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ABA REAL ESTATE QUARTERLY REPORT

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AMERICAN COLLEGE
OF MORTGAGE ATTORNEYS

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Quarterly Report on Current Developments in Real Estate Law

July 1 - September 30, 2010

Sponsor:
ABA Section on Real Property, Trust and Estate Law
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This publication is intended to provide experienced real estate practitioners with information on recent decisions and writings affecting real estate practice. Although there are occasional reports of administrative or legislative decisions or related matters, the primary focus of the Report is on appellate court decisions. Members of the Committee are assigned to review all reported decisions in standard reporting services received in their libraries prior to the close of the stated reporting period. They forward their summaries those cases that they deem to be of interest to a nationwide audience. They forward their summaries and copies of the cases to the editor, who substantially edits the summaries and frequently adds comments.

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*The editor frequently revises reports and occasionally adds comments not submitted by a contributor. Time constraints do not permit contributors to review and ratify such changes. Therefore, inaccuracies in the reports and the content of many comments are the responsibility of the editor, and not necessarily of the identified contributor.

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ADVERSE POSSESSION. Where title to property has vested through adverse possession, it may not be disturbed retroactively by newly-enacted or amended legislation. ***Franza v. Olin, 897 N.Y.S.2d 804 (N.Y. App. Div. 2010)***.

Plaintiff sought a declaration that the Plaintiff had acquired title to a specific property surrounding the Plaintiff's home through adverse possession. Plaintiff's claim was based upon regular maintenance and lawn mowing on the disputed property over a number of years, together with erection of a shed and satellite receiver.. Under the New York adverse possession statute in effect at the time that the statutory period had run, possession may be established where the claimed property is "usually cultivated."

The trial court denied the Plaintiff' s claim to title based, because, at the time of the lawsuit, New York had changed its statute, and the statute became effective approximately six weeks before the Plaintiff brought suit. Under the newly-enacted statute the "cultivation language" was removed and the adverse possession test is stated to be "where there have been acts sufficiently open to put a reasonable person on notice." In addition, certain *de minimis* non-structural encroachments are deemed permissive and non-adverse, including fences, hedges,shrubbery, plantings, sheds and non structural walls." Another part of the statute stated that lawn mowing is deemed permissive. These amendments seemed to fit plaintiff's activities very closely

The appeals court nevertheless reversed the trial court's judgment, holding that although the Plaintiff did not seek judicial relief until after the operative statute was amended, the Plaintiff's title to the property would have vested long before the amendments were enacted in 2008 and thus, application of the newly enacted statutes would be unconstitutional. "Although a statute is not invalid merely because it reaches back to establish the legal significance of events occurring before its enactment, ... the Legislature is not free to impair vested or property rights"

Comment: The New York statute is part of a group of statutory responses upholding the "property rights" view of adverse possession following some unfortunate outcomes favoring willful possessors in New York, Colorado, and possible elsewhere. We may see other statutes be tested as this one was over the next few years.

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; INCORPORATION CLAUSES: An incorporation clause binding a subcontractor to all terms in a prime contract does not incorporate an arbitration agreement in absence of an express and specific agreement to arbitrate. ***Wonder Works Construction v. R.C. Dolner, Inc. 901 N.Y.S. 2d 30 (N.Y. App. Div. 2010). ,*** discussed under the heading: "Construction Law; Alternative Dispute Resolution; Arbitration; Incorporation Clauses."

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; MORTGAGES: A mortgagor may waive its right to compel arbitration if it acts inconsistently with the intention to arbitrate in the litigation of the foreclosure. ***LZG Realty, LLC v. H.D.W. 2005 Forest, LLC 896 N.Y.S.2d 389 (N.Y. App. Div. 2010)***, discussed under the heading: "Mortgages; Foreclosure; Arbitration; Waiver:"

BANKRUPTCY; AUTOMATIC STAY; RELIEF FROM STAY; MERS: Noteworthy bankruptcy decision clarifies the rules about foreclosure of MERS related mortgages. It's all about the note. ***In re Tucker, Case No. 10-61004 (W.D. Bkrtcy 9/20/10)***

The case law throughout the country recently has exhibited great uncertainty as to the role and authority of MERS in foreclosures. Many of these cases have been complicated by the language of statutes in judicial foreclosure jurisdictions that may impose greater burdens on mortgagees than might exist elsewhere. In addition, there has been some authority that tangentially discusses the role of MERS with respect to other issues, and these cases may have further muddied the waters. An important course of this nature has been the *Bekistri* case, decided by the Missouri Court of Appeals (284 S.W.3d 619 (Mol App. 2009) and regularly appearing in briefs and discussions around the country. Another important decision – also a non-foreclosure decision, has been the *Landmork* case in the Kansas Supreme court. Both cases have given some support to the notion that a recordation of a mortgage with MERS is a mullity in cases in which the lender does not also give MERS the note, creating some question as to whether the mortgage can be foreclosed to collect the unpaid debt.

There has been a growing consesus among courts not bound by particular statutory language that the important question is whether the party seeking relief from foreclosure has possession or control of the promissory note.

Now we have a clear, thoughtful, and well written decision from a bankruptcy court finding that, whatever *Ocewn* meant on the facts of that case, it did not mean that an assignment of the note without a concomitant assignment of the recorded mortgage [a deed of trust in this case] terminated the debt or the ability of the holder of the note to rely on the mortgage to foreclose.

The facts of *Tucker*, the instant case, are consistent, as the court notes with the vast majority of MERS related foreclosures nationwide. When the original lender made the loan, it took a note and the deed of trust securing the note was given to MERS, as nominee of the lender, which recorded. Subsequently, the note was assigned a number of times, and possession of the note passed, but there was no recorded of the MERS held mortgage. Each of the assignees of the note was a participant in the MERS related system and agreed by master agreement that MERS served as their nominee in holding the mortgage. When the borrower defaulted, the mortgagee's servicer foreclosed. When the borrower sought bankruptcy protection, the mortgagee sought relief from the stay. Mortgagee had physical possession of the note and an assignment of the mortgage from MERS. Borrower argued that the mortgagee lacked standing for this purpose, citing *Bellistri, supra.* .

In *Bellestri*, a Missouri court of appeals had refused to permit a loan servicer, Ocwen, from challenging what Ocwen regarded as an improper tax lien foreclosure ot property in which Ocwen (and MERS, its nominee) had a junior position. The court's rationale was that Ocwen itself was not a recorded owner of an interest in the property and that the MERS interest was a mullity, because the note and mortgage had been "severed" when MERS took the mortgage without the note. Neither Ocwen, nor MERS, nor the owner of the note had been given notice of the proceeding or the right of redemption, although the original lender had been notified -and did nothing. MERS was not a party to that litigation and has since successfully challenged the outcome as to MERS in federal court. *MERS v. Bellistri, 2010 Westlaw 272 0802 (E.D. Mo. 7/1/10)* (holding that MERS constitutional rights would be violated if it failed to receive notice of redemption.)

But there is difficult language in *Bellistri* that had been picked up in a number of foreclosure cases.

> "[When a mortgage loan is made . . . t]ypically, the same person holds both the noted and the deed of trust. In the event that the note and the deed of trust are split, the note, as a a practical matter becomes unsecured. [U]nless the holder of the deed of trust is the agent of the holder of the note . . . the person holding only the note lacks the power to foreclose [and] the person holding only the deed of trust will never experience default. . . . The mortgage loan became ineffectual l when the note holder did not also hold the deed of trust. "

This language, and other language in *Bellistri*, appeared to say that the whole MERS apparatus was ineffectual because of the court's characterization that the arrangement at the outset of the loan "split" the mortgage and the note.

Judge Federman, in deciding the current *Tucker* case, noted that the *Bellestri* court was not, directly or indirectly, making any determination with respect to MERS rights in the deed of trust in that case, but only as to the rights of a servicer that had been unable to convince the court of its ownership of the note. The servicer, Ocwen, argued that MERS had assigned the note to it, and indeed there was language in the assignment agreement that purported to do so. But the court ruled, correctly, that MERS didn't have the note and couldn't assign it. It did not rule on the ability of MERS or anyone else to foreclose the deed of trust.

Here, Judge Federman rule, MERS had assigned the deed of trust to the servicer, and the servicer had actual possession of the note. He effectively dismissed the *dicta* in *Bellistri* by stating that "in Missouri, . . . the holder of the note, whoever it is, would be entitled to foreclose, even if the deed of trust had not been assigned to it." Where MERS is the original recorded of the deed of trust, as a "placeholder," the agent of the noteholder for purposes of holding the mortgage. The judge specifically discussed and dismissed any argument that the characterization of MERS as a "nominee" instead of "agent" undercuts it limited agency for purposes of dealing with the deed of trust at the direction of the note holder.

The judge further ruled that the assignment, in this case, of the deed of trust to the servicer following the inception of bankruptcy did not violate the automatic stay. The assignment was not an action against the debtor's property, because the deed of trust and note were already in existence.

Comment: Judge Federman had elected to try and deal comprehensively and clearly with the questions about MERS related foreclosures in bankruptcy. Remember that only a short time before he had denied standing to a MERS related lender that could not show possession of the note. This opinion, where the note was indisputably in the hands of the servicer, gave the judge the opportunity to deal with the arguments based upon the *Bellistri dicta* and put to rest much of the confusion in the litigation.

This case will be of extreme benefit to those involved in both the mortgagee's and mortgagor's side in future bankruptcy disputes, since the rules are clear and consistent with those that the editor has espoused (at least he thinks so) since the beginning. The opinion should also be useful in state courts where statutes or court rules do not provide a different set of requirements.

BANKRUPTCY; AUTOMATIC STAY; RELIEF FROM STAY; STANDING: Neither MERS assignment of the note (along with the mortgage) nor alleged mortgagee's affidavit that the note was assigned to it, together with a copy of the note, are sufficient, as against challenge to establish that Mortgagee has standing in bankruptcy to obtain relief from automatic stay on foreclosure. ***In re Box 2010 Westlaw 2228289 (Bkrtcy W. D. Mo. 6/20/10)***

BAC sought relief from the automatic stay in this Chapter 7 proceeding to foreclose on Debtor's home pursuant to a deed of trust. When the loan had been made originally, the note had been give to Taylor and Bean and the mortgage to MERS as the nominee of the lender.

BAC claimed to be the assignee of both the note and mortgage and submitted an affidavit in the bankruptcy court to that effect. The affidavit contained a statement of a BAC official that BAC was the owner of the note and mortgage and that both had been assigned to BAC of even date in August of 2009. But the only document attached to the affidavit was an assignment by MERS, which purported to assign both the note and the mortgage. That assignment was dated February of 2010. It stated that MERS assigned the mortgage "together with any and all notes therein described or referred to [and] the debt respectively secured thereby."

The bankruptcy court noted that a prior Missouri case, *Bellistri v. Ocwen Servicing, LLC.,* 284 S.W. 3d 219 (Mo. App. 2009) had held that in another MERS related transaction, MERS did not become the owner of the note, either individually or as nominee, notwithstanding the presence of an assignment by MERS (which had not been discussed in *Ocwen*). Further, although the *Box* court was quite clear that transfer of the note will accomplish transfer of the mortgage without more, the opposite is not true. Transfer of the mortgage alone does not transfer ownership of the note.

Here, again, the court held that there was no evidence that MERS owned own the note or authority to transfer to note. As to the affidavit, the court commented:

> [T]Affidavit does not state with any specificity how BAC purportedly became the "holder" of the Note and Deed of Trust or how the documents were "transferred" to BAC. Although I overruled the Trustee's objection to the admission of the Affidavit and admitted it into evidence at the hearing, the Affidavit, in and of itself, is self-serving, lacks credibility, and is entirely unpersuasive on the question of whether the Note and Deed of Trust were properly assigned to BAC. [citing authority]
>
> As the Trustee suggests, the Affidavit is hearsay. In addition, the Federal Rules of Evidence provide that, generally, to prove the content of a writing, the original is required. Fed.R.Evid. 1002. Duplicates are permitted unless (1) a genuine question is raised as to the authenticity of the original or (2) in the circumstances it would be unfair to admit the duplicate in lieu of the original. Fed.R.Evid. 1003. Although I received the Affidavit into evidence at the hearing, I emphasize that, since the Affidavit has been challenged, it cannot substitute for production of the Note.

The court noted that the only actual evidence of any assignment at all in this case is the February 18, 2010 assignment which was attached to the Affidavit submitted at the hearing. It stated that the fact that the February 18, 2010 Assignment was made after the bankruptcy case was filed does not render it *per se* invalid in that there is no rule prohibiting a creditor from assigning its claim postpetition. However, the February 18 "assignment" contradicts the date stated in the Affidavit and, particularly since no August 25 documents were attached, made the Affidavit even more suspect.

Further, the 2010 affidavit suffered from the same defect noted above – it was an assignment by MERS and the court noted no evidence that MERS owned the note or had authority to assign it. It wittheld judgment on whether MERS had authority to assign the deed of trust as nominee for the lender, since it was the record owner of the deed of trust. That question was not necessary to decide here, since the case is mostly about the note.

Apparently, by the time of the hearing, a copy of the note, endorsed in blank by Taylor Bean, had been produced in court. The court ruled that although sometimes a copy of the note may suffice, it will not be enough when challenged as here. BAC could solve its standing problem, the court noted, by producing the original note. It did suggest that a recent Kansas case *Landmark* had suggested that MERS lacked authority to assign the mortgage, but the *Box* court's earlier citation of Missouri authority that the mortgage follows the note would appear to render that problem moot in Missouri.

Comment: 1 Although a MERS related assignee lost here, the court provides significant clarity on some important issue that may assist MERS in conforming behavior to court expectations in the future. Most important, probably, is the focus on the possession of the note (if endorsed in blank or endorsed to the assignee). If this possession carries with it the ownership of the mortgage, then lengthy assignment chains can be avoided in some cases. Of course, where state law restricts foreclosure rights to the record owner of the mortgage, there still may be problems.

Another issue address by the court is the post-default assignment. Here the court, at least for bankruptcy purposes, appears to have no problem with this set of facts.

Comment 2: Missouri is a deed of trust state, so most foreclosures do not find their way to court. Therefore, this bankruptcy decision will not have the same effect on Missouri foreclosures as it might have in another state. But it might provide some support for wrongful foreclosure suits, should borrowers see fit to bring them.

BANKRUPTCY; AVOIDANCE; DEFECTIVE NOTARIZATION: Although a secured claim may be represented by a defectively notarized instrument, the Trustee may not avoid the claim if there is another basis for constructive notice, such as a recorded notice of default, in the record. ***BowlNebraska LLC v. Omaha State Bank (In re BowlNebraska), (MLW No. 60814/Case No. 10- 6016 – 8 pages) (U.S. Bankruptcy Appellate Panel, 8th Circuit, Federman, J.) (7/1/10) (no Westlaw cite could be found)***

A principal of debtor, prior to bankruptcy, had executed and recorded a series of notes and modifications of notes, all secured by deeds of trust, to Bank. The principal's signature on all these documents was notarized by a the bank's president, who was a licensed notary, but was also the brother in law of the principal.

One of the deeds of trust (the first one) had also been executed by another officer of the Debtor, but the signature was also notarized by the brother in law of his co-signor.

Under Nebraska law, a notary is disqualified from performing notarial functions "if the notary is a spouse, ancestor, descendent, or sibling of the principal, including in-law, step, or half relatives." Further, an improperly notarized document does not provide constructive notice under Nebraska law. The lower courts upheld the avoidance, even of the first deed of trust, since they ruled that the "infection" of the brother in law also disqualified him from notarizing another signature on the same document.

When Debtor went bankrupt, the Trustee attempted to avoid the various mortgages on the basis that the Debtor was a "hypothetical BFP" and took free of all liens not properly recorded. The BAP agreed with this analysis, but took the case a step further, reversing the lower courts on the grounds that the Trustee had an alternate form of constructive notice of the liens.

The BAP noted that the Bank had recorded properly notarized notices of default on all the relevant secured claims before the filing of the bankruptcy. The court commented:

> "[E[ven assuming for these purposes that the recorded deeds of trust did not provide constructive notice of the Bank's liens, the notices of default constitute suspicious circumstances which would put a prudent person on inquiry that the Bank claimed an interest in [Debtor's] prooperty. In addition, Nebraska law provides that a 'notice of default, . . . when acknowledged as provided by law, shall be entitled to be recorded, and shall, from the time of filing the same with the register of deeds for record, impart notice of the contents thereof, to all persons, including subsequent purchasers and encumbrancers for value.'"

Consequently, the Trustee could not exercise the avoidance power. The lack of proper notarization of the original documents did not render them void, but only avoidable by a BFP. Consequently, since the Trustee was not a BFP due to the recorded notices, the claims would bind the estate.

Comment: The case provides an excellent tactic for avoiding the "faulty notarization" trap that is cropping up around the country. In some cases, it might even be easier to file some instrument such as a notice of default that to try to redo and refile the original defectively notarized documents, even if the creditor discovers them.

BANKRUPTCY; PREFERENCES; PROPERTY SOLD AT FORECLOSURE PRE-FILING: Unlike in the case of bankruptcy fraudulent conveyances, a regularly conducted foreclosure sale will not be viewed as producing value sufficient to satisfy the preference test of "no more than the trustee could obtain in a Chapter 7 liquidation." Hence, foreclosure sales with the characteristics of preference scan be avoided in bankruptcy. ***In re Villareal, 413 B.R. 633 (Bkrtcy. S.D. Texas, 2009)***

This is the case that is said to have awakened the title insurance industry to the dangers of granting the "creditor's rights" endorsement. It states a concept that law professors knowledgeable about bankruptcy law have been driving into their students ever since In re BFP was first decided by the U.S.. Supreme Court.

Although the Supreme Court in *In re BFP* emphasized deference to the state law procedures for liquidating property and establishing value, the fact is that the test of "reasonably equivalent value" – which is what the Supreme Court was evaluating, is quite different from the "liquidation value" that appears in the preference statute. The court in the instant case emphasized that a bankruptcy court is not bound by the strictures of an auction sale – it can advertise and negotiate, separate and combine. The price produced for that asset often will exceed the price tha tmight be produced at a foreclosure sale, especially a Texas sale in which there is little notice and a short notice period.

Of course, it didn't help the petitioner's case that the appraisal evidence showed that equity in the property sold (at a second mortgage foreclosure) was in excess of $3,250,000, and it sold at the foreclosure sale to the junior creditor for $70,000.

Comment: Here are some comments from Jack Murray on the decision (previously published on DIRT:)

> In Newman v. FIBSA Forwarding, Inc. (In re FIBSA Forwarding, Inc.), 230 B.R. 334 (Bankr. S.D. Tex. 1999), aff'd, 244 B.R. 94 (S.D.Tex.1999), the bankruptcy court held that the Supreme Court's ruling in BFP — finding that a regularly conducted, non-collusive foreclosure sale was not a fraudulent transfer under § 548 of the Bankruptcy Code — should be applied to nullify a challenge to a real estate foreclosure sale on the basis that it constituted a preferential transfer under § 547. But in In re Villarreal, the bankruptcy court concluded that it was not bound by stare decisis to follow the decision in In re FIBSA Forwarding, Inc., supra, stating that "FIBSA is a decision reached by United States Bankruptcy Judge Steen and affirmed by United States District Judge Ellison of this District. This Court concludes that — although such an opinion deserves great deference — it is not binding on this Court." In re Villarreal, supra, 413 B.R. at 640. [Note: Most bankruptcy judges state that they are bound only by decisions handed down by the U.S. Supreme Court and their respective Circuit Court of Appeals. Cases from other circuit courts, district courts outside their district, the District Court for the district in which they sit, or even other bankruptcy judges within their district, may support an argument but are not binding on bankruptcy judges. See John C. Murray, The Lender's Guide to Single-Asset Real Estate Bankruptcies, 31 REAL PROP. PROB. & TR. J. 393, 411 (1996)].
>
> It will be interesting to see if other bankruptcy courts follow the court's reasoning in In re Villarreal. As a result of the court's ruling in that case (as well as other cases holding that BFP does not apply to preferential transfers under § 547) and the current litigious climate in general, title insurers may no longer be willing to delete the creditors' rights exclusion or issue the ALTA Form 21-06 Creditors' Rights Endorsement (which insures against loss because of the occurrence, on or before the date of the policy, of a fraudulent transfer or preference under federal bankruptcy law or state insolvency or creditors' rights laws) with respect to Loan Policies (assuming the deletion or endorsement is otherwise appropriate and available) that would cover preferential transfers – at least until 91 days have elapsed since the foreclosure sale, with no intervening bankruptcy filing by or against the borrower. (Also, it may be prudent for the lender to obtain a current appraisal from an independent reputable appraiser at or near the time of the foreclosure sale to support the lender's position that it did not receive more than it would have as the result of a Chapter 7 liquidation (if such is the case)).

BROKERS; DUTY TO WARN: Even though a broker's duty to warn of hazardous conditions at a property is not limited to instances where a broker is holding an open house for potential buyers, where a broker arranges for a rental, but the renters had ample time to inspect the property themselves to find any dangerous conditions, the broker will not be liable for injuries resulting from the dangerous condition at the property. ***Reyes v. Egner, 201 N.J. 417, 991 A.2d 216 (2010)***

A renter entered into a short term lease agreement for a house at the Jersey Shore. She intended to occupy it, along with her family, for a vacation over the Labor Day weekend. The house had an elevated rear deck adjacent to the master bedroom. The deck was accessible through a sliding glass door in the master bedroom which led to a small wooden platform on the top of the deck. The platform was about seven inches below the door frame, and there was another six and one-half inch drop from the platform to the deck. There were no handrails attached to the platform or the deck.

On their ninth day at the house, the renter's father, for the first time, opened the sliding glass door to go out onto the deck. He fell down the stairs and permanently injured his back. The father then sued the property owners and the broker for negligence, breach of implied warranty of habitability, and violations of the Consumer Fraud Act. The lower court found that, as a matter of law, neither the home owners nor the broker had a duty to conduct a reasonable inspection of the property for hazardous conditions before renting it out. The father appealed.

The Appellate Division affirmed summary judgment for the broker, and remanded as to the homeowners.

With respect to the broker liability issue, the Appellate Division noted that a prior New Jersey Supreme Court case, *Hopkins v. Fox & Lazo Realtors*, imposed a duty of care upon real estate agents conducting open houses to attract potential home buyers to inspect the property and warn about reasonably discoverable dangerous conditions. In *Hopkins*, the Supreme Court extended a duty of care to broker based on a fairness inquiry that balanced four factors: (1) the nature of the parties' relationship; (2) the nature and foreseeability of the risk; (3) the existence of an opportunity to inspect and warn; and (4) the public policy behind the duty. The Court imposed a duty of care upon brokers to protect invited visitors to open houses because the nature and duration of their visit would not afford them the opportunity to recognize the dangerous conditions for themselves. However, the Appellate Division refused to extend the duty to warn to brokers that facilitate short term leases of summer rental property. The Appellate Division deferred to the Supreme Court to determine whether or not the Hopkins duty to warn should be extended to short-term rentals.

The Supreme Court granted certification. The Court was deadlocked, and therefore the Appellate Division decision was affirmed. The Court's refusal to extend the *Hopkins* duty to warn was not based on the Court's conviction that the duty be limited to instances where a broker is holding an open house for potential buyers. Rather, the Court's decision not to extend the duty to warn was limited to the facts of this case. The Court found no obligation to warn in this case because the renters were in the house for nine days before the accident occurred. Therefore, they had ample time to inspect the property for themselves to find any dangerous conditions.

The dissenting justices rejected the Court's finding that there was no duty to warn because the renters had ample opportunity to inspect the property. They noted that the renters' opportunity to discover the defects on their own raised an issue as to whether or not they were comparatively negligent, not whether or not the broker had a duty to warn them about the deck.

Editor's Comment: For a discussion of the landlord liability issue on this one, see the DD for 3/9/09 on the DIRT website. The court stated a new rule that short term landlords have a duty of reasonable care to discover and disclose defects not reasonably discoverable by tenant. It appears that the landlord in fact knew of the somewhat special nature of the stairs here, and the court triable issues on the questions of whether landlord should have known of the danger and whether the tenant should have discovered it during their week on the premises before the accident occurred.

The reporter for this item was Ira Meislik of the New Jersey Bar.

CONSTRUCTION LAW; ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; INCORPORATION CLAUSES: An incorporation clause binding a subcontractor to all terms in a prime contract does not incorporate an arbitration agreement in absence of an express and specific agreement to arbitrate. ***Wonder Works Construction v. R.C. Dolner, Inc. 901 N.Y.S. 2d 30 (N.Y. App. Div. 2010)***.

Contractor demanded that Subcontractor participate in arbitration proceedings with the project owner. The Subcontractor petitioned to stay the arbitration. The subcontract contained incorporation clauses binding subcontractor to all provision and terms in the prime contract. The Subcontractor was also required to assume all of the rights and obligations that the Contractor had assumed in respect of the project regarding the Subcontractor's work. A provision within the prime contract stated that the Subcontractor is bound by any arbitration award between the Contractor and project owner.

The prime contact contained inconsistencies with respect to the arbitration provision, at one point giving the project owner with the exclusive right to consent to the addition of a subcontractor in an arbitration proceeding and in another provision providing the Contractor with such a right. The prime contract also stated that arbitration would not include "by consolidation as joinder or in any manner " parties other than the project owner and Contractor.

The trial court dismissed the Subcontractor's petition, ordering the Subcontractor to participate in the arbitration.

The appellate court reversed, holding that the arbitration clause in the prime contract was not incorporated by reference into the subcontract. Under New York law, incorporation clauses referencing prime contract clauses in a construction subcontract bind a subcontractor only to "prime contract provisions relating to the scope, quality, character, and amber of the work to be performed by the subcontractor" which the court held was not included an arbitration agreement. The court found that intent to incorporate the terms of an arbitration provision must be clear to be enforceable. On this basis, the court held that the arbitration provision in the prime contract relied on "implication and subtlety" and thus lacked any express and specific agreement holding the Subcontractor to arbitration.

Comment: Note that the decision and supporting authority relate only to the construction context – contractors and subcontractors. Further, it included the notion that the prime contract relied upon "implication and subtlety." What does that do to this case as authority, even in the construction law context?

CONSTRUCTION LAW; CONSTRUCTION LOANS; DUTY TO FUND LOAN; INJUNCTION: Under a construction mortgage loan structured as an advancing term loan may obtain a preliminary injunction requiring the lender to fund draw requests. ***Destiny USA Holdings, LLC v. Citigroup Global Mkts. Realty Corp., 889 N.Y.S.2d 793 (N.Y. App. Div. 2009)***,. Discussed under the heading: "Mortgages; Construction Loans; Preliminary Injunction to Lend:

EASEMENTS; TERMINATION; ADVERSE POSSESSION: Owner of servient tract failed to establish that he terminated the easement by adverse possession, where he had erected transitory impediments to use and acted in an otherwise unneighborly manner. ***Gellerman v. Aldrich, 2010 WL 895102 (Cal. Ct. App. March 15, 2010) (Not officially published)***

Gellermans' land was the dominant tract to an access easement; Aldrich's land was the servient tract. The easement was created and recorded by predecessors in interest in 1961. The opinion states flatly that, but for the easement, "the Gellermans' property would be landlocked."

Gellermans acquired the property in 1998; it had previously changed hands several times, beginning with the original subdivider and then to a number of family members. A road existed along the easement on the servient tract. However, "in 1983 a washout on the road caused damage to the Aldrich property, and after that the road was not driveable."

Bruce Gellerman, Gellermans' immediate predecessor in title testified that, although he did not drive across the road after the washout, he continued, from time-to-time to walk the property. The easement covered not only the Aldrich tract; it also ran along property owned by other neighbours, including the McGregors. "At some point a gate was placed on the McGregor property, but he [Bruce Gellerman] was always able to pass around it, so it did not bother him." The opinion also discloses that both Aldrich and McGregor placed relatively minor or temporary physical obstacles on the property, which Gellerman walked around or stepped over. (For example, McGregors placed a storage container on the easement.) Both servient tract owners displayed what might be described as "rude" behaviour to the owners of the dominant tract (at least according to the facts in the opinion).

The nature of the obstructions became a bit more significant over time. Aldrich placed a wire fence on the property in 2006 "which prohibited access over the easement. In 2007 the wire fence was cut to permit property inspection."

This case describes shifting sets of facts, and different persons appear in the opinion to tell a somewhat different story. Aldrich's mother makes an appearance, and according to the opinion explained that her neighbour, Mr. McGregor installed a gate that was meant to exclude everyone from his property. She nevertheless saw hikers on the easement road. Aldrich's mother also met Bruce Gellerman on the property at one point. She testified that she did not know of any other obstructions on the Aldrich property, on which she lived from 1973 until 1997.

Aldrich lived on the property from the time of his birth. (one imagines that Aldriche's visceral connection to his property was quite real.) Aldrich testified that he did not see anyone using the property between 1997 and 2002. He placed "No Trespassing" signs on the servient tract in 1997, and also placed what the court describes as a lightweight chain across the easement in 1997. The chain was short lived, and was removed in 2000. Aldrich erected a fence on his property in 2006. Apparently he erected the fence after seeing some surveyors on his property, and "commanded them to leave."
Gellermans brought suit against Aldrich and McGregor alleging interference with easement. Aldrich responded that the easement was terminated by adverse possession and abandonment. (Aldrich dismissed the latter defence during the pendency of the case.)

The trial court found for Gellermans and enjoined any further obstruction of the easement. Aldrich and McGregor were ordered to remove all obstructions to the easement including storage containers, concrete pillars at the gates to the easement, and fence. To add insult to injury, the trial court granted costs for attorneys' and expert witness fees, and further found that the "oppressive" behaviour of Aldrich entitled Gellermans to punitive damages.

The court of appeals agreed with the trial court that Aldrich failed to establish adverse possession of the easement, but it reversed the trial court on the issue of damages.

According to the court, the owner of a servient estate may use the easement area so long as he does not unduly burden the easement. At some point, however, the servient tract holder may so interfere with the use by the owner of the dominant tract that the behaviour may lead to a successful claim of adverse possession. California statute (Code Civ. Proc. § 325) establishes a five-year period.

In order to make his case, Aldrich would have to show that "under an adverse claim of right, with notice thereof to the owner of the dominant tenement, continuously during a period of five years" he used the servient tract "in such a manner as to obstruct its use for easement purposes." Quoting Ross v. Lawrence, 219 Cal. App. 2d 229 (Cal. Ct. App. 1963). According to the court, these issues are one of "fact" and as a result, the court was interested only in whether the trial court had sufficient evidence with which to reach its conclusion.

Aldrich argued that the trial court misunderstood and misapplied easement law, by requiring the "obstructions" necessary to constitute adverse possession to be permanent. In Gellerman, all of the interferences upon which Aldrich relied to make his adverse possession claim were essentially removable and transitory.

The trial court judge used the word "permanent" at different times in the course of its interaction with attorneys, during the litigation and at hearing – when describing the meaning of hostility in adverse possession doctrine. The trial judge explained that he did not believe that mere unneighborly behaviour [verbal threats] "should ever give rise to adverse possession of an easement when it's otherwise not – there's not permanent structures being put on the easement." [These are the words of the trial judge, repeated in the appellate opinion.]

The attorneys for Aldrich argued that the trial court's ruling had the effect of setting aside the rules of adverse possession, because "you can't get adverse possession where the road has slipped out so they don't want to use it; therefore, your blocking it is not hostile because of the slip out." In other words, the attorney viewed the ruling as saying that if the road has "slipped out" and become unusable, it cannot be adversely possessed. The trial court, and the court of appeals, disagreed.

The court of appeals, in an act of generosity to the trial court, explained what it believed the trial court must have really meant in its various verbal statements on the nature of permanence of structures and obstructions to the adverse possession argument: "The court did not find an insufficient showing of adverse possession based on an assumption that a permanent structure was required to meet the claimants burden of proof. The point of the court's comments at the hearing was that if the acts of the servient tenement holder did not actually preclude the use of the easement, they were insufficient to constitute adverse possession." Had the owner of the servient tract owner erected a truly permanent structure blocking easement use, this would certainly have qualified. Presumably, by this logic, a continued series of interferences that obstructs use of the easement would do the trick, even if individual obstructions were transitory in nature.

Adverse possession cases are by nature fact intensive. At one point, Aldrich argued that Gellermans had notice of the adverse use because, among other things, Aldrich had placed a chain across the easement. Adverse possession requires that the possession be "open"—and the court understands this to mean that the property owner must have notice (whether actual, constructive or inquiry.) The court noted, however, that Aldrich removed the chain "around 2000." It was simply unclear if Gellerman had even seen the chain. And if Gellerman saw it, it was placed in such a way that a pedestrian could walk over it without effort. The chain would therefore not signify that the owner of the servient tract was asserting possession over the easement area. This is enough to suggest that notice was lacking.

Gellermans were awarded $78,659 in damages. The courts of appeals stated that it was not clear what portion of this amount was intended to be compensatory and what portion punitive. That the Gellermans should receive damages was not really in doubt. What was problematic was that the award apparently included Gellermans' attorneys' costs and expert witness fees. The court rejected this inclusion, maintaining the American rule that parties bear their own costs, absent a statute or agreement to the contrary. Furthermore, this was a suit based in the interference of a property right, and not a tort.

The court also explained that, to award punitive damages, the trial court must have discovered Aldrich acting in an "oppressive" manner, and then determined and amount of money that bears a reasonable and proportionate relationship to the behaviour. According to the court, sufficient evidence existed for the trial court to find oppressive behaviour. Gellermans tried repeatedly to negotiate and to settle out of court. Furthermore, Aldrich was aware of the easement and continued with a pattern of interference.

The court remanded to the trial court for a determination of reasonableness and proportionality of damages.

Reporter's Comment 1: Aldrich dropped his argument that Gellermans abandoned the easement. This makes sense. The usual rule is that "mere non use" of an easement does not constitute abandonment. The owner of the easement must affirmatively renounce its interest or at the least, take steps significantly inconsistent with the easement. Otherwise, an easement may lie dormant for many, many years. In this case, there is no suggestion that Gellermans took steps inconsistent with the easement. Gellermans did not cause the "wash out"; this was an act of nature. Afterwards, to the extent Gellermans used the easement, Gellermans did so on foot. This is consistent with the easement to the extent the property changed as a result of the wash out.

Reporter's Comment 2: The opinion quotes the trial court to the effect that mere letters telling the owner of the dominant tract to stop using the easement are not sufficient to demonstrate hostility. Something concrete is required. (Indeed, something actually "concrete" is preferred.) The reporter agrees that obstructions are typically viewed as physical. But he wonders if all jurisdictions would be as stingy with the owner of servient tract. Just how determined must the owner of the servient tract be? A letter, combined with verbal abuse making passage along an easement unpleasant, and a gate, even if it can be circumvented, sounds to the author like a pretty good demonstration of hostility. Hostility is sometimes characterized in this way: "I know the property (or property interest) is not mine but I am taking it, or obstructing it, anyway." If Aldrich did not cross the line, he may have come closer than the court was willing to admit.

The reporter for this item was Professor Daniel Bogart of the Chapman Law School.

EMINENT DOMAIN; INVERSE CONDEMNATION; OVERFLIGHTS: To establish a taking by aircraft overflights, a landowner must show that the flights directly, immediately, and substantially interfere with the land's use and enjoyment; specifically, that the overflight effects directly and immediately impact the land such that the property is no longer usable for its intended purpose. ***Alewine v. City of Houston, 309 S.W.3d 771 (Tex. Ct. App. 2010).***

In November 2003, the Houston's Bush Intercontinental Airport opened a new east-west runway. The flight path for some of the aircraft which used the new runway extended over the southwest tip of nearby Woodcreek Subdivision and through the airspace of a few homes in the Subdivision. Due to the opening of the new runway, the Subdivision experienced a large increase in the number of airplanes passing over its homes. On October 31, 2005, several Subdivision residents (the "Plaintiffs") filed suit against the City of Houston, alleging intentional nuisance and inverse condemnation. The Plaintiffs alleged that by building a new runway and thereby increasing overflights, the City took their property without just compensation in violation of the Texas Constitution.

At trial, the City argued that the City's actions did not rise to the level of a constitutional taking because the Plaintiffs' homes remain habitable, no taking occurred because the average noise level in the neighborhood did not exceed that approved by the federal government, and the "community damages rule" barred recovery since all of the Plaintiffs claimed similar injuries. The trial court granted summary judgment in favor of the City without specifying the basis for its ruling. Plaintiffs appealed.

The court began by deciding upon the appropriate legal test to prove a "taking-by-overflight" claim. Because the City did not file condemnation proceedings seeking to acquire the Plaintiffs' property, the court determined that "this case would more appropriately be described as an 'inverse condemnation' action, in which an owner claims his property has already been taken-outside the proper condemnation proceedings-without compensation." The court noted that in order to recover on an inverse condemnation action, "a claimant must plead and prove (1) an intentional governmental act; (2) resulted in a 'taking' of his property; (3) for public use." In the subject case, the resolution of the takings claim turned on element (2), "the proof necessary to establish a 'taking' of property by airplane overflights."

With regard to when airplane overflights become a "taking," the Texas Court of Appeals first discussed authority from the U.S. Supreme Court. The seminal U.S. Supreme Court case in this area was decided in 1946, in which the owners of a chicken ranch were forced out of business because noise generated by low overflights resulted in scores of chickens flying into walls due to fright. In addition, the owners were frequently unable to sleep and became frightened and nervous as well. The Supreme Court found the facts of the case to be sufficient to establish a Fifth Amendment taking, but did not define the outer boundary of proof necessary to show a taking. Similarly, in subsequent cases, the Supreme Court concluded a "taking" occurred because frequent low-altitude overflights rendered the affected property unusable for residential purposes. However, in each of those cases, the Supreme Court failed to describe which amount of evidence is necessary for a plaintiff to prevail in an inverse condemnation claim.

In 2002, the Texas Supreme Court addressed this issue in *City of Austin v. Travis County Landfill Co.* ("TCLC"). In TCLC, the plaintiff owned property a half mile from Austin-Bergstrom International Airport which it intended to operate as a landfill. When the airport began accepting civilian air traffic, the plaintiff sued the City of Austin for an alleged taking. Despite the jury's finding of a compensable taking and accompanying damage award, the Texas Supreme Court granted the City's petition for review "to decide whether TCLC established that the civilian overflights . . . constituted a taking under the Texas Constitution." In that case, the court recited the following legal standard:

"[T]o establish a taking by aircraft overflights, a landowner must show that the flights directly, immediately, and substantially interfere with the land's use and enjoyment. To meet this standard, the landowner must show that the overflight effects directly and immediately impact the land so that the property is no longer usable for its intended purpose" (emphasis added).

Therefore, while the Supreme Court cases did not explicitly require the landowner to show his property was unusable for its intended purpose in order to establish a taking, the Texas Supreme Court did so in TCLC. Applying such precedent, the Texas Court of Appeals held that because the homeowners did not show they could not live in their homes because of the overflights, none of the houses in the neighborhood were vacant, and that roughly half of the homes in the neighborhood had increased in value, the homeowners did not meet the evidentiary standard required to show a constitutional taking.

Comment 1: Of course, for purposes of making out an inverse condemnation claim under the U.S. Constitution, the Texas court might have difficulty narrowing the test used by the U.S. Supreme Court. But states do have some power to define what constitutes "property" within their bounds, and that power may be at work here. Note that this issue does not arise in all states, because some state constitutions permit damages against the government for "taking or injuring" property rights or some other language that awards damages for tortious nuisance. This test was not present here.

Comment 2: Obviously flights at very high levels (usually the FAA set 5000 foot level) are in the public airspace and it is difficult to make out a taking of property. Flights lower than that level often are found tortious if they interfere with activity on the ground – a nuisance test. Here it would appear that the overflights are in the low range, but the test for a taking means a complete loss of use – so no damages.

Comment 3: What about flights in the low range – within the "area of anticipated use" by the landowner? Do those also have to cause injury to be takings? Or do they directly interfere with property rights? Apparently the flights in question weren't that low, so we don't have an answer yet for this question.

EMINENT DOMAIN; NOTICE OF INTENT: The mere receipt of notice that a condemning authority is considering the purchase of an owner's property does not preclude the owner from continuing with its development and construction of the property. If condemnation later takes place, the value of any such improvements must be considered in awarding just compensation for the condemnation of the property. ***New Jersey Schools Construction Corporation v. Lopez, 2010 WL 936111 (N.J. Super. App. Div. 2010); February 19, 2010.***

Right after taking title to its property, the new owner demolished a building on the property. The owner then used the property as a parking lot, but intended to develop the property as a mixed use building. The planning board denied the owner's application because a use variance was needed. Around the time the owner applied for a use variance, the New Jersey Schools Construction Corporation (SCC) adopted a facilities management plan calling for the acquisition of property for construction of a school. The SCC sent the property owner a Notice of Intent (NOI) advising the owner that it was considering such a purchase. The NOI clearly stated that it was not to be construed as an offer to purchase the property. Several weeks later, the owner appeared before the zoning board in connection with its variance application. The owner did not disclose that it received the NOI from SCC. The owner's variance application was approved and it commenced construction of the mixed use building. Then, the municipality's board of education approved the acquisition of the property.

By the time the municipality made an offer to buy the property, the building was 80 percent complete. The municipality's offer, which valued the land without the new improvements, was rejected. The lower court rejected the municipality's claim that the value of the new improvements should have been excluded from any price determination. The parties settled and set the property's value with the improvements, subject to the municipality's right to appeal the inclusion of the improvements in the property's valuation.

The municipality appealed, arguing that the value of the improvements should have been excluded from the determination of "just compensation" for the taking, because the owner had received the NOI before it received its zoning approvals and it failed to disclose that fact to the zoning board.

The Appellate Division found that the owner's receipt of an NOI was not sufficient notice of the municipality's imminent intent to condemn the property so as to trigger the owner's obligation to either notify the zoning board or abandon development of the property. The Court held that a property owner may continue to utilize and develop its property even though it is aware of condemnation plans, and that "plotting and planning in anticipation of condemnation without physical appropriation or interference does not constitute a taking." A property owner is entitled to just compensation for the value of improvements unless the improvements are made in bad faith for the sole purpose of enhancing a condemnation award. In this case, the lower court found that there was no clear indication of the municipality's intent to condemn the owner's property and therefore the owner's zoning board application and construction were not in bad faith.

The Court agreed with the owner that the NOI was only a notification that the property was one of many properties being considered for acquisition and not evidence of imminent condemnation. Further, it noted that the NOI specifically stated that it was not to be construed as a formal offer to purchase the owner's property and that the SCC may have decided not to acquire the property. In addition, the condemnation complaint was not filed until fifteen months after the NOI was sent and after the zoning board approvals were received. Therefore, the Court agreed that the owner's construction of improvements was not in bad faith and that the value of the improvements had to be considered in awarding just compensation for the condemnation of the property.

Editor's Comment 1: The case is particularly noteworthy because of the issue of whether the owner was obligated to notify the zoning commission of the NOI, particularly in connection with a request for a discretionary action (use variance) where the zoning authorities are authorized to take into account a variety of factors in determining whether to issue the variance, one of which usually is stated to be something like "the overall public interest."

Editor's comment 2: On the other hand, could the zoning authorities refuse to grant a variance on the sole ground that the school district had the parcel in mind for acquisition, and therefore it was desirable to control possible condemnation damages? One assumes not. Is there a middle ground? If not, then perhaps the pendency of the condemnation is none of the zoning authorty's business.

The reporter for this item was Ira Meislik of the New Jersey Bar.

ENVIRONMENTAL LAW; BROWNFIELDS: New York Court of Appeals broadens state Brownfield benefit qualifications ***Lighthouse Pointe Property Associates LLC v. New York State Department of Environmental Conservation, 14 N.Y.3d 161, 924 N.E.2d 801 (N.Y.2010)***

The law creating the Brownfield Cleanup Program (BCP) defines a "brownfield" as "any real property, the redevelopment or reuse of which may be complicated by the presence or potential presence of a contaminant". Developers who satisfactorily complete cleanups may be entitled to reimbursement up to 24% of the total development costs subject to two caps: A "hard cap" of lesser of $35MM and a soft cap of three times the site preparation costs, whichever is less ($45MM and six time site prep costs for manufacturing projects).

Because the tax credits were so generous, NYSDEC was tasked with the job of reining in the cost of the program by three separate administrations. To accomplish this goal, NYSDEC adopted guidance that narrowed eligibility for admission into the BCP by modifying the statutory definition of "brownfields" as follows. NYSDEC said (1) there must be confirmed contamination on the property or a reasonable basis to believe that contamination is likely to be present on the property; and (2) there must be a reasonable basis to believe that contamination or potential presence of contamination may be complicating the development or re-use of the property. For each element, the New York State Department of Environmental Conservation (NYSDEC) identified a number of factors that it will take into consideration to determine whether a particular site meets the agency's qualified definition of a brownfield.

In determining if there is confirmed contamination or a reasonable basis to believe that contamination is likely to be present on the property, NYSDEC indicated it would consider the following factors:

"The nature and extent of known or suspected contamination.

" Whether contaminants are present at levels that exceed standards, criteria or guidance.

" Whether contamination on the proposed site is historic fill material or exceeds background levels.

" Whether there are or were industrial or commercial operations at the proposed site which may have resulted in environmental contamination.

" Whether the proposed site has previously been subject to closure, a removal action, an interim or final remedial action, corrective action or any other cleanup activities performed by or under the oversight of the State or Federal government.

The most troublesome criteria for potential brownfield applicants are the third and fourth factors. Many urban properties throughout the state have contaminated fill material that was placed onto the property and that has to be managed as a hazardous waste because it exhibits a hazardous characteristic for metals. Under NYSDEC's current interpretation, unless a developer can show that the historic fill material was contaminated from an on-site source, the site will not be eligible for the BCP even though the developer will incur additional costs to dispose of the hazardous fill materials off-site.

In determining if there is a reasonable basis to believe that contamination or the potential presence of contamination may be complicating the redevelopment or re-use of the property, NYSDEC indicated it will look at the following factors:

" Whether the proposed site is idled, abandoned or underutilized.

" Whether the proposed site is unattractive for redevelopment or reuse due to the presence or reasonable perception of contamination.

" Whether properties in the immediate vicinity of the proposed site show indicators of economic distress such a high commercial vacancy rates or depressed property values.

" Whether the estimated cost of any necessary remedial program is likely to be significant in comparison to the anticipated value of the proposed site as redeveloped or reused.

Even if an applicant could get past these two hurdles, the BCP Eligibility Criteria provided that NYSDEC could redefine the "brownfield site" so that only a portion of a proposed site may be enrolled in the program. Thus, if the improvements were to be constructed on the portion of the property that NYSDEC determined was not a "brownfield site", the developer would not be to claim BCP tax credits for the improvements even though the building is part of the entire project. As a result, applicants not only had to demonstrate to NYSDEC that there was contamination or a reasonable belief that contamination is present but also that the prior on-site sources of the contamination were likely located in the proposed footprint of the improvements to be constructed. Thus, so-called "plume sites" where contaminated groundwater was migrating onto the site from an off-site source were not eligible for the BCP even though the presence of the groundwater contamination could result in increased project costs and delays.

The brownfield sites in dispute in Lighthouse Pointe are located along the Genesee River in Rochester, New York. Most of the so-called Inland Site was a former landfill which for a time was listed on the New York State Registry of Inactive Hazardous Waste Disposal Sites. The so-called Riverfront Site had a history of prior rail yard and marina usage but was now mostly vacant. The applicant plans to redevelop the site with condominiums, town houses, a marina, restaurants, retail stores and a hotel.

An investigation performed by the developer's environmental consultant indicated widespread contamination of both the soil and groundwater with hazardous substances above the state's Soil Cleanup Objectives (SCOs) and groundwater cleanup standards. There was uncontradicted evidence in the record that the developer has not been able to finance the project because of liability concerns associated with these substances. Additionally, local officials opposed development unless a comprehensive cleanup of the sites were undertaken.

NYSDEC rejected the applications for admission to the BCP, stating that the SCOs and groundwater exceedances were not significant and did not indicate the need for remediation. To the extent that cleanup was required, NYSDEC asserted that it was because the Inland Site had been a former landfill containing solid waste, which was not a "contaminant" for purposes of admission into the BCP. The developer appealed NYSDEC's denial of its applications.

In December 2007, the state trial court ruled that DEC had no rational basis to determine that the sites' contamination was minimal, ruling that since the SCOs were the cleanup level that had to be achieved to receive a Certificate of Completion, the agency could not rationally claim that exceedances of SCOs were not relevant in determining site eligibility. The Court acknowledged that there may be sites whose contamination is so minimal that it does not "complicate" reuse or redevelopment, but that DEC failed to explain why the contamination had not complicated reuse. Thus, the Court ordered the sites admitted to BCP.

The Appellate Division reversed, holding that NYSDEC was the agency charged with determining whether a cleanup was required and that courts should not substitute their own views for the expertise of the DEC in this complex area.

On further appeal, the New York Court of Appeals upheld the trial court. The Court of Appeals began its opinion by holding that the meaning of the term "brownfield site" was one of pure statutory interpretation and therefore the NYSDEC's interpretation was not entitled to deference.

Turning to the first plain language of the statute, the Court said the only relevant consideration was (a) whether contamination was actually present or potentially present, and (b) that this presence or potential presence complicates reuse or redevelopment. Turning to the first component of the test, the Court noted that the term “present” was not defined in the statute but said its common English usage as set forth in the Webster Third New International Dictionary was “being in one place and not elsewhere: being within reach, sight, or call or within contemplated limits: being in view or at hand: being before, beside, with, or in the same place as someone or something. Thus, the court concluded, a contaminant is “present or potentially present on real property” when it does or may exist or be found within the property’s limits, and that the statutory definition did not on its face mandate the presence of any particular level or degree of contamination. With respect to the meaning of “complicate”, the court said Webster’s definition was “to make complex, involved, or difficult.” Putting these two key terms together, real property qualifies as a “brownfield site” for purposes of acceptance into the BCP so long as the presence or potential presence of a contaminant within its boundaries makes redevelopment or reuse more complex, involved, or difficult in some way.

The Court characterized this two-part test as setting a “low threshold for eligibility”. The court also pointed out that a low eligibility threshold was supported by the legislative history of the implementing legislation that even “marginally polluted property” had become virtually unmarketable” over concerns about unknown cleanup costs and that “lenders were reluctant to finance development on property historically used for industrial or commercial purposes. The court went on to say that the BCP was intended to alleviate these concerns and to improve upon the success of the NYSDEC’s prior administrative voluntary cleanup program that was open to anyone willing to remediate a site.

With the scope of the statutory definition now established, the court then turned to the specific facts of the case to conclude that there was indeed contamination that complicated the reuse of the site. The court found there was no doubt that properties were in fact contaminated, pointing to the presence of multiple contaminants that often exceed the NYSDEC’s SCOs and other environmental standards or criteria as well as the fact that the Inland Site has for years been included in the NYSDEC’s database of hazardous substance waste disposal sites.

The Court also said the applicant had produced undisputed evidence demonstrating that the presence of contaminants at the properties has complicated redevelopment or reuse in several ways. These facts included:

> “The contamination at the Inland Site prevented the owner of the largest portion of it from developing a residential project;
>
> “The county public health department refused to approve any development at the Inland Site unless Lighthouse implemented NYSDEC-sanctioned remedial measures; and
>
> “The project financing was expressly contingent upon NYSDEC’s approval of Lighthouse’s proposed investigatory and remedial measures and a release of liability.”

The NYSDEC had argued that it did not believe the site required remediation but the court said that this did not relieve the applicant’s plight because without a release of liability neither “Lighthouse nor its prospective lender can be confident that regulatory views about the necessity for or the adequacy of any self-directed cleanup will not change sometime down the line.” Interestingly, the Court said it might reach a different conclusion about whether the presence of contamination was complicating redevelopment or reuse if NYSDEC backed up its assurances that no cleanup would be required with a release of liability. However, the Court said this was apparently impossible because DEC had told the Court that it could not do this under its current remedial programs. Given the factual record on these issues, the Court saw no need to remand the matter to the DEC and instead simply reinstated the judgment of the Trial Court.

Reporter’s Comment1: Among the questions that will need to be answered over the coming months are the following:

“What standards will NYSDEC now apply in determining site eligibility- The Lighthouse Pointe sites had widespread and significant contamination. Where will NYSDEC and, ultimately, the courts, draw the line as to BCP eligibility at sites where the contamination is not as severe, and/or the potential complications for development is less self-evident? It does appear that the

Court implicitly invalidated NYSDEC's Eligibility Criteria for determining if there is a "reasonable basis" for determining if a site was contaminated. The first and last criteria (extent of contamination and relative cost) would seem to be part of the complication analysis while the need for exceedances, exclusion of fill material and requirement that there be an on-site source would no longer seem to be valid criteria.

"The decision would also seem to invalidate the agency's practice of limiting brownfield sites to areas where there was contamination as opposed to the footprint of the project. The complication that the court discussed was to the entire redevelopment and not just the area where the contamination existed. If the proposed project will include contaminated and uncontaminated lots, then the proper analysis following Lighthouse Pointe would seem to be how is the contamination no matter where it is located on the site complicating the proposed project. It appears that NYSDEC can no longer admit only portions of a proposed building or isolated hot spots at a redevelopment site appear to be over.

Reporter's Comment 2: Likewise, it would seem that NYSDEC will not be able to exclude sites with historic fill, pesticides from former agricultural use or that have been impacted by depositions of air pollutants or contaminated groundwater migrating from an off-site source on the basis that the site is not contaminated.

"In discussing the extent of the contamination, the court noted that the contaminants were "often" present at concentrations exceeding applicable standards. Thus, it would appear that the presence of contamination exceeding cleanup standards will not be necessary to establish that contamination is present or may be present. Instead, this issue now seems to be a question of how the contamination complicates the reuse.

Reporter's Comment 3: On the other hand, the issue of complication is, for lack of another term, still "complex." The opinion seemed to suggest that if NYSDEC had been able or willing to issue a release of liability, the Court may have found that the contamination did not complicate the reuse of the properties. Thus, it is possible that if NYSDEC resurrects its voluntary cleanup program, the option of obtaining liability relief might enable NYSDEC to continue to restrict admission to the BCP. Of course, any liability relief offered by such a program would not be from the State of New York but just the NYSDEC which could be a significant obstacle for petroleum-contaminated sites where the Attorney General and the Oil Spill Fund that is administered by the State Comptroller have independent authority to pursue cost recovery. Moreover, any such voluntary program would not offer the generous BCP tax credits that defray cleanup costs and otherwise provide the kind of return that developers must achieve to attract investors.

Reporter's Comment 4: Another option that NYSDEC could use is to use its inherent authority under the regulations implementing its Superfund program to issue some form of release for sites that are not listed on the Registry of Inactive Hazardous Waste Sites. This concept seems to have gained creditability with the recent decision of the United States Court of Appeals for the Second Circuit in *Niagara Mohawk Power Corporation v Chevron*, 2010 U.S. App. LEXIS 3859 (2nd Cir. 2/24/10) where the court allowed a contribution action to proceed because the plaintiff had resolved its liability under a state order on consent where DEC supervised the cleanup.

In any event, potential applicants should pay close attention to the factors the Court used to conclude that the redevelopment was complicate and make sure they include a similar analysis in their applications so they can create an administrative record on how the presence or potential presence of contamination is complicating reuse. Lighthouse Point make effective use of affidavits from seasoned real estate developers and local officials in establishing the evidentiary record of complication.

Reporter's Comment 5: Another interesting issue is whether applications that have previously been denied admission to the BCP could now reapply and be reconsidered under the new standards articulated by the Court? Arguably, there has been a change in law that would seem to allow applicants to submit another application.

Repporter's Comment 6: It is unclear how NYSDEC will respond to the Lighthouse decision. The fact that the Court unanimously rejected NYSDEC's interpretation of the Ach shows what an unreasonably narrow and unnatural reading of the statute NYSDEC made to accommodate the wishes of three Governors.

The Reporter for this item was Larry Schnapf of the New York Bar.

GUARANTORS; "BAD BOY" CLAUSE: N.Y. court construes springing guarantee narrowly in favor of guarantors, saving them $60 million deficiency. Court further suggests that not all events that literally would trigger a "bad boy" clause will do so – it depends upon expectations of the parties. ***ING Real Estate Finance (USA) LLC v. Park Avenue Hotel Acquisition LLC, 2010 Westlaw 653972 (2/24/10) (Unpublished)*** , discussed under the heading: "Mortgages; Guarantees; "Bad Boy" Clause."

INSURANCE; PROPERTY INSURANCE; APPRAISAL CLAUSE: When appraisal clauses in property insurance policies provide for a right of the insured to demand an appraisal of the "amount of loss," Texas courts will generally enforce such provisions by requiring insurance companies to participate in the appraisal process, even if the appraiser must make some causation determination. ***State Farm Lloyds v. Johnson, 290 S.W.3d 886 (Tex. 2009).***

Johnson's roof was damaged by a hailstorm, prompting Johnson to file a claim under her homeowners' insurance policy with State Farm Lloyds ("State Farm"). Johnson's contractor concluded that the entire roof needed to be repaired, at a cost of $13,000. State Farm's inspector concluded that hail had damaged only the ridgeline of her roof, and estimated repair costs at an amount less than Johnson's $1,477 deductible.

To settle the difference, Johnson demanded an appraisal of the "amount of loss" under her policy's provision that either party "can demand that the amount of loss be set by appraisal" upon written demand. State Farm refused to participate in the appraisal, asserting that the dispute concerned causation rather than the "amount of loss," and appraisers cannot decide causation issues. Johnson filed suit seeking a declaratory judgment compelling an appraisal.

The trial court held in favor of State Farm, and the court of appeals reversed. The Texas Supreme Court took the case to address, as a matter of first impression, the scope of such appraisal clauses and the meaning of "amount of loss."

The court began by referring to its prior cases in which appraisal clauses have been discussed in some form (typically in the context of waiver or enforceability of the appraisal clause, rather than the scope of appraisal), concluding that while "[m]ost appraisal clauses do not define the scope of appraisal in detail" and "the line between liability and damage questions may not always be clear," the scope of appraisal is generally to determine damages owed under the policy rather than liability of the insurance company. With respect to whether an appraisal can establish causation, the court addressed several issues: (1) whether the subject dispute was about causation, (2) whether causation disputes are questions of liability or damages, and (3) when appraisals should be reviewed.

Despite State Farm's contention that the only shingles damaged on Johnson's roof were those on the ridge of her roof, and that such shingles were the only shingles damaged by hail (i.e., the causation of any damage covered by the policy), the court held that it could not determine that the parties' dispute was about causation. The record lacked evidence that the roof was damaged by anything else, and nothing established that the parties' dispute was solely about how much of the roof was damaged rather than how much needed replacement.

Nevertheless, even if the dispute involved causation, this fact would not prove whether the case was a question of liability (not subject to appraisal) or damages (subject to appraisal). The court noted that while causation relates to both liability and damages because it is the connection between them, "in actual cases, causation usually falls into one category or the other." When different causes are alleged for a single injury to property, causation is a liability question for the courts. However, when different types of damage occur to different items of property, appraisers may have to decide the damage caused by each before courts can decide liability, or when the causation question involved separating loss due to a covered event from a pre-existing condition of the property. In those cases, appraisers must always consider causation as part of their assessment, particularly because "setting the 'amount of loss' requires appraisers to decide between damages for which coverage is claimed from damages caused by everything else." In concluding that State Farm could not avoid participating in the appraisal process because there might be a causation question exceeding the scope of the appraisal, the court noted that its holding does not mean appraisers can rewrite policies: "whether appraisers have gone beyond the damage questions entrusted to them will depend on the nature of the damage, the possible causes, the parties' dispute, and the structure of the appraisal award."

As further support for its holding that the appraisal in question should not initially be prohibited, the court highlighted the unusual nature of the case (in that typical appraisal cases involve challenges to appraisals after they have taken place), noting that this fact "makes a big difference" for several reasons: (1) allowing litigation about the scope of appraisal before the same takes place would encourage more litigation; (2) most appraisals can be structured in a way that decides amount of loss without determining liability; and (3) the scarcity of court cases involving the scope of appraisals suggests that appraisals resolve disputes, and therefore the subject dispute may be similarly resolved. Finally, noting that the appraisal could always be disregarded later, the court concluded that "unless the 'amount of loss' will never be needed . . ., appraisals should generally go forward without preemptive intervention by the courts."

Comment: Although this case came out for the insured, the rule set forth certainly is a double edged sword, and might give the insurer to duck into appraisal and avoid more expensive and less predicable litigation in tough cases.

FORECLOSURES; JUDGMENTS; 'FAIR VALUE RULE:" Even though there is no statutory provision that would give a judgment debtor, in a foreclosure of a non-mortgage lien, a credit for the fair market value of the property when sold for only a nominal value at a sheriff's sale, a court has inherent equity authority to allow such a credit in order to prevent a double recovery by the judgment creditor. ***MMU of New York, Inc. v. Grieser, 2010 WL 3022220 (N.J. App. 8/4/2010)***

The New Jersey Superior Court, Appellate Division, was faced with the issue as to "whether a judgment debtor is entitled to a fair market value credit for property that is executed upon and then purchased by a judgment creditor at a sheriff's sale for a nominal amount." It decided that "a court has inherent equitable authority to allow a fair market value credit in order to prevent a double recovery by a judgment creditor against a judgment debtor."

A tenant failed to pay rent, leaving a substantial deficiency. Although it had filed for bankruptcy, it failed to list its landlord as a creditor. The landlord obtained a judgment essentially covering "unpaid rent for the entire ten-year term of the lease." The judgment was assigned to a company in the business of buying judgments. Subsequently, the tenant obtained title to a piece of real property in New Jersey and the judgment, by law, became a lien against that property. Four years later, the company holding the judgment, as judgment creditor, "levied an execution on the property to satisfy the default judgment and scheduled a sheriff's sale." Despite some procedural delays, the sheriff's sale took place and the judgment creditor purchased the property for a nominal amount – $100. Then it quickly resold the property for over $1,200,000 and collected approximately another $190,000 by executing on six other properties owned by the judgment debtor. Thus, through its collection activities, the judgment creditor realized about $1,390,000.

Several years later, the judgment debtor successfully challenged the original default judgment and, on remand from the Appellate Division, the lower court reduced the judgment from about $1,630,000 (plus accrued interest) to about $643,000 (including interest). The lower court also ruled that the judgment debtor "was entitled to a credit against his reduced judgment for the full amount [the judgment creditor had] realized from his executions upon" the various properties owned by the judgment debtor, notably including the approximately $1,200,000 that had been realized from the re-sale of the property acquired at the foreclosure. The lower court "apparently determined [this] was an accurate reflection of [the property's] fair market value." All of these changes meant that the judgment creditor was now being asked to return about $750,000 to the judgment debtor.

As would be expected, the judgment creditor appealed the lower court's decision. It did not challenge the reduction in the judgment amount or the credits resulting from the sale of the other six properties. Its argument was "directed solely at the part of the judgment that allow[ed] [the judgment debtor] a fair market value credit of [about $1,200,000] based on the" foreclosure sale. It argued: (a) laches; (b) that the judgment debtor was not entitled to a fair market credit even if the property had been sold for a nominal amount at a sheriff's sale; and (c) even if the fair market value credit was proper it thought the court could not issue an "affirmative money judgment" against it, the judgment creditor.

The Court rejected the laches defense and analyzed the "affirmative money judgment" defense as being inapplicable because all the lower court was seen to be doing was to reduce the original amount of the judgment.

What the Court did do, it said, was to analyze the "fair market credit defense." New Jersey has a statute governing mortgage foreclosures and that statute specifically "allows a fair market value credit if a mortgagee seeks a deficiency judgment." The statutory provisions governing execution sales, however, do "not include express authorization for a fair market value credit."

The Court did have some precedential case law to look at. In 1986, it had examined a situation where a "non-mortgage judgment creditor sought to intervene in a mortgage foreclosure action to assert a claim against surplus funds from the foreclosure sale, at which the judgment creditor was a successful bidder." There, as here, the "fair market value of the property allegedly exceeded the amount required to satisfy both the foreclosure judgment and the non-mortgage judgment of the creditor seeking intervention." While the Court, in that case, did not permit the judgment creditor to intervene in the foreclosure, it allowed the judgment creditor to apply for a share in the surplus funds derived from the foreclosure sale.

The Court then considered the issue directly relevant to the case at hand: "whether the judgment debtor was entitled to a credit for the fair market value of the property." In doing so, it cited, with favor, the following text from an earlier decision: "Although N.J.S.A. 2A:50-3 does not by its express terms extend to a subsequent judgment creditor, we must consider nonetheless whether overriding equitable considerations exist, or whether there is a discernable probable legislative intent. Where property is sold to a holder of the subsequent obligation, by analogy to and in accordance with the spirit of N.J.S.A. 2A:50-3, the debtor in the foreclosure action should be entitled to show the fair market value of the property and obtain a credit against the amount due on the judgment. Likewise, we see no reason why a court of equity should not condition its award of relief to an applying creditor to prevent a possible double recovery or windfall, where the judgment creditor has purchased the property. A court of equity has the inherent power to prevent a potential double recovery or windfall to the judgment creditor who not only may profit on the purchase of the property at the foreclosure sale (if purchased for less than fair market value), but also seeks to obtain satisfaction of his judgment."

Comment 1: This case, obviously, could have huge precedential impact in states in which there are "fair value" limitations that apply only to mortgage foreclosures. One wonders why the New Jersey courts concluded that the legislature did not know what it was doing when it limited the application of the statute. Or perhaps, because of the wide range of equity the court simply didn't care what the statutes said.

Comment 2: It is this second notion that gives the editor even more qualms. Could a court in which there is no fair value limitation decide to impost such a limitation on a deficiency claim or on a judgment debtor's claim as a consequence of this kind of thinking? There is a single case in Missouri in which the court refused to grant a deficiency claim following a non judicial foreclosure where the debtor showed that the lender had "pre sold" the foreclosed land for a higher price to someone else, and now was trying to "double collect" that excess sale price. The editor has always found that case troubling, but obviously it stands on narrow facts. The general notion that a court, without statutory authority, could limit deficiency claims might strike fear into any self respecting mortgagee foreclosure specialist (assuming that, these days, they have any self respect left.)

The reporter for this item was Ira Meislik of the New Jersey Bar.

LANDLORD/TENANT; MODIFICATION OF LEASE; REQUIREMENT OF WRITING: In Florida, under certain circumstances, written contracts can be modified by a subsequent oral agreement of the parties even though the written contract purports to prohibit such modification. For example, an oral modification may be enforced where otherwise a party would be a victim of fraud or where the subsequent conduct of the parties indicates the acceptance of the oral modification. ***Husky Rose, Inc. v. Allstate Insurance Company, 19 So.3d 1085 (Dist. Ct. of App. Florida, 4th Dist. 2009):***

The parties' original lease did not require the tenant to maintain property insurance. Their renewal lease did. The parties agreed orally that the landlord did not have to be added to the policy until the policy came up for renewal. About six weeks before the insurance policy came up for renewal, but after the new lease was in effect, the tenant's restaurant was destroyed by fire. The landlord received nothing from the tenant's insurance recovery, but did receive payment under its own policy.

The landlord sued the tenant and the tenant's owner, who had guaranteed the lease for breach of their lease arising out of the tenant's failure to name the landlord as an additional insured on its property insurance policy. The landlord assigned its claim for breach of contract to its own insurance company. The tenant counterclaimed for the landlord's failure to rebuild the leased premises after it was destroyed by the fire.

The landlord admitted that it had agreed to wait for the tenant's insurance policy to renew before being named as an insured. But it argued that the "anti-waiver provision" of the lease negated that agreement. In particular, it pointed to a section of the lease reading: "The waiver of Landlord of any breach of any term, condition, or covenant herein contained shall not be a waiver of such term, condition, covenant, or any subsequent breach of the same or any other term, condition, or covenant herein contained." The Court quickly dispensed with this argument, pointing out that this was not a provision prohibiting any waiver of contract terms, but actually served only to prevent the assertion of the defense of waiver where the landlord might have declared a default based upon a subsequent breach of the same condition.

The Court, on its own, looked to the lease's provision that prohibited oral agreements to modify its terms. It recognized that the agreement of the tenant and landlord "not to comply with the insurance provision until policy renewal constitute[d] an oral understanding which" would be inconsistent with the lease's "modifications in writing only" provision. In Florida, however, courts maintain the principle that "under certain circumstances, written contracts can be modified by a subsequent oral agreement of the parties even though the written contract purports to prohibit such modification." Some circumstances cited by the Court included: "(1) where it would be a fraud on a party to refuse to perform the oral modification, or (2) where the subsequent conduct of the parties indicates the acceptance of the oral modification." As a result, the matter had to be remanded to the lower court because the lower court had never gotten past summary judgment and therefore there was no finding of fact as to whether the "no oral amendments to the lease" provision applied.

Comment: The rule here appears to be consistent with the general rule established in New York, Pennstylvania, and other jurisicitions. See Friedman on Leases, Randolph edition, at Sec. 32.1.1.

The reporter for this item was Ira Meislik of the New Jersey Bar.

LANDLORD/TENANT; ROOMMATES; TERMINATION: Where a "roommate" arrangement is deemed a sublease, the primary tenant/sublessor is not legally entitled to eject sublessee from an apartment without a court order and at least 30 days notice. ***Tiller v. Shuboney, 894 N.Y.S.2d 343 (N.Y. City Ct. 2009)***.

Plaintiff and Defendant, both college students, agreed to rent an apartment together. Only Defendant signed the approximately year long lease for the apartment, but the landlord was notified that Plaintiff was living in the apartment and Plaintiff verbally agreed to pay half the costs associated with renting the apartment. There was no written or verbal agreement regarding the obligations of either party in the event that one of the parties wanted to move out before the lease expired.

After months of living together, tensions increased amongst the two parties and relations deteriorated. Plaintiff left the apartment for winter break and upon her return to the apartment, she learned that Defendant had changed the locks. Defendant's mother answered the door and told Plaintiff that Plaintiff would have to move out of the apartment.

Plaintiff and Defendant later exchanged letters regarding the removal of Plaintiff's belongings from the apartment and in one of such letters Defendant threatened that if Plaintiff did not remove Plaintiff's belongings by a certain date, such belongings would be moved to the basement. When Plaintiff arrived at the apartment to pick up her belongings, she found all her belongings in the basement and she noticed that some items were damaged.

After being ousted from the apartment, Plaintiff moved back home with her mother and was unable to complete the rest of the academic semester because of the distance between her mother's home and the college.

Plaintiff sued Defendant for damages. According to the court, a contractual relationship existed between Plaintiff and Defendant and Plaintiff was the sublessee of Defendant. The court determined that: (i) as Defendant's sublessee, Plaintiff was entitled to the same legal protections from Defendant that Defendant was entitled to from her landlord and (ii) Defendant was also required to provide the same legal protections to Plaintiff that

Defendant's landlord was required to provide to Defendant, which protections included the right to have a minimum of 30 days notice prior to an eviction and the right to not be ejected from an apartment without a court order. Since Defendant accepted Plaintiff's rent during the month in which she locked Plaintiff out of the apartment, did not give Plaintiff sufficient notice and did not obtain a court order of eviction the Court determined that Defendant was not legally entitled to oust Plaintiff from the apartment and Plaintiff was entitled to damages.

Comment 1: The court commented that roommate arrangements can be characterized in a number of different ways, but its reasoning here did not leave much room for a characterization that would not at least require that there be notice and a court order before the roommate's occupancy could be terminated.

Comment 2: The defendant in fact got off lightly, as the court recognized an unstated provision in the oral lease that the roommate's occupancy rights were subject to termination – presumably by either party. Otherwise the Defendant would be liable for damages for Plaintiff's loss of the balance of the lease term.

Comment 3: Another was this could be characterized and technically (to the editor) should have been characterized is a cotenancy. Both sides agreed to be liable for the rent for the term of the lease and, although only one party's name was on the lease, that party could be viewed as the agent for the cotenancy. Terminating possession rights under such an arrangement would be more complicated, involving a suit for partition. Since the lease was only for a year and all arrangements were verbal, the court wisely set aside this technically preferred construction. If both parties were, say, operating a business, wouldn't the court be more likely to use the same construction if all other facts were the same?

Comment 4: If the roommate was deemed a licensee, she might have been easier to evict, depending upon state law, as in some states licensees have no possession rights to assert. But where roommate had affirmatively agreed to pay half the right, construction of her rights as only a licensee would seem to be unfair.

LANDLORD/TENANT; SURRENDER: The mere taking of keys to leased premises by a landlord does not give to an inference that the landlord has accepted surrender of the premises. ***Sirdah v. North Springs Associates, LLLP, 2010 WL 2278184 (Ga.App 6/8/10.)***

Even though Georgia law generally obligates an injured party to mitigate damages, this general rule to mitigate damages does not apply to lease contracts. In Georgia, the rule is: "if a tenant abandons leased premises without authorization prior to the expiration of the term, the landlord is not required to mitigate damages by releting the premises. Rather, he may allow the premises to remain vacant and hold the tenant responsible for accruing rent."

There are two limited exceptions to this general rule: "[I]f the landlord accepts the tenant's surrender or the tenant successfully terminates the lease, the landlord is required to make reasonable efforts to re-lease the premises and mitigate his damages." In this case before the Georgia Court of Appeals, it was undisputed that the tenant did not successfully terminate the lease.

Here, the tenant wrote to its landlord that it "would no longer be open for business." In that same letter the tenant returned the keys and specifically wrote: "I am turning in my keys to the premises." In response, the landlord, by certified letter, notified the tenant as follows: "be advised that although [the tenant] has given up possession of the premises through return of his key, [the landlord] has accepted same without terminating the Leases. The landlord [intends to hold the tenant] liable for all sums due and owing through the expiration of the term of the Leases, together with any damages to the premises, to be reduced only by sums received by [the landlord] through re-letting of said premises."

The Court rejected the tenant's assertion that he had "given up possession of the premises through his return of his key" and that the landlord "accepted same." In essence, the tenant argued that the landlord was then required to "have made reasonable efforts to re-let the premises."

The Court was unpersuaded. "The mere taking of the keys to the leased premises by a landlord does not give rise to an inference that the landlord accepted surrender of the premises. . . . Likewise, '[t]he mere entry upon the premises to protect the property after abandonment by the lessee will not amount to an acceptance of a surrender of a lease.'" In addition to looking at the subjective intent of the landlord, the Court pointed to the landlord's response letter wherein it expressly said that it was not terminating the leases. Fundamentally, to the Court, there was uncontradicted evidence that the landlord neither expressly nor impliedly accepted the tenant's surrender of the leased premises.

To reinforce its reasoning, the Court pointed to a Bankruptcy Court decision in the Southern District of Georgia which recited: "surrender differs from abandonment, as applied to leased premises, inasmuch as the latter is simply an act on the part of the lessee alone; but to show a surrender, a mutual agreement between a lessor and a lessee that the lease is terminated must be clearly proved."

Comment 1: The Georgia court emphasized that there is is no duty to mitigate in that state, and that this contributes to its conclusion that simply returning the keys does not contribute to a surrender. Georgia, by the way, is one of fifteen states that recognize no commercial duty to mitigate. It is in company with NewYork, Pennsylvania, Missouri, and nine others, all listed inthe appendix to Chapter 16 of the Randolph Edition of Friedman on Leasing.

But it should be noted that the same conclusion reach here might also be relevant in a mitigation state. Even under the mitigation rule, the landlord still can collect rent from the defaulting tenant when the landlord's reasonable efforts to mitigate do not replace the defaulted rent for the balance of the term. A surrender, however, would mean that the lease was at and end, and therefore the landlord could not look to the defaulting tenant for those missing rents. Thus, the rule that simply giving the keys to the landlord is not, without more, a surrender, is relevant in mitigation states as well.

Comment 2: The rule here is consistent with other authorities elsewhere, as delineated in note 145 to Chapter 16 in the Randolph edition of Friedman and in an ALR annotation at 84 ALR 4th 183 (1991).

The Reporter for this item (but not the comments) was Ira Meislik of the New Jersey Bar.

LANDLORD/TENANT; RENEWAL; WAIVER OF TIME OF ESSENCE: Where tenant fails to give timely notice of option to renew, but parties later agree to a renewal term, the renewal is valid because landlord has waived the right to insist that renewal request be timely. ***Paterno v. Carroll, 2010 WL 2091769 (N.Y.A.D. 2 Dept. 7/2710)***

A residential apartment tenant had a one year lease with an option to extend the lease for one additional year if the tenant exercised the option by written notice on or before a given date. That date passed without the tenant exercising the option but, about three weeks later, the landlord wrote to the tenant to ask if she wished to renew the lease. The tenant faxed a signed statement to the landlord asserting that she wished to 'renew the option'" for the additional one year period. Six days before the renewal year was to begin, the tenant discovered "toxic" mold on the ceiling in the master bedroom; and a little more than two weeks into the renewal year, the tenant faxed the landlord saying that because of the mold she "would be forced to vacate the premises as soon as possible, and that '[g]iven this untenable living situation, we believe that our financial obligation under the lease should cease today.'"

The tenant moved out and then demanded return of the security deposit. In the suit that followed for return of the security deposit, the landlord asserted a counterclaim for one year's unpaid rent and damages incurred in removing the tenant's personal property.

The New York Supreme Court (New York's court of original jurisdiction) declined to award summary judgment to the tenants on their claim to recover the security deposit, but the Appellate Division reversed that decision.

In its defense to the landlord's claim for rent to cover the one year renewal period, the tenant argued that she had "failed to timely exercise [its] option to extend the lease, thus forfeiting [her] right to exercise the option. The Appellate Division, acknowledging that this was true, refused to allow this defense to stand based on its holding that the landlord, in turn, had "waived [its] right to refuse renewal on this ground, and the parties effectively agreed to a one-year renewal of the lease." As a result, the lower court would now have to resolve the landlord's claim for unpaid rent.

The court affirmed summary judgment on the security deposit issue because the landlord had failed to give its tenant "written notice of the banking institution that held the deposit." This was a violation of New York's General Obligations Law (Sec. 7-103) and "permitted an inference" that the landlord had comingled "the security deposit monies with his own personal funds." Because the landlord failed to rebut that inference, the landlord "forfeited [its] right to avail [itself] of the deposit for any purpose, and the [tenant had] an immediate right to return of the funds notwithstanding that [she] may have breached the lease."

Comment: Both holdings here are unremarkable, but the security deposit discussion certainly contains a "word to the wise" to those counseling residential landlords concerning security deposit practices. Even if the deposit is held in an account, the landlord will lose on summary judgment if it fails to provide the tenant with the proper notice. One assumes there would have to be a new notice if the landlord changes banks. Note that the same analysis might apply in other states with security deposit statutes that are similar. The states identified with security deposit statutes are listed in appendix 20A of the Randolph edition of Friedman on leases, identifying whether the statute deals with escrowing of security deposits in bank accounts. this appendix will be updated in the supplement just sent to the publisher.

The Reporter for text of this item (but not the comments) was Ira Meislik of the New Jersey Bar.

LENDER LIABILITY; DUTY TO FUND LOAN; INJUNCTION: Under a construction mortgage loan structured as an advancing term loan may obtain a preliminary injunction requiring the lender to fund draw requests. ***Destiny USA Holdings, LLC v. Citigroup Global Mkts. Realty Corp., 889 N.Y.S.2d 793 (N.Y. App. Div. 2009)***,. Discussed under the heading: "Mortgages; Construction Loans; Preliminary Injunction to Lend:

LENDER LIABILITY; SLANDER OF TITLE: Even where position relied upon by party filing *lis pendens* is clearly wrong, and pending lawsuit will not result in an interest in the subject property, owner of property cannot succeed in a slander of title action unless it can show that the filing was "malicious." Stupidity is a defense. ***First Nat'l Bank of St. Louis v. Ricon, 2010 Westlaw 1223788 (Mo. App. 3//30/10) (not yet released for publication)*** **,**discussed under the heading: "Slander of Title; Lis Pendens."

LIS PENDENS; PERSONAL PROPERTY; PRIORITY: The doctrine of *lis pendens* no longer applies to personal property in Kentucky, and the filing of a *lis pendens action* is insufficient to create a security interest in real property, even if the *lis pendens* is filed prior to another lender's perfection of its security interest in certain property. ***Citizens National Bank of Jessamine v. Washington Mutual Bank, 309 S.W.3d 792 (Ky. Ct. App. 2010).***

In 1999, Day conveyed title to Reynolds property on which a mobile home was located. Day s recorded a deed in the county real estate records. While the deed did not specifically indicate that title to a mobile home was being conveyed in addition to the underlying real property, it was clear from the record that the parties intended that both be subject to the conveyance.

In connection with the sale, the Reynolds executed a mortgage in favor of Washington Mutual's predecessor, which mortgage transferred a security interest in the "Thompson Road Property." The mortgage did not specifically mention the mobile home, and the Reynolds did not obtain a title certificate to the mobile home in their name. The mobile home was never affixed to the real property, which might have changed its character from personal property to real property. In addition, prior to the filing of the complaint in this case, no party had perfected a security interest in the mobile home.

In 2002, Reynolds executed a second mortgage encumbering the real property in favor of Citizens National Bank of Jessamine County. Similar to the first mortgage, no description of the mobile home appeared in the second mortgage. Subsequently, Reynolds defaulted on both loans.

Washington Mutual filed a complaint on April 2007, claiming lien priority on both the real property and the mobile home. Three days later, Washington Mutual also filed a *lis pendens* notice in Garrard County, claiming an interest in both. After being served with the complaint, Citizens and the Reynolds executed a Title Lien Statement regarding the mobile home, which was recorded in the county recorder's office on August 14, 2007. Both Washington Mutual and Citizens obtained judgments entered by the court on September 14, 2007 granting each priority claims on the mobile home.

The master commissioner found that "the filing of the [c]omplaint and *lis pendens* by Washington Mutual created a priority claim in the mobile home." It also held that Citizens "had legal notice of Washington Mutual's claim to the mobile home." Citizens filed exceptions to the master commissioner's report, claiming the filing of the notice of *lis pendens* did not independently create a lien against property and did not take priority over liens filed subsequent to the *lis pendens* filing. The trial court denied the exceptions and confirmed the master commissioner's report.

On appeal, the Kentucky Court of Appeals addressed (1) whether a *lis pendens* independently creates a lien which takes priority over subsequently perfected liens, and (2) whether the *lis pendens* doctrine applies to personal property. Specifically, Washington Mutual argued (and the master commissioner had held) that the *lis pendens* doctrine applies to personal property and that Citizens' perfection of its interest in the mobile home subsequent to the *lis pendens* filing cannot result in Citizens acquiring a superior interest.

The court first held that Kentucky's *lis pendens* statute applies only to real estate, and that the mere filing of a notice of *lis pendens* is insufficient to create independently a security interest. While the common law doctrine of *lis pendens* formerly applied to personal property, such cases were decided prior to Kentucky's adoption of the UCC, which does not allow for the filing of *a lis pendens* on personal property. Because the mobile home was not affixed to the property, it was personal property, and perfection of a security interest in personal property occurs only when a notation of the lien is placed on the applicable certificate of title. Accordingly, by noting its lien on the Title Lien Statement, Citizens perfected its security interest in the mobile home, and the court held that its lien was prior to Washington Mutual's claim.

Comment 1: Although the editor was not aware that the UCC precluded *lis pendens* claims in personal property, he's not surprised, and assumes most readers are aware of this fact.

The interesting part of the case is that the receipt of notice of the foreclosure action did not place Citizen's on notice of the claim against the mobile home, which apparently did appear in the text of the foreclosure filing. Citizens did not file its own UCC lien security claim against the mobile home until after receipt of Washington Mutual's foreclosure filing.

Here is what the court had to say about that:

> "There is no dispute Citizens has . . . perfected its lien [by a UCC filing] but Washington Mutual has not. It is fundamental that unperfected security interest are subordinate to perfected security interests. This is true regardless of Citizen's knowledge of Washington Mutual's filing of a notice of lis pendens and any claim set up by such filing because, as we stated earlier, the notice of applied only to the real estate which was the subject of the underlying foreclosure action, and not the manufactured home situated thereon. Because Washington Mutual has failed to perfect its lien under the mandates of [the UCC], its interested in the [mobile home] must necessarily giver way to Citizens' perfected claim. . . ."

Comment 2: Likely Washington Mutual in fact obtain a lien against the mobile home when it filed its mortgage. Citizens' had both actual and constructive knowledge of that lien. But apparently under the UCC's "race" approach to priority of personal property liens, the Citizens' lien was first perfected, first in claim, whether Citizens was a BFP or not. This was explained to my by our UCC guru at UMKC, Ken Ferguson.

LIS PENDENS; SLANDER OF TITLE: Even where position relied upon by party filing *lis pendens* is clearly wrong, and pending lawsuit will not result in an interest in the subject property, owner of property cannot succeed in a slander of title action unless it can show that the filing was "malicious." Stupidity is a defense. ***First Nat'l Bank of St. Louis v. Ricon, 2010 Westlaw 1223788 (Mo. App. 3//30/10) (not yet released for publication)*** ,discussed under the heading: "Slander of Title; Lis Pendens."

MECHANICS' LIENS; ENFORCEABILITY: A state statute requiring that a mechanics' lien claimants "do or perform any work or labor upon land" shall be interpreted such that a claimant who hires and pays subcontractors will be viewed as having "performed work on the property" by furnishing labor through such subcontractors, and therefore such claimants may place a lien on property for work performed by subcontractors. ***Midwest Floor Company v. Miceli Development Company, et al., ___ S.W.3d ___, 2008 Westlaw 4124595 (Mo. Ct. App. 2009).***

Preckels purchased a home from builder Miceli in 2006. As part of the construction project, Miceli hired Kelpe

Contracting) to stabilize a slope on the property. Kelpe performed this work at various times. After invoices for such work remained unpaid, Kelpe filed a mechanics lien for $127,776.50 against the property, followed by a claim for breach of contract and enforcement of mechanics lien against Kelpe and the Preckels. The trial court granted Kelpe's motion, and the Preckels appealed.

On appeal to the Missouri Court of Appeals, the Preckels argued that Kelpe's statement of mechanics' liens required by statute failed to set forth a just and true account of the work performed. Specifically, the Preckels argued that each subcontractor must file a timely mechanics' lien and then assign its rights to the contractor, even in cases where the subcontractors are paid by the contractor. In the subject case, because the subcontractors were paid, they did not file mechanics liens or assign them to Kelpe. Therefore, the Preckels concluded that Kelpe wrongfully included non-lienable items, which resulted in its failure to file a just and true account of the lien.

In its analysis of this issue, the court recognized that this was an issue of first impression in Missouri, and noted that the Preckels cited no case law to support their position. Instead, they based their argument on a Missouri statute which provides that "'[a]ny person who shall do or perform any work or labor upon land' may have a lien upon the land." According to the Preckels, this language "expressly limits the class of people who can claim a mechanics' lien to those who actually 'engage in affirmative acts to improve the property by performing work,'" and that "Kelpe cannot include the cost of the subcontractors' labor in the mechanics' lien because it did not actually perform the work of the subcontractors."

Missouri courts construe mechanics' lien statutes "as favorably to the materialman as its terms permit." The statutory construction proposed by the Preckels in this case "would deny contractors security for the labor and materials they furnish in improving the property, and it would defeat the purpose of the statute." Instead, the court held that the proper construction is that Kelpe "performed work on the property by furnishing labor through subcontractors," and that any other construction of the statute would deny contractors security for such labor. Accordingly, the court rejected the Preckels' argument and held that "lien claimants may include the work performed by subcontractors in their mechanics' lien."

Comment: 1 As this is an issue of first impression in Missouri, which has a long established mechanic's lien law, the editor suspects that it may come up later elsewhere, and therefore, although an interpretation of local law, it is useful for the national audience.

Comment 2: On the substantive point, so long as the statutory language supports this interpretation, it appears to be a correct one. From the owner's standpoint, what difference does it make whether the subcontractor used employees or another level of subcontractors? The only question might be whether these "second tiers" subcontractors have been fully paid. Otherwise, the owner might get double thunked.

MORTGAGES; ASSIGNMENTS OF RENTS; FORECLOSURE PURCHASERS: Purchaser of property at a foreclosure sale must disgorge to prior mortgagee rental income generated by the property, even though there is no privity of contract between the purchaser and such prior lender. ***Higdon v. Regions Bank, ___ S.W.3d ___ , 2010 Westlaw 1924019 (Tenn. Ct. App. 5/13/10).*** (Another aspect of this case was the subject of yesterday's DD)

Stinnetts refinanced an existing deed of trust loan on their Property with a loan obtained from ORNL. On September 9, 1999, Weather Tamer advanced additional money to the Stinnetts, secured by a deed of trust that subsequently was assigned to KeyBank USA, N.A. Finally, on September 20, 1999, the Stinnetts obtained another loan from ENM, Inc. Such loan was secured by a third deed of trust which was subsequently assigned to Regions Bank ("Regions").

While the Regions deed of trust was executed after the KeyBank deed of trust, Regions recorded its deed of trust prior to KeyBank, thereby making the Regions lien prior to the KeyBank lien.

The Regions deed of trust included a mortgage acceleration clause that could be executed upon the borrower's breach of the terms of the applicable loan agreement. It also contained standard assignment of rents language providing that "Borrower . . . assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration [of the deed of trust] . . . or abandonment of the Property, have the right to collect and retain such rents as they become due and payable."

Later Key Bank foreclosed and Higdon purchased. Higdon made no effort before purchasing to discover the Regions claim (which remained unaffected by the KeyBank foreclosure). Later a court awarded Regions the principal owned on the loan and amounts Regions had paid on a prior lien it had paid, and also required that Higdon disgorge rents he had received on the property following his acquisition that related to the period prior to the KeyBank foreclosure.

Higdon argued on appeal that he was not liable for rent payments made to him because of his absence of contractual privity with Regions. (The court does not tell us whether the rent payments were for periods before or after the foreclosure. Apparently the court, correctly, saw no distinction for purposes of its analysis.)

The court noted that "it was Mr. Higdon's responsibility to inquire about the status of any mortgage liens or encumbrances with respect to the Property prior to purchasing it at a foreclosure auction." Because the Regions deed of trust contained an express assignment of rents "which it enforced in good faith following proper notice and the mortgagor's subsequent failure to cure the default" and because "the Property purchased by Mr. Higdon at the foreclosure sale is subject to [Regions'] security interest in the hand of any subsequent purchaser," the lack of contractual privity between Higdon and Regions was irrelevant and the trial court's judgment was affirmed..

Comment 1: Because of the wording of the assignment of rents clause, the court appeared to view the mortgagee's right to rents to arise immediately upon notice of acceleration. The lender had sent Higdon notice of acceleration. There is no indication that it sent a separate notice of activation of its security interest in the rents. Most modern cases, and the Restatement, view it necessary for a mortgagee to "activate" its rents interest before it has a right to claim the rents, even if the lender has accelerated and notwithstanding "automatic" language such as that which appears in the mortgage here. The Tennessee court did not discuss the fact that its upholding of an automatic activation went beyond most other jurisdictions, perhaps because Higdon was resisting the mortgagee's claim on another ground and the court simply didn't focus on the issue.

Comment 2: Other courts are reluctant to enforce boiler plate "automatic activation" clauses because the parties often act without regard to them, causing great confusion later. The wording is an accidental byproduct of a bankruptcy problem since corrected.

MORTGAGES; CONSTRUCTION LOANS; PRELIMINARY INJUNCTION TO LEND: The borrower under a construction mortgage loan structured as an advancing term loan may obtain a preliminary injunction requiring the lender to fund draw requests. ***Destiny USA Holdings, LLC v. Citigroup Global Mkts. Realty Corp., 889 N.Y.S.2d 793 (N.Y. App. Div. 2009)***.

In 2005, defendant lender (the "Lender") agreed to provide financing to plaintiff borrower (the "Borrower") in connection with its construction of a shopping center using a novel financing structure for green economic development. The total loan commitment from this lender was $155 million, which was only part of the overall construction cost. Pursuant to the financing agreement, the Lender was permitted to deny a draw request by Borrower if a "Deficiency" existed. In 2009, the Lender sent the Borrower a Deficiency notice alleging that the Borrower was Deficient and declared the Borrower in default after the cure period had passed and the Borrower failed to cure the Deficiency. At this time, the project was 90% complete and the parties were facing the hardest edge of the recent financing crisis – there was very little money available to borrow at any price.

The claimed deficiency was Borrower's failure to fund Tenant Improvements as part of the Construction Fund. The total amount of such improvements was about $15 million. The Borrower brought a claim against the Lender for the methods it used to calculate such Deficiency and also sought a preliminary injunction ordering the Lender to fund the unpaid draw requests.

The Appellate Division affirmed the lower court's grant of a preliminary injunction, holding that the applicable three-prong test was met: (i) interpretation of the definition of Deficiency is a matter for the court's consideration, (ii) irreparable injury would occur if provisional relief was withheld, and (iii) a balance of the equities necessitated relief because the burden to the Borrower of not imposing an injunction would be greater than the burden to the Lender of imposing the injunction.

First, and most significantly, the Appellate Division affirmed the federal district court's holding that cases of construction mortgages are an exception to the general rule that irreparable injury cannot be established where monetary damages are calculable. A construction mortgage is “not a simple contract to lend money. It is an integral part of a contract to sell [or develop] real property.”

The Appellate Division further held that the unprecedented nature of the project, focusing on sustainable design and renewable energy, made it sufficiently unique that no established market existed and damages could not be easily calculated. Finally, the Appellate Division recognized that the enormous potential harm to the Borrower’s reputation for failure to complete the project validated the injunction.

Significantly, however, the Appellate Division reversed the lower court’s decision not to require a bond, and ordered that borrower put up a bond of $15 million pending resolution of whether it in fact was required to fund the Tenant Improvements.

Comment 1: Any decision ordering a lender to actually lend money, rather than simply pay money for refusing to loan, is a standout case. It is further significant that this decision carves out construction loans for special consideration, thus strengthening the position of construction borrowers in future cases. On the other hand, the court took judicial notice of the financial crisis, and this was taken into account in assessing borrower’s predicament.

Comment 2: It is not clear whether the $155 million figure was for all phases, or only Phase One, which was the only construction in dispute. Even if we are talking only about Phase One, if the project was 90% complete, it would appear that the missing loan disbursements amounted only to about $15 million dollars or so (at most). If borrower is required to post a $15 million bond to force the disbursements to be made, has it really gained much?

Comment 3: Perhaps timing explains the issues discussed in Comment 2 above. At the present time, everything having been delayed during the appeal, it may be possible for the borrower to obtain the balance of the funds. The financial crisis had eased. And the question of whether an injunction was warranted at time of first hearing may be little more than academic.

Comment 4: This was a 3-2 decision of a five judge panel. What’s it really worth except for the language?

MORTGAGES; FORECLOSURE; FUTURE ADVANCES; PROTECTION OF SECURITY: A lender who forecloses on a deed of trust is secured not only as to the amount of debt secured by its original deed of trust, but also for amounts advanced by such lender to pay off debts secured by a prior deed of trust, notwithstanding the existence of a recording tax requirement.. ***Higdon v. Regions Bank, ___ S.W.3d ___ (Tenn. Ct. App. 2010).*** (Another aspect of this case will be the subject of tomorrow’s DD)

Stinnetts financed their purchase of the Property it through a secured loan from Bank, which recorded a deed of trust against the Property. In April 1998, the Stinnetts refinanced the Property with a loan obtained from ORNL, and the Bank deed of trust was released. On September 9, 1999, Weather Tamer advanced additional money to the Stinnetts, secured by a deed of trust which was subsequently assigned to KeyBank USA, N.A. Finally, on September 20, 1999, the Stinnetts obtained another loan from ENM, Inc. Such loan was secured by a third deed of trust which was subsequently assigned to Regions Bank (“Regions”).

While the Regions deed of trust was executed after the KeyBank deed of trust, Regions recorded its deed of trust prior to KeyBank, thereby making the Regions lien prior to the KeyBank lien.

In August 2001, Regions satisfied the debt secured by the ORNL deed of trust in order to stop an impending foreclosure sale. The Stinnetts filed a Chapter 13 bankruptcy petition in 2001, and the Property was subsequently sold to Jon Higdon at a foreclosure auction conducted on behalf of KeyBank on November 8, 2007. Prior to purchasing the Property, Higdon did not contact the Stinnetts or Regions Bank to ascertain the payoff amount of the Regions loan. After Higdon took title to the Property, Regions notified Higdon’s attorney that Higdon’s failure to resolve the deed of trust default would result in the acceleration of the mortgage debt. The default was not cured and Regions accelerated the deed of trust on April 6, 2008.

Higdon filed a complaint requesting an injunction against Regions prohibiting it from completing the foreclosure sale until the amount secured by the Regions deed of trust was judicially determined, which the court issued. In Regions’ answer, it asserted a security interest in the rents generated by the Property and claimed its deed of trust secured not only its original debt (plus interest and costs), but also the amount Regions advanced for the payoff of the ORNL debt. The trial court found that the amount secured by the Regions deed of trust included the amount advanced to ORNL. Higdon appealed to Tennessee Court of Appeals.

On appeal, Higdon argued that Regions' claim was limited to the indebtedness amount on which it paid recordation tax, and that he was not liable for rent payments made to him because of his absence of contractual privity with Regions. Therefore, the issues addressed by the court were (1) whether Regions was secured for the amount of its original debt plus the amount of indebtedness paid by Regions to release the ORNL deed of trust, and (2) whether Higdon was liable to Regions for payment of rent pursuant to the Regions deed of trust, despite the fact that Higdon was not a party to such instrument.

Regarding the amount of the debt secured by the Regions deed of trust, the court noted that Higdon's primary argument relied on precedent established prior to the Tennessee legislation's amendments of the statutes requiring the payment of mortgage registration tax. Prior to such amendments in 1987, Tennessee courts had held that "any indebtedness beyond the amount for which mortgage recording tax was paid constituted a nullity." Therefore, prior to 1987, lenders' security would be limited to the amount of principal indebtedness recorded in their deed of trust, and any protective advances made by a lender would not "relate back to the time of the original loan as to give it priority." However, subsequent to the 1987 amendments, the statutes provided in part that "[n]onpayment or underpayment of tax on an indebtedness . . . shall not affect or impair the effectiveness, validity, priority, or enforceability of the security interest or lien created or evidenced by the instrument, it being declared the legislative intent that the effectiveness, validity, priority, and enforceability of security interests and liens are governed solely by law applicable to security interests and liens."

The legislative amendments, coupled with the fact that the Regions deed of trust included a future advances clause providing that the deed of trust would also secure "the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Deed of Trust," resulted in the court holding that Regions' payment of the ORNL deed of trust to prevent a foreclosure sale "was secured by the future advances clause in [Regions'] original Deed of Trust" and the trial court "did not err in holding that [Regions] was secured for the amount of its original debt in addition to the amount of indebtedness paid by Regions Bank to release a prior deed of trust."

Comment: Note that the Regions apparently paid off the ORNL subsequent to the creation of the lien under which Mr. Higdon purchased. Undoubtedly, by the time Regions made such payment, it was aware of the KeyBank mortgage. Why wasn't this payoff deemed an "optional advance" and therefore in junior priority to Mr. Higdon? Tennessee apparently has abandoned the "optional/obligatory" test by statute and now permits future advance clauses to enjoy the priority of the date of their creation and recording regardless of the fact that they might constitute "optional advances." This approach, generally, is also that taken by the new Restatement of Mortgages.

MORTGAGES; FORECLOSURE; ARBITRATION; WAIVER:. A mortgagor may waive its right to compel arbitration if it acts inconsistently with the intention to arbitrate in the litigation of the foreclosure. ***LZG Realty, LLC v. H.D.W. 2005 Forest, LLC 896 N.Y.S.2d 389 (N.Y. App. Div. 2010)***.

Mortgagees brought a foreclosure action A year and a half later, while the action was still pending, Mortgagor asserted the right to arbitrate the debt claim under a provision in the loan agreement. The Mortgager had failed to assert his right to arbitrate in his answer to the action. The trial court held that the Mortgagor had waived his right to arbitration.

The appellate court affirmed, finding that the Mortgagor acted inconsistently with the intention to arbitrate as (i) Mortgagor used litigation tools such as extensive discovery, (ii) Mortgagor waited until over one year after the action aroused to assert his arbitration right, and (iii) the Mortgagor's only reason for not asserting his arbitration right earlier was that he lacked a copy of the contract and had forgotten that he had the right to arbitrate.

Comment: Once again, the principle is interesting, but the court's analysis of the equitable basis for waiver is somewhat special – as the alleged waiver was non-volitional. Perhaps an estoppel claim would be more appropriate – if the court could show that the mortgagee was injured by the delay.

Is the waiver based upon sheer laziness of the mortgagor (and its counsel) by failing to read the loan agreement for a year after the filing of foreclosure?

MORTGAGES; FORECLOSURE; STANDING: Neither MERS assignment of the note (along with the mortgage) nor alleged mortgagee's affidavit that the note was assigned to it, together with a copy of the note, are sufficient, as against challenge to establish that Mortgagee has standing in bankruptcy to obtain relief from automatic stay on foreclosure. ***In re Box 2010 Westlaw 2228289 (Bkrtcy W. D. Mo. 6/20/10)***, discussed under the heading: "Bankruptcy; Relief from Stay; Standing,"

MORTGAGES; FORECLOSURE; STANDING: Although state law requires that the foreclosure defendant raise the issue of standing at the beginning of a case, where foreclosure defendant does not appear and files no response, court may raise standing issue independently and will dismiss if it determines that filed papers do not support verified complaint stating that plaintiff is owner of the note and mortgage. ***Deutsche Bank National Trust Co. v. McRae, 2010 Westlaw 309105 (N.J. Sup. 1/25/10)***

This case likely is a product of the current turmoil, well known to the New York courts, concerning whether mortgagees seeking to foreclose in fact have control over the debt. New York law apparently that the mortgagee of a "high cost home loan, or the mortgagee's agent, demonstrate when filing for foreclosure that it "is the owner and holder of the mortgage and note."

> "1. Any complaint served in a proceeding initiated pursuant to this article relating to a high-cost home loan or a subprime home loan, as such terms are defined in section six-l and six-m of the banking law, respectively, must contain an affirmative allegation that at the time the proceeding is commenced, the plaintiff:
>
> (a) is the owner and holder of the subject mortgage and note, or has been delegated the authority to institute a mortgage foreclosure action by the owner and holder of the subject mortgage and note; and
>
> (b) has complied with all of the provisions of section five hundred ninety-five-a of the banking law and any rules and regulations promulgated thereunder, section six-l or six-m of the banking law, and section thirteen hundred four of this article.
>
> 2. It shall be a defense to an action to foreclose a mortgage for a high-cost home loan or subprime home loan that the terms of the home loan or the actions of the lender violate any provision of section six-l or six-m of the banking law or section thirteen hundred four of this article."

It is not clear whether possession of the debt might be deemed the possession of the rights under the mortgage. The editor would venture the conclusion "probably not." but that issue is moot in this case, because the question raised by the court on its own motion was whether the mortgagee in fact held the note at the time of filing for foreclosure. There was a written assignment of the mortgaage.

As indicated the mortgagee filed a verified complaint stating that is was the owner of the note and mortgage, but the attorney's verified the complaint on the basis of "information and belief." It attached a xerox copy of the note, made out to original lender, was attached to the complaint filing. The court commented that this clearly does not satisfy the statutory standards for ownership of the note

The judge first determined that the mortgagee had not met New York's new statutory procedure mandating a kind of mediation period prior to final foreclosure, and also that it had not demonstrated to the court's satisfaction that it owned the note and mortgage. In this opinion, the court does not give the basis for that original opinion.

Later, after meeting the requirement concerning mediation, the mortgagee sought to reargue the question as to whether it was the holder of the note. This time it attached a copy of the note that contained an endorsement of the note from the original mortgagee to an apparent related party to the original mortgagee and then an endorsement in blank, executed by the original mortgagee. Both were undated. The judge did not indicate whether these endorsements were on the note body itself or in allonges attached to the note.

Although there was authority, and the statute suggested, that issues of possession of the note are to be raised defensively at the first hearing, the judge determined that, in the absence of the mortgagor or its counsel at that hearing, the court should represent the interest of the mortgagor and make a ruling on standing where appropriate.

> "Today, with multiple and (and often unrecorded) assignments of mortgage obligations and multiple securitizations often related to the same debt, the courts should carefully scrutinize the status of parties who claim the right to enforce these mortgage obligations. For the unrepresented homeowner, the issues of standing and real party in interest status of the foreclosing party are never considered. Without such scrutiny, there is a risk that the courts will give the judicial "seal of approval" to foreclosures against unrepresented homeowners who have little, if any, understanding of these issues, much less the legal significance thereof. To quote my colleague in Kings County, "[a]llowing this case to proceed on behalf of a plaintiff without standing at the commencement of the action would [also] open the door to potential fraud and place in jeopardy the integrity of title to the property to be foreclosed."

Comment: This case could have been avoided easily if the parties responsible for the foreclosure had arranged their ducks in a row prior to filing. They clearly had an assignment of the mortgage and control over the note. But the editor agrees that the circumstances suggest that the formal endorsements of the note did not occur until after the mortgage was first filed. And it might have been difficult for the mortgagee to demonstrate that the original note was actually in possession of the foreclosing party, unendorsed, prior to the filing.

There is a lot of fuss and feathers about the propriety of behavior of mortgage foreclosure lawyers. It seems likely that, in the past, they routinely fudged the rules because, after all the debt was not paid and the mortgagor was not contesting.

MORTGAGES; FORECLOSURE; STANDING; MERS: Noteworthy bankruptcy decision clarifies the rules about foreclosure of MERS related mortgages. It's all about the note. ***In re Tucker, Case No. 10-61004 (W.D. Bkrtcy 9/20/10)*** discussed under the heading: " Bankruptcy; Automatic Stay; Relief from Stay; MERS."

MORTGAGES; GUARANTEES; "BAD BOY" CLAUSE: N.Y. court construes springing guarantee narrowly in favor of guarantors, saving them $60 million deficiency. Court further suggests that not all events that literally would trigger a "bad boy" clause will do so – it depends upon expectations of the parties. ***ING Real Estate Finance (USA) LLC v. Park Avenue Hotel Acquisition LLC, 2010 Westlaw 653972 (2/24/10) (Unpublished)***

This unreported New York case is important because, in the context of a major financing with professionally negotiated and prepared documents, a court will not give the lender the benefit of a springing guarantee as an exception to the non-recourse nature of the original debt where the events triggering the guarantee are of little consequence, short duration, and do not injure the interest of the guarantor.

The main part of the case, however, focused on an interpretation of the interaction between the "cure" provisions of the loan agreement and the "bad boy" clause. The "bad boy" clause listed a large number of events that might trigger recourse liability, among them the incurring of any additional debt or a lien obtaining priority over the secured lien. A separate default clause, which also prohibited additional debt and liens obtaining priority, provided a cure opportunity – in this case 30 days.

Following default on the $145 million mortgage, the borrowers also failed to make a tax payment in the amount of $279,000. Lenders promptly pointed to this event as a trigger for recourse liability under the "bad boy" clause. But the borrowers paid the taxes, with accrued interest, in less than 30 days. Lenders claimed that this didn't matter, since the "bad boy" clause provided for no cure.

The court held that it was necessary to reconcile the default clause, which permitted cure, with the "bad boy" clause, which didn't. It stated that under New York law "the terms of a guaranty are to be strictly construed in favor of a private guarantor." The court concluded that necessarily the cure periods provided elsewhere in the agreement controlled whether the events to which they applied could be used as a trigger for the "bad boy" clause. Thus, since the tax defalut had been cured within 30 days, and the senior lien thereby removed within 45 days, there could be no claim of recourse liability.

The court also noted that New York will not attempt to collect on a tax lien for at least a year, so lender's position was in scant jeapordy.

This was the holding – but additional language in the opinion is also worthy of considerable note – even though it represents only the view of one judge. This is because it follows the New Jersey appeals court decision in CSFB 2001-CP-4 Princeton Park Corporate Center, LLC v. SB Rental I, LLC, A-6307-07T2, 2009 WL 2431530. (N.J. Super. App. Div. 2009); August 11, 2009, which delighted lenders when it held that a relatively inoffensive event two years before default nevertheless triggered the bad boy clause in that loan – following the language of the documents exactly and finding no forfeiture or penalty problems.

Here, the closing language of the New York court expresses a quite different view:

> "Finally, "[a] commercial agreement, of course, should not be interpreted in a commercially unreasonable manner or contrary to the reasonable expectations of the parties" . . . . Immediate liability for the entire debt is not a reasonable measure of any probable loss associated with the delinquent payment of a relatively small amount of taxes. Here, pursuant to [the bad boy clause], plaintiffs would have moving defendants potentially liable for the entire debt of up to $145 million if the Borrower is just one day delinquent in paying a dollar in property taxes or any other debt for which a lien may be imposed. Such an unlikely outcome could not have been intended by the parties, sophisticated commercial borrowers and lenders aided by competent counsel at the time of the drafting, and is impermissible under New York law]. . . ["The rule is now well established. A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced."] [citations omitted].

Comment 1: The editor believes that the fundamental objective of "bad boy" clauses is to enforce behavior rather than to insure that the lender is fully paid. As a consequence, the editor believes that as against the mortgagor, "bad boy" language acts as a penalty for default and should be evaluated by liquidated damages analysis.

Comment 2: The problem is more acute when it comes to guarantors. Such parties may or may not have any control over the behavior of the borrower leading to behavior subject to a "bad boy" clause, and thus, the clause may have no impact on protecting the lender from the prohibited acts. Still, the guarantor gets stung with a potentially huge liability. The editor has believed that courts in general are not particularly sympathetic to guarantors, and so he'd pretty much concluded that the invocation of "bad boy" liability was just viewed by the courts as a gamble that was lost. But the court's far more protective language here may give guarantors some hope based upon close reading of the documents with the intent of the parties in mind, even though the editor still has a hard time seeing a penalty in the case of guarantors.

MORTGAGES; PRIORITY; LOST MORTGAGE AFFIDAVIT: While an Affidavit of Lost Mortgage provides notice that a mortgage was executed and that it has been lost, such an Affidavit is not an "instrument affecting title" and cannot be substituted in place of the mortgage it describes. ***Wetzel v. Mortgage Electronic Registration Systems, Inc., ___ S.W.3d ___ (Ark. 2010).***

In 2005, Pirlee Fox executed a mortgage (the "Mortgage") which was subsequently placed into a pool of mortgages. Mortgage Electronic Registration Systems, Inc. ("MERS"), acting as nominee for NovaStar Mortgage, Inc., failed to record the mortgage with the applicable Arkansas county. However, on April 30, 2007, MERS filed an "Affidavit of Lost Mortgage" with a copy of the Mortgage attached as an exhibit. The Affidavit sufficiently described the Mortgage and the property securing the Mortgage (the "Property"), acknowledged the lack of proper recording thereof, and asserted NovaStar's interest in the Property.

Subsequently, Fox filed a Chapter 7 bankruptcy, scheduling two parcels of real property in which she had an interest, including the Property. With respect to the Property, Fox indicated her intention to surrender her interest to the bankruptcy estate, which she listed as $75,000. Prior to the meeting of creditors, MERS filed a motion for relief from the automatic stay, asserting that it had a perfected lien of $70,000 against the property based on the Mortgage.

After MERS withdrew its motion for relief from stay, the bankruptcy trustee (the "Trustee") filed an adversary proceeding, seeking to avoid the lien held by MERS on the basis that MERS' lien was unperfected since the Mortgage was never recorded. Specifically, the Trustee asserted that MERS' filing of the Affidavit, with a copy of the Mortgage attached, did not constitute constructive notice of a lien on the Property, and as a bona fide purchaser under 11 U.S.C. § 544(a), the Trustee could avoid the unrecorded lien. Despite the fact that nothing in the Arkansas recording statutes specifically allowed for the filing of an affidavit of lost mortgage, MERS responded that the recorded Affidavit "was properly drafted, acknowledged [by the lender], and recorded, and, thus, became part of the mortgage chain of title thereby giving constructive notice of its lien on [the Property]." The issue of whether MERS properly perfected its lien was certified by the Arkansas Bankruptcy Court to the Supreme Court of Arkansas.

The court began its analysis by noting that Arkansas is a recording state. As such, "an instrument in writing that affects real property shall not be valid against a subsequent purchaser unless it is filed of record in the county where the real estate is located." The governing statutory provision provides that it shall be the county recorder's duty to record "all deeds, mortgages . . ., affidavits . . ., or other instruments of writing . . . that are authorized to be recorded in his or her office." While acknowledging that affidavits are specifically listed in the recording statute, the Trustee argued that such instruments' inclusion in the statute was for the purpose of allowing perfection of materialman's liens, and that an affidavit stating a mortgage is lost "is not an instrument conveying title such that it provides constructive notice under [Arkansas law]." In response, MERS argued that not only are affidavits specifically set forth in the statute, but that "other instruments of writing affecting title to the property" would pick up affidavits of lost mortgages.

The court noted that while an affidavit of lost mortgage is an instrument of writing, "[t]he purpose of the affidavit in this case was to give notice that there was a mortgage executed and that it was lost. It in no way affected the title of the property at issue in the bankruptcy proceeding." Moreover, the court pointed out that any instrument affecting real estate must be acknowledged before it shall be admitted to record, and there is no acknowledgment requirement for such affidavits (nor was the subject affidavit actually acknowledged by the grantor in the subject case). Accordingly, the court held that the Affidavit was not an instrument affecting title and was not entitled to recordation, and therefore did not constitute constructive notice sufficient to defeat the claim of a bona fide purchaser.

Comment 1: It is necessary to file an action to prove the lost mortgage in order to get into the record? Perhaps this would hold mortgagee's feet to the fire. But it is the editor's impression that lost mortgage statutes are common and don't necessarily require a lawsuit. If the statute isn't clear about the constructive notice given by the filing of the lost mortgage claim, however, then the process is useless. See you in court.

Comment 2: It is interesting whether, in the present climate, mortgagees in Kentucky will be able to get a legislative fix of this problem. Or is it much of a problem outside of the securitization mess?

Comment 3: The editor does not necessarily advocate that all sorts of affidavits and claims be given constructive notice authority. It seems that a lost mortgage affidavit is of particular concern.

MORTGAGES; STRUCTURED FINANCE; MEZZANINE LOANS; New York court provides broad interpretation of "default cure" in structured finance intercreditor agreement. Mezzanine lender takes loss. ***Bank of America v. PSN, Index No. 651293/10, (N.Y. Sup. Ct. 9/15/10)***

New York State Supreme Court Justice Lowe (a trial judge in the New York system) ruled that investors who had acquired a piece of a a mezzanine lender could not foreclose on its mezzanine lien and take Stuyvesant Town/Peter Cooper Village (Stuyvesant Town) from its current owner and a foreclosing mortgage lender without paying the accelerated senior loan on the property of $3+ billion. The ruling, if upheld and followed, will add considerably to the power of senior commercial real estate (CRE) mortgage lenders versus subordinate "mezzanine" lenders where assets have decreased massively in value.

When the deal was formed in 2007, a consortium of investors bought Stuyvesant Town, a, 11,200-unit Manhattan residential development, for $5.4 billion. This "top of the market" price was the highest price ever paid for contiguous U.S. realty. Buyers financed the purchase with a $3 billion securitized first-mortgage loan and a $1.4 billion mezzanine loan secured by the ownership interest in the owner. The project is now said to be worth less than $2 billion. The owner defaulted on the senior mortgage and mortgagee accelerated the loan later that month.

Investors ("Pershing") unexpectedly responded to the acceleration and scheduled foreclosure by buying the top $300 million slice of the mezzanine loan for just $45 million. They then scheduled their own Uniform Commercial Code (UCC) foreclosure sale of the equity collateral. Pershing intended to buy at the UCC foreclosure sale and informed the press that they planned to put Stuyvesant Town into bankruptcy prior to the scheduled mortgage foreclosure auction.

Prior to the UCC sale, the servicer for the first mortgagee sued to stop the Pershing auction. There was an inter-creditor agreement binding the mezzanine lender which stated, in what has been described as "industry-standard" language, that the mezzanine lender must cure all defaults before acquiring the property. ,Senior lender argued that this meant that the mezzanine lender must cure the $3.7 billion accelerated claim on the senior debt. Pershing argued that the clause applied only to amounts owed before senior loan acceleration,

The trial court agreed with CW the senior lender, concluding that the intercreditor agreement language was "unambiguous" and that "its plain language" required Pershing to pay the $3.7 billion due on the accelerated loan before it acquires the ownership of the equity collateral. Pershing and Winthrop have already appealed the decision.

Comment: In the past, parties involved in arguments over these intercreditor agreements rarely thought it appropriate to bring them to court. The huge differences in value at stake and the leverage enjoyed by the party controlling a bankruptcy may lead to further litigation of this and other issue. But this case certainly will be a powerful bargaining chip in favor of senior lenders, assuming that it is upheld if appealed.

There always has been some question on Wall Street of the position of the mezzanine lender. Nonetheless, significant mezzanine loans exist in many deals and often have been successfully resold, as was the case here. The heat's now up in the kitchen. Let's see how the mezzanine lenders can really protect their position. It's unlikely that they'll have to step up to these massive senior loans. But they may have to bargain for a discounted purchase of such loans. Whether these purchases will include claims against any guarantors will also be interesting.

MORTGAGES; SUBROGATION; "DERIVATIVE EQUITABLE SUBROGATION:" Colorado court requires that candidate for subrogation have been unaware ot prior intervening lien; further holds that subrogated status cannot normally be transferred to another that has knowledge of the intervening lien. ***Joohdeph v. Hicks, 235 P.3d 303 (Colo. 2010)***

Hicks recorded a valid $468,000 judgment lien against property owned by Grubbs. At the time the lien attached there were three deeds of trust against the property, with the first position held by a WaMu deed of trust. . Thereafter, Grubbs sold the property to Londres. Londres obtained a deed of trust loan from Chase, and they and Chase paid the Wamu deed of trust loan and obtained releases of the other two, leaving Chase, they thought, as a first lien lender and the Londres free of any other liens. In fact, however, their title search had not identified the Hicks lien, and it remained unpaid and still valid.

Hicks attempted to foreclose his judgment lien and Londres took the position that they and Chase should be subrogated to the first priority position of WaMu. Londres and Chase prevailed in an earlier decision affirmed by the Colorado Supreme court, and Hicks was in junior position due to equitable subrogation. .

But Londres then sold the property to Joohdeph. Joohdeph, of course, had actual knowledge of the ongoing dispute over Hicks priority and in fact got a title endorsement indemnifying Joodeph of any liability on the Hicks lien. But the title company, of course, had an interest in financing a contest between Joodeph (and Joodeph's lender) and Hicks, which was kicked off by a declaratory judgment action by Hicks.

On final appeal, the Colorado Supreme court ruled that Hicks did enjoy first lien priority. Unlike their predecessors, the court commented, Joodeph and its lender knew about Hicks' lien when they took their interest, and had no basis for equitable subrogation in Colorado, which apparently requires lack of actual notice of a claimed intervening lien in order to permit subrogation to a paid off senior lien. Londres and their lender were innocent of any knowledge of Hicks, but Joodeph and its lender knew full well about Hicks claim.

Joodeph then argued that it was entitled to "derivative equitable subrogation," since it and its lender entered into the deal expecting that the priority position of Londre and its lender would be conveyed to them. The Colorado court acknowledged that there was recent Third Ciruit authority (applying New Jersey law) that recognized such a concept, but that no Colorado court had ever accepted it.

Joodeph and its lender could not succeed to the rights established by Londres subrogated position. They (and their title insurer) must deal with Hicks as a first lienholder.

Comment 1: This opinion clearly rejects the view of the Restatement of Mortgages, which would allow subrogation quite broadly, even when the subrogated party has knowledge of the prior claim at the time it pays off a higher priority lien. A number of cases have followed the Restatement down this path, but definitely not all, and clearly not Colorado.

The Restatement, to the editor's memory, does not mention "derivative" claims, but presumably it would permit them, since it recognized priority simply on the basis of paying off the prior senior debt, whether or not there is knowledge of the intervening claim. If that is a rule, why shouldn't successors have the same position? Any other rule would deprive the transferor subrogated party of the benefits of its subrogation. It must deal with the intervening lien upon resale.

Comment 2: The case is also careful to outline its view of the subrogation process. The party enjoying subrogation does not get its own lien, but rather stands in the shows of the prior lien that it paid off. The case apparently intends that this applies to contractual provisions of the prior lien. The editor, in fact, had held the same view, but Nelson and Whitman take a very different view in their treatise and casebook, stating that the party enjoying subrogation gets its own loan agreement with the priority of the prior loan that it paid.

MUNICIPAL LAW; GIFT OF PUBLIC FUNDS : Arizona court finds that benefits of anticipated future taxes cannot be taken into account in computing the value of benefits the municipality receives in exchange for money or other benefits conferred upon developer. ***Turken v. Gordon, 223 Ariz. 342, 224 P.23d 158 (Ariz. 2010)***

Developer proposed a huge commercial/retail development in Phoenix, which was very afraid that significant retail tenants would migrate to Scottsdale if they did not find a comfortable home in a nicely developed space in Phoenix. Thus, the city agreed to rebate to developer one half of a variety of business and sale taxes that would be generated at the development for a period of eleven and a half years. This amount was capped at the figure os $97.4 million, and the court used this cap figure frequently in discussing the benefit that the city was giving to the developer.

In exchange, the developer agreed to construct a parking facility with over 3000 spaces, of which 2980 parking spaces were to be reserved for use the retail development for 45 years. Two hundred spaces were to be used to facilitate park and ride for the city. The developer also agreed to build 1.02 million square feet of retail space.

In a taxpayer's lawsuit, plaintiffs alleged that the deal constituted a gift of public funds in violation of the Arizona Constitution because the City was not getting back $97.4 million in public benefits from the developer's activities. Instead the primary function o the arrangement was to provide a benefit to a private party.

The alleged "gift" of course was the rebate of tax monies, which should be used only for public purposes. In response to the argument that the development of the new Center was itself a public benefit, the court admitted that the development would provide other public benefits – denser development, decreased pollution, and the plaintiff argued that under Arizona precedent, anticipated tax revenues that applied generally to all taxpayers could not be viewed as a special benefit conferred on the city. But it concluded that the benefits of this project were primarily private, and not public in character. It apparently did not try to quantify the public benefits here or credit them in its equation of determining public benefit.

This left the parking garage, in which the City was getting 200 spaces and arguably the right for the public to use the other spaces, although limited to servicing the retail operations of the developer for 45 years. The court stated that if the value of this benefit, allowing some deference to the public agency's judgment, was $97.4 million, then there was no gift of public funds. If the $97.4 million was substantially greater in value than the amount that the city was receiving, then the city was paying to much and there was a prohibited gift.

But, speaking of gifts, the court concluded that the court's position on the "gift clause" had been somewhat misunderstood in the past (though it refused to take much blame for this) and noted that many other public agencies had not distinguished between benefits that had some public value but were primarily private and benefits that were primarily public in nature. To rule retroactively in this case might put many completed public projects in jeopardy of a constitutional challenge. Therefore, the court concluded that it would make its ruling prospective only.

Comment 1: Many states have "gifts of public funds" prohibitions in their constitutions – dating back to the bad old days when cities and counties lavished bonuses on railroad companies in exchange for promises for routings through their areas. Many such promises were not kept. But the money was gone. Even when they were kept, the local budgets were bankrupted by the lavish payments that were made.

Comment 2: Prior to *Kelo,* there didn't seem to be much life in the jurisprudence over these cases, although there had been some activity, notably in Mississippi. Will this holding stoke the first in other jurisdictions as well?

Comment 3: What is the relationship between this case and the popular development tool of tax increment financing? First, as the court confessed here, if the area to be developed was already "blighted," then perhaps there would be public benefit in redeveloping that area sufficient to support investment of public funds. Such is frequently the case in tax increment deals.

Where, as here, the city did not or could not make out a case that the land where this project was going was "blighted," simply subsidizing a tax and job generating development project will not be enough to support the public component. And increased taxes also cannot be taken into account. Thus, the tax increment bond proceeds must be used to provide primarily public facilities – such as roads, sewers, and *parking facilities that are not dedicated to a retail developer.* Perhaps land clearance of the "blight" might also be permitted. In the editor's experience there is sometime ambiguity on the question of whether parking facilities are indeed public. This case will sharpen the focus on that issue. the foreclosure proceeding. No more fudging. But why haven't they heard this message already?

OPTIONS; RIGHTS OF FIRST REFUSAL; RULE AGAINST PERPETUITIES: A right of first refusal purporting to benefit heirs and successors and assigns of optionee and optionor is void due to the Rule Against Perpetuities. ***Hensley-O]Neal v. Metropolitan Nat. Bank, 297 S.W. 3d 610 (Mo. App. S.D. 2009)***

Once again, the RAP proves a trap for the unwary in a "quasi commercial" transaction. The optionee and optionor in the original agreement had the same last name, but the court gives no other information about their relationship. Four years after executing and recording the refusal right the optionor mortgaged the property, and two years later there was a private foreclosure through a trustee.. The Lender bid in what apparently was the whole debt, and thereafter the Trustee tendered the property to the holder of the first refusal right at the same price. She counteroffered a much lower number, which was refused.

Two years after that, the bank sold the property for a price close to its foreclosure bid, and the holder of the first refusal right demanded to exercise her right. The Bank, of course, took the position that she'd had one bite of the apple. We are not told why the holder of the refusal right felt otherwise. (Foreclosure sales have been held to trigger a right of refusal in other cases.)

When litigation commenced, however, the bank's lawyers found an easy way to finesse any argument about the continued existence of the right. They noted that, since the right was stated to continue to bind successors, heirs and assigns into the future, it could be exercised by its terms beyond the period of a life in being plus 21 years and thus was void from the outset.

Court said: "That's right." Missouri has the common law RAP with some statutory adjustment for trusts with a power of sale, but the Rule clearly applies to commercial transactions.

Comment 1: The objectives of the parties in this case likely could easily have been realized through use of a "perpetuities savings clause," but it is likely that the lawyers involved didn't even understand the Rule, much less the clause. One wonders whether, if they held themselves out as competent to write up this deal, they should be viewed as liable for malpractice. What about their first year Property professor? (Since this case is out of Springfield – it might have been me.)

Comment 2: Many other states have statutes that limit the application of the Rule to family wealth transactions and eliminate its coverage for regular property deals. Is it a good idea to permit perpetual refusal options in any event?

PERSONAL PROPERTY; PRIORITY: The doctrine of *lis pendens* no longer applies to personal property in Kentucky, and the filing of a *lis pendens action* is insufficient to create a security interest in real property, even if the *lis pendens* is filed prior to another lender's perfection of its security interest in certain property. ***Citizens National Bank of Jessamine v. Washington Mutual Bank, 309 S.W.3d 792 (Ky. Ct. App. 2010)***, reported under the heading: "Lis Pendens; Personal Property; Priority.

RECORDING ACTS; LOST MORTGAGE AFFIDAVIT: While an Affidavit of Lost Mortgage provides notice that a mortgage was executed and that it has been lost, such an Affidavit is not an "instrument affecting title" and cannot be substituted in place of the mortgage it describes. ***Wetzel v. Mortgage Electronic Registration Systems, Inc., ___ S.W.3d ___ (Ark. 2010).*** Discussed under the heading: "Mortgages; Priority; Lost Mortgage Affidavit."

REDEVELOPMENT LAW; TAX INCREMENT; GIFT OF PUBLIC FUNDS: Arizona court finds that benefits of anticipated future taxes cannot be taken into account in computing the value of benefits the municipality receives in exchange for money or other benefits conferred upon developer. ***Turken v. Gordon, 223 Ariz. 342, 224 P.23d 158 (Ariz. 2010)***, discussed under the heading: "Municipal Law; Gift of Public Funds."

RULE AGAINST PERPETUITIES; OPTIONS; RIGHTS OF FIRST REFUSAL: A right of first refusal purporting to benefit heirs and successors and assigns of optionee and optionor is void due to the Rule Against Perpetuities. ***Hensley-O]Neal v. Metropolitan Nat. Bank, 297 S.W. 3d 610 (Mo. App. S.D. 2009)***, diiscussed under the heading: "Options; Rights of First Refusal; Rule Against Perpetuities."

SERVITUDES; BUILDING RESTRICTIONS; DEMOLITION: Where a restrictive covenant requires homeowners' association approval of changes or alterations to buildings in a development, such approval is not required for a homeowner to demolish the homeowner's house where no replacement structure is planned. ***Service Corp. of Westover Hills v. Guzzetta, 2009 Del. LEXIS 221 (Del. Ch. Dec. 22, 2009).***

Compare: Goldmuntz v. Town of Chilmark, 651 N.E.2d 864 (Mass. App. Ct. 1995). (DIRT DD for 12/19/96)(A covenant which prohibits the construction or placing of buildings or other structures on or above ground bars the installation of a swimming pool.)

SLANDER OF TITLE; *LIS PENDENS:* Even where position relied upon by party filing *lis pendens* is clearly wrong, and pending lawsuit will not result in an interest in the subject property, owner of property cannot succeed in a slander of title action unless it can show that the filing was "malicious." Stupidity is a defense. ***First Nat'l Bank of St. Louis v. Ricon, 2010 Westlaw 1223788 (Mo. App. 3//30/10) (not yet released for publication)***

Bank had an outstanding loan to Borrower secured by certain personal property, perfected through a UCC assignment for creditors, and by a deposit agreement whereby Borrower agreed to maintain its deposits with Bank, subject to setoff rights if it defaulted on the loan.

Bank alleged that Borrower established new accounts in another bank and transferred funds from the accounts with Bank to those accounts, and that further that Borrower sold some of the personal property collateral and deposited the proceeds in the other bank. It further alleged that Borrower used these funds in other bank to acquire certain real and personal property.

Bank filed a lawsuit for the amount of the loan, $350,000, and "such further relief, as the court deems just and proper" It alleged all of the above facts.

In fact, it appeared that Borrower had acquired two homes financed 100% with money borrowed from other sources than Bank, but that it may have used some of the monies in the accounts established in the other bank to make mortgage payments on those houses.

Bank filed notices of *lis pendens* against these two residences, alleging, that its pending lawsuit might result in its acquiring an interest in them. It had not named or described these residences in its complaint, making only allusions to the fact that Borrower had acquired certain "real property" with money diverted from Bank's collateral.

Borrower counterclaimed in Bank's collection action for slander of title, alleging by affidavit that another lender had committed to make a refinancing loan for a lower interest rate on the two residences, but withdrew from that commitment when it learned of the *lis pendens* filings. The trial court awarded summary judgment to Borrower on liability.

At trial on the issue of damages only, a jury awarded Borrower $250,000 in actual damages and $500,000 in punitive damages against Bank. It further awarded Borrower $40,000 in attorney's fees. The court also awarded Bank $375,000 (including accrued interest) in its suit on the loan, but obviously this was cold comfort at this point.

On Bank's appeal, the Missouri appellate court reversed, on grounds that it stated were very narrow. Bank barely escaped from the liability.

Bank argued that the *lis pendens* filings were valid because indeed its lawsuit might support the creation of an interest in the properties. Presumably (the court does not tell us) it was arguing that it could trace the converted collateral into these properties. Unfortunately, its suit was for damages, and not for the establishment of an equitable lien or constructive trust in any real estate. The mere request for "such relief as the court deems just and proper" was not enough to convert a lawsuit for damages into a claim for a property interest, particularly in undescribed real estate.

Bank argued that Borrower's naked allegation that it had been denied a valuable loan because of the *lis pendens*, was based upon hearsay evidence concerning the position of the other lender, and was inadequate to support summary judgment. The appeals court noted that Bank had failed to introduce any evidence to refute Borrower's allegation, so the affidavit was sufficient. There had been a wrongful filing of *lis pendens* and Borrower had been injured.

But Borrower foundered on its attempt to establish that there was an adequate basis for summary judgment on the final requirement for slander of title – that the *lis pendens* was filed with malicious intent. Here, Borrower relied upon a letter from Bank's counsel in which it refused to release the *lis pendens."* The contents of the letter proved relevant to both sides of the controversy:

> "[W]e recorded the notice lis pendens with the reasonable belief that the collateral securing the loans in issue were used by the [Borrower] to make payments on, purchase and/or finance other assets such as the real property against which the notices were recorded. This [sic] the Bank's collateral were [sic] used by [Borrower] to make payment toward., or on, their real property. To that end, your statement that our notice lis pendens was filed to the [Borrower's] real property to preserve the Bank's right to dispose of or have a lien against the same is quite correct, but clearly was not the only reason the notice was filed."

Bank relied on the first half of the letter, Borrower on the second half, where counsel agreed that a purpose of the *lis pendens* was to have the property available in the event of judgment in the lawsuit on the note. Tying up property for this purpose is malicious. But tying it up because you have a reasonable belief in establishing an equitable lien is not.

The appeals court ruled that, although the question was close, the issue of malice ought to go to a jury, so it reversed summary judgment as to liability.

Comment 1: The court commented that a slander of title action would not be actionable if it was "innocently made out of stupidity or ignorance." It concluded absolutely that the filed lawsuit would not create an interest the subject properties, so one wonders it was accusing the Bank's counsel of ignorance, stupidity, both or neither. You be the judge.

Comment 2: In any event, since the Borrower's lawyer was able to wring a $500,000 punitive damages judgment out of the first jury, Bank's counsel at this point would be wise to conclude that the risk of a finding that its *lis pendens* was maliciously filed is quite likely, and perhaps it would want to settle this case if it can.

TITLE INSURANCE; AGENT LIABILITY; CLOSING ATTORNEYS: Where a closing attorney represents both the purchaser/borrower and the title insurance company, as is common in parts of New Jersey, if the title company wants to disclaim liability for the closing attorney's misappropriation of client funds, the disclaimer must be delivered directly to the insured and not merely to the attorney as part of the title insurance commitment, but, even so, the title company will not be liable for the closing attorney's act that took place before the title company appointed the attorney as its agent. ***New Jersey Lawyers' Fund for Client Protection v. Stewart Title Guaranty Co., A-44-09 (N.J. Super. App. Div. 8/210)***

The buyers contracted to purchase a new home. They retained their neighbor, an attorney, to represent them in the transaction and instructed him to deposit the net sale proceeds from the sale of their home into his attorney trust account to use those funds to pay the purchase price for their new home. They also deposited additional funds into their attorney's trust account, believing that those funds would be needed for the closing. The attorney then ordered title insurance and received a title insurance commitment. It had a disclaimer stating that the attorney was not an agent of the title company and the title company would not be responsible for the attorney's malfeasance. Prior to even ordering the title insurance, the buyer's attorney stole his client's funds. As a result, the checks he wrote from his trust account were not honored by reason of insufficient funds. The buyer filed a claim with the title company, but it was denied.

The New Jersey Lawyer's Fund for Client Protection (Lawyers' Fund) reimbursed the buyers and assumed their rights to recover from other sources. The lower court found that the title company was not liable for the attorney's misconduct because the buyer's attorney stole the funds before he had any contact with the title company. Lawyers' Fund appealed and the Appellate Division reversed. That court rejected the title company's argument that it was shielded from liability because of the disclaimer in the title commitment stating that it was not liable for the attorney's misconduct. The title company argued that since the attorney was the buyer's agent, delivery of the commitment with the disclaimer to the attorney put the buyers on constructive notice that they would not be insured if their attorney stole their money. The Appellate Division disagreed, noting that this case involved the "North Jersey" closing practice where the buyer's attorney handles the closing of title and disbursement of funds. In North Jersey practice, the buyer's attorney acts as agent for the title company for the purpose of dealing with the insured. Therefore, there is an inherent conflict of interest between the role served by the attorney when acting as both attorney for the buyer and as closing agent for the title company.

The Appellate Division held that if a title company wants to disclaim liability for a closing attorney's misappropriation of client funds, a disclaimer notice must be delivered directly to the insured. Inclusion of the disclaimer as an insert with the title insurance commitment is insufficient.

The New Jersey Supreme Court reversed.

Although the title company's commitment stated that "the attorney closing title on the property was not the agent of the title company and the title company assumed no liability for any loss caused by the attorney's mistake or misapplication of funds. The New Jersey Supreme Court agreed with the Appeals Court that the disclaimer was insufficient because it was "buried" in the commitment, , but held this concept applied only to acts taken by the agent after the agent's appointment. .

The basis for the Supreme Court's reversal of the Appellate Division's decision and for its reinstatement of the lower court's decision was that "[n]o agency relationship existed between the title company and the attorney who misappropriated the client's funds at the time the misappropriation occurred," and therefore "the title company [was] not liable for the misappropriation." According to the Court, a trial court "must examine the totality of the circumstances to determine whether an agency relationship existed in a situation in which the principal did not have direct control over the agent." The buyers gave their attorney funds before the attorney even ordered title insurance and, by that time, he had already misappropriated the funds.

The Supreme Court rejected the Appellate Division's conclusion that title companies are in a better position than the insured to prevent misappropriation at any time during the closing process, and therefore should bear liability where the title company knows that the buyer's attorney will oversee the transaction and ultimately will become its agent for issuing insurance.

VENDOR/PURCHASER; SELLER'S BREACH; DAMAGES; RELIANCE DAMAGES: Where a seller of land fails to perform under a real estate sales contract, a purchaser is entitled to recover reliance damages reasonably incurred in preparing to perform such contract, including money spent to arrange financing or to secure tenants for the anticipated project. ***St. Lawrence Factory Stores v. Ogdensburg Bridge and Port Auth., 889 N.Y.S.2d 534 (N.Y. 2009).***

Plaintiff Purchaser sought damages against Seller for failure to sell approximately 12 acres of land, upon which the Purchaser planned to build a shopping mall. Purchaser originally sought three types of damages in its breach of contract claim: (i) lost profits (amounts that it would have received from the shopping center), (ii) the "benefit of its bargain" (the difference between the market value of the property and the contract price) and (iii) reliance damages (amounts spent in preparation for performance of the purchase contract).

The lower court dismissed all actions for damages, and the Appellate Division affirmed.

On further appeal, the Court of Appeals affirmed in part and reversed in part. The Court of Appeals held agreed that lost profits here were speculative and that there was no evidence that the value at breach exceeded the contract price. But the Court that it was in error to dismiss Purchaser's claim for reliance damages before trial.

The Court stated that it is incorrect to state that reliance damages for failure to tender land upon closing were restricted only to the costs of title search, survey and attorney's fees. The Court instead upheld the rule in the Restatement (Second) of Contracts Section 349, that a plaintiff purchaser may recover "damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed."

Among other things, the lower court should, at trial, consider whether Purchaser is entitled to damages for costs incurred in preparing for performance, including money spent to arrange financing and to secure tenants for the shopping mall.

Comment: This is a short case making a minor point, but specific authority upholding costs of negotiation with prospective tenants and costs of obtaining financing for a blown deal don't come 'round that often. The result makes sense, but it's good to have high court authority.

VENDOR/PURCHASER; EARNEST MONEY DEPOSITS; FORFEITURE: On buyer's breach of purchase agreement, provision for seller's retention of deposit amount in excess of actual damages is unenforceable. ***Kuish v Smith 181 CA4th 1419 (Cal. App. 2010)***

In January 2006, Kuish agreed to purchase Smith's Laguna Beach home for $14 million. The property was a "dream house" right on the beach and plaintiff had extensive plans to remodel it and make it even more "dreamy." Both parties were described by the trial court as "big boys," especially sophisticated in real estate.

Plaintiff originally agreed to make a "non refundable" deposit into escrow of $820,000 in two installments. Plaintiff promptly paid $400,000, and would make later deposits of $20,000 and $400,000 at set dates. Subsequently, apparently due to delays in arranging for the remodelling, the parties extended the escrow several times. In the first such extension, the parties reduced the total deposit requirement to $620,000 and provided that plaintiff would deposit an additional two escrow payments somewhat later than planned. A second extension agreement changed the closing date to September, 15, 2006. As part of that agreement the Plaintiff paid the remaining $220,000 of the escrow deposit and agreed that Defendant Seller could withdraw $400,000 of that amount.

Plaintiff never closed and canceled the escrow and signed escrow cancellation instructions on October 17, 2006. One month later, the Defendant Sellers closed escrow on the sale of the property to a backup purchaser for $15 million. Nevertheless, the Defendants refused to return Kuish's $620,000 deposit on the ground that it was a nonrefundable deposit.

After a bench trial, the court ruled in favor of the Smiths except as to $20,000 of the deposit. The trial court concluded that the various extension agreements should be characterized as an agreement that the nonrefundable deposit should be viewed as consideration for the various extensions in the closing date. The court commented that the parties knew exactly what they were doing, and permitted the Seller to retain $600,000 of the total $620,000 deposited. The appeals court does not give sufficient detail of the lower court opinion to make clear why the court treated the $20,000 amount as separate.

The appeals court treated the case as a straightforward earnest money deposit case controlled by California's rules against forfeiture. It noted that California law permits the parties to provide in the contract for the forfeiture of a deposit as liquidated damages, with 3% of the purchase price being a figure of "presumptive validity" of the liquidated damages computation. The parties had not made use of the statutory liquidated damages option. Thus, it applied relatively standard rules:

First, In a rising market, a seller is limited to the recovery of consequential damages and interest against a buyer who breached. Second, retention of the breaching buyer's deposit in a rising market constitutes an invalid forfeiture under the revered precedent of *Freedman v St. Matthias Parish*, 37 C2d 16, 230 P2d 629 (1951).

Importantly, the appeals court concluded that the deposit was not separate consideration for the Smiths' agreement to extend the escrow. The court distinguished the Smiths' authority for the separate consideration argument. See *Horowitz v Noble* (1978) 79 CA3d 120, 144 CR 710. Unlike in *Horowitz*, the acknowledgment and two sets of amended escrow instructions signed by Plaintiff Buyer did not reflect an irrevocable disbursement of funds in exchange for extension of the closing date. The court of appeal noted that the Kuish/Smith documents did not include the term "nonrefundable" or any similar term. Rather, the nonrefundable deposit provision was contained in the initial agreement, which in no way could constitute separate and additional consideration for subsequent agreements to extend the closing date.

Reporter's Comment: Because the market value of this property grew by $1 million between the time of the parties' first execution of a contract for it and the purchaser's subsequent breach of it these vendors were not able to retain the $600,000 deposit that they held. Unlike New York and some other states (see *Maxton Builders v Lo Galbo* 493 NYS2d 825 *(*App Div 1985))- and, indeed, unlike California's own original rule)- liquidated damages provisions in residential real estate purchase contracts may be enforced only when they comply with California statutes.

The provisions in this contract were not separately initialed, as CC §§1675 and 1677 require. (It looks like the amount also exceeded the 3-percent cap that those code sections set for presumptive validity, $600,000 being well over 4 percent of the $14 million purchase price.) The language of those code sections seems to not impose many formal requirements, and therefore an enforceable liquidated damages provision might have appeared in the escrow instructions as effectively as in the original contract. But wherever it is put, it had better be separately initialed (and probably in big print).

Editor's Comment: The Editor is less comfortable with the result here, although in the end he reluctantly must conclude it is probably right.

It is true that, going into the final negotiation for an extension, the Buyer was obligated to put up $620,000 (on a schedule) into escrow and it appears that the Buyer was the one asking for a further extension.

But the Buyer's $400,000 escrow payment was not yet due for several months, and of course typically escrow payments remain in escrow and are not released to the Seller. The Buyer agreed to pay the money quite a bit earlier and to permit the release of $400,000 to the Seller right away. This is a considerable departure from the original agreement. It would seem that, somewhere in this agreement, the Seller received considerable additional consideration for the extension. Nevertheless, even if we view this as an new sale agreement, it is still subject to the California rules against forfeiture. And Seller could not prove damages.

Editor's Comment 2: As the editor understands the New York (and Missouri) rule, permitting forfeiture of earnest money payments into escrow without regard to actual damages, this rule is not one applying liquidated damages analysis. Rather, the rule simply views these forfeitures as valid – perhaps as consideration for the Seller taking the property off the market during the escrow period and thus foregoing the possible opportunity to sell for a higher price. There does seem to be some discussion in New York case law, at least, of the notion that there is an outer limit – perhaps measured by market, of the amount of such forfeitures. But a forfeitable 10% deposit does not seem to trouble the conscience of New York courts, although it would cause consternation and stomach upset to many California judges.

The Reporter for this item was Roger Bernhardt of the Golden Gate Law School. The item is reprinted, heavily edited, from the California CLE Real Property Reporter, with permission.

VENDOR/PURCHASER; INSPECTIONS; ILLUSORY CONTRACT: Where buyer reserves the right to withdraw, in "absolute and sole discretion" during the inspection period, the contract is an option unsupported by consideration, and unenforeable; but if buyer undertakes significant costs of inspection or zoning efforts prior to seller's objection, such part performance may supply consideration for the option. ***Steiner v. Thexton, 106 Cal. Rptr 3d 252, (Cal. 3/18/10)***

Thexton owned property that apparently was valuable for development, but Thexton wanted nothing to do with going through the process of subdividing and preparing the property for development. He had turned down an offer for $750,000 that required that he carry out the subdivision process. Steiner then offered Thexton $500,0000, and Steiner indicated that he would carry out the subdivision approvals before he closed on the deal. The parties entered into a contract that obviously contemplated Steiner's activities in subdividing the land – stating a three year closing window, giving Steiner access to the land and rendering Steiner liable for damages occurring during the process. There were many other similar provisions as well.

The contract provided that Steiner would post a $1000 earnest money agreement and further there was the language that later caused so much difficulty:

> "It is the intent of Buyer that the time period from execution of this contract until the closing of escrow is the time that will be needed in order to be successful in developing this project. It is expressly understood that the Buyer may, at its absolute and sole discretion during this period, elect not to continue in this transaction and this purchase contract will become null and void."

Later , after more than a year, during which Steiner expended more than $50,000 in seeking subdivision clearance, Thexton decided that this deal wasn't such a good idea and cancelled the contract. Steiner did follow through an get tentative map approval. Then Steiner sued Thexton for specific performance.

The trial court entered judgment for Thexton, finding that the contract did not bind Steiner to anything and was nothing more than an option, for which there was no consideration. . Consequently, Thexton could cancel as he saw fit. .The Court of Appeal affirmed on the same reasoning

This raised consternation in the real estate community, and a number of groups joined as *amicus* in the appeal to the California Supreme Court. In a Solomonic decision which will require rewriting of all the property and real estate transactions teaching books that cover this area, the California Supreme Court decided (1) the contract indeed was nothing more than an open option, which the seller could cancel at will before buyer undertook to do the subdivision work, but (2) once the buyer did undertake to do the work that was expected, this served as consideration for the option and the contract became irrevocable.

The court noted that under California law, the necessary consideration could be benefit conferred on the seller *or* "any [prejudice suffered or agreed to be suffered by [the optionee] other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the [optionor]." The court added that such benefit or detriment must actually be bargained for as the exchange for the promise. "Put another way, the benefit or prejudice must have induced the promissor's promise.

Of course, it might be argued that Steiner didn't agree to confer a benefit or incur a prejudice, but it was clear that there was an expectation that he would and that this induced Thexton to enter into the contract, as Thexton had turned down 50% more for the property when there was no expectation that the buyer would carry out the subdivision arrangements. Thus, if Steiner did withdraw, Thexton's proeprty was rendered more valuable if Steiner did what was necessary to secure the subdivision.

Comment 1: As to the $1000 earnest money, the court even suggested that in another case this might have supplied the consideration, even though refundable to

Steiner if Steiner withdrew. Simply putting up the money was a detriment to Steiner. The court did not elect to rely on this argument, and it is clear that the amount was so small here that is may not have been such a strong argument, but it might be helpful to guide buyers in such contracts in the future to put up more substantial earnest money, albeit refundable if the buyer later cancels.

Comment 2: Even though the buyer came out a winner here, clearly this decision creates some new concerns for contracting parties in situations in which the buyer wants to take a "free look." The editor has always been able to provide that the buyer certainly would expend certain amounts in evaluating the property, and that such expenditures of time and money were valuable to the seller and the seller acknowledged such efforts constituted consideration. But the editor had a client buyer who would agree to this and a seller that found the language acceptable. Neither situation may always be the case.

Comment 3: Good faith and fair dealing? Not here – since the buyer expressly reserved the right to withdraw at any time – even before doing anything – in his sole discretion. When clear open and unlimited discretion is given to a party, there is no duty that the discretion be exercised with good faith and fair dealing. The language stating that principle in this case is also a useful aspect of the case for lawyers in the future.

Thanks to Gary York at Ballard Spahr in L.A. for putting the editor on to this case.

ZONING AND LAND USE; NONCONFORMING PREEXISTING USE: The operation of a landfill is similar in nature to the operation of a quarry; therefore special New York case law involving expansion of quarries that qualify as preexisting uses will apply to landfills as well. A landndfill operator is entitled to prior non-conforming use protection from zoning ordinances that may later bar new landfill operations, even as to portions of the site as to which no permit has been obtained. ***Jones v. Town of Carroll, 15 N.Y.3d 139, 2010 WL 2399642 (N.Y. June 17, 2010.)***

A property owner had 50 acres of land in an agricultural/residential zoning district. In 1989, the municipality granted a special use variance permitting the operation of a construction and a demolition landfill on the entire parcel. The land use variance was contingent on obtaining a state landfill permit. The owner obtained the proper permit from the state to allow landfill operations to commence on roughly two acres. Subsequently, the permit was expanded to cover three acres.

Everything went well until 2005 when the municipality "adopted a new zoning law that prohibited the expansion of any landfill beyond the area and scope allowed under the operators [sic] permit from [the state] as of the date of this Local Law." Then, the municipality sought to prevent the landowner from using the remaining 47 acres of its property for landfill purposes.

The landowner sued, and the lower court ruled in its favor. The municipality appealed, and the Appellate Division "held that the local law was applicable since the [state] permit covered only three acres and [the landowner] merely contemplated the future expansion of [its] operation." The landowner appealed to the New York's Court of Appeals (its highest court). That Court ruled in the landowner's favor, applying the following principles. "As a general rule, a nonconforming use of real property that exists at the time a restrictive zoning ordinance is enacted is 'constitutionally protected and will be permitted to continue, notwithstanding the contrary provisions of [an] ordinance." Ordinarily, "[a] party seeking to overcome a restrictive zoning ordinance 'must demonstrate that the property was indeed used for the nonconforming purpose, as distinguished from a mere contemplated use, at the time the zoning ordinance became effective.' … Where only part of a parcel is being used, a landowner may seek protection for the remaining portion by demonstrating that the use is unique and adaptable to the entire parcel … and showing that the landowner took 'specific actions constituting an overt manifestation of its intent to utilize the property for the ascribed purpose.'"

The law in New York grants dispensation to mining operations. In 1980, the Court of Appeals "observed that mining, unlike other types of nonconforming uses, is unique in that it 'contemplates the excavation and sale of the corpus of the land itself as a resource.' … Thus, 'as a matter of practicality as well as economic necessity, a quarry operator will not excavate his entire parcel of land at once, but will leave areas in reserve, virtually untouched until they are actually needed."

In a 2009 case, the Court of Appeals recognized "that a quarry owner 'would not necessarily seek a permit for lands that it did not intend to excavate immediately, or at least not until some time in the future." This means that the Court's reasoning was "that it would be unreasonable to limit the boundaries of the vested right [e.g., for a quarry] to just the area approved for mining under a [] permit where the quarry owner demonstrated an intention to eventually use a larger area for such mining activities." In that 2009 case, the Court "explained that a contrary rule would 'fail[] to consider the realities of the [mining] industry' and require 'a very narrow reading of'" the 1980 case.

In this case, dealing with a landfill, the Court felt that the operation conducted by the landowner was "sufficiently similar in nature to the quarries" that were involved in the earlier cases. "As opposed to other nonconforming uses in which the land is merely incidental to the activities conducted upon it, … the use of property as a landfill, like a mine, is unique because it necessarily envisions that the land itself is a resource that will be consumed over time. Additionally, the owner of landfill property can reasonably be expected to hold a portion of the land in reserve for future expansion of that activity, just as a quarry operator may find necessary. The fact that the [state] permit covered only a limited area [in this case was] not determinative of [the landowner's] rights over the remaining 47 acres of the parcel." Once the landowner "dedicated substantial areas around the actual landfill for site related purposes," purchased extensive equipment, employed many people, "developed plans for multi-stage enlargement of the landfill and engaged in discussions with investors regarding future operations," the landowner adequately demonstrated a vested right to operate the landfill throughout the entire property notwithstanding and the zoning change would not be applied to restrict that right.

Editor's Comment: 1 Here is a post from Ira ten years ago, involving a New Jersey case, on another aspect of the problem. *Fred McDowell, Inc. v. Board of Adjustment of the Township of Wall*, 334 N.J. Super. 201, 757 A.2d 822 (App. Div. 2000) (Though a non-conforming use can be expanded beyond the boundaries of a property in the case of extractive industries, such as mining, it is first necessary for an owner to objectively manifest its intent to use a contiguous lot or even one across a highway for such extractive purposes before the zoning law changed.)

Editor's Comment 2: On the notion of quarry expansion after it becomes a nonconforming use, there are differing approaches in different states. Extensive research is recommended. *Compare: Buffalo Crushed Stone, Inc. v. Town of Cheektowaga, 864 N.Y.S.2d 598 (A.D. 4 Dept. 2008).* (A landowner is not entitled to conduct quarrying activities on parcels of land not zoned for such activities merely because the parcels are contiguous to other parcels of land also owned by the landowner and on which quarrying had occurred over a long period of time.*) With Hansen Bros. v. Bd. of Supervisors of Nevada County*, 35 Cal. Rptr. 358 (Cal. App. 1994) (The DIRT DD for 4/11/95) (Mining use in one area of a parcel land is entitled to be extended to balance of parcel as a pre-existing use, but owner cannot significantly intensify rate of extraction.) Hansen held that the mining activity "imprinted" the entire parcel, and acknowledged that the doctrine applies primarily to mining and not to other activities. *But also compare: Township of Fairfield v. Likanchuk's, Inc.*, 644 A.2d 120 (N.J.Super.App.Div. 1994). (part of the same DD) (The expansion of a mining operation from a small area of a tract to the entire tract, where mining is a prior nonconforming use, constitutes an illegal expansion of the use.) The *Fairfield* case differentiates its facts from those applying the "diminishing asset" notion. It characterized the "so called diminishing asset" cases as slightly different, since the nature of the nonconforming use, such as excavation or soil removal, involves the utilization of a wasting asset and requires continual expansion over an area. Nonetheless, in such cases, the owner must show that the entire tract was dedicated by the owner to the mining activity despite the fact that the activity was limited when it was rendered a nonconforming use. The mere unexpressed intention or hope of the owner to use the entire tract at the time the restrictive zoning ordinance is adopted is not enough. Intent must be objectively manifested by the initial and ongoing operation of the owner before the activity was rendered nonconforming. *Hansen*, cited above, also embodies this principle.

The Reporter for this item was Ira Meislik of the New Jersey Bar.

ZONING AND LAND USE; VARIANCES; PENDING CONDEMNATION: The mere receipt of notice that a condemning authority is considering the purchase of an owner's property does not require that the owner suspend development plans or even notify the zoning authorities of the NOI in connection with a use variance application. ***New Jersey Schools Construction Corporation v. Lopez, 2010 WL 936111 (N.J. Super. App. Div. 2010); February 19, 2010.*** , discussed under the heading: "Eminent Domain; Notice of Intent."