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N.Y. Real Property Law Journal

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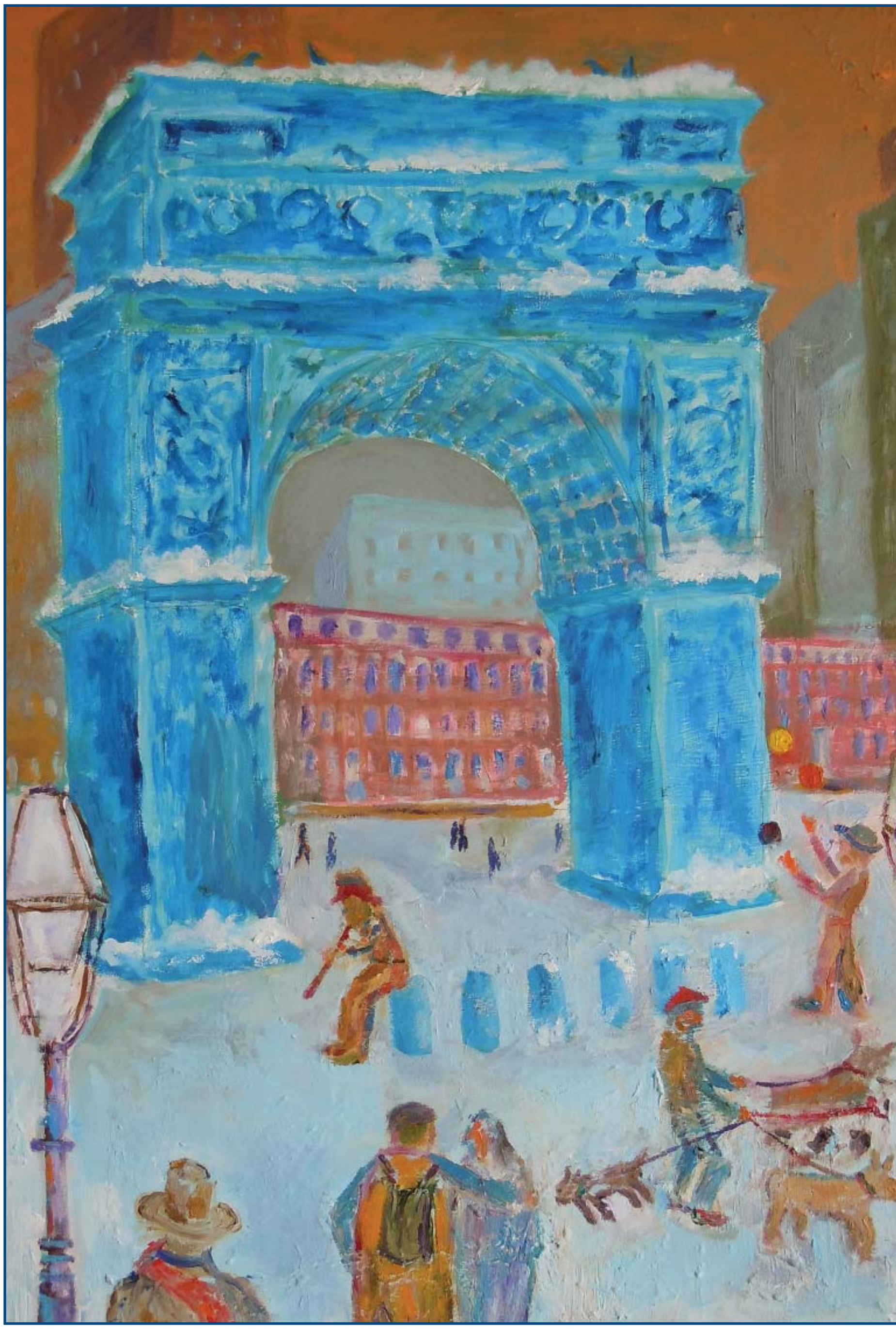


Inside

Table of Contents

On the Cover

Washington Square Arch, painted by Sherman Stein, father of Section member and former Section Chair Joshua Stein. Commissioned by Alfredo R. Lagamon, Jr. (NYU Tax LLM), a friend of Joshua's, who enjoyed spending spare time in the park during law school. The people in the park were added at Alfredo's request. The artist added the dogs. Painting appears courtesy of Sherman, Joshua, and Alfredo.

Message from the Outgoing Section Chair

One year ago, when I wrote my message as the incoming Section Chair, I said I was fortunate to follow a long line of terrific chairs who left the Section in fantastic shape. Now, I am pleased to report that I am equally fortunate to precede a line of stellar chairs, vice chairs and a secretary who will keep the Section in wonderful shape and will continue to carry on the Section's mission of providing first-rate continuing legal education programs, books and materials, creating and advancing a cooperative and collegial real estate Bar, proposing and monitoring legislation affecting real estate and real estate lawyers, and developing fair, just, necessary and appropriate real property law in New York State.

Ben Weinstock, the incoming Section Chair, has already distinguished himself by planning, organizing, and overseeing our 2012 Summer Meeting and our 2013 Annual Meeting. Both meetings were truly sensational and the Summer Meeting was the first meeting to produce a significant profit for the Section. David Berkey, the incoming First Vice-Chair, has already broken important new ground for the Section. David created, nurtured and leads our student intern program, lining up half a dozen law schools around the State to provide law student interns, specifically interested in real estate law, to work with active real estate lawyers in large and small law firms, which David recruited to participate in the program. Leon Sawyko, having faithfully and accurately kept detailed minutes of our Executive Committee meetings, now moves up the ladder to become Second Vice-Chair, and he is already deep into planning our 2014 Summer Meeting. Our new, incoming Secretary, Mindy Stern, has been one of the most active members of our Section, having served most recently as co-chair of our Committee on Not-For-Profit Entities and Concerns, as Chair of our Task Force on Attorney Escrows, as a member of our Diversity Committee and as the Chair of our Lorraine Power Tharp scholarship award committee. Finally, we continue to benefit from the longtime service of Spencer Compton, as our watchful and protective Budget Officer. A superb team indeed.

During the past year, several members have rendered service to our Section well above and beyond the call of duty. I particularly recognize and thank Karl Holtzschue, winner of our most recent Professionalism Award, for his continuing leadership of our Legislation Committee and his organization and leadership of our annual Lobby Day in Albany (where we regularly meet with members of the State Senate and Assembly and where George Haggerty has enabled us to meet with the Governor as well), the father-son team of John and Tom Hall, who continue to volunteer, respectively, as leaders of our Task Force on Publications and our always active Title and Transfer Committee, Larry Wolk and Joe Walsh for their superb service in organizing and arranging our many well-attended CLE programs and events, Harry Meyer for promoting both increased membership and diversity for our Section and for serving as a mentor to many younger members, Brian Lustbader and Ken Block for making our relatively new Real Estate Construction Committee a resounding success, Vince Di Lorenzo, Bill Colavito, Marvin Bagwell and Bill Johnson for obtaining articles and producing and publishing our *N.Y. Real Property Law Journal*, and Mike Berey for wearing several hats as Chair of our Task Force on e-Recording Legislation and overseeing our website/blog. I also thank our many other Committee chairs, Jerry Antetomaso, Joel Binstok, Lauren Breen, Peter Coffey, Nancy Connery, Anne Copps, Karla Corpus, Lew Creekmore, Joe DeSalvo, Ed Filemyr, Richard Fries, Matt Fuller, Garry Graber, Dennis Greenstein, Laureen Harris, Jimmy Lathrop, Linda Margolin, Laura Ann Monte, Greg Pressman, Chip Russell, Frank Sarratori, Richard Singer, Sam Tilton, Gino Tonetti, Stacy Wallach, Nick Ward-Willis, David Zinberg, and Bob Zinman. They have all arranged and conducted numerous committee meetings, keeping the Section active, vital and interesting for all of our members. We have also been the beneficiaries of the special assistance, particularly with membership and recruitment, of our thirteen District Representatives, all of whom are listed on p. 36 in this *Journal* and to whom we extend our sincere thanks and appreciation.

Also in the past year, we have significantly increased our role with the NYSBA through the activities of our representatives to the House of Delegates. Ira Goldenberg parlayed his position as one of our four delegates into the Chair of the Caucus of Section Delegates and, from there, he was unanimously selected to serve as one of the first two Section representatives on the Executive Committee of the NYSBA. Ira now represents all of the many Sections of the NYSBA and makes all of our own Section members proud of his work and our association with him. At the same time, our four delegates have become active members of the Section Delegates Caucus, with Joel Sachs, Trish Watkins, Larry Wolk and Sam Tilton accepting membership on the continuing legal education, membership and finance committees of the Caucus.

On the legislation front, one long-awaited success we achieved was with the legislation making the unlicensed practice of law a felony.

Several of our members, George Haggerty (now the Deputy Secretary for Financial Services under Governor Cuomo in Albany), Karl Holtzschue, John Hall and Harry Meyer promoted this legislation for several years and their success resonates well beyond our Section; it is a benefit to all lawyers in New York State.

On the financial front, after three years of running annual deficits, we returned to a significant surplus thanks to the groundwork laid by Heather Rogers, my immediate predecessor as Chair, and the help of Ben Weinstock, my immediate successor as Chair.

In January, we awarded the Lorraine Power Tharp scholarship to Alyssa Fortuna, a third-year student at Buffalo Law School. I am also pleased to report that since our Section has returned to generating a surplus, we were able to take the important step of increasing the amount we will provide to the New York Bar Foundation for the awarding of both of our sponsored scholarships— the Lorraine Power Tharp scholarship and the Mel Mitzner scholarship. We now expect to be able to provide meaningful assistance to those students to whom these scholarships are awarded.

I have truly enjoyed my three years serving as an officer of the Section and working closely with all of our officers, committee chairs, task force chairs and district representatives. I also appreciate the attention, assistance and participation we've received from Seymour James, Jr., immediate past President of the NYSBA, and from Rich Martin, Lori Nicoll, and Vincent Titus, all of whom work for all of us in Albany, and from Tom Myers, our liaison with the NYSBA Executive Committee. There is, however, one person who is truly the absolute best, Tiffany Bardwell. I have especially enjoyed and benefited from her wonderful work as our liaison and meetings coordinator at the NYSBA in Albany. She is always there for our Section, watching out for us and watching over us.

Please be sure to keep July 11-13, 2013 on your calendar and join us at the gorgeous Mohonk Mountain House in New Paltz, New York for our 2013 Summer Meeting. The facilities are amazing; we are arranging some new, unique activities (fly fishing, for example), and David Berkey has assembled a superb line-up of speakers to deliver an educational and enjoyable two days of continuing legal education, including presentations on 1031 exchanges, current mortgage financing and foreclosure issues, the right to enter upon neighboring property for construction, lease escalation clauses, a panel on real estate broker issues, and Anne Copps's chocolate-covered course on ethics.

In closing, I thank you for my tenure as an officer of the Section. I am honored and delighted to have been given the opportunity to serve you. I thank you all for enriching my life with this experience.

Steven M. Alden

Message from the Incoming Section Chair

It is with a tremendous sense of pride and honor that I embark upon my new role as Real Property Law Section Chair of the New York State Bar Association. It has been a privilege to be actively involved for many years in a Section that is, by the number of its members, among the largest in the Bar. More significant than its size, however, is the fact that it is the most active. Our committee chairs and members are devoted to improving the proficiency of our profession by offering so many continuing legal education programs and other educational presentations. The number and variety of scholarly and practical articles, books and other communications published by the brightest minds in our profession is staggering. Our members teach, mentor and provide internships. They readily serve in pro-bono positions and devote their time and energy to helping others without the expectation of recognition or gain. They actively review and comment on existing and pending legislation, and offer guidance to public officials, judges and the media on the principles and precedents of real property law.

Our Section is very well represented at all levels of NYSBA's governance and our members help shape the policies of the entire State Bar.

Above all, our members lead by example with wisdom, humor, grace, dignity and a unique camaraderie

Every new year brings challenges and shared goals. Paramount is the growth our Section's membership. We value our longstanding existing members and look-forward to welcoming new members and their active participation. Several significant legislative issues are pending that we must address decisively. We are firmly committed to the expansion of the internship program and dedicated to enhancement of diversity in our Section generally, and on our Executive Committee specifically.

My thanks go out to each Committee Chair, member at large and district representative for their devoted service to our Section. Therefore, I express on behalf of the entire State Bar a collective thank you for a job well done and a prayer that they remain encouraged to continue to serve for the good of the public and our profession

Our outgoing Chair, Steve Alden, deserves special recognition and thanks. I am astounded by his nearly immediate response to Section emails. It's not just the speed that is so impressive. The wisdom and thoughtfulness of his decisions and recommendations are uniquely noteworthy. He astutely identifies the core of the issue and lasers in on a solution instantaneously.

The work that that our Section has accomplished is exceptional, and it is due to the stellar work of the officers in charge. David Berkey, our First Vice-Chair, has planned a terrific Summer Meeting and is already planning the Annual Meeting for January. Second Vice-Chair, Leon Sawyko, has the most compelling soft-spoken style of reasoning that I have ever encountered. Finally, our incoming Secretary, Mindy Stern, brings broad knowledge and keen insight to the table. I have high expectations for the increased success of our Section due to their leadership.

With our collective expertise and dedication I look forward to the achievement of our goals and a productive tenure as Chair. I look forward to greeting you and spending time with each of you at our upcoming summer meeting.

Benjamin Weinstock

New York's Mortgage Tax Partially Securing Multiple Obligations

By Michael J. Berey

New York State's Department of Taxation and Finance (the "Department") has issued a Bulletin on applying the State's mortgage recording tax to a mortgage partially securing multiple obligations.[1] A commercial mortgage may secure term loans, revolving credit loans, agreements to reimburse lenders issuing letters of credit, and guarantees of loans made to someone other than the mortgagor.

Mortgage recording tax is payable in New York on the amount of principal indebtedness which is, or under any contingency may be, secured on the execution of a mortgage or at any time thereafter, unless a mortgage is exempt from imposition of the tax. The applicable mortgage tax rate, as much as $2.80 for each $100.00 of principal indebtedness in The City of New York, is the rate in effect in the county[2] in which the mortgage is to be recorded. If less than the proper amount of mortgage recording tax due is paid, the mortgage and the note it secures, even if the mortgage is not recorded, cannot be enforced.[3] Mortgage tax is payable only through the recording process.

In 1993, the Department issued an Advisory Opinion on the imposition of mortgage recording tax on a mortgage securing a portion of a single, larger obligation.[4] In such a case, mortgage recording tax can be limited by stating the maximum amount secured, or "cap,"[5] by providing that the mortgage partially secures a large obligation, and by adding a so-called "last dollar" clause, stating that the secured amount is the last dollars of the loan to be repaid.[6] If the loan is revolving credit, the last dollar provision will also provide that only the amount above the cap will revolve, in effect rendering the secured portion of the loan a term obligation.[7] The Department has informally advised that it interprets the 1993 Advisory Opinion, setting forth mortgage text that the "[s]ecured amount represents only a portion of the first sums advanced," as requiring that such a mortgage also identify the first sums advanced, or a portion thereof, as the amounts to be secured. The partial securing of multiple obligations by a single mortgage has not previously been addressed.

When a mortgage secures more than one obligation, and the stated maximum amount to be secured on which the mortgage recording tax is paid is less than the sum of the obligations or, alternatively, the mortgage does not contain a distinct maximum amount clause and separate "last dollar" text for each obligation, mortgage tax will be payable on the stated maximum amount secured when the mortgage is recorded. However, under the Bulletin, the maximum amount secured, absent an express allocation of the cap amongst the obligations partially secured, is to be deemed allocated amongst the various obligations.

Further, if an obligation, which is one of multiple obligations partially secured by a mortgage, is paid down below its allocated portion of the cap, additional mortgage recording tax can be paid to enable the mortgage to be enforced as to an additional portion of that obligation up to the amount of the allocated cap.

As stated in the Bulletin: [8]

> Unless the mortgage provides otherwise, when different notes or bonds are secured by the same mortgage, the holders of the various notes or bonds share proportionately in the proceeds of the mortgage security in any foreclosure action. Thus, when a mortgage given as security for multiple debts or obligations contains a maximum-amount-secured provision, the mortgage must identify the fraction of the cap that applies to each debt. Otherwise, the cap will be prorated based on the balance of each debt over the total balance of all debts at the time the mortgage is executed.
>
> This approach also ensures that the proper mortgage recording taxes related to each secured debt are paid when the mortgage is recorded, and that the mortgage is enforceable against each debt. It is also necessary to determine the portion of the cap that applies to each debt in order to determine if one or more of the secured debts is paid down below the secured amount, and a supplemental instrument is recorded reflecting further advances subject to mortgage recording tax.

The following are drawn from examples in the Tax Bulletin.[9]

ABC Bank and XYZ Bank each make a separate $10,000,000 term loan to the mortgagor. A mortgage, under which the lenders are co-mortgagees, is recorded with a maximum amount clause of $10,000,000 on which amount mortgage tax is paid. The mortgage recites that it secures the first sums advanced and the last and final amounts repaid. The mortgage does not identify the amount of the cap that applies to each loan. Accordingly, the mortgage secures and is enforceable only as to $5,000,000 of the loan made by ABC Bank and $5,000,000 of the loan made by XYZ Bank.

A mortgagor obtains a term loan of $6,000,000 and a revolving line of credit for $4,000,000 with the same lender, both loans being secured by a single mortgage. The maximum amount secured, on which amount mortgage tax is paid, is $6,000,000. The mortgage recites that it secures the first sums advanced and the last and final amounts repaid. The mortgage does not identify the amount of the cap that applies to each loan. The maximum amount secured is therefore allocated. $3,600,000 of the cap applies to the term loan ($6,000,000 cap X $6,000,000 term loan/$10,000,000 total loans), and $2,400,000 applies to the revolving line of credit ($6,000,000 cap X $4,000,000 credit line/$10,000,000 total loans). The mortgage is enforceable as to the term loan up to $3,600,00, the amount of the $6,000,000 cap allocated to that obligation. The mortgage is enforceable as to the revolving credit loan up to $2,400,000, the amount of the $6,000,000 cap allocated to that obligation.

If the outstanding balance of the term loan falls below $3,600,000, to enforce the mortgage as to additional amounts advanced under the term loan, mortgage tax must be paid on the difference between the cap and the outstanding balance of the term loan. The term loan will then again be enforceable up to the amount of the cap. If, for example, the term loan is paid down to $2,000,000 and the lender has or is to advance additional amounts under the term loan which it wishes to enforce under the mortgage, mortgage tax is payable on $1,600,000 (the $3,600,000 cap less $2,000,000, the outstanding balance of the term loan), and the mortgage would again be enforceable up to $3,600,000.

A mortgage is executed to secure a guarantee of a term loan of $45,000,000 and a guarantee of the borrower's obligations under a revolving credit facility under which $15,000,000 can be outstanding at any one time. The maximum amount secured under the mortgage, on which amount mortgage tax is paid, is $50,000,000. The mortgage secures the first $50,000,000 of the guaranteed obligations advanced and the last and final amounts to be repaid. The guarantee of the term loan is secured and the mortgage is enforceable as to that obligation up to $37,500,000 ($50,000,000 cap X $45,000,000 term loan/$60,000,000 total loans). The guarantee of the revolving line of credit is secured and the mortgage is enforceable as to that obligation up to $12,500,000 ($50,000,000 cap X $15,000,000 line of credit/$60,000,000 total loans).

If the guaranteed revolving line of credit is paid down below the allocated cap of $12,500,000, to enforce the guarantee mortgage as to additional advances, further mortgage tax computed on the difference between the allocated cap and the outstanding amount of the credit line is payable. Once paid, the mortgage will again be enforceable as to advances made under the credit line up to the amount of the cap. To secure additional amounts under the mortgage as to the guaranteed term loan when a payment on the term loan is made, additional mortgage tax is payable computed on the difference between the allocated cap of $37,500,000 and the outstanding amount of the term loan. Once paid, the mortgage will again be enforceable as to the term obligation up to the amount of the cap.

Accordingly, when a mortgage partially secures more than one obligation, that is, when mortgage tax is not paid on the entire amount of all obligations intended to be secured or when there is not a separate maximum amount clause and "last dollar" provision as to each debt, the Department requires that the mortgage (a) contain a maximum amount secured provision on which mortgage tax will be paid on recording, (b) identify the portion of each obligation that may be enforced under the maximum amount provision (or there will be a deemed allocation), (c) include a statement that the mortgage secures the first sums advanced or a portion thereof, and (d) include the "last dollar" text stating that the mortgage secures the last amounts to be repaid.[10]

The Bulletin cannot address all situations. When a mortgage secures both a direct obligation of the mortgagor and an obligation which is primarily secured by a separate mortgage on which mortgage tax was paid, will the Department allocate the cap between the obligation primarily secured by the new mortgage and the obligation which is collaterally secured, notwithstanding that the mortgage tax was previously paid on the collateral obligation? Absent formal guidance on this issue, it will be prudent to separately secure the collateral obligation by a different mortgage executed for that purpose, claiming in a Tax Law Section 255 affidavit, that the collateral mortgage is exempt from mortgage tax as a "supplemental" instrument.

The Bulletin needs to be reviewed when a mortgage will be executed to partially secure multiple obligations. An experienced title insurance underwriter will be able to assist in its application.

Endnotes

1. N.Y. Dep't Tax & Fin. Taxpayer Guidance Div. Tax Bull. MR-580 (TB-MR-580) (Jan. 7, 2013), *available at* http://www.tax.ny.gov/pubs_and_bulls/tg_bulletins/mrt/multiple_obligations.htm (one of the series of Bulletins being issued by the Department on mortgage recording tax, the state's transfer tax and Mansion Tax.); *see, e.g.*, Tax Bulletin TB-MR-30 (June 5, 2012) ("Application of the Mortgage Recording Tax to Breakage Costs Secured Under Interest Rate SWAP Agreements." The Bulletins are posted at www.tax.ny.gov/pubs_and_bulls/tg_bulletins/default.htm).

2. Except in the City of Yonkers, in which mortgage tax is imposed at the rate of $1.80 per $100; a rate greater than the rate of $1.30 per $100 is otherwise imposed in Westchester County.

3. Commonwealth Land Title Ins. Co. v Lituchy, 161 A.D.2d 517, 518, 555 N.Y.S.2d 786, 787 (1st Dep't 1990).

4. BT Commercial Corp., N.Y. Dep't Tax & Fin. Tech. Servs. Bur. Adv. Op., TSB-A-93 (15) R (Sept. 3, 1993), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/mortgage/a93_15r.pdf.

5. 20 N.Y. COMP. CODES RULES & REGS. § 648.2(a)(2)(1994).

6. *See* Michael J. Berey, *The Last Dollar Endorsement and Capping the New York Mortgage*, N.Y. L.J., Oct. 11, 1995.

7. *See* N.Y. TAX LAW § 253-b (McKinney 2013) (exempting certain revolving credit mortgages from mortgage tax on re-advances); *see also* Michael J. Berey, *Commercial Credit Line Mortgages and Mortgage Recording Tax*, N.Y. L.J., July 27, 2011, at 4; Michael J. Berey, *Credit Line Mortgages in New York*, N.Y. L.J., Feb. 17, 1999.

8. Tax Bull. MR-580, *supra* note 1, at 2, *available at* http://www.tax.ny.gov/pubs_and_bulls/tg_bulletins/mrt/multiple_obligations.htm.

9. *See id*. at 3-6.

10. The relevance of "last dollar" text to a mortgage partially securing multiple obligations is not clear, but it is required by the Bulletin.

Michael J. Berey is Senior Vice-President and Chief Underwriting Counsel at New York First American Title Insurance Company, Chairperson of the Law Committee, and President-elect of the New York State Land Title Association.

The views and opinions expressed in this article are solely those of the author, and do not necessarily reflect the views, opinions, or policies of the authors' employer, First American Title Insurance Company.

New York Lien Law Notice of Lending

By Lance Levine

Like Rip Van Winkle awakening from a long sleep to find a changed world, New York construction lenders are arousing from their recession-induced slumber to find certain subtle yet significant transformations to the landscape since their last forays into construction lending. One such change in New York concerns when a construction lender is required to, or for prudence sake should, file a Notice of Lending (NOL) under New York's Byzantine Lien Law.

Prior to the middle of the last decade, construction lenders, already faced with a cumbersome filing process unique to New York, rarely felt the need to file a NOL. In fact, the practice of filing a NOL was generally limited to the scenario where the construction lender, prior to the initial advance of its construction loan, had already disbursed funds to the borrower for costs associated with the applicable project. However, an unexpected ruling by New York's highest court in *Aspro Mechanical Contracting Inc. v. New York City Housing Authority*,[1] handed down just prior to the pricking of the 2000s' real estate bubble, necessitates that the prudent New York construction lender now consider filing a NOL for all or most of its construction loans.

The primary purpose of New York's Lien Law is to reduce the number of projects in which laborers and materialmen are not paid for their work and/or the materials they supply, and to eliminate the practice of "pyramiding," in which developers use the loans or payments advanced in the course of one project to complete another. The New York Lien Law affords a contractor, subcontractor, materials supplier, laborer and certain others (for simplicity sake in this article I shall collectively refer to such parties as "contractors") three essential protections: the right to file a mechanic's lien against the property for failure to receive payment, the right to constructive notice of the amount of loan proceeds that will be available to pay contractors' claims, and the right to be designated as a beneficiary of a trust imposed over the loan or sales proceeds from the property.

> *"Like Rip Van Winkle awakening from a long sleep to find a changed world, New York construction lenders are arousing from their recession-induced slumber to find certain subtle yet significant transformations to the landscape since their last forays into construction lending."*

The first benefit granted to contractors by the New York Lien Law is that a contractor may file a mechanic's lien as an encumbrance on the real property and any improvements thereon improved by the work or materials supplied by such lien filer for failure to receive payment. A notice of lien may be filed at any time during the progress of work and/or furnishing of materials or within eight months after the completion of the final contract, final performance of the work or the final furnishing of materials (unless the improvement is single family dwelling, in which case the eight-month time frame is reduced to four months). The mechanic's lien is effective for one year from filing, unless an action is commenced and a notice of pendency is filed within such period. New York prohibits the execution of mechanic's lien waivers and such waivers are therefore void and unenforceable unless executed on or after the date payment is due.[2] A properly filed mechanic's lien has priority over any construction loan mortgage filed against the property and any loan advances secured thereby, except for prior advances made pursuant to a properly filed building loan agreement.

This leads us to the second benefit afforded to contractors by the New York Lien Law: notice. The provisions at the heart of New York's Lien Law, §13 and §22, through their filing requirements, were designed to incentivize construction lenders into providing contractors with constructive notice as to the amount of the construction loan proceeds that will be available to the owner for payment of contractors' claims. As a result of the New York Lien Law requirements, construction lenders bifurcate their loans. A first priority loan is issued pursuant to a building loan agreement, and the proceeds of this building loan may be used solely to fund "costs of the improvement."[3] Unlike garden variety loan agreements, the building loan agreement must be filed of record with the county clerk's office for the county where the property is located.[4] In addition to filing its building loan agreement, the construction lender is also required to file a §22 affidavit, signed by the borrower under oath, which states the amount of the building loan, subtracts from that amount the consideration paid for the building loan (the commitment fee, if any), and further subtracts all other "soft" costs and expenses that are still nonetheless properly deemed "costs of the improvement" (such as real estate taxes, architect's fees, recording fees, lender's legal fees and interest on the building loan). The difference, which is also stated in the affidavit, is the amount of building loan proceeds available for payment of the contractors. In theory, then, for any given project a contractor can review the building loan agreement and §22 affidavit filed of record before starting work to get a sense of whether there will be adequate available funds to make payment in full.[5]

If the construction lender satisfies the foregoing New York Lien Law requirements, the advances it makes pursuant to the building loan agreement receive priority over subsequently filed mechanic's liens, although building loan advances will have priority over a filed mechanic's lien only to the extent made before the lien is filed (hence the need to do a title update every time an advance is made as assurance before making such advance that no new mechanic's liens have been filed).[6] The result of not following these requirements or filing a materially false lien law affidavit is that the building loan mortgage will be subordinated to even subsequently filed mechanic's liens, thus creating a strong incentive for the construction lender to comply with the New York Lien Law notice requirements.

The second priority loan, which funds expenses related to the project that are not "costs of the improvement" (such as marketing expenses and borrower's legal fees), is issued pursuant to a project loan agreement that does not have to be filed of record; however, advances made pursuant to the project loan agreement do not have priority over subsequently filed mechanic's liens.[7] The concept behind the project loan is that this portion of the construction loan is being used to fund costs that are not directly connected to the improvements and as a result the project loan mortgage does not deserve to have priority over a mechanic's lien filed by a contractor for payment in respect of work or materials that were integral to the improvements.[8]

As a third benefit to contractors, the New York Lien Law, in Article 3-A, entitles contractors to a trust claim arising out of the improvements.[9] Unlike the right of a contractor to file a mechanic's lien, which is a right granted by most or all of the states and therefore generally well appreciated by construction lenders and their counsel, the trust fund concept as a means to protect contractors is virtually unheard of outside New York and is therefore arguably the least understood of the rights granted to contractors. Still, New York's Lien Law makes it clear that the funds received by an owner for or in connection with an improvement—including the proceeds of a construction loan and the proceeds from the sale of the property or a portion thereof—form a separate trust fund, with the property owner the trustee of such trust.[10] The import of this designation is that the proceeds from a construction loan or the sale of the property, as trust assets, must first be used by the owner to pay for costs of the improvement associated with the development project. In order to insure the owner complies with its obligations as trustee, New York requires that a construction lender insert into its:

> building loan mortgage and every mortgage recorded subsequent to the commencement of the improvement and before the expiration of the period…for filing of a notice of lien after the completion of the improvement…a covenant by the mortgagor that he will receive the advances secured thereby and will hold the right to receive such advances as a trust fund to be applied first for the purpose of paying the cost of the improvement, and that he will apply the same first to the payment of the cost of the improvement before using any part of the total of the same for any other purpose.[11]

This covenant is known as the "trust fund covenant."

It is to establish a defense against a claim that trust assets—loan or sales proceeds—were improperly diverted that a construction lender will file a NOL.[12] The relevant section of the New York Lien Law provides with respect to NOLs:

> In any action against a person to whom trust assets have been transferred, to recover assets diverted from the trust or to recover damages from the diversion, a transferee named in an…[NOL]…shall be entitled to show by way of defense that the transfer was made as security for or in consideration of or in repayment of advances made to or on behalf of the trustee in accordance with such…[NOL]…and that prior to making of such advance the transferee procured from the trustee the written agreement of the trustee that he will receive the advances and will hold the right to receive such advances as trust funds to be first applied to the payment of trust claims…, and that he will apply the same to such payments only, before using any part of such advances for any other purpose.[13]

Prior to the *Aspro Mechanical* case, it was generally thought that, for a typical construction loan, filing a building loan agreement and §22 affidavit and recording a building loan mortgage with the trust fund covenant constituted all that a construction lender needed to do to preserve the priority of its building loan advances over any subsequently filed mechanic's liens. More to the point, construction lenders believed that they were not required to file a NOL or take any other action specifically to comply with the trust provisions of Article 3-A of the New York Lien Law (other than to include the trust fund covenant in the building loan mortgage to insure the borrower's compliance). The borrower, as a recipient of loan proceeds, to be sure, was treated as a trustee of those funds and therefore needed to be concerned about the fiduciary duties that implied, but the lender who, after all was advancing loan proceeds, not receiving them, had no reason to believe that it also would be treated as a trustee.[14]

Moreover, because repayment of the building loan is legitimately considered a "cost of the improvement," it was generally believed by the real estate bar that so long as a construction lender complied with the requirements of §13 and §22 of the New York Lien Law, any payments made to the construction lender by its borrower in respect of repayment of the building loan were permissible payments of trust assets by the borrower/trustee.

It did become common practice, however, for construction lenders to file a NOL in one situation: when the lender had made an unsecured loan advance for costs of improvements prior to execution of the building loan agreement. In a typical scenario, the construction lender is asked to make an unsecured loan to the borrower to pay for pre-development costs, such as architect's fees and surveying costs, prior to the time when both parties are ready to enter into the construction loan. After making the initial unsecured pre-development loan, the construction lender will subsequently enter into a building loan that, in addition to funding construction of the project, will be used to repay the earlier unsecured loan amount. The construction lender thus becomes a direct transferee of the construction loan proceeds/trust assets. So that the use of building loan proceeds to repay the earlier loan will not be deemed a diversion of trust assets by the borrower/trustee, the construction lender will file a NOL at the time it makes the initial unsecured loan,[15] thereby establishing the defense codified in New York Lien Law §73(2). Absent these particular circumstances, however, no one found a need to file a NOL.

Aspro Mechanical has forced those of us representing construction lenders to rethink that position. The case arose with respect to a government assisted project in Brooklyn, New York developed by Berry Street Corp. The developer entered into a turnkey contract of sale with the New York City Housing Authority (NYCHA) pursuant to which the developer agreed to acquire certain real property in Brooklyn owned by NYCHA, construct multifamily buildings on such land and then re-convey title of the improved land back to NYCHA in consideration for payment of a purchase price. The project was to be developed in stages. Fleet (now part of Bank of America) provided first priority construction financing for the project. Fleet made a building loan, filed a §22 lien law affidavit and inserted into its building loan mortgage the trust fund covenant required by §13 of the New York Lien Law, none of which were challenged during the course of the case. As part of its security for the construction loan, Fleet received a collateral assignment of the turnkey contracts. As buildings were completed and re-conveyed to NYCHA, NYCHA paid the purchase price directly to Fleet for application to repayment of the building loan. While the mortgage contained a reference to the collateral assignment of the turnkey contracts, the assignment itself was not recorded.

The court, not surprisingly, found that the funds NYCHA owed the developer under the turnkey contract were trust assets, that the contractors working on the job were beneficiaries of that trust and that the developer was a trustee of the trust. The court went on to find, however, that when Fleet accepted the collateral assignment of the developer's rights in the turnkey contracts, it stepped into the developer's shoes, and as a result Fleet had become a statutory owner-trustee that owed a duty to the contractors as trust beneficiaries. Suddenly, a construction lender could be considered a trustee under New York's Lien Law. The court then concluded, "In these circumstances, Fleet's application of the trust assets to repay its loans to Berry Street—without acknowledging its status as trustee and providing notice to trust beneficiaries of the transfer—constituted a breach of fiduciary duty."[16] Fleet's attempted defense that it had complied with §12 and §22 of the New York Lien Law, in the court's opinion, "overlooks the important fiduciary considerations adopted by the Legislature to safeguard beneficiaries. Potential trust beneficiaries might have been able to ascertain Fleet's claim of priority as a secured mortgage lender but nothing in the mortgage documents identified Fleet as a trustee of the Article 3-A assets."[17] Significantly, the court reached this conclusion even though Fleet had filed a building loan agreement and §22 affidavit and recorded a mortgage with a trust fund covenant. The problem was that "[e]ven if [the contractors] had surmised Fleet's role as the trustee by examining the mortgage documents, those filings would not have informed beneficiaries that Fleet planned to use trust assets to repay itself."[18]

What could Fleet have done to protect itself? The court went on to:

> conclude that the filing by Fleet of a Notice of Lending—although not necessarily the only device available—would have satisfied Fleet's fiduciary duty to provide notice to the trust beneficiaries of its use of trust assets to discharge Berry Street's debt. Such a filing would fulfill the legislative purposes of Article 3-A and eliminate any taint of self-dealing by a trustee who is also a trust beneficiary. Notably, had Fleet filed a notice of lending regarding its use of the trust assets to repay itself, the beneficiaries could have ascertained that (1) the trust assets were being depleted and (2) Fleet was a trustee acting as both transferor and transferee of those funds.[19]

While allowing that there may have been devices other than filing a NOL that could have saved Fleet under the circumstances, the *Aspro Mechanical* court unfortunately did not set forth what those other options might be, meaning construction lenders wanting to be sure of complying with *Aspro Mechanical's* dictates have no real choice but to file a NOL.

The *Aspro Mechanical* court may have placed too much reliance on the benefits afforded by a constructive notice filing.[20] As with the filing of the building loan agreement and §22 affidavit, it is highly questionable whether contractors will actually search for and review the NOL prior to starting work on a project. One could reasonably ask whether a NOL's only practical benefit to a contractor is that its absence is now another piece of ammunition afforded to the contractor in a lawsuit filed after the fact when the project has already gone bad.

Following *Aspro Mechanical*, when exactly does a construction lender need to file a NOL? Since the decision in *Aspro Mechanical*, there has been a paucity of new case law on the topic that might provide guidance. You can be sure, however, that contractors' counsel have read *Aspro Mechanical* backwards and forwards and that they are hard at work devising creative arguments as to why *Aspro Mechanical* should be applied broadly to cover any situation where the construction lender is repaid out of cash proceeds from the property, even if that means construction lenders will never, or virtually never, be able to satisfy their New York Lien Law requirements simply by filing a building loan agreement and §22 affidavit and recording a mortgage with the trust fund covenant. Virtually the first question a contractor's counsel will now ask when retained on any New York project gone bad is whether the construction lender properly filed a NOL in addition to its building loan agreement and §22 affidavit. Keeping that in mind and given the loss of priority that noncompliance with the trust fund provisions entails and the relative ease of filing a NOL, many commentators and counsel have started advising construction lenders to simply file a NOL on all of their New York construction loans as a matter of pre-emptive protection.[21]

Still, even though the filing of NOLs has become more common today than it was prior to *Aspro Mechanical*, it has hardly become universally accepted practice to file a NOL on all New York construction loans, perhaps because the filing of a NOL is not without potential peril or added work for the construction lender. While the filing of the NOL itself is fairly straightforward, a mechanic's lien claimant is also entitled to receive from any construction lender who has filed a NOL, within ten days of written demand, a verified statement as to the construction lender's advances. If the construction lender fails to comply in a timely manner it will lose the benefit of the NOL.[22] The burden of complying with the statement of advances needs to be added to the equation for determining whether a NOL should be filed.

Today, in addition to any transaction where building loan advances will be used to fund repayment of prior loan advances, a construction lender should without hesitation file a NOL in any transaction where it will be taking a collateral assignment of the borrower's right to receive sales proceeds, such as for a turnkey project (like the one at the heart of the *Aspro Mechanical* case) or a typical condominium construction project (where the proceeds of the sale of individual units are used to pay down the construction loan). Additionally, if the borrower has entered into a commitment for take-out financing that is collaterally assigned to the construction lender, the construction lender will want to file a NOL.

What if the construction loan is for an office building or shopping center where the construction lender expects to be repaid partially out of excess operating cash flow once the project is open for business and then ultimately in full when its borrower refinances through a permanent loan? What if the project develops problems during construction, the borrower defaults under its obligations and the initial construction lender ends up getting taken out by a new construction lender willing, for whatever reason, to take on the troubled project, a scenario no one expected at the outset of the initial construction loan but which was always a foreseeable possibility? The argument could be made that in each of these cases the initial construction lender has not taken an assignment of the right to funds from its borrower, is therefore not stepping into the borrower's shoes as a trustee and as a result filing of a NOL is unnecessary. On the other hand, the construction lender cannot be sure that future court decisions will hold that the mere knowledge that the borrower will or might be repaying the loan out of funds that otherwise could have been used to pay contractors (without the added weight of the construction lender having taken an assignment of a sales contract) is insufficient to require the filing of a NOL. Until future case law or the New York state legislature provides clear answers to these questions, the prudent practitioner needs to weigh the burden of filing the NOL and the verified statement of advances against the comfort of knowing the client, by filing a NOL in addition to satisfying the requirements of §13 and §22, has taken every step possible to fend off a future claim that repayment of its loan was not an improper diversion of trust assets.

Endnotes

1. *See* Aspro Mech. Contracting, Inc. v. Fleet Bank, N.A., 1 N.Y.3d 324, 805 N.E.2d 1037 (2004).
2. *See* N.Y. Lien Law § 34 (McKinney) (explaining that mechanic's lien waivers in New York are void and unenforceable, unless executed on or after the date payment is due).
3. *See* N.Y. Lien Law § 71(1) (McKinney) (Pursuant to New York Lien Law §2 a "cost of improvement," means "expenditures incurred by the owner in paying the claims of a contractor, an architect, engineer or surveyor, a subcontractor, laborer and material-man, arising out of the improvement, and in paying the amount of taxes based on payrolls including such persons and withheld or required to be withheld and taxes based on the purchase price or value of materials or equipment required to be installed or furnished in connection with the performance of the improvement, payment of taxes and unemployment insurance and other contributions due by reason of the employment out of which any such claim arose, and payment of any benefits or wage supplements or the amounts

necessary to provide such benefits or furnish such supplements, to the extent that the owner, as employer, is obligated to pay or provide such benefits or furnish such supplements by any agreement to which he is a party, and shall also include fair and reasonable sums paid for obtaining building loan and subsequent financing, premiums on bond or bonds filed pursuant to section thirty-seven of this chapter or required by any such building loan contract or by any lease to be mortgaged pursuant thereto, or required by any mortgage to be subordinated to the building loan mortgage, premiums on bond or bonds filed to discharge liens, sums paid to take by assignment prior existing mortgages, which are consolidated with building loan mortgages and also the interest charges on such mortgages, sums paid to discharge or reduce the indebtedness under mortgages and accrued interest thereon and other encumbrances upon real estate existing prior to the time when the lien provided for in this chapter may attach, sums paid to discharge building loan mortgages whenever recorded, taxes, assessments and water rents existing prior to the commencement of the improvement, and also those accruing during the making of the improvement, and interest on building loan mortgages, ground rent and premiums on insurance likewise accruing during the making of the improvement. The application of the proceeds of any building loan mortgage or other mortgage to reimburse the owner for any payments made for any of the above mentioned items for said improvement prior to the date of the initial advance received under the building loan mortgage or other mortgage shall be deemed to be an expenditure within the 'cost of improvement' as above defined; provided, however, such payments are itemized in the building loan contract and/or other mortgage other than a building loan mortgage, and provided further, that the payments have been made subsequent to the commencement of the improvement.").

4. *See* N.Y. Lien Law § 22 (McKinney) (explaining that a building loan agreement must be filed of record with the county clerk's office for the county where the property is located).
5. The practical benefits afforded by this type of notice system are open to conjecture. Do contractors really take the time to review these documents prior to starting a job? Or does their counsel only seek them out once the project has gone bad?
6. N.Y. Lien Law §13(2) (McKinney) ("When a building loan mortgage is delivered and recorded a lien shall have priority over advances made on the building loan mortgage after the filing of the notice of lien; but such building loan mortgage, whenever recorded, to the extent of such advances made before the notice of filing of such lien, shall have priority over the lien, provided it or the building loan contract contains the covenant required by subdivision three hereof, and provided the building loan contract is filed as required by section twenty-two of this chapter.").
7. If the proceeds of the loan are also being used to fund acquisition of the property, a third loan may be created to fund the acquisition costs. The acquisition loan will not have a future advance component but will have priority over subsequently filed mechanic's liens.
8. As any practitioner who has tried to complete or carefully review a §22 affidavit can tell you, the line between what constitutes a "cost of improvement" and what does not is often a fuzzy and not necessarily logical one. For instance, funds used to pay the lender's counsel are considered a cost of improvement and therefore may be included in a building loan and receive priority over subsequently filed mechanic's liens. Conversely, funds used to pay borrower's counsel are not considered costs of the improvement, must therefore be included in the project loan, and consequently do not receive priority over a subsequently filed mechanic's liens. *See* N.Y. Lien Law §22 (McKinney).
9. N.Y. Lien Law §70(1) (McKinney) providing that ("The funds described in this section received by an owner for or in connection with a contract for the improvement of real property in this state…or received by a contractor under or in connection with a contract for an improvement of real property... or received by a subcontractor…shall constitute assets of a trust….").
10. N.Y. Lien Law §70(2) (McKinney).
11. N.Y. Lien Law §13(3) (McKinney).
12. N.Y. Lien Law §73(3)(b) (McKinney). Like the building loan agreement and the §22 affidavit, the NOL is filed in the county clerk's office where the improvement is located. The requirements for an NOL are fairly simple: it must contain (a) the name and address of the lender making the loan advances, (b) the name and address of the borrower receiving the advances, (c) a description of the improvements and real property to which the advance relates, (d) the maximum amount of all advances which may be made pursuant to the NOL and (e) the date of any advance made on or prior to the date of filing for which the NOL is intended to be effective. If the NOL relates to several or undetermined projects, the NOL must contain a termination date which may not be later than two years after the date of filing, provided that an amendment may be filed extending the date of termination so long as such amendment is filed within 60 days of the termination date. The NOL is effective with respect to all advances made (i) on the date of filing, (ii) subsequent to the date of filing and (iii) up to five days before the date of filing.
13. N.Y. Lien Law §73(2) (McKinney).
14. In fact, there is a line of cases that expressly states that a construction lender is **not** a trustee under the N.Y. Lien Law. *See, e.g.*, *In Re:* Elm Ridge Associates, Elm Ridge Associates II, Nob Hill Partners III, L.P. and Ritz-Craft Corporation of PA, Inc. v. National Electric Benefit Fund, 234 F.3d 114 (2d Cir. 2000) *citing In Re:* ALB Contracting v. York-Jersey Mortgage Co., 60 A.D.2d 989, 401 N.Y.S.2d 934 (App. Div. 1978).
15. In addition, when making the building loan, the lender will disclose in the §22 affidavit that a portion of the loan proceeds are being used for repayment of the prior loan.
16. *Aspro Mechanical,* 1 N.Y.3d at 331.
17. *Id.*
18. *Id.*
19. *Id.*
20. *See Aspro Mechanical*, 1 N.Y.3d 324 at 331 (holding that a Notice of Lending would have allowed the trust beneficiaries suitable notice of Fleet's use of the trust assets).
21. *See, e.g.*, Joshua Stein, *Stein on New York Commercial Mortgage Transactions*, § 5.14 (2008).
22. N.Y. Lien Law § 73(4) (McKinney).

Lance Levine serves as a partner in the Real Estate Group at Cassin & Cassin LLP. Mr. Levine has more than 15 years of general real estate experience, with particular expertise representing commercial lenders originating mortgage and mezzanine construction, permanent and bridge loans, including financings for syndication and securitization. Mr. Levine is admitted to practice in the State of New York and is a member of the CRE Finance Council, Mortgage Bankers' Association of New York, New York State Bar Association Real Property Law Section, and Real Estate Board of New York. He received his Juris Doctor from Columbia Law School and his Bachelor of Arts and Bachelor of Science from the University of Pennsylvania.

Five Issues in Bankruptcy with Which a Real Estate Attorney Should Be Familiar

By Thomas A. Glatthaar

Having worked as a title attorney for many, many years now, I have seen my share of bad real estate markets. I started in the business in 1981, and those of you who were around in those days remember that things were bad then. I worked my way through the steep but short recession of 1990-91 and the little downturn in 1999-2000, and have had the pleasure of participating in the Great Recession and its aftermath. I would like to think that I have learned a lot from these experiences, but if there is one thing I have learned from these experiences it is this: there is a connection between bankruptcy and real property law, and it is helpful when practicing one to have at least a working understanding of how the other one affects what you do.

Coming fresh off of several recent title matters where the owner was in bankruptcy and where I had to wade, once again, into the bankruptcy waters, I thought it a good opportunity to visit on five situations that commonly arise in a bankruptcy context with the hope of giving a basic explanation of how these play out. I tried to hit on situations where, in my experience, the bankruptcy lawyers and the title lawyers seem to speak different languages, hoping, perhaps, to bridge a gap or two. The issues, and my discussion of each of them, are set forth below.

Is My Transaction in Bankruptcy (Sale or Mortgage) Exempt from Transfer Tax or Mortgage Tax?

The bankruptcy code contains a provision at 11 U.S.C. Section 1146(a) that exempts "the issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title" from "a stamp or similar tax." Courts have defined a "stamp or similar tax" as a tax having all or most of the following characteristics:

1. the amount of tax is determined by the consideration recited in the document;
2. the taxes must be paid as a prerequisite to recording the document;
3. the use of a stamp or other device to conveniently provide for clear and visible evidence of payment;
4. the tax relates to a written document;
5. the written documents to which the tax relates are recognized in law as important evidence of the enforcement of legal rights.[1]

Under that criteria, the New York State Real Estate Transfer Tax (the "NYSRETT"), the New York City Real Property Transfer Tax (the "NYCRPTT") and the New York Mortgage Recording Tax (the "Mortgage Tax") have all been viewed as stamp or similar taxes;[2] the now-repealed Tax on Gains Derived from Certain Real Property Transfers (New York Tax Law Article 31-B) was not.[3]

In addition, in order to assert this exemption the transfer must be made pursuant to a confirmed plan of reorganization under 11 U.S.C. Section 1129. The requirement that the transfer be a transfer under a plan does not mean that the transfer be mentioned or authorized under the plan of reorganization,[4] but it does require that the transfer be one over which the bankruptcy court has jurisdiction. Accordingly, a mortgage that was executed and recorded by a purchaser from a debtor, the proceeds of which were used to fund that purchase, was not exempt under 11 U.S.C. Section 1146(a) since the mortgage was arguably an event over which the court lacked jurisdiction and since bankruptcy courts generally lack jurisdiction to determine the tax liability of a non-debtor.[5]

Provisions contained in the statutes imposing the NYSRETT, NYCRPTT and the Mortgage Tax, or the regulations promulgated pursuant thereto, all reinforce or even expand the exemption in 11 U.S.C. Section 1146(a). Pursuant to Section 1405(b)(8) of the New York Tax Law, conveyances made "pursuant to the federal bankruptcy act" are exempt from New York State Real Estate Transfer Tax.[6] This exemption applies whether the bankruptcy is a Chapter 7, 11 or 13, or whether or not the conveyance is made pursuant to a confirmed plan.[7] The regulations relating to the Mortgage Tax affirm but do not expand on the 1146(a) exemption.

There is no exemption contained in the NYCRPTT, or in the regulations promulgated thereunder. In the past, the New York City Department of Finance had expressed a willingness to allow deeds executed and delivered pursuant to a bankruptcy court order to sell under 11 U.S.C. Section 363 to be recorded without payment of the NYCRPTT before the confirmation of a plan provided that (i) the bankruptcy was a Chapter 11 proceeding,[8] (ii) the bankruptcy court order approving the sale exempted the transfer from NYCRPTT, (iii) the bankrupt agreed to promptly cause a plan of reorganization to be confirmed, and (iv) adequate security was posted to make certain that the tax was paid should the conditions not be fulfilled. That procedure went by the wayside, however, only after the U.S. Supreme Court, in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*, held that the Section 1146(a) stamp-tax exemption applies only to transfers made pursuant to a Chapter 11 plan that had been confirmed before the transfer.[9]

What Happens to Pre-Petition Ad Valorem Real Estate Taxes That Are Covered by an Order or a Plan of Reorganization That Contemplates a Sale "Free and Clear" of Liens?

As a matter of law, real estate taxes that are a lien at the time of the commencement of the bankruptcy case are a secured claim in a bankruptcy proceeding,[10] and a plan of reorganization can call for the property to be sold free and clear of the liens, which liens would attach to the proceeds. The same is true for a sale pursuant to a court order under 11 U.S.C. Section 363. Real estate taxes that are a lien due and payable after the commencement of the case, however, cannot be treated so specifically because they arise after the commencement of the case; they are either administrative expenses of the estate that are paid during the pendency of the bankruptcy proceeding,[11] or they must be paid out of the proceeds of sale. If not, the lien survives the sale of the property.

Problems arise all of the time in the context of a bankruptcy where the real estate taxes are not paid at the time of closing. In many instances, the taxing authority was not named and served in the bankruptcy (and was therefore not subject to the court's jurisdiction). Often, the tax collector will step up collection efforts after the property has been sold, and will pressure the new owner. Other times, when the post-petition taxes are paid, the payments are posted (as is the taxing authority's practice) against the oldest open liens, so that it is actually the pre-petition taxes that are paid off.

In short, this situation always seems to be a problem whenever it arises. Prudent practice dictates that special arrangements be made for dealing with the lien of pre-petition real estate taxes. These arrangements can include actually paying the taxes out of the sales proceeds with the court's approval (rather than having them paid post-closing), having the court direct special payment of the pre-petition taxes, or working out an arrangement between the parties for dealing with the prospect that the taxing authority will not discharge the lien for pre-petition taxes. Any such arrangement should be set forth in the plan of reorganization that is approved by the court or, should the sale be a Section 363 sale, in the contract that is ultimately approved by the court so that there is no question regarding the special treatment of this obligation.

What Is the Status of Liens Filed or Docketed After the Commencement of the Bankruptcy Case?

As you know, the fundamental purpose of bankruptcy law is to maximize the size of the bankruptcy estate so that it can be used to equitably pay creditors in accordance with certain rules of distribution. This purpose would be defeated if creditors of the bankrupt were concerned (rightfully) that every other creditor of the bankrupt was feverishly enforcing remedies such that at the end of the day there was nothing left to distribute. To solve this problem, the Bankruptcy Code includes an automatic stay provision[12] that arises at the commencement of the case and that bars creditors from, among other things:

1. commencing or continuing any action or proceeding against the debtor;
2. enforcing a pre-petition judgment against the debtor or its property;
3. any effort to obtain possession or control of debtor assets or property;
4. any act to create, perfect or enforce any lien against the property of the estate, whether the lien is pre-petition or post-petition.

The purpose of the automatic stay is to prevent chaotic and uncontrolled scramble for debtor's assets in a variety of uncoordinated proceedings in different courts[13] and to provide debtors with temporary respites from their creditors so that they may have the opportunity to develop and implement plans of reorganization to satisfy their creditors and, if possible, resuscitate their businesses.[14]

The Bankruptcy Code's automatic stay is extremely broad, and it needs to be to accomplish its intended purpose. However, there are some exceptions to the stay that are important to the real estate practitioner. First, the perfection of liens, the priority of which "relates back," is not stayed by 11 U.S.C. Section 362.[15] Since the New York Lien Law creates a mechanic's lien that relates back to the date that work was completed,[16] mechanic's liens on New York real property come within the safe harbor 11 U.S.C. Section 362(b)(3), and a lien that arises for work done, materials furnished or services rendered prior to the filing of a bankruptcy petition can be perfected by the lien claimant after the commencement of the case notwithstanding the automatic stay.[17] Such a lien constitutes a valid, perfected and secured lien in the bankruptcy case. Similarly, the action to continue a filed lien is also not stayed by the bankruptcy[18] whether such continuation occurs by virtue of an extension of the lien or the filing of a notice of pendency.[19]

Second, any act to perfect, maintain or continue the perfection of an interest in real property is not subject to the stay "to the extent that such act is accomplished within the period provided under" 11 U.S.C. Section 547(e)(2)(A).[20] This section of the bankruptcy code deals with the authority of a debtor-in-possession or trustee to void certain transfers of property interests made less than ninety days before the commencement of the case[21] and which otherwise meet the standard of being a "preference" as defined therein. Subsection (e)(2)(A) defines a transfer of property interests to have occurred "at the time the transfer takes effect between the transferor and transferee, if such transfer is perfected at, or within 30 days after, such time." All of this means that a transfer that occurs prior to the commencement of the bankruptcy case can be perfected *after* the commencement of the bankruptcy case without being subject to the automatic stay provisions of 11 U.S.C. Section 362 provided that the interest is perfected within thirty days of transfer.

For example, assume that ABC LLC ("ABC") is the owner of certain real property known as Blackacre. On August 1, 2012, ABC executes and delivers a mortgage to Sunshine Bank in the amount of $100,000.00, the proceeds of which are delivered to ABC at closing. On August 8, ABC files a petition in bankruptcy, and at that time Sunshine Bank had not recorded its mortgage. Realizing its problem, Sunshine becomes aware of the bankruptcy a week later and then rushes and gets its mortgage recorded on August 23. The automatic stay provisions of 11 U.S.C. Section 362 would generally bar perfection of Sunshine's security interest after the bankruptcy filing. However, the exception described above would allow the interest to be perfected by Sunshine if it was accomplished within thirty days of the closing of the transaction. This would allow Sunshine to get a perfected, secured claim in the bankruptcy case.[22]

What Is a "363 Sale" and How Can the Sale Be Free and Clear of Existing Mortgages and Other Liens?

The bankruptcy code allows, at Section 363, a debtor to sell assets of the bankruptcy estate after the commencement of the case. That concept in and of itself is not surprising; ofttimes assets need to be liquidated in order to raise the funds needed to right the foundering business. These sales can take place without even the need for notice and a hearing where the sales are in the ordinary course of business of the debtor.[23] It would seem this power exists so that the business of the debtor can be operated "day-to-day" without the need to run into court with every move and without the risk of over-burdening the courts. However, the "ordinary course" standard turns out to be a pretty high standard to meet. The sale must be of the sort that a creditor could have reasonably foreseen as occurring at the time that credit was extended—the creditor cannot be put in a position of being subjected to unforeseen risk. Further, the sale must be the type of transaction that the debtor or its industry competitors would enter into regularly, and cannot be so large that it, by its nature, is extraordinary.[24] Accordingly, most of the Section 363 sales occur under sub-section (b), which allows sales "other than in the ordinary course of business" after notice and a hearing. Such sales, whether or not in the ordinary course of business, can be made free and clear of interests,[25] including liens, *only if* the standards set forth in Section 363(f) are met. Section 363(f) requires that one of the following apply to the proposed sale:

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Any order to sell free and clear under Section 363(f) should clearly set forth which of the above standards are met to support the order. Net sale proceeds are generally turned over to the bankruptcy court or held under the court's supervision, so that it can determine the priority of claims and direct their payment. Any excess proceeds are retained by the debtor and could be used to help fund a plan, pay creditors or be used as needed (subject, obviously, to the court's jurisdiction and oversight).

The five requirements, when read together, cover a wide variety of situations and would, accordingly, allow a large number of transactions to proceed under Section 363(b) and (c). It is true that real property law rarely, if ever, allows the nonconsensual sale of property free and clear of existing liens, and requirement (1) is rarely used, especially in a real property context. A consent requirement, however, is more broadly applicable, and makes sense, especially in the context of notice and a hearing, from a policy perspective.[26] Similarly, since the proposed sales price exceeded the "value" of the aggregate amount of liens on the property (such "value" being either the face amount of the liens,[27] or more likely, the actual value of the liens as determined by the court[28]), the provision allowing for a sale free and clear where the proceeds of sale will be more than adequate to pay the claims of all lienholders makes policy sense—if a lienholder gets paid in full (or at least to the extent that the party can establish a valid lien), its consent should be a given. This requirement should cover any instance where the debtor has equity. Further, the court can act where there is an interest in the property asserted, but such interest is in bona fide dispute. The debtor's interest in the property must be substantial and the debtor must be the one disputing the interest of others,[29] but the interests can range from an ownership interest[30] to a mortgage lien[31] to a judgment creditor,[32] so long as the dispute is bona fide. As for the last requirement, it is well-established that most real property interests can be satisfied by the payment of money, and that in most instances the holder of a real property interest could be compelled to accept money in satisfaction of such an interest; it certainly covers the interests of all lienholders and secured creditors.

In addition to establishing that the proposed sale meets one of the foregoing requirements, the court must also determine that the proposed sale is in the best interests of the estate, including all creditors, secured and unsecured,[33] that the parties are acting in good faith and at arm's length,[34] and that the procedures utilized were reasonably calculated to cause the resulting purchase price to be a fair and reasonable price for the asset, taking into account the surrounding facts and circumstances.[35] Most Section 363 orders affirmatively indicate that the court has made a finding not only as to the requirements in Section 363(f), but also the good faith of the parties, the procedures utilized for the sale were sufficient and the resulting purchase price being fair and reasonable under the circumstances regarding such sale.

There is no mandated procedure for the sale of property under Section 363(b). Such a sale can occur by private sale or by public auction.[36] One common procedure used includes finding a prospective buyer and entering into a contract with that buyer for the purchase of the real property, and then going to the bankruptcy court on motion (obviously, with notice to all interested parties) to approve the contract as well as a procedure for an auction. This motion must be made in accordance with Bankruptcy Rule 9014 and must be served on the parties who have liens or other interests in the property to be sold. Oftentimes, the contemplated procedure allows the contract vendee to get a small advantage over other prospective purchasers through the use of breakage fees payable to the contract vendee should the auction result in the sale of the property to another.[37] The bid procedure takes place under the general supervision of the court and utilizing the procedure that the court has previously approved in its Order.

Once the bid procedure is completed a determination is made as to whether any bids (should there be any) are high enough to award the property to a person other than the vendee. The court will then, on motion of the debtor served as aforesaid, issue its Section 363 order to sell free and clear. This order must find that the sale met the requirements of Section 363(f), that the procedure utilized for the sale was fair and reasonable and met the requirements of the bankruptcy rules (including those with respect to notice), that the price being paid was fair and reasonable,[38] that the proposed sale is based on the highest or otherwise best bid for the property at arm's length and in good faith, and without collusion,[39] and is in the best interests of the debtors, their estate, their creditors and other parties in interest. Such an order is stayed until 14 days after the date of entry unless the court orders otherwise.[40]

I Have Been Told That if a Bankruptcy Court Issues an Order Authorizing the Sale of Property and the Closing for That Sale Occurs Either (i) During the Appeal Period if the Stay Period Is Shortened, or (ii) in the Face of a Filed Appeal if There Is No Stay in Place, That the Sale Cannot Be Upset or Overturned on Appeal. Is This Correct?

The purpose of Bankruptcy Code Section 363(m) is to offer "finality to bankruptcy court judgments by protecting good faith purchasers, the innocent third parties who rely on finality of bankruptcy judgments in making their offers and their bids."[41] It states:

> A reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.[42]

The statute affirms that an approved sale of property under Section 363 (b) or (c) generally cannot be challenged on appeal if the sale has already been consummated in good faith without an intervening stay.[43] It derives from Article III of the Constitution, which states that courts only decide on actual controversies. The nature of the appeal is, in theory, not relevant—both jurisdictional and non-jurisdictional challenges will be barred provided that the order was not stayed at the time of the sale and the purchaser acted in good faith.[44] Knowledge of a pending appeal affects neither the validity of the same nor the finding that the purchaser was acting in good faith.[45] The presumption in favor of finality in Section 363(m) is so strong that it has been held to apply even where the bankruptcy court may have lacked subject matter jurisdiction,[46] or where the asset that is the subject of the sale order is not even part of the bankruptcy estate.[47]

A purchaser under a confirmed plan of re-organization is similarly protected by this doctrine of constitutional mootness, which is evidenced by Bankruptcy Rule 8005. So long as a purchaser is a good faith purchaser for value, the sale is protected in the same manner as is a sale under Section 363(b) or (c) provided there is no stay in place at the time of sale.[48]

There are some holes, however, in the protection that Section 363(m) or Rule 8005 affords to purchasers under these sales (and to those who take by, through or under them). Two prominent exceptions to the protections afforded to purchasers under Section 363(m) and Rule 8005 are the "good faith" exception and the "equitable mootness" exception.[49]

Any sale that is protected by Section 363(m) or Rule 8005 is only protected to the extent that the purchaser acted in "good faith," and any appeal challenging the "good faith" status of the purchaser cannot be rendered moot by a sale of the property even without a stay.[50] Though it is not mandatory to do so, courts will generally make an affirmative finding that a prospective purchaser has acted in "good faith." The concept of good faith encompasses fair value and speaks to the overall integrity of the transaction,[51] while "bad faith" includes collusion between buyer and seller or any attempt to take unfair advantage of potential purchasers.[52] Among the circumstances held to be inadequate to find bad faith were: the fact that a purchaser was also a creditor who was an insider of the debtor, of itself, where other parties were given ample opportunity to bid and where the successful bid was for value;[53] the fact that the successful purchaser was a newly formed corporation owned and operated by debtor's former principals;[54] or where the "good faith" purchaser paid $100,000.00 for an asset valued eighteen months earlier at over $900,000.00.[55] By contrast, bad faith (or lack of good faith) could be evidenced by the parties' hiding of material facts (in this case, the existence of permanent injunctions barring certain parties from doing *exactly* what they were doing) and ulterior motives from the court,[56] or by an offer of employment to the CEO of debtor together with other facts that arose during the case (including, without limitation, efforts to chill the bidding process and the fact that the winning bidder paid insufficient value).[57]

The legal doctrine of "equitable mootness" is by its nature another hurdle for an appellant seeking to overturn a bankruptcy order to overcome. It is a prudential doctrine by which a court may dismiss a bankruptcy appeal even though effective relief could be fashioned because the granting of such relief would be inequitable.[58] It is generally (but not exclusively) applied in cases where there is a confirmed plan of reorganization. Courts will consider the following elements to determine whether to apply equitable mootness to a particular case: whether a stay was sought, whether there has been substantial consummation[59] or such a comprehensive change in circumstances that it would be inequitable for the court to exercise its jurisdiction and act.[60] The doctrine has, however, been used periodically to allow a court to intervene even in the case where a sale had occurred without an intervening stay and no finding of a lack of "good faith" on the part of the purchaser. In In re *Karta Corp.*,[61] an order confirming a plan was signed and entered on a Friday. The order waived the usual stay period under Bankruptcy Rule 6004, thereby allowing a sale to occur at any time. The following Tuesday, appellant filed a notice of appeal together with an Order to Show Cause seeking an expedited appeal. That same day, however, the property was sold. The court denied a motion by the debtor to dismiss the appeal on the grounds of equitable mootness, holding that appellant's actions were sufficient to preserve his rights on appeal, even though he failed to apply for or obtain a stay.

In conclusion, one can see the value of a real estate practitioner having a working knowledge of some of the common bankruptcy-related issues associated with the conveyancing of real property. Obviously, these issues, which run from transfer and mortgage tax to details involving certain conveyances coming through a bankruptcy, do not arise on every (or even most) transactions you will do, but one or more could impede your next real estate deal. Familiarity with these issues and the problems that they cause may help save time and money.

Endnotes

1. In re Jacoby Bender, Inc., 40 B.R. 10,13 (Bankr. E.D.N.Y. 1984), *aff'd*, 758 F.2d 840 (2d Cir. 1985); In re Amsterdam Ave. Dev. Assoc., 103 B.R. 454, 456-57 (Bankr. S.D.N.Y. 1989).
2. *Jacoby Bender*, 40 B.R. at 15; *Amsterdam*, 103 B.R. at 456-57.
3. In re 995 Fifth Ave. Assoc., L.P., 963 F.2d 503, 513 (2d Cir. 1992). The courts felt that this tax was a tax on gains and not on consideration, and accordingly, fell outside the scope of the exemption.
4. In re Jacoby Bender, 758 F.2d at 841-42; In re Smoss Enter. Corp., 54 B.R. 950, 951 (Bankr. E.D.N.Y. 1985).
5. *Amsterdam*, 103 B.R. at 460; In re Brandt-Airflex Corp., 843 F.2d 90, 92 (2d Cir. 1988).
6. This exemption also applies to the so-called mansion tax imposed by N.Y. Tax Law § 1402-a (McKinney 2008).
7. Paul B. Coburn, N.Y. Dep't Tax & Fin. Tech. Servs. Bur. Adv. Op., TSB-A-90(9) R (Oct. 29, 1990), *available at* http://www.tax.ny.gov/pdf/advisory_opinions/multitax/a90_9r.pdf.
8. There is no similar provision exempting transfers made under Chapter 7 or Chapter 13 of the Bankruptcy Code, so there was no basis to treat transfers under these chapters as exempt.
9. Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 46-47, 52-53 (2008).
10. 11 U.S.C. § 506 (2008).
11. 11 U.S.C. § 503(b)(1)(B)(i) (2005).
12. 11 U.S.C. § 362 (2010).
13. In re Rimsat, Ltd., 98 F.3d 956, 961 (7th Cir. 1996).
14. In re 160 Bleecker St. Assocs., 156 B.R. 405, 411 (Bankr. S.D.N.Y. 1993).
15. Yobe Electric, Inc. v. Graybar Electric Co., Inc., 728 F.2d 207, 208 (3d Cir. 1984); In re Cohen, 279 B.R. 626, 635 (Bankr. N.D.N.Y. 2002).
16. N.Y. Lien Law §§ 17, 13(5); *see also* In re Millerlee Corp., 70 B.R. 780, 782 (Bankr. S.D.N.Y. 1987).
17. In re Chesterfield Developers, Inc., 285 F.Supp. 689, 690 (S.D.N.Y. 1968); In re C. H. Stuart, Inc., 17 B.R. 400, 405 (Bankr. W.D.N.Y. 1982).
18. In re Willax, 93 F.2d 293, 294 (2d Cir. 1937); In re Millerlee, 70 B.R. at 780.
19. In re Kodo Props., Inc., 63 B.R. 588, 590 (Bankr. E.D.N.Y. 1986).
20. 11 U.S.C. § 362(b)(3) (2010).
21. The preference period is extended to one year before the commencement of the case where the creditor is an "insider."
22. It is noteworthy to point out that although Sunshine Bank would be allowed notwithstanding the automatic stay to record its mortgage after the commencement of the case and to obtain a secured lien claim in the bankruptcy, this lien claim is still vulnerable to being voided in the case. *See* In re Planned Protective Servs., Inc., 130 B.R. 94, 98 (Bankr. C.D. Cal. 1991), where the court used the strong-arm provisions in 11 U.S.C. § 544 to void a mortgage under these facts.
23. 11 U.S.C. § 363(c)(1) (2010).
24. In re Lavigne, 183 B.R. 65, 69 (Bankr. S.D.N.Y. 1995), *aff'd*, 114 F.3d 379 (2d Cir. 1997).
25. Such "interests" includes leases and monetary liens, but does not include restrictions or easements affecting the land. FutureSource LLC v. Reuters Ltd.,

312 F.3d 281, 284 (7th Cir. 2002), *cert. denied*, 538 U.S. 962 (2003); In re Oyster Bay Cove, Ltd., 196 B.R. 251, 256 (Bankr. E.D.N.Y. 1996).

26. While there are always disputes about what constitutes “consent,” it is clear that it includes a “lack of objection” by the lienholder. *FutureSource*, 312 F.3d at 281; *but see* In re DeCelis, 349 B.R. 465, 469 (Bankr. E.D. Va. 2006) (where a failure to object by a co-owner did not constitute consent).
27. *See* In re Canonigo, 276 B.R. 257, 263 (Bankr. N.D. Cal. 2002); In re Perroncello, 170 B.R. 189, 190 (Bankr. D. Mass. 1994); Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25, 37 (B.A.P. 9th Cir. 2008).
28. In re Beker Indus. Corp., 63 B.R. 474, 476 (Bankr. S.D.N.Y. 1986); In re Oneida Lake Dev., Inc., 114 B.R. 352, 355 (Bankr. N.D.N.Y. 1990); In re Boston Generating, LLC, 440 B.R. 302, 332 (Bankr. S.D.N.Y. 2010).
29. Missouri v. U.S. Bankr. Court for E.D. of Ark., 647 F.2d 768, 778 (8th Cir. 1981), *cert. denied*, 454 U.S. 1162 (1982).
30. *See* In re Fillion, 181 F.3d 859, 862 (7th Cir. 1999) (where the interest was a purported fee interest based on a claim for rescission of a deed).
31. *See* In re Octagon Roofing, 123 B.R. 583, 590 (Bankr. N.D. Ill. 1981) (where debtor had shown evidence that the mortgage at issue may be voidable as a fraudulent transfer or preference).
32. *See Oneida*, 114 B.R. at 357-58 (where court held that the interest of a judgment creditor was in bona fide dispute even where debtor had not commenced any adversary proceeding against judgment creditor).
33. *See* In re Golf, L.L.C., 322 B.R. 874, 878 (Bankr. D. Neb. 2004).
34. *See* In re Wild Horse Enters., Inc., 136 B.R. 830, 841 (Bankr. C.D. Cal. 1991).
35. *See* In re Circus Time, Inc., 5 B.R. 1, 2 (Bankr. D. Me. 1979); In re Tennessee Chem. Co., 122 B.R. 984, 984-85 (Bankr. E.D. Tenn. 1990).
36. Fed. R. Bankr. P. 6004(f)(1).
37. The breakage fees are intended to reimburse the contract vendee for costs associated with the process of due diligence and negotiation of the contract.
38. *See, e.g.*, *Golf*, 322 B.R. at 878; *Circus Time*, 5 B.R. at 2.
39. 11 U.S.C. § 363(n) (2010).
40. Fed. R. Bankr. P. 6004(h).
41. In re Dist. 65, United Auto. Aerospace and Agric. Implement Workers of Am., UAW, 184 B.R. 196, 200 (Bankr. S.D.N.Y. 1995), *quoting* In re Stadium Mgmt., 895 F.2d 845, 847 (1st Cir. 1990).
42. 11 U.S.C. § 363(m).
43. In re Nashville Senior Living, LLC, 407 B.R. 222, 231 (B.A.P. 6th Cir. 2009).
44. In re Motors Liquidation Co., 428 B.R. 43, 54-55 (Bankr. S.D.N.Y. 2010).
45. In re Youngstown Steel Tank Co., 27 B.R. 596, 598-99 (Bankr. W.D. Pa. 1983).
46. In re Gilchrist, 891 F.2d 559, 560-61 (5th Cir. 1990).
47. In re Sax, 796 F.2d 994, 994 n.7 (7th Cir. 1986).
48. Charlton v. Ariz. Title Ins. and Trust Co., 708 F.2d 1449, 1454 (9th Cir. 1983); Vacinek-Windus v. Vacinek, 1992 WL 450777 (W.D.N.Y. Aug. 3, 1992).
49. For a discussion of other instances that fall outside the scope of the safe harbor in 11 U.S.C. § 363(m), see “Section 363(M) Title Endorsements,” by John Collen, 4 J. Bankr. L. & Prac. 531, July/August, 1995.
50. Petroleum & Franchise Funding LLC v. Bulk Petroleum Corp., 435 B.R. 589, 590 (Bankr. E.D. Wi. 2010).
51. In re 240 North Brand Partners, Ltd., 200 B.R. 653, 659 (B.A.P. 9th Cir. 1996).
52. *Id.*; *see also* In re Perona Bros., Inc., 186 B.R. 833, 839 (Bankr. D.N.J. 1995).
53. In re Filtercorp., 163 F.3d 570, 577 (9th Cir. 1998).
54. Hower v. Molding Sys. Eng’g Corp., 445 F.3d 935, 939 (7th Cir. 2006).
55. Willemain v. Kivitz, 764 F.2d 1019, 1021 (4th Cir. 1985).
56. In re White Crane Trading Co., Inc., 170 B.R. 694, 705 (Bankr. E.D. Cal. 1994).
57. In re Abbotts Dairies of Pennsylvania, Inc., 788 F.2d 143, 148 (3d Cir. 1986).
58. In re Charter Commc’n, Inc., 691 F.3d 476, 481 (2d Cir. 2012); *see also* In re Chateaugay Corp., 94 F.3d 772, 776 (2d Cir. 1996).
59. *Charter*, 691 F.3d at 482.
60. *See Chateaugay*, 94 F.3d at 778.
61. 342 B.R. 45, 51 (Bankr. S.D.N.Y. 2006).

Thomas A. Glatthaar is Senior Vice President and Senior Underwriting Counsel at Fidelity National Title Insurance Company in New York, N.Y.

Leasehold Title Insurance: A Pathway to Closing?

By S.H. Spencer Compton

Law school teaches that real property consists of a bundle of rights associated with certain estates or interests, foremost of which is the fee simple absolute. Much has been written about the insurability of fee estates. This article will discuss title insurance products for leasehold estates and their practical value in consummating significant commercial lease transactions.

Just like fee owners and fee mortgagees, certain prospective tenants, tenants' assignees and leasehold lenders can benefit from the information furnished in a title report and the subsequent protections of a leasehold title insurance policy. Nonetheless, only a few long term lessors of high value real property with costly leasehold improvements purchase leasehold title insurance unless their lenders simultaneously purchase it, thus affording such lessors a discounted premium rate. This is counter-intuitive, given that the impairment or loss of a long term leasehold estate due to a title claim or failure of title can be every bit as devastating to the tenant as such a loss or claim might be to a fee owner. In addition, the leasehold endorsement to the 2006 ALTA owner's policy expands the policy as to the computation of loss or damage and identifies compensable items of loss for a policy insuring a leasehold.

The value question of whether or not to purchase a Leasehold Owner's title insurance policy is a secondary consideration. First, let us focus on what information can be derived from a leasehold title report:

(1) Who is the fee owner of the premises (and thus the party with the authority to execute the lease as landlord)? Is there an overlandlord? Does this raise consent/recognition/ estoppel issues?

(2) What judgments and liens have been recorded against the fee estate? Does this raise creditworthiness concerns about the landlord?

(3) If there is a (re) mortgage(s) recorded against the fee estate, is it current or in foreclosure? If current, does this raise consent/nondisturbance/estoppel issues?

(4) Are there any covenants or restrictions in deeds or easements of record that might limit the tenant's intended use of the premises? A covenant prohibiting the sale of alcoholic beverages could be disastrous to a tenant who intends to open a restaurant.

(5) Are there any purchase options or reversionary rights? Changing landlords in the middle of the term of a lease can be problematic.

The answers to these questions can provide valuable negotiating leverage (or at least a reality check) to a prospective tenant or assignee. A leasehold title report is inexpensive, can provide possibly critical due diligence, and, just as in a fee transaction, will establish a pathway to closing by identifying issues to be resolved prior to lease execution.

But what about paying the premium to turn that title report into a leasehold owner's policy?

What Does a Leasehold Owner's Policy Insure?

Leasehold title insurance has evolved since the first ALTA forms were introduced in 1975, tracking the growing complexity of leasehold transactions. In addition to insuring the possessory rights conferred by the lease, the Leasehold Endorsement to the 2006 Revised ALTA Owner's Policy addresses a host of collateral concerns:

1. Increase in market rent rates when rent is payable to a person having paramount title to the lessor under the lease;
2. If the tenant's leasehold improvements are not substantially completed at the time of eviction, the cost, less the salvage value, for the leasehold improvements up to the time of eviction (including costs of: land use, zoning, building and occupancy permits; architectural, engineering and construction management fees; environmental testing and reviews; landscaping; and fees, costs and interest on acquisition and construction loans);
3. Cost of relocating and repairing movable equipment and personalty to a new site within 100 miles;
4. The cost to secure a replacement leasehold equivalent to the lost leasehold;
5. Rent the tenant must continue to pay its landlord if the tenant is evicted from part of the leasehold estate;
6. The fair market value of the insured's interest as lessor in any lease or sublease of all or part of the leasehold estate or the tenant's leasehold improvements;
7. Damages the tenant may be obliged to pay its subtenant; and
8. Defense of title claims adverse to the tenant's leasehold estate.

Coverages 1 through 7 above have no corresponding provisions in fee title insurance policies. These unique coverages have been expressly crafted to protect leasehold owners and lenders and address critical financial risks. Practitioners should discuss the value of these protections with their tenant clients before electing not to purchase a leasehold owner's policy.

How is the value of a leasehold estate determined?

While the liability amount of a lender's leasehold policy is based on the amount of the mortgage (just as in insuring a mortgage on a fee estate), various states use a formula similar to New York's to determine the amount of insurance to purchase for a leasehold owner's policy.

In New York, Section 7(A) of the Title Insurance Rate Manual of the Title Insurance Rate Service Association, Inc., approved by the New York State Department of Insurance (now a part of the State's Department of Financial Services), provides in pertinent part:

> (1) For leases having a term of six (6) years or less, an amount equal to the aggregate of the total rents payable under the lease; or
>
> (2) For leases having a term of more than six (6) years, an amount not less than the aggregate of the total rentals for the six (6) years immediately following the closing of the lease transaction…; or
>
> (3) Not less than the fair market value of the land and improvements at the time of closing of the leasehold transaction; or
>
> (4) Not less than the appraised value of the land and improvements at the time of the closing of the leasehold transaction.

Note that, in (A) (1) above, whereas the six years or less term is regardless of whether part of the term has elapsed, it is unclear whether "total rents payable" includes only the base rents (thus excluding so-called additional rent comprised of real estate taxes, insurance premiums and other charges). (A)(2) specifies that "on percentage leases, a statement of estimated rent may be used."

Section 7(A) also includes methodology for calculating the amounts of insurance applicable for (i) proposed construction ("the projected cost of improvements may, at the option of the insured, be added to the amount specified in (1 through 4, above)"; and (ii) an assignment of a leasehold estate ("the minimum amount of insurance is calculated by the greater of:

(a) The full consideration for the leasehold estate, including all mortgages assumed or taken subject to; or

(b) The value of the leasehold estate calculated by the method outlined in Section 7(A)(1) or Section 7(A)(2), above").

Certain other states, such as California, use the same formula to calculate the liability insurance amount, but use a different number of years in the lease term periods set forth in 1 and 2 above.

Recorded Interest

Absent a recorded interest, a lease will not be financeable and it may not be title insurable. Typically, the landlord and the tenant may enter into a lease memorandum or, in some jurisdictions, a short-form lease in recordable form, which sets forth certain of the lease provisions (the parties; the lease term; the description of the leased premises at a minimum). It is unusual (but not unheard of) to record the entire lease. Where evidence of a leasehold interest is not already on record, even where the lease requires the landlord to enter into a lease memorandum or short-form lease, it can be a long negotiation to get the landlord to cooperate. The need for and status of a recorded leasehold interest should be addressed early on in any leasehold finance transaction or other leasehold transaction where title insurance may be required.

Landlord Estoppel Certificate

The certificate, executed by the landlord, should reference the lease together with all modifications, amendments, extensions and/or agreements pertaining thereto. It should state that the lease "remains in full force and effect and that no event has occurred, or failed to occur, which, with notice or the passage of time, or both, shall become a default or Event of Default thereunder." In the case of a leasehold mortgage and/or lease assignment, the certificate should set forth the landlord's consent to the mortgage and/or assignment, unless such consent is expressly not required by the terms of the lease. Where a new lease is being executed at closing, the landlord's estoppel is usually not necessary (unless it is an overlandlord who must consent).

Approval Rights of the Fee Mortgagee

Where there is fee mortgage financing in place, any lease transactions will exist in the shadow of the mortgage loan documents. Leaseholds will likely be subordinate to the fee mortgage, unless and to the extent a subordination, non-disturbance and attornment agreement ("SNDA") is negotiated. If the title report turns out a fee mortgage, the tenant's attorney may want to inquire whether the lender's consent is required for the lease transaction and, if the size of the lease transaction warrants it, whether an SNDA can be obtained.

Conclusion

When negotiating a significant commercial lease or ground lease, a savvy tenant's attorney, as part of his or her due diligence process, should consider mining the information contained in a leasehold title insurance report. Whether or not to turn that title report into a leasehold insurance policy by the payment of a premium can be decided as the transaction approaches closing.

S.H. Spencer Compton is a vice-president and special counsel with the New York office of First American Title Insurance Company's national commercial services division.

Post-Sandy Landlord-Tenant Questions and Answers About Your Apartments

By Adam Leitman Bailey and Dov Treiman

Q Is there any difference in the law between how regulated and unregulated apartments are handled when the tenant cannot live there because of storm damage?

A Rent regulation makes almost no difference in the legal treatment of storm-damaged or destroyed apartments. In unregulated apartments, the lease may give the landlord the option to cancel the lease in the event of serious damage to the apartment or the building in which the apartment is located. However, in regulated apartments, such clauses are almost completely unenforceable. Normally, if there is serious damage to the building, New York State's Division of Housing (the DHCR) will allow the tenants to move away temporarily and pay rent at $1/month to hold on to their tenancies post-reconstruction.

Q What if a building is subject to a vacate order?

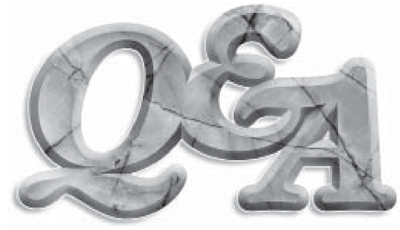
A In regulated buildings, the rent gets reduced to $1/month. In unregulated buildings, the rent goes to zero and, if the lease allows, either party can cancel the lease.

Q What if the tenant won't be allowed back in the building for a month or more?

A Under nearly all leases, the lease would be in full force, but the tenant would be entitled to a rent credit for each of the days of forced absence. If the building can be fixed up in a month, the tenant may not be allowed to break the lease. However, under many leases, if it would take the landlord a month or more to fix the building, the landlord may be entitled to cancel the lease.

Q Is the tenant entitled to a return of the security deposit in a storm-damaged or destroyed apartment?

A The landlord is only allowed to deduct from the security deposit



for tenant-caused damage and rent that should have been paid. In most of the Sandy cases, it will be hard to show that the damage was caused by the tenant, but whether the rent should have been paid will be a question of whether the tenant really had to live in a substandard apartment or had to move elsewhere.

Q What if the tenant is allowed back in the building after a week or less?

A Under nearly all leases, the lease would be in full force, but the tenant would be entitled to a rent credit for each of the days of forced absence.

Q Does the landlord have to pay for the tenant's hotel or other emergency accommodations?

A No, the landlord does not have to pay for the tenant's hotel, emergency accommodations, or eating out expenses.

Q Can the landlord be compelled to repair the building?

A In both regulated and unregulated buildings, tenants who are forced out of the building by storm damage can compel the landlord to repair the building by bringing an HP action in the Housing Court. While such proceedings can compel the landlord to restore the building's ability to accept utilities (safe wiring, safe plumbing, etc.), it cannot compel the utility companies to restore those utilities. In some extremely rare cases, the landlord can claim "economic infeasibility" by showing that the expense of repairing the building would exceed the value of the building once restored. Courts recognize this doctrine but are extremely hostile to it and assembling convincing proof of it is both expensive and difficult. Tenants can also call in the City's Department of Buildings to place violations for storm-related failures of the building's structure (such as sidewalks torn up by fallen trees). Such things are prosecuted before the Environmental Control Board (the ECB), rather than the courts. Generally, before the ECB, only the owners and the City participate in the hearings, but the ECB can allow tenant testimony. In the regular courts, the tenants normally testify.

Q Does it make any difference if the landlord did nothing wrong?

A Except for damages that can actually be traced to the landlord having failed to do proper repairs before the storm, the fact that there is no fault of the landlord makes no difference in the legal rights and responsibilities of the parties.

Q Does the landlord have any responsibility for loss of value of the apartment due to the storm damage or due to the apartment's now apparent vulnerability to storms?

A Neither in a conventional rental nor in a cooperative will any loss of value of the apartment make any difference in the economic responsibilities of the parties in nearly all cases. The one place where this may make a difference is in apartments newly entering the rent stabilization system for any reason (decontrol, J51, 421-a, etc.) where a new rent has to be set at fair market value for that neighborhood. The tenants may be able to dispute the validity of the proofs of comparable rents in the neighborhood by proving that due to the effects of Sandy, that neighborhood could no longer command those rents.

Q Does the tenant have to pay rent for the period the tenant is sitting in an apartment with no electricity and no heat?

A In both regulated and unregulated buildings, the requirement to pay rent in a less than completely functional apartment is on a sliding scale, not an on/off switch. Unless the parties can agree to an appropriate dollar adjustment to the rent while the apartment or building is being repaired or while certain utilities are shut down, it will be up to the Housing Court (principally, but it could be other courts, even including Small Claims) to figure out how much is a reasonable discount. If the apartment is both unusable and the tenant actually goes somewhere else during the period of un-usability, the courts will likely find that the tenant is entitled to complete rent forgiveness on a per diem basis for that period the tenant is absent. If the apartment is substantially unusable, but the tenant is still living there anyhow, the court will have to determine a reasonable percentage downward adjustment to the rent for the affected period. Some outages are fairly predictable from the case precedents: 25% for lack of hot water, 25% for lack of heat, 50% for lack of electricity, 10% for broken windows, 10% for plaster damage from water penetration, and so on. None of these figures are hard and fast.

Q Is the landlord liable for damage to the tenant's property caused by the storm?

A Generally speaking, the landlord is not liable for damage to the tenant's property caused by the storm. However, there is an exception for conditions of which the landlord had notice that were defective prior to the storm, conditions that allowed the storm to do damage when a proper apartment would not have. Examples of this are missing window panes and façade brick work damaged to the point that the exterior walls of the apartment were already leaky prior to the storm.

Q Can the landlord cancel the lease?

A In regulated apartments, the landlord cannot cancel the lease except under exceptional circumstances. In unregulated apartments, it depends on the wording of the lease. While some residential leases allow the landlord to cancel the lease if the apartment is totally or partially unusable and the tenant may cancel the lease if it becomes completely unusable, not all leases contain such a clause. In unregulated apartments, there is no doubt that the landlord can always enforce these clauses. There is such a clause in paragraph 21 of many Real Estate Board leases. There are other leases commonly used, but these are among the most common. Different form leases have different clauses. In regulated apartments, the exact circumstances of the case will determine whether the courts (and DHCR) will or will not allow the landlord to enforce these clauses.

Q Can the tenant cancel the lease?

A In both regulated and unregulated apartments, this depends on the terms of the lease. In Bailey/Treiman leases and some Real Estate Board leases, the tenant can only cancel the lease if the apartment is made completely unusable or is not repaired within thirty days.

Q What if there is no lease?

A In an unregulated apartment without a lease, the landlord has to give 30 days notice to cancel the tenancy in New York City or one month's notification outside the City. Inside the City, the tenant has no obligation to give notice, but outside the City the tenant must notify the landlord one calendar month ahead of time.

Q Should the tenant escrow the rent?

A There is no legal authority for a tenant to escrow the rent. However, failing to do so under some circumstances could be a serious mistake. If the landlord is generally responsible and appears to be an honest businessperson, the tenant can simply pay the rent and if the parties cannot agree on an appropriate deduction to it, the tenant has the option of going to Small Claims Court to recover it. While the tenant could theoretically refuse to pay the next month's rent in order to recover the loss, this would be a very bad idea. Provoking a lawsuit would show up both on the tenant's credit report and tenancy history, making it difficult to rent somewhere else. If the landlord has previously proven irresponsible or unethical, the tenant could make the decision to withhold the rent at the risk to credit rating and tenancy history. Although it won't help with either of these ratings, placing the funds in an escrow account could have two possible beneficial effects. First, the tenant will not get caught short in the event the court finds that the money is owed. Second, with the funds escrowed, the tenant can more easily convince the landlord that the money is available and that negotiations should simply proceed in good faith.

Q Is loss of income due to the storm a valid excuse for not paying rent?

A Loss of income or increased expenses because of the storm are no excuses to stop paying rent. Prudent landlords will give the tenants some leeway as the courts are not likely to have much sympathy for landlords who come across as being Sandy Scrooges. Thus, it is wise to waive late fees and legal fees, but subject to the matters we have discussed above, the rent will have to be paid reasonably quickly and close to on time.

Q Is lack of subway service a valid excuse for not paying rent?

A A landlord has no responsibility at all for continued neighborhood amenities. Subway and other transportation outages will generally have no legal effect.

Adam Leitman Bailey is the founding partner and Dov Treiman the landlord-tenant managing partner of Adam Leitman Bailey, PC.

Bergman on Mortgage Foreclosures: Unusual Events: Borrower Loses Motion to Dismiss; Lender Is Sanctioned

By Bruce J. Bergman

Suggesting to attorneys that the outcome of cases is unpredictable is rather gratuitous; they already know that too well. And it is what they tell their clients with regularity. Nonetheless, a recent case which catches our attention is an odd confluence of two unusual, indeed unexpected, events: a defaulting borrower's motion to dismiss is denied for lateness, but the lender is sanctioned for misstatements to the court. [*U.S. Bank Nat. Ass'n v. Gonzalez,* 99 A.D.3d 694, 952 N.Y.S.2d 59 (2d Dept. 2012)].

First, as to a motion to dismiss, of course a defendant can make such a motion—even before it is required to answer the complaint—but it must do so no later than its time to answer expires [CPLR 3211(a)]. Generally, the courts tend to be very liberal with time limits. Thus, experience suggests that if a party is late with an answer or a motion or a response, the courts are most often overwhelmingly accepting of such tardiness. That is another subject, but the point is that time limit rules are typically only honored in the breach.

Here, though, the defendant borrower was obliged to have made his motion to dismiss thirty days after March 6, 2009 (this is pursuant to CPLR §3211). But he did not submit the motion seeking to dismiss the complaint until October 21, 2009. (He also moved for sanctions against the plaintiff pursuant to 22 NYCRR 130-1.1.)

"Not only do courts often ignore many time limits, they only very rarely impose sanctions, this to the chagrin of rectitudinous counselors."

Having not requested an extension of time to make the motion to dismiss, and offering no good cause excuse for his delay in making that motion to dismiss—indeed, he didn't even address the untimeliness of the motion—the court should not have accepted such a motion. The trial court did, but on appeal, there was a reversal. The borrower was defeated here, albeit at the cost of an appeal to the plaintiff and the time that involved.

Not only do courts often ignore many time limits, they only very rarely impose sanctions, this to the chagrin of rectitudinous counselors. Foreclosing plaintiffs are frequently dismayed by outrageous and baseless charges assessed by defaulting borrowers in mortgage foreclosure actions. On some occasions, the foreclosing plaintiff is so exercised by the nonsensical responses, it seeks sanctions against the borrower as a punishment for the abusive assertions. (The previously cited court rule supports such a procedure.) Foreclosing plaintiffs' attorneys, however, will confirm that such motions for sanctions are almost invariably futile and are hardly worth making.

In the recent case, the motion for sanctions was by the borrower against the lender—and the borrower won. The court found that the plaintiff had submitted various affirmations and affidavits in which it made a certain representation that proved to be false and then persisted in making that representation after it knew or should have known it was false. Therefore, the trial court was affirmed in granting the imposition of sanctions upon the plaintiff (citing 22 NYCRR 130-1.1[c][3]; *Schwab v. Philips* 78 A.D.3d 1036, 1036-1037, 912 N.Y.S.2d 255).

Yes, as Chuck Berry sagely observed, it goes to show you never can tell.

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

Student Case Comment: *American Building Supply Corp. v. Petrocelli Group, Inc.*: The Court of Appeals Rules Against a Conclusive Presumption Protecting Insurance Brokers

On November 19, 2012 the Court of Appeals held, in *American Building Corp. v. Petrocelli Group, Inc.*, that an insured's failure to read and understand the general liability policy obtained by its broker was not an absolute bar to recovery on its negligence and breach of contract claims against the broker for failure to procure adequate insurance coverage.[1] This ruling clarifies that the "conclusive presumption rule," which provides that the insured knows and assents to the contents of the insurance contract when he or she signs or accepts the contract, does not apply to protect a broker that has allegedly failed to obtain the requested coverage.[2]

Plaintiff American Building Supply Corp. ("ABS") was the sole tenant of a building subleased from DRK, LLC ("DRK").[3] As the sublessee, ABS consented to all the terms of DRK's lease agreement with DRK's lessor.[4] In October 2004, ABS hired defendant Petrocelli Group, Inc. ("Petrocelli") to replace its current insurance broker because its current policy did not comply with the requirements set forth by the lease agreements.[5] ABS claims that in its discussions with Petrocelli regarding the new policy, it specifically requested liability coverage for its employees in case of injury, as required by the lease agreements. In addition, Petrocelli visited the premises and assured the lessor that the insurance deficiencies would be corrected.[6] The new policy that Petrocelli provided for ABS was essentially the same as the coverage ABS previously had and, as such, was not in compliance with the lease agreements.[7] Neither ABS nor Petrocelli read the insurance policy upon receipt. Subsequently, ABS's employee was injured on the insured premises, and ABS was not covered.[8] As a result, ABS brought suit against Petrocelli for negligence and breach of contract in connection with defendant's procurement of insufficient insurance.[9]

The Supreme Court denied Petrocelli's motion for summary judgment, holding that an issue of fact existed as to whether ABS made a "specific request" for liability coverage.[10] The Appellate Division reversed, holding that ABS's failure to "read and understand the policy" precluded recovery in the action.[11]

In its opinion, the Court of Appeals stated that in order to set forth a case for negligence against the broker, a *specific* request for coverage must be made by the insured. A general request is insufficient.[12] The Court also noted that there was corroborating evidence supporting ABS's claim and the respective coverage it needed for its business.[13] Although appellate courts are split on the issue of whether the "conclusive presumption rule" applies to protect an insurance broker, the Court of Appeals found that the receipt and presumed reading of the policy does not act as an absolute bar of an action for negligence against the broker.[14] Rather, the Court emphasized that an insured should have a right to "look to the expertise of its broker with respect to insurance matters."[15] The failure to read the policy, at most, may give rise to the defense of comparative negligence but does not bar, altogether, an action against the broker.

In the dissent, Judge Pigott argued that the majority opened the door for the insured to complain, following a loss, that it made a request for the relevant coverage from its broker, but it was not forthcoming.[16] After the *Petrocelli* decision, insurance brokers should take precaution to document their clients' requests and communications sufficiently, and comply with such requests, in order to protect themselves.

Endnotes

1. Am. Bldg. Supply Corp. v. Petrocelli Group, Inc., 19 N.Y.3d 730, 979 N.E.2d 1181, 955 N.Y.S.2d 854 (2012).
2. *Id.* (citing *Metzger v. Aetna Ins. Co.*, 227 N.Y. 411, 416, 125 N.E. 814 (1920)).
3. *Id.* at 733.
4. *Id.* at 734.
5. *Id.*
6. *Id.*
7. *Am. Bldg. Supply Corp.*, 19 N.Y.3d at 734.
8. *Id.* at 735 (citing *DRK, LLC v. Burlington Inc. Co.*, 74 A.D.3d. 693, 905 N.Y.S.2d 58, holding that Burlington Insurance Company had no duty to defend or indemnify ABS based on the cross liability exclusion clause).
9. *Id.*
10. *Am. Bldg. Supply Corp. v. Petrocelli Group, Inc.*, 2010 N.Y. Slip Op. 30611 at *6 (Sup. Ct., New York County 2011).
11. *Am. Bldg. Supply Corp. v. Petrocelli Group, Inc.*, 81 A.D.3d 531, 918 N.Y.S.2d 28 (1st Dep't 2011).
12. *Am. Bldg. Supply Corp*, 19 N.Y.3d at 735.
13. *Id.* at 736.
14. *Id.*
15. *Id.*
16. *Id.* at 738.

Joshua Asherian is a second-year student at St. John's University School of Law and a Staff Member of the *N.Y. Real Property Law Journal*.

Student Case Comment:
Chazon, LLC v. Maugenest: The Court of Appeals Applies a Strict Interpretation of the Loft Law

On June 7, 2012 the New York Court of Appeals in *Chazon, LLC v. Maugenest* held that the landlord of a New York City loft who had not complied with the Loft Law and had not received an extension of time to comply may not maintain an ejectment action based on nonpayment of rent.[1]

The plaintiff was the landlord of a loft building in Brooklyn where defendant failed to pay rent since 2003.[2] As a result, the loft owner brought an action in ejectment. The Supreme Court granted summary judgment awarding plaintiff possession of the apartment, and the Second Department Appellate Division affirmed.[3]

In this case, the landlord failed to comply with the Loft Law or get an extension. Section 284(1)(vii) of the Multiple Dwelling Law states that "[a]n owner who is unable to satisfy any requirement…of this subdivision for reasons beyond his/her control…may apply to the loft board for an extension of time."[4] Moreover, "[t]he loft board may grant an extension of time to meet a requirement…provided that the owner demonstrates that he/she has made good faith efforts to satisfy the requirements."[5] In 2006, the Loft Board rejected the landlord's claim that compliance was hindered by circumstances beyond his control. Therefore, the Loft Board did not grant an extension.[6]

In declaring that the owner would not be able to prevail on the circumstances of this case, the Court discussed the historical background that led to enactment of the Loft Law.[7] The term "lofts" is used to describe rental apartments that were once used for commercial purposes.[8] These apartments lack a residential certificate of occupancy and therefore residential occupancy was illegal.[9] The legislature acknowledged that illegal occupancies in New York City were common and in an effort to encourage owners to bring these buildings into compliance, it enacted the Loft Law.[10] The Loft Law redefines these illegal buildings as "interim multiple dwellings" and allows for owners to convert them into residential buildings without penalties as long as they meet the requirements specified in the provisions of the Multiple Dwelling Law.[11] According to Section 285(1) of the Multiple Dwelling Law, "an owner of an interim multiple dwelling may recover rent payable…and maintain an action or proceeding for possession of such premises for nonpayment of rent, provided that he is in compliance with this article."[12] The Loft Law established a series of deadlines by which owners of interim multiple dwellings were required to alter them to conform to safety and fire protection standards. If a landlord was unable to meet the deadlines "for reasons beyond his/her control" an extension could be granted if the landlord demonstrated to the Loft Board that he/she "has made good faith efforts" to comply. Failure to satisfy the requirements of the Loft Law, within the stated or extended deadlines it imposes, prevents the owner from recovering unpaid rent or evicting the tenant.

Although the law may have encouraged some loft owners to comply with the law, it has not been a complete success as the Court in this case acknowledged.[13] The Court noted that after 30 years of the law being in effect, over 300 buildings still remain as "interim multiple dwellings," almost one-third of the 1983 total.[14] Citing the "slow pace of legalization," the Court concluded that there appears to be a "significant practical problem."[15]

Lower courts recognized the unfavorable result of having a tenant live rent-free for an extended period of time without any recourse. As a result, the courts interpreted the statute with some flexibility in order to reach a different outcome.[16]

However, the Court of Appeals did not find sufficient justification to depart from the strict reading of the statute even though it might make sense "from a practical point of view."[17] In fact, the Court concluded that a different holding could not be "reconciled with the text of the statute."[18] Section 302(1)(b) of the Multiple Dwelling Law bars not only an action to recover rent but also an "action of special proceeding…for possession of said premises for nonpayment of such rent."[19] The Court concluded that if that result is undesirable, the problem is one to be addressed by the Legislature.

Endnotes

1. Chazon, LLC v. Maugenest, 19 N.Y.3d 410, 413, 971 N.E.2d 852, 853, 948 N.Y.S.2d 571, 572 (2012).
2. *Id*.
3. *Id*.
4. N.Y. Mult. Dwell. Law 284(1)(vii).
5. *Id*.
6. *Chazon, LLC*, 19 N.Y.3d at 414.
7. *Id*. at 413.
8. *Id*.
9. *Id*.
10. *Id*. at 414.
11. N.Y. Mult. Dwell. Law 281(1).
12. N.Y. Mult. Dwell. Law 285(1).
13. *Chazon, LLC*, 19 N.Y.3d at 414.
14. *Id*.
15. *Id*.
16. *Id*. at 415.
17. *Chazon, LLC*, 19 N.Y.3d at 416.
18. *Id*. at 415.
19. *Id*.

Edda J. Santiago is a second-year student at St. John's University School of Law and a Staff Member of the *N.Y. Real Property Law Journal*.

Real Property Law Section Professionalism Award

Over the years the Real Property Law Section has honored individual real estate practitioners with its Professionalism Award.

Some of the criteria which are used to identify an individual are as follows:

1. The nominee possesses in her/his practice a continuing civility and appreciation for others.
2. The individual possesses an outstanding level of competence—legal ability—and achievement.
3. The nominee has in her/his practice made a strong contribution to the development of the practice of law, the improvement of the practice of law, particularly in the field of education—frequent lectures in CLE programs—writings—publications.
4. The nominee over the years has engaged in mentoring of younger attorneys.
5. The nominee has involved herself/himself in Bar activities, both on the local level and the State level, holding positions as an officer or chairing committees, etc.
6. The nominee has been a voice on legal issues.
7. The nominee has throughout his/her career maintained the highest ethical standards.

We are reaching out to you in seeking nominations of individuals who fulfill the ideals listed above. We are hopeful that we can identify outstanding real estate practitioners throughout the State, thereby bringing recognition to these individuals and to their locale.

We have no forms. We do ask that we receive a letter of recommendation and will certainly entertain additional letters and, of course, endorsements by local county bar associations.

Thank you for your attention to this matter.

Letters, endorsements, etc. should be mailed to :

Peter Coffey
Awards Committee Chair
224 State Street
Schenectady, New York 12305
or
e-mail: pcoffey@ecmlaw.com

NEW YORK STATE BAR ASSOCIATION

Section Chair
Benjamin Weinstock, Esq.
Ruskin Moscou Faltischek, P.C.
Uniondale

Program Chair
David L. Berkey, Esq.
Gallet Dreyer & Berkey LLP
New York City

NYSBA

Real Property Law Section

Summer Meeting

Mohonk Mountain House
New Paltz, New York

July 11–14, 2013

This program will provide you with a total of **7.5 MCLE credit hours,** consisting of **6.5** in **Professional Practice** and **1** in **Ethics.**

SCHEDULE OF EVENTS

Thursday, July 11

1:00 p.m. – 6:00 p.m.	**Registration – *Lake Lounge***
1:00 p.m. – 3:00 p.m.	**Officers' Meeting – *Mountain View Room***
3:00 p.m. – 5:00 p.m.	**Executive Committee Meeting – *Parlor Room***
6:30 p.m. – 7:30 p.m.	**Cocktail Reception – *Parlor Porch***
7:30 p.m. – 9:30 p.m.	**Dinner – *West Dining Room***

Friday, July 12

7:30 a.m. – 8:15 a.m.
Committee on Condominium and Cooperatives Breakfast Meeting
Committee on Not-For-Profit Breakfast Meeting
Committee on Real Estate Construction Breakfast Meeting
Committee on Title and Transfer Breakfast Meeting

8:00 a.m. **Registration – *Outside Parlor Room***

8:15 a.m. – Noon **General Session – *Parlor Room***

8:15 a.m. – 8:30 a.m. **Welcome and Introductory Remarks**

Benjamin Weinstock, Esq., Ruskin Moscou Faltischek, P.C., Uniondale

David M. Schraver, Esq., President, New York State Bar Association, Nixon Peabody LLP, Rochester

8:30 a.m. – 9:20 a.m. ***1031 Exchanges*** (1.0 Professional Practice)

A thorough discussion of IRC Section 1031 Exchanges, including Forward 1031 Exchanges, qualified like-kind property, the role of the Qualified Intermediary, Reverse Exchanges, Construction Exchanges, LLCs, Corporations and Partnerships, state and federal law updates and the impact of Tax Reform on Section 1031, will be presented by experts in the field.

Speakers:
S.H. Spencer Compton, Esq., First American Title, New York City
Michael S. Brady, Esq., Riverside 1031, LLC, Kings Park
Hugh E. Pollard, CES, Vice-President, First American Exchange Company, LLC, Northbrook, IL

9:20 a.m. – 10:10 a.m. ***Consumer Financial Protection Bureau Mortgage Regulatory Updates for 2013 and 2014***
(1.0 Professional Practice)
The Consumer Financial Protection Bureau (CFPB) has implemented sweeping mortgage regulatory updates that will have a direct and lasting impact on real estate practitioners. This presentation will discuss how these changes will play out. The discussion begins with an overview of mortgage servicing issues and then details updates in the arena of federal foreclosure protection. It also includes information on how the CFPB's developments impact specific mortgage servicing issues such as mortgage modifications. The new sweeping rules on qualified mortgages will be addressed as well as some updates to loan officer compensation. The presentation concludes with the new TILA Rule of Appraisals.

Speaker: **Daniel M. Shlufman, Esq.**, Classic Mortgage LLC, Maywood, New Jersey

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

10:20 a.m. – 11:10 a.m. ***Alternatives to Mortgage Foreclosure and What You Need to Know***
(1.0 Professional Practice)
A review of foreclosure alternatives will be presented, including refinancing under the Home Affordable Refinance Program (HARP), loan modification using the Home Affordable Modification Program (HAMP), use of special forbearance agreements, loan reinstatement, and short sales using the Home Affordable Foreclosure Alternatives Program (HAFA), and HAFA deed in lieu of transfers; and the role of the Federal Housing Finance Agency.

Speaker: **Michael Adges, Esq.**, Law Offices of Michael C. Adges, Williston Park

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11:10 a.m. – Noon	***RPAPL 881 Entry Upon Neighboring Property for Construction*** (1.0 Professional Practice) Construction in close proximity to a neighbor's property poses special problems that may be overcome by using negotiated licenses or those obtained using Real Property Actions and Proceedings Law Section 881. This program will explore the competing interests of builder and adjoining owners, how to negotiate an effective license agreement, litigation issues and strategies if a Section 881 proceeding is needed, and insurance and practical concerns for the builder and the neighboring owner.
Speaker:	**Brian G. Lustbader, Esq.**, Mazur Carp & Rubin, P.C., New York City
1:00 p.m.	**Golf – Mohonk Golf Course** Mohonk's 116-year-old course is a shot-maker's paradise. Like other early courses in America designed at the turn of the 19th century, the golf course has a strong Scottish influence. It was first laid out by Mother Nature and Albert Smiley (Mohonk's founder), along with two house guests, E.E. Schermerhorn and Mr. James Talcott. Mohonk's golf course features undulating fairways that require you hit to flat landing areas called bowls. The course protects itself with blind tee shots and uneven lies. Mohonk's 19th century design is able to battle 21st century equipment. There is no charge for **green fees** for overnight guests. There is a cart rental fee and boxed lunch fee for a total of **$38.00** per person. ***(Advance sign-up and payment is required)*** **Golf Chair:** Ken Block
1:00 p.m.	**Hiking is back!** Mohonk is a hiker's paradise! Hike one or more of the many local trails. Bob Hoffman will organize a family event and we'll design a hike to fit the group's ability. ***Please sign up on registration form, or email Bob for more information: bob@hoffnavlaw.com***
6:30 p.m. – 7:30 p.m.	**Cocktail Reception – *Pavilion*** Dinner is on your own this evening and is included in your Full American Plan room charge. Reservations in Mohonk's main dining room are recommended.

Saturday, July 13

7:30 a.m. – 8:15 a.m.	**Committee on Workouts and Bankruptcy Breakfast Meeting**
8:00 a.m.	**Registration – *Outside Parlor Room***
8:30 a.m. – Noon	**General Session – *Parlor Room***
8:30 a.m. – 9:10 a.m.	***Lease Escalation Clauses, Operation, Computation*** (.5 Professional Practice) Lease escalation clauses are often difficult to understand and greatly affect the economic impact of a lease negotiation for both landlord and tenant. Our program will explain the economic reasons for the lease escalation clauses, how they function, what the landlord and tenant obligations are pursuant to these clauses, how consultants are used by landlords and tenants to bill and review and challenge escalation charges, and explore alternatives to the escalation clauses in use today.
Speaker:	**Joel I. Binstok, Esq.**, York Consulting, New York City
9:10 a.m. – 10:50 a.m.	***Can't We All Just Get Along? Commercial Real Estate Brokers and Lawyers at Work Together*** (2.0 Professional Practice) This panel will explore how real estate lawyers can best work together with the commercial real estate brokers engaged by their clients (property owners, landlords, and tenant/space users). Topics will include: (i) how to help your client find (and recognize) a top-notch commercial real estate broker who's right for the specific task at hand; (ii) how to recognize and deal with a less-than-sterling broker your client has already hired; (iii) contractually, how to engage and how to terminate a broker; (iv) what to expect from a competent broker; (v) how to ensure your client gets what's been promised; and, in addition (vi) the panel will explore selected issues in the most common commercial brokerage agreements: (a) leasing agency agreements covering the leasing of buildings on behalf of owners and landlords; (b) tenant representation agreements; and (c) brokerage commission agreements. The panelists are Wanda Goodloe/CBRE-NYC, Andrew Herz/Patterson Belknap, Richard Sleasman/CBRE-Albany, Stacy Wallach/Pace Law School—who collectively have over a century of practical experience in this area.

FOR MORE INFORMATION, GO TO WWW.NYSBA.ORG/REALSUMMER13

SCHEDULE OF EVENTS

Speakers: **Wanda N. Goodloe, Esq.**, Senior Vice President, General Counsel, New York Tri-State Region CBRE, New York City
Andrew L. Herz, Esq., Patterson, Belknap, Webb & Tayler, LLP, New York City
Richard P. Sleasman, SIOR, President/Managing Director, CBRE, Albany
Prof. Stacy Wallach, Pace Law School, New York City

10:50 a.m. – 11:00 a.m. **Refreshment Break**

11:00 a.m. – Noon ***Ethics Update*** (1.0 Ethics)
This will be an interactive program using fact patterns derived from recent cases and opinions. Chocolate will be provided.

Speaker: **Anne Reynolds Copps, Esq.**, Law Office of Anne Reynolds Copps, Albany

1:00 p.m. **Tennis –** Two courts have been reserved for those who wish to play. No fee is charged for overnight guests. Just bring your rackets, tennis balls and enjoy your game.
Tennis Chair: John Privitera ***(Sign up on meeting registration form)***

1:00 p.m. **Disc Golf** - Learn one of the world's fastest growing sports on Mohonk's own 18 basket disc golf course. Fun for the whole family. (Think ball golf, but substitute a Frisbee-like disc instead of a ball, thrown into a basket). Bob Hoffman will conduct a beginner's clinic and supervise play on the newly designed Mohonk course. No cost - Loaner discs available. ***Please sign up on registration form, or email Bob for more information: bob@hoffnavlaw.com***

2:00 - 4:00 p.m. **Geology Tour –** Join Naturalist Michael as you explore the wonders and mysteries of the local geology. Approximately 2 miles. Moderate pace. Meet on the Lake Porch. No charge.
(Sign up on meeting registration form)

2:00 - 4:00 p.m. **Fly Fishing - (2 hours - $108 per hour per person).** Fly fishing is the art of fishing using a rod, reel, line, and a lure specifically designed to resemble a fly and its activity. The first hour will be on land where fly fishing expert Bert Darrow will teach you how to cast. The next hour Bert will take you on the water where you will actually fish. ***You can sign up for a one hour fly fishing lesson or both lesson and fishing on the meeting registration form.*** Fee is inclusive of equipment. Meet at the Information Summer House, which is next to the boat dock.

6:30 p.m. – 7:30 p.m. **Cocktail Reception – *Parlor Porch***

7:30 p.m. – 9:30 p.m. **Dinner – *West Dining Room***

Dinner Speaker: **John Privitera, Esq.**
McNamee, Lochner, Titus & Williams, P.C.

Sunday, July 14

Departure - Breakfast is included in your Full American Plan room charge. Enjoy!

IMPORTANT INFORMATION

The New York State Bar Association's Meetings Department has been certified by the NYS Continuing Legal Education Board as an accredited provider of continuing legal education in the State of New York. Under New York's MCLE rule, this program will provide you with a total of **7.5 credit hours,** consisting of **6.5** in **Professional Practice** and **1** in **Ethics.**

DISCOUNTS AND SCHOLARSHIPS: New York State Bar Association members and non-members may receive financial aid to attend this program. Under this policy, anyone who requires financial aid may apply in writing, not later than two working days prior to the program, explaining the basis of his/her hardship and, if approved, can receive a discount or scholarship, depending on the circumstances. For more details, please contact: Lori Nicoll, New York State Bar Association, One Elk Street, Albany, New York 12207 or e-mail lnicoll@nysba.org.

Accommodations for Persons with Disabilities: NYSBA welcomes participation by individuals with disabilities. NYSBA is committed to complying with all applicable laws that prohibit discrimination against individuals on the basis of disability in the full and equal enjoyment of its goods, services, programs, activities, facilities, privileges, advantages, or accommodations. To request auxiliary aids or services or if you have any questions regarding accessibility, please contact Lori Nicoll at 518-487-5563.

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Section Committees and Chairs

The Real Property Law Section encourages members to participate in its programs and to volunteer to serve on the Committees listed below. Please contact the Section Officers or Committee Chairs for further information about the Committees.

Attorney Opinion Letters
Charles W. Russell
Harris Beach PLLC
99 Garnsey Road
Pittsford, NY 14534
crussell@harrisbeach.com

Gregory P. Pressman
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022-4728
gregory.pressman@srz.com

Awards
Peter V. Coffey
Englert, Coffey, McHugh
& Fantauzzi, LLP
224 State Street
P.O. Box 1092
Schenectady, NY 12305
pcoffey@ecmlaw.com

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

Condemnation, Certiorari and Real Estate Taxation
Laureen Harris
Cronin Cronin Harris & O'Brien PC
333 Earle Ovington Blvd., Suite 820
Uniondale, NY 11553
lharris@cchotax.com

Karla M. Corpus
Hiscock & Barclay LLP
One Park Place
300 South State Street
Syracuse, NY 13202-2078
kcorpus@hblaw.com

Condominiums & Cooperatives
Ira S. Goldenberg
Goldenberg & Selker, LLP
399 Knollwood Road, Suite 112
White Plains, NY 10603
igoldenberg@goldenbergselkerlaw.com

Dennis H. Greenstein
Seyfarth Shaw
620 Eighth Avenue
New York, NY 10018
dgreenstein@seyfarth.com

Steven D. Sladkus.
2 East End Avenue
New York, NY 10021-1151
sladkus@whafh.com

Continuing Legal Education
Joseph M. Walsh
Walsh & Walsh, LLP
42 Long Alley
Saratoga Springs, NY 12866-2116
joewalsh@spalaw2.com

Lawrence J. Wolk
Holland & Knight LLP
31 West 52nd Street, 11th Floor
New York, NY 10019-6111
Lawrence.Wolk@hklaw.com

Diversity
Harry G. Meyer
Hodgson Russ LLP
The Guaranty Building
140 Pearl Street
Buffalo, NY 14202
hmeyer@hodgsonruss.com

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

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

Land Use and Environmental Law
Matthew F. Fuller
Meyer & Fuller, PLLC
161 Ottawa Street
Lake George, NY 12845
mfuller@meyerfuller.com

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

Landlord and Tenant Proceedings
Edward J. Filemyr IV
11 Park Place, Suite 1212
New York, NY 10007
filemyr@verizon.net

Peter A. Kolodny
Kolodny PC
338-A Greenwich Street
New York, NY 10013
kolodnylaw@earthlink.net

Law School Internship
David L. Berkey
Gallet Dreyer & Berkey LLP
845 Third Avenue, 8th Floor
New York, NY 10022-6601
dlb@gdblaw.com

Stacy L. Wallach
Pace Law School
Land Use Law Center
78 North Broadway
White Plains, NY 10603
slw1234@hughes.net

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

Karl B. Holtzschue
Law Office of Karl B. Holtzschue
122 East 82nd Street, Apt. 3c
New York, NY 10028
kbholt@gmail.com

Low Income and Affordable Housing
Laura Ann Monte
HSBC Bank USA
One HSBC Center, 27th Fl.
Buffalo, NY 14203
Laura.A.Monte@us.hsbc.com

Richard C. Singer
Hirschen Singer & Epstein LLP
902 Broadway, 13th Floor
New York, NY 10010

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

Harry G. Meyer
Hodgson Russ LLP
The Guaranty Building
140 Pearl Street
Buffalo, NY 14202
hmeyer@hodgsonruss.com

Not-for-Profit Entities and Concerns
Mindy H. Stern
Schoeman Updike Kaufman Stern & Ascher LLP
551 5th Avenue
New York, NY 10176
mstern@schoeman.com

Anne Reynolds Copps
Law Office of Anne Reynolds Copps
126 State Street, 6th Floor
Albany, NY 12207
arcopps@nycap.rr.com

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

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

Public Interest
Lewis G. Creekmore
Legal Services of the Hudson Valley
90 Maple Avenue
White Plains, NY 10601
lcreekmore@lshv.org

Lauren E. Breen
Western New York Law Center, Inc.
237 Main Street, Suite 1130
Buffalo, NY 14203
lbreen@wnylc.com

Publications
Vincent Di Lorenzo
St. John's University School of Law
8000 Utopia Parkway
Belson Hall, Room 4-46
Jamaica, NY 11439
dilorenv@stjohns.edu
William A. Colavito
One Robin Hood Road
Bedford Hills, NY 10507
wcolavito@yahoo.com

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

William P. Johnson
Nesper, Ferber & DiGiacomo, LLP
501 John James Audubon Pkwy
One Towne Centre, Suite 300
Amherst, NY 14228
wjohnson@nfdlaw.com

Real Estate Construction
Brian G. Lustbader
Mazur Carp & Rubin, P.C.
1250 Broadway, 38th Floor
New York, NY 10001-3706
blustbader@mazurcarp.com

Kenneth M. Block
Tannenbaum Helpern Syracuse & Hirschtritt, LLP
900 3rd Avenue
New York, NY 10022-4728
block@thsh.com

Real Estate Financing
Richard S. Fries
Bingham McCutchen LLP
399 Park Avenue
New York, NY 10022
richard.fries@bingham.com

Frank C. Sarratori
Pioneer Bank
21 Second Street
Troy, NY 12180
sarratorif@pioneersb.com

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

Robert M. Zinman
St. John's University School of Law
8000 Utopia Parkway
Queens, NY 11439
robertzinman@gmail.com

Gino Tonetti
238 South Washington Street
North Attleboro, MA 02760-2250
gino_tonetti@yahoo.com

Title and Transfer
Joseph D. DeSalvo
First American Title Insurance Company of New York
633 Third Avenue, 17th Floor
New York, NY 10017
jdesalvo@firstam.com

Thomas J. Hall
The Law Firm of Hall & Hall, LLP
57 Beach Street
Staten Island, NY 10304-2729
hallt@hallandhalllaw.com

Gerard G. Antetomaso
Gerard G. Antetomaso, PC
1674 Empire Boulevard, Suite 200
Webster, NY 14580
jerry@ggalaw.com

Task Force on e-Recording Legislation
Michael J. Berey
10 Stewart Place
Apartment 8ae
White Plains, NY 10603
mberey@firstam.com

Task Force on NYSI D TI Regs
Karl B. Holtzschue
Law Office of Karl B. Holtzschue
122 East 82nd Street, Apt. 3c
New York, NY 10028
kbholt@gmail.com

Thomas J. Hall
The Law Firm of Hall & Hall, LLP
57 Beach Street
Staten Island, NY 10304-2729
hallt@hallandhalllaw.com

Section District Representatives

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

Second District
Lawrence F. DiGiovanna
357 Bay Ridge Parkway
Brooklyn, NY 11209-3107
ldgesq@ldigiovanna.com

Third District
Alice M. Breding
536 Kenwood Avenue
Delmar, NY 12054
alice@piedmontlawfirm.com

Fourth District
Michelle H. Wildgrube
Cioffi Slezak Wildgrube, P.C.
2310 Nott Street East
Niskayuna, NY 12309
mwildgrube@cswlawfirm.com

Fifth District
Frederick W. Marty
Mackenzie Hughes LLP
101 South Salina Street
P.O. Box 4967
Syracuse, NY 13221
fmarty@mackenziehughes.com

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

Seventh District
Scott A. Sydelnik
Davidson Fink LLP
28 E. Main Street, Ste. 1700
Rochester, NY 14614
ssydelnik@davidsonfink.com

Eighth District
David Christopher Mineo
Fidelity National Financial Inc.
55 Superior Boulevard
Mississauga, ON L5T2X9
Canada
lawmineo@aol.com

Ninth District
Lisa M. Stenson Desamours
Metlife
1095 Avenue of the Americas, 19th Fl.
New York, NY 10036
lstenson@metlife.com

Tenth District
Abraham B. Krieger
Meyer, Suozzi, English & Klein P.C.
990 Stewart Avenue
Garden City, NY 11530
akrieger@msek.com

Eleventh District
Robert E. Parella
St. John's University School of Law
8000 Utopia Pkwy
Attn: Lyn Kavourgias
Jamaica, NY 11439-0001
rparella@optonline.net

Twelfth District
Martin L. Popovic
Bronx County Surrogate Court
851 Grand Concourse, Room 330
Bronx, NY 10451-2937
mpesq@verizon.net

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

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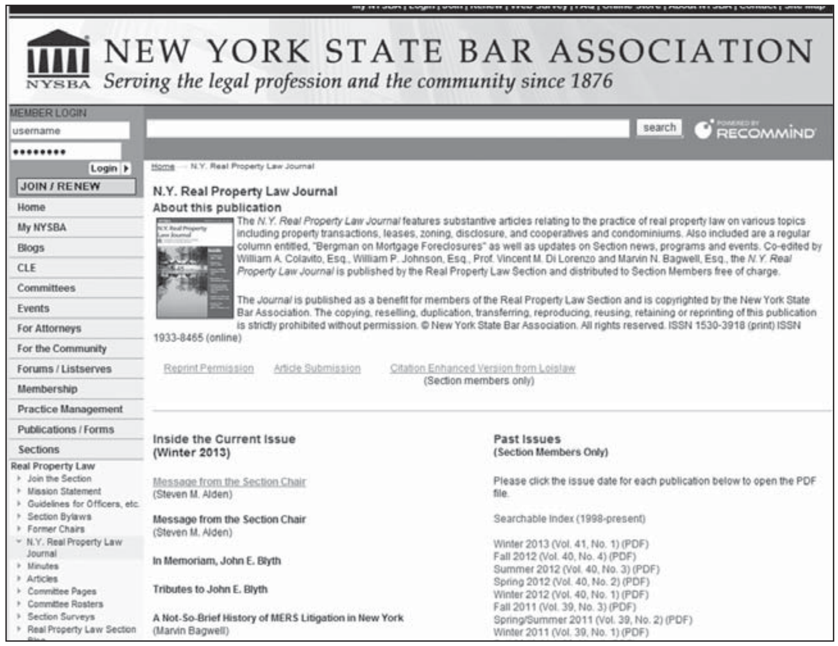

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NEW YORK STATE BAR ASSOCIATION
REAL PROPERTY LAW SECTION
One Elk Street, Albany, New York 12207-1002

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