *Journal*. She is curious about the use of the subjunctive form in a quotation I used, although my comment about the quotation had to do with the use of "aspect." That quotation, from a statement made by Sen. Charles E. Schumer of New York, was, "That would have been one of the Senate's finest hours if the bill was passed." Ms. Buebel asks whether Senator Schumer should have used the subjunctive form, "if the bill were passed."

Answer: There are really two questions here. The first has to do with aspect, whose grammatical meaning is the use of verbs to denote the relationship of one action to another, especially their temporal relationship. With respect to Sen. Schumer's comment, to indicate that one action took place before the other he should have said, "That would have been one of the Senate's finest hours if the bill had been passed," (or "had the bill been passed"). That is, had the Senate passed the bill (prior action), it would have created a "finest hour" (later action). In legal writing the use of aspect is very important to indicate how actions occurred temporally relative to each other.

The second question, about subjunctive, is not really pertinent here because in English the subjunctive mode in the past perfect tense is exactly like the indicative mode. (As Ms. Buebel noted, Latin contained a much-expanded subjunctive mode, and we should all be grateful that English does not.) So in the statement submitted, my substitution of "had been" for "was" would be correct.

However, as Ms. Buebel correctly noted, if the statement had been in the present tense, the subjunctive form would be necessary because the statement is "contrary to fact." Thus, using the present tense, you would say, "If I were a senator I would vote for the bill." ("I" am not a senator.)

Gertrude Block is the writing specialist and a lecturer emeritus at Holland Law Center, University of Florida, Gainesville, FL 32611, and a consultant on language matters. She is the author of Effective Legal Writing, fifth edition (Foundation Press, July 1999), and co-author of Judicial Opinion Writing Manual (West Group for ABA, 1991).

The author welcomes the submission of questions to be answered in this column. Readers who do not object to their names being mentioned should state so in their letters. E-mail: Block@law.ufl.edu.