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Quarterly Report on Current Developments in Real Estate Law

July 1, 2006 to September 30, 2006

Sponsor:

ABA Section on Real Property
Probate & Trust Law
American Bar Association

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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.

The editors hope to provide a comprehensive review of significant new developments, but obviously they cannot warrant that every new case is reported. Further, readers should be aware that the editors specifically eliminate from coverage cases that are of interest primarily to lawyers within a given state. Thus, significant interpretations of state statutes or constitutions, even if of critical importance to local practitioners, may not appear in the Report. Readers should rely upon update services provided by state or local sources to stay current on such developments.

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Highlights in this Report

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ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; FEDERAL ARBITRATION ACT: A New York Statute barring mandatory arbitration clauses is enforceable unless the agreement invokes the Federal Arbitration Act. ***Baronoff v. Kean Development Co., Inc., 818 N.Y.S.2d 421 (Sup. 2006).*** Petitioners entered into two Construction Management Agreements with a contractor, engaging him to supervise the renovation of two residential properties. After petitioners terminated the contractor and refused to pay several outstanding invoices, contractor initiated arbitration proceedings pursuant to the Construction Management Agreements. Petitioners sought to permanently stay the arbitrations, and the court held that pursuant to General Business Law Section 399-c(2)(a), which bars enforcement of mandatory arbitration clauses, the arbitration clause is unenforceable. The court further held that, as a matter of first impression, this law is not pre-empted by the Federal Arbitration Act because the agreement does not "affect commerce," a requirement for the Act to apply.

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; RESIDENTIAL LEASES: A mandatory arbitration clause in a residential lease is void as against public policy when statutes create a specific housing court to hear housing complaints. ***D'agostino v. Forty-Three East Equities Corp., 820 N.Y.S.2d 468 (N.Y.City Civil Ct. 2006)***, discussed under the heading: "Landlord/tenant; Residential; Alternative Dispute Resolution; Mandatory Arbitration."

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; MORTGAGES: The New Jersey Supreme Court analyzes whether a subprime mortgage's arbitration agreement, or any of it, is unconscionable, under New Jersey law. ***Delta Funding Corporation v. Harris, 2006 WL 2277984 (N.J. 2006),*** discussed under the heading: "Mortgages; Alternative Dispute Resolution; Arbitration."

BANKRUPTCY; AVOIDANCE; LIEN PERFECTION: Complex Virginia decision evaluates scope of Virginia title searches, after acquired property doctrine, purchase money priority, inquiry notice, agent notice, and more, and more and more. ***Wilson v. Moir (In re Wilson), 2006 Westlaw 3804543 (Bkrtcy E.D. Va. 12/27/06)***, discussed under the heading: "Recording Acts; Priorities; Chain of Title."

BANKRUPTCY; CHAPTER 13; REINSTATEMENT OF HOME MORTGAGE: Non- assuming grantee can reinstate home mortgage in face of default, but can it be done in face of "due on sale" acceleration? ***In re Ramos, 2006 Westlaw 3733252 (Bankr. S.D. Fla. 2006)***

One day after securing a mortgage on a residence, the mortgagor transferred to a third party, Ramos, who took subject to the mortgage, but did not assume it. The mortgage contained a due on sale clause, and there appears to be no dispute that the transferred triggered an acceleration right under that clause. Of course, no one bothered to tell the mortgagee of the transfer.

A year later, Ramos, who had been making payments on the mortgage loan, defaulted. Lender brought sued to foreclose and obtained a foreclosure judgment, but no foreclosure sale had been held before Ramos filed a Chapter 13 bankruptcy proceeding. Lender petitioned for relief from the stay.

In its petition, Lender asked in the alternative that it be granted relief from the stay to complete the pending foreclosure or that it receive adequate protection and that the court reinstate the Mortgage for that purpose.

The court concluded that, contrary to the Lender's assertions, there was value in the property in excess of Lender's loan amount. But it noted that there were a number of other liens against the property (four mortgages) that more than exhausted any equity in the borrower. Nevertheless, the court concluded, unsurprisingly, that the home was critical to carrying out an effective reorganization. In fact, the borrower asserted in its brief that the whole purpose of the bankruptcy was to salvage the home and prevent it being lost to foreclosure. The court acknowledged that most probably an evidentiary hearing would be necessary in most cases to resolve any dispute on these issues, but it stated that since the Lender had asked in the alternative for reinstatement of the Mortgage and adequate protection, no evidentiary hearing was necessary.

But Lender pressed the claim that there was an additional basis for relief from the stay – "cause" in the form of what the court characterized as "breach" of the due on sale clause. The court acknowledged that "many cases" appear to support this notion, and indicated that the apparent rationale for these cases was "the reasoning that a debtor who is not a borrower can not cure a default under the relevant Chapter 13 Section – 1322(b)(3).

But the court pointed to another line of cases that deny relief notwithstanding a due on sale acceleration. Prominent in this line of cases was *In re Garcia,* 276 B.R. 627 (Bankr. Ariz. 2002). It stated that the appropriate interpretation of the Bankruptcy Law is that a party holding property subject to a mortgage is *always* in a debtor-creditor relationship with the mortgagee and thus entitled to reinstatement, whether or not the debtor has personal liability on the mortgage note.

The court then decided that, despite this reasoning, it would not decide that the sale in the face of a due on sale clause did not constitute "cause" justifying relief from the stay. It did not have to decide because, the court concluded, Lender had waived its right to make such a claim when it asked for alternative relief in the form of reinstatement and adequate protection. We are not told why such a waiver resulted.

The court did hold, however, that Ramos was not entitled to reinstatement of the mortgage by paying off the defaulted back payments over time as part of the plan, but would have to make up defaults upon confirmation of the plan.

Comment 1: This is not the editor's area of expertise, but he still expresses wonder that the bankruptcy court basically reads the due on sale clause right out of the mortgage. The clause give the lender a right to accelerate. This right, incidentally, is protected by federal law, so one wonders why the Bankruptcy law would be seen as preemptive. The only "default" that could be cured, one would think, would be the failure to pay the lawfully accelerated total loan balance, rather than reinstatement of the loan to the payments. The court seems to be of the view, however, that the borrower can preserve her ownership and simply continue on with the old payment structure. This is not a holding, *per se*, since the court makes that crazy waiver ruling. But the court certainly has a peculiar view of the situation.

Comment 2: Lacking any ability to make sense of this case from what the court said, the editor turned to the case that influenced this decision, *Garcia.* Here, indeed there is a much more thorough analysis of the issues. First, the court in *Garcia* clearly treated as separate the issues of whether a non-assuming debtor may reinstate and the issue of whether a due on sale acceleration can be cured. As to the latter, the court still, and incorrectly, characterized the sale under the due on sale clause as a "breach," but still had this to say, that does seem relevant in any event:

"No Defaults Are Inherently Incurable Even if the drafters did not intend to exclude any kinds of defaults from the legal right to cure, the Bank could argue that the drafters meant to grant legal authority to cure only when that could be accomplished as a practical matter, such as where missed installment payments can be made up. But if a default could not be cured as a practical matter, then the legal authority to do so is irrelevant. And here, the Bank can well argue that the predefault conditions cannot be restored because the original borrower is dead. In any event it would little benefit the Debtors to cure the default by selling their home back to Emmet Murray even if they could, and then, having no ownership rights to the property, they would have no right to cure because there would be no secured claim against the Debtors or against property of the estate.

Again, of course, there is no language in the Code to suggest the drafters recognized a practical limitation on the legal ability to cure. And in any event, that argument has also been rejected by the Ninth Circuit.

In [the Ninth Cirucit decision *in Entz-White*], the bank argued that because the debtor's balloon note obligation naturally matured prepetition, without acceleration, that was a default that could not be cured under § 1123. It argued that cure was limited to deceleration of an accelerated obligation, which would not apply to an obligation that naturally matured prepetition. In other words, the failure to pay the obligation when it fully matured was an historical fact that could not be undone by payment later. The Ninth Circuit rejected this argument, primarily by relying on the plain language of the statute that permits cure of "any default." [FN39] It also relied on the House Report on § 1124, stating that "Reinstatement consists of curing any default (other than a default under an ipso facto or bankruptcy clause) and reinstatement of the maturity of the claim or interest." It added: "This broad language, subject only to two listed exceptions, mirrors the language of the statute and refutes [the bank's] position."" (citations omitted)

Further, a bit later:

Most, Possibly All, Nonmonetary Defaults May Be Cured: If plans may cure all defaults, this leaves the question of what is required for cure. For missed payments the answer is easy—make up the payments. But what if the default is a nonmonetary default such as a violation of a due on sale clause or a "going dark" provision? Certainly one aspect of cure must be to cease any ongoing violation. For example, one part of a cure of a "going dark" clause must be to reopen the store. This does not seem to help here, however, where there is no ongoing violation of the due on sale clause—the Debtors are not in the process of selling the home without the lender's consent, nor do they seek the right to do so in the future. The prohibited sale has already occurred.

What else, if anything, must be done to cure a nonmonetary default other than to cease any ongoing violations? Perhaps nothing. For example, what would be necessary to cure a default of an *ipso facto* clause, a default arising solely from the fact of filing the bankruptcy case? [FN46] Although § 365(b)(2)(B) makes it unnecessary to cure such defaults in executory contracts and leases, there is no similar provision excusing cure of such breaches in nonexecutory contracts, such as the note and deed of trust involved here. It might be contended that § 541(c)(1) voids such clauses upon the filing of the bankruptcy case. [FN47] That seems to have been the intent of the Bankruptcy Commission's original draft of what became the Bankruptcy Code, because it "invalidated" ipso facto clauses and restraints on alienation, [FN48] and the Ninth Circuit has referred to the provision ultimately adopted as "voiding" such provisions. But there is contrary authority *640 that § 541(c)(1) does so only to the limited extent necessary to permit property to become property of the estate, so such clauses remain effective thereafter and thus binding on the trustee. If such clauses survive, how can the default be cured so that the nondebtor party cannot assert the default postconfirmation? Perhaps nothing more is required for the cure other than complying with the Code's confirmation requirements."

. . . To restore the lender to a predefault situation, which is the essence of cure, it would seem the debtor must compensate the lender for any loss occasioned by the default. For example, if "going dark" caused a loss of percentage rents, perhaps those should be estimated and paid as part of a cure.

The Bank may object that the violation of its due on sale clause cannot be compensated by money. But that argument is not well supported by the parties' conduct, by state or federal nonbankruptcy law, or by the Bankruptcy Code.

The Bank argues strenuously (even in the absence of any waiver argument by the Debtors) that the Bank has not waived its right to enforce its due on sale clause. The Bank argues that it did not know these Debtors were the source of the payments it received for the four or five months between Debtors' acquisition of the property in November, 2000, and the monetary default in April, 2001. It says the checks were received at a P.O. Box and deposited without discerning the source, and that it did not learn of the sale until notified by its foreclosure trustee after it had commenced the trustee's sale due to the monetary default.

But the Debtors' purchase agreement was promptly and duly recorded, and under Arizona law that recording constitutes constructive notice to the world of the Debtors' interest in the property. Moreover, because Arizona law requires notice to any subsequent purchaser of a trustee's sale, the Bank's agent had to actually know of the Debtors' ownership before the trustee's sale was commenced; it could not have been validly commenced as against the Debtors unless the Bank notified them."

Although all this seems to argue that the Bank is without a remedy in *Garcia*, the court does not reach that conclusion. Rather, it states that the "due on sale" acceleration is mostly all about money – the lender's right to increase its interest rate to reflect new money market conditions. Consequently, the court concludes, except in the rare case where the borrower is demonstrably a risk to the physical security of the mortgage property, the Bank's primary concern resulting from the sale under the due on sale clause can be addressed by the reorganization giving the Bank a higher interest rate "as market conditions justify."

Actually, the editor thinks this is probably an accurate reading of the significance of the due on sale clause. It does tend to negate the Lender's argument that it is entitled to a borrower that meets its lending standards, and one who has just gone through a Chapter 13 proceeding probably doesn't, but the editor is not so concerned with this problem as the whole "fresh start" purpose of bankruptcy would suggest that the court could justify this aspect of the lender's concerns. It can always foreclose later if its new borrower defaults again (and, of course, be faced with a new Chapter 13 proceeding – the that's the lender's fate.)

BROKERS; COMMISSIONS; BUYERS' BROKERS; "TAIL AGREEMENTS:": A real estate broker is entitled to receive its commission if he or she substantially complies with the contract and if the other party receives substantially the same benefit it would have received from literal performance of the terms of the contract. ***Reece & Nichols Realtors v. Zoll, 201 S.W.3d 516 (Mo. Ct. App. 2006)***:

The defendant in this case entered into an exclusive buyer agency agreement with Reece & Nichols pursuant to which Reece & Nichols would locate a home in the Kansas City area and assist in the negotiations on behalf of the buyer. Reece & Nichols would receive a 3.5% commission on the purchase price of the home and a $160 administrative commission. Reece & Nichols found a house for Ms. Zoll and negotiated a real estate contract with the seller, which was contingent upon the bank approving Ms. Zoll for a loan. One day prior to closing, the bank denied the loan due to a past child support order against Ms. Zoll.

Two weeks after the cancellation of the contract, the seller informed Ms. Zoll, without consulting Reece & Nichols, that she had removed the house from the market. The seller asked Ms. Zoll if she wanted to rent the home. The parties entered into a limited on-year landlord-tenant arrangement which was neither a rent-to-buy nor a lease option contract.

Reece & Nichols learned of the arrangement and notified Remax (as agent for seller) and Ms. Zoll that it expected to be paid a commission on the "sale" when it closed.

Ms. Zoll was later approved by the bank for a loan. She and the seller executed a new real estate contract but retained the negotiated terms under the first contract, including the purchase price. Reece & Nichols filed suit against Ms. Zoll for breach of contract.

The circuit court found in favor of Ms. Zoll, and Reece & Nichols appealed, arguing that Ms. Zoll was liable for the commission under the Agreement because she purchased a home in Kansas City that Reece & Nichols had shown her within 180 days after the Agreement terminated.

Ms. Zoll argued that she is not liable because Reece & Nichols did not comply with the terms to extend the Agreement. To comply literally with the Agreement, Reece & Nichols was required to submit a written description of the house shown to Ms. Zoll either in person or by mail within 7 days after the Agreement terminated in order to receive its commission on the home.

Reece & Nichols argued that the benefit of the extension provision only required timely notice and cited supporting authority. The appellate court agreed. The court noted that a broker is entitled to its commission if it substantially complied with the contract, and it stated that "substantial compliance" would occur if there is only a slight deviation and "if the other party received substantially the same benefit it would have from literal performance." Because Ms. Zoll received a copy of Reece & Nichols' letter to Remax which contained a written description of the house prior to the termination of the Agreement, she did receive timely notification and was obligated to notify Reece & Nichols that she was purchasing the house so that it could seek its commission. Thus, the court reversed and remanded, ordering the trial court to enter judgment in favor of Reece & Nichols.

Comment 1: This is a relatively unusual situation involving a tail period on a buyer broker contract, but the principle would be the same for a seller broker contract. Of course, where there is debate about whether a broker introduced a buyer to a house, then punctilious compliance with the notification procedures might be more important. But here there is no question about the fact that the broker in fact introduced the parties, was involved in the negotiation of the deal that the parties actually consummated and, in short, did everything that the buyer agreed to pay the broker for.

Apparently the deviation from the contract was that Reece & Nichols filed its demand letter to Remax (with copy to Zoll) *before* the buyer broker agreement expired, rather than after. The court held that Zoll was fully on notice of Reece & Nichols claim when she bought the house, and enjoyed the benefit of its services.

Comment 2: The buyer's commission obligation typically would be satisfied out of the seller's proceeds if the buyer coops with a multiple listing broker. The court's description of the buyer broker contract includes that feature. If the original seller lists the property and controls the amount to be paid to cooperating brokers? One assumes all this gets disclosed to the buyer before contract, and the buyer can bargain about that and refuse to buy.

Comment 3: Just to pull an Andy Rooney – is the editor the only one angered by this new practice of brokers (at least in his area) to add "junk fees" to their already inflated commissions? We can say that brokers have more responsibilities in the modern era, but that's largely because of consumer protective legislation or legislation promoted by the NAR to insulate brokers from consumer lawsuits. And we can say that brokers now have bigger offices and more overhead – but that's their business choice. Housing prices have tripled in many markets in the last decade, and continue a steady rise over time, but the broker's commission has not remained a percentage of the sale price but in some cases the percentage has gone higher. Well, everything costs more these days – but why do the brokers nickel and dime with these little fees? Makes them look more like mortgage brokers. Isn't seven percent of $500,000 enough?

CONDOMINIUMS; LIABILITY OF UNIT OWNER TO FELLOW UNIT OWNERS; ATTORNEY'S FEES: Where owner of condominium unit is sued for damages to neighboring condominium owner based upon duties established in the CC&R's for the condominium relating to pet management, in general the CC&R duties will not be held to establish a private right of action, and the prevailing party in such action is entitled to attorney fees. ***Chee v Amanda Goldt Prop. Mgmt. 143 CA4th 1360, 50 CR3d 40 (2006)***

Chee, a resident and owner of a condominium unit, was injured when Kiymaz's dog jumped on her and caused her to fall. Kiymaz rented a neighboring condominium from Brown, who had hired a leasing agent (Goldt) to find a tenant and collect rents.

Chee sued Brown, Goldt, the homeowners association, Kiymaz, and others. As against Brown, the complaint alleged causes of action for premises liability, negligence, and nuisance.

Relevant to this discussion, Chee also claimed Brown was vicariously liable for Kiymaz's acts and had breached a contract. Both of these latter claims were premised on the condominium's CC&Rs. Chee sought a declaration that, under the CC&Rs, Brown was liable for Kiymaz's negligent acts and contracted to indemnify Chee for any losses suffered as a result of his tenant's actions.

In support of both the tort and contract theories, Chee relied primarily upon language in the CC&R's providing that an "owner may delegate his right of enjoyment to the common area to … tenants [and such] owner is fully responsible for all acts or omissions of his delegates " (italics added). She also relied on the provision that states "[a]n owner of any pet shall assure that such pet is restrained at all times it is upon the common areas, that such pet does no waste to common areas or other Units, and that such pet causes no unreasonable noise or other disturbances within the Project ." Plaintiff contended that this language meant that an owner who leases his or her unit may be held vicariously liable for any act or omission of his tenant that results in personal injury to another homeowner, including the failure of the tenant to control her pet. She further contended that these provisions constituted a contract whereby each owner agreed to indemnify any other homeowner for loss caused by his tenant's negligence in handling a pet, or to act as a surety or guarantor in the event that the tenant does not compensate the injured homeowner.

The trial court granted Brown and Goldt summary judgment and awarded Brown and Association attorney fees on the breach of contract and declaratory relief actions under CC §1354. The court of appeal affirmed.

The premises liability and negligence claims against Brown were based on the general principle that one is responsible for an injury caused by want of ordinary care in the management of his or her property (CC §1714(a)). The general duty of care owed by a landowner is attenuated when the premises are let because the landlord is not in possession and usually lacks the right to control the tenant and the tenant's use of the property. Accordingly, a landlord does not owe a duty of care to protect a third party from a tenant's dog unless, unlike this case, the landlord has actual knowledge of the dog's dangerous propensities and the ability to prevent the harm. Landlords of residential property have no duty to inspect the premises for the purpose of discovering the existence of a tenant's dangerous animal. *Portillo v Aiassa*27 CA4th 1128, 32 CR2d 755 (1994) , expressly limited the imposition of a duty to inspect to a commercial landlord who leases property for a purpose involving the admission of the public, distinguishing between guard dogs in public places and residential family pets.

Generally, a landlord is not liable for a nuisance created by a tenant after the premises are let. No triable issue of fact existed here as to the limited exceptions to the general rule when the landlord participates in the wrongful act by authorizing or permitting it to be done, fails to conduct a reasonable inspection of the premises before renewing a lease, or knows about the hazard and is able to prevent the harm.

The causes of action seeking to impose vicarious liability on Brown for injuries caused by Kiymaz and her dog and for breach of contract based on the CC&Rs failed as a matter of law. The negligence of a tenant cannot be imputed to the landlord. The doctrine of nondelegable duty is a form of vicarious liability and does not create a duty when, as here, none would otherwise exist. Nor was there reason to extend the legal effects of CC&Rs – private recorded restrictions on the use of property – to expand established law defining the duty of care and relationships for which vicarious liability is imposed.

Assuming *arguendo* that CC&Rs could create a contractual obligation between individual homeowners, the court declined to read a sweeping deviation from established common law into the CC&Rs absent language expressly specifying that owners assume tort liability to other owners for the acts and omissions of their tenants causing personal injury, and that such owners agree to indemnify members for any injuries caused by the act or omission of a tenant, or agree to act as surety or guarantor for a tenant's obligation to compensate another homeowner for personal injuries.

As prevailing parties, Brown and Association were entitled to attorney fees incurred in defense of the declaratory relief and breach of contract claims under former CC §1354(f) (now CC §1354(c)). As required by §1354, both causes of action sought to enforce the rights and obligations of the parties under the governing documents of a common interest development, specifically the CC&Rs. By seeking damages as well as a declaration of rights, Chee unequivocally sought to enforce her rights under the CC&Rs based on the judicial declaration she sought. Chee sought damages for the alleged breach of a contractual obligation whose source was the CC&Rs; an action for damages arising out of a breach of contract is an action to enforce the contract.

Reporter' s Comment: Personal injury attorneys should learn from this case to be careful about stretching their imaginations too far-they can bite back, like a biting dog. This would have been a run-of-the-mill "tenant dogbite" case but for plaintiff's counsel's creative use of the condominium's CC&Rs as a way to impose liability on deeper pockets. A landlord is liable for the bites inflicted by a tenant's dog only if it has actual knowledge that the dog is dangerous; attorneys for this victim sought to find some way around the ignorance defense in the CC&Rs. Had those restrictions been interpreted to make all condominium owners vicariously (i.e., strictly) liable for their tenants' negligent acts, the defense of lack of knowledge would have been swept away.

Normally, one wants a personal injury attorney who can come up with innovative theories, especially in an otherwise losing case, because there is usually no harm in trying. But when the novel doctrine implicates CC&Rs-which contain attorney fee provisions-less resourcefulness may be safer. The demand for attorney fees by a successful defendant does not need to be made in advance of the outcome and can spring up to surprise a defeated plaintiff already grieving over the disappearance of a hoped-for recovery. (I wonder whether this client's attorneys had warned her that this could happen.) As far as warnings go, it should be obvious that all defense counsel in this particular case had better advise their clients that they will be in serious trouble if the dog bites another neighbor, because their lack of knowledge defense no longer exists. We are not told what kind of lease was involved or what kind of powers the lease gave the landlord in cases of known dangerous dogs, but that had better now be looked into by all concerned.

CONSTITUTIONAL LAW; DUE PROCESS; "PUBLIC PURPOSE:"Maryland high court, in an opinion laden with "anti-*Kelo"* sentiment, holds that City may not "quick take" property for urban renewal purposes when no specific development plan can be shown, even where City's practice has been to issue RFP's after it has "locked in" property so that developers can efficiently design their proposals. ***Mayor and City Council of Baltimore City v. Valsamaki, 2007 Westlaw 415356 (Md. 2/08/07)***, discussed under the heading: "Eminent Domain; "Quick Take;" Public Purpose."

COOPERATIVES; RULES; COMMON AREAS; : A Cooperative cannot require that the guests of certain residents be accompanied by building staff through a shared vestibule, but it can grant to certain residents an exclusive right to receive packages and store goods in the vestibule. ***Braun v. 941 Park Avenue, Inc., 816 N.Y.S.2d 58 (A.D. 1 Dept. 2005)***. In order to resolve a dispute between residents of a unit whose lower level entered a certain vestibule ("LL residents") and the residents of a unit whose upper level entered the same vestibule ("UL residents"), the Cooperative board gave LL residents the exclusive right to store items and receive deliveries in the vestibule. The cooperative also put into place a requirement that the guests of UL residents be accompanied by a member of the building staff whenever they are passing through the vestibule.

The court deemed the former requirement reasonable because of the constricted area of the vestibule. However, the court deemed the latter requirement unreasonable, because it gave the impression that the guests of UL residents were of "such unsavory character" that they would not be permitted inside without a member of the building staff to accompany them.

COTENANCY; FORECLOSURE; STATUTORY REDEMPTION; ASSIGNMENT OF RIGHTS OF REDEMPTION: Parties to whom tenants in common assign their rights to redeem property following foreclosure take their assignments as tenants in common. A redemption by one tenant in common inures to the benefit of all the other cotenants, subject to the right of contribution. ***Bankers Trust Co. v. Woodall, 2006-NMCA-129, 140 N.M. 567, 144 P.3d 126 (8/23/06)***, discussed under the heading: "Mortgages; Statutory Redemption; Assignment of Rights of Redemption; Cotenant Borrowers."

EMINENT DOMAIN; "QUICK TAKE;" PUBLIC PURPOSE: Maryland high court, in an opinion laden with "anti-*Kelo"* sentiment, holds that City may not "quick take" property for urban renewal purposes when no specific development plan can be shown, even where City's practice has been to issue RFP's after it has "locked in" property so that developers can efficiently design their proposals. ***Mayor and City Council of Baltimore City v. Valsamaki, 2007 Westlaw 415356 (Md. 2/08/07)***

It appears, based upon testimony quoted in the opinion, that Baltimore had been using a redevelopment scheme for certain blighted areas that involved securing parcels within the area for redevelopment based upon a rather generally stated "mixed use" description and then inviting redevelopment proposals for those parcels. The city would use "quick take" eminent domain proceedings to acquire the properties so that the developers submitting proposals would be confident that the property was indeed available and that there would be no long delays in relocating the former owners.

The area in which the parcel in question was located, according to testimony of city officials, had seen no new investment in over 40 years, was inadequately developed, and ripe for redevelopment. In fact, it does not appear that these facts were seriously in question in this opinion.

The opinion, rather, focused upon whether the City had demonstrated that the quick take" process was necessary in order to meet the admitted public purpose goal of urban renewal. The court held, unanimously, that the City had not met its burden. Narrowly stated, the opinion was simply an interpretation of a local code provision relating to the condemnation authority of the City of Baltimore and applied only to "quick take" authority. Nevertheless, the court takes pains to analyze a huge body of Maryland precedent on the whole question of urban renewal powers. By the end of the opinion, one is left with the distinct impression that the court has alerted Maryland urban renewal enthusiasts that in the future a stronger showing will be necessary to support public takings for purposes of facilitating private development. Two members of the court felt it necessary to comment that they merely concurred in the result reached on "quick take" and that they did not concur in the discussion of "public purpose" takings.

The landowner here had questioned the legitimacy of the use of "quick take" authority in this case where the City had not identified a particular purpose or even a particular project for his parcel. Rather, the City Redevelopment officials readily admitted, they were securing the parcel before going out for redevelopment proposals specifically to make things easier for developers by providing assurances that the property would be ready when they were for a redevelopment project. The City had abundant statutory authority for redevelopment plans in general, and with respect to quick take authority, the City code provided that to institute quick take condemnation proceedings the City was required to file "a Petition under oath stating that it is necessary for the City to take immediate possession of, or obtain immediate title to, the property in question, and the reasons therefore. . . ." The court, in concluding whether to authorize the taking, could grant such authority "if it appears from a Petition for Immediate Possession, with or without supporting affidavits and sworn testimony, that the public interest requires the City to have immediate possession of said property . . . ." The affidavit in this case stated that the property was needed immediately "for business expansion."

In cross examination quoted extensively in the opinion, counsel for the landowner was able to show that the City in fact had no concrete plans for the parcel in question other than to include it in a mixed use development that would involve new investment and otherwise would meet the redevelopment criteria of the City. The precise nature of the development would be decided after competing development proposals were received and evaluated. But the City officials insisted that it was necessary to reassure developers that the property would be there for them, and that therefore "quick take" was a useful device here.

The trial court concluded that the City had not met its burden of proof to justify the quick take, and, on appeal, the Maryland Court of Appeals agreed.

In a separate part of the opinion, however, the court stated that, notwithstanding the broad latitude given to public agencies in *Kelo* to evaluate the public interest in urban renewal takings, the inadequate description of the public benefit to be derived from the renewal process in this case did not meet federal Constitutional standards, even if quick take were not at issue. This is pure *dicta*, of course, but it is a statement that will shake up City Attorney offices throughout the state, and perhaps in other states. It does seem that the "fishing expedition" type of redevelopment does not impress the court as adequate.

Comment 1: The holding, of course, required an interpretation of the statute to establish that it in fact imposed a burden of proof on the City to show that a "quick take" was necessary. This was made more difficult by the existence of decades of Maryland decisions concluding that in general there was a presumption of legitimacy in City takings, including takings for redevelopment purposes. The court indicated that these cases did not involve "quick take," and there distinguished them, while also relying upon the precise language of the statute. But a reading of the 60 pages of analysis here gives the reader a distinct feeling that the court is in fact saying something here that a simple revision of an administrative statute regarding affidavit requirements won't cure.

Comment 2: The court, for instance, appears to be saying that the right to be free of unjustified "quick take" processes arises to Constitutional stature, even in circumstances in which the ultimate purpose of the taking is shown to be acceptable. The editor, frankly, is uncertain whether there is any U.S. Supreme Court authority clearly standing for that proposition. It appears to be a question of first impression for Maryland.

Comment 3: Will it be sufficient for the City to hold hearings to explain why "quick take" in general is a useful tool in redevelopment activities? It struck the editor that the City redevelopment officials did a pretty good job of explaining that to the trial court below. But the court seemed concerned that the "quick take" process severely truncates the ability of the landowner to conduct discovery concerning the legitimacy of the public taking here, both the speed and the fact of it.

Comment 4: Note that there was no question really discussed here as to the adequacy of the showing that the property was blighted and in need of the redevelopment process. Why aren't those facts enough? Why can't the City, rather than the court, be the arbiter of the best way to carry out an admittedly necessary redevelopment. Here's what the court said:

"Thus, while economic development may be a public purpose, it must be carried out pursuant to a comprehensive plan. In a specific case, simply providing that a property is be be condemned "for urban renewal purposes," without more, is not enough. This is particularly true where "quick take condemnation proceedings are concerned . . . "

This language clearly is not limited to "quick take" situations. The court is reserving the right to review the adequacy of all redevelopment plans. The editor submits this is precisely what *Kelo* declined to do.

"When, and if, a governmental entity attempts to unnecessarily utilize a form of condemnation that procedurally abridges te right of the property owner to contest the taking of his or her property, it is the function of the court to assure to the property owner that his or her procedural rights are protected. . . ."

The court further emphasizes that if the landowner is in fact ultimately successful in contesting the purpose of the taking, the landowner may have suffered irremediable harm because by then, for instance, his house may have been torn down during the City's possession of the property.

EMINENT DOMAIN; JUST COMPENSATION; PUBLIC UTILITIES; CONSTITUTIONAL LAW;: A "contribution in aid of construction" (CIAC) charge is used for the purpose of setting utility rates. It is not equivalent to the fair market value of property in a condemnation action, and if a school district later elects to condemn the facilities built with the CAIC, the school district may not deduct the charge from the condemnation award, as this will result in an unconstitutional taking of property without just compensation. ***Bd. of Educ., Moriarty Mun. Sch. Dist. v. Thunder Mountain Water Co., 2006-NMCA-135, 140 N.M. 612, 145 P.3d 92 (8/30/06; cert. granted, 8/19/06).***

In 1999 the School District paid the Water Company a fee of $60,715 for the installation of a water line and related equipment to serve one of its schools. Under the applicable statute the fee was denominated as a "contribution in aid of construction" (CIAC). In 2002 the School District became dissatisfied with the quality of the Water Company's water and decided that it wanted to serve the school with water from its own well. It filed a condemnation action against the Water Company seeking to condemn the same water line and related equipment. It was stipulated that they had an actual value of $60,715. Note that this is the same amount that the School District paid the Water Company to install the same water line and related equipment three years earlier.

The School District asserted it was entitled to deduct the CIAC charge from the compensation due to the Water Company, in order to keep from paying twice for the same property. The Water Company disagreed, arguing that the first payment was a "charge" for purposes of setting rates for water, that had nothing to do with condemnation, and that allowing deduction of the charge would result in a taking for public use without payment of just compensation. The district court granted summary judgment in favor of the Water Company. The School District appealed to the New Mexico Court of Appeals, which affirmed the district court.

The Court of Appeals relied upon condemnation cases and principles, as opposed to rate-making cases and principles, to answer the question presented before it. The Court of Appeals concluded that the School District exercised its right to acquire the water line extension belonging to the Water Company by eminent domain, and therefore, the Water Company was constitutionally entitled to "just compensation" for the taking. "Just compensation" includes "the fair market value of the property on the date of the taking." *Id.* ¶ 12 (*citing* N.M. Uniform Jury Instruction 13-703 NMRA). The Court of Appeals also held that "[c]ondemnation cases teach that property contributed to the utility by a CIAC is not excluded from just compensation." *Id.* The Court of Appeals continued its analysis by interpreting, and even relying upon, cases from other states, recognizing that the CIAC is a separate act from the condemnation. Ultimately, the Court of Appeals concluded that deducting the CIAC payment from the condemnation award would unconstitutionally deprive the Water Company of its property without just compensation.

Comment: Obviously these kinds of cases don't come along all the time, but the attitude shown by the school district here is not surprising, and one would expect that if your utility client's property is condemned under circumstances like those set forth here, the condemning public agency will take the same view as the school district did here. So let's hope you remember this case.

ENVIRONMENTAL LAW; HAZARDOUS SUBSTANCES; STATE ENFORCEMENT: Both the prior and current owner of a contaminated parcel of real property are liable for the production or exposure of hazardous substances on the premises and failure to remedy the contamination. ***500 Assoc., Inc. v. Natural Res. and Envtl. Cabinet, 204 S.W.3d 121 (Ky. Ct. App. 2006)***:

The Natural Resources and Environmental Cabinet (the "Cabinet") filed an administrative complaint against the Vermont American Corporation ("VAC") and 500 Associates, Inc. ("500") to hold both entities responsible for the characterization and remediation of an environmentally contaminated vacant industrial lot in downtown Louisville, Kentucky (the "Site"). The Cabinet based its claim on evidence that both parties violated Kentucky's Superfund statute by failing to comply with certain obligations regarding alleged hazardous substances released on the Site.

During VAC's period of ownership, it had generated and released various hazardous wastes associated with the manufacturing of circular saw blades and hand tools and untreated waste water. When VAC closed its manufacturing operations, it hired Petrochem to restore the buildings to acceptable industry standards. Unfortunately this cleanup activity generated additional hazardous waste that was left in pits and trenches.

500 purchased the property from VAC after conducting a cursory environmental audit of the Site and hiring an environmental consultant, Ro-Tech. 500 had specific knowledge of the potential for discovery of hazardous materials at the Site because it had purchased an adjacent industrial parcel which was also contaminated. During its investigation, Ro-Tech failed to take any samples of environmental media, soil or groundwater and did not review available public documents. Ro- Tech's report to 500 gave the site a clean bill of health and recommended no further testing.

Three years after it purchased the Site, 500 demolished a portion of one of the buildings on the Site, exposing part of the earth. That same year, 500 contracted to sell the property to Doe Anderson Advertising Agency ("Doe"). Doe hired its own environmental consultant, ECRE. ECRE's review of public records and soil and groundwater sampling revealed potentially hazardous substances, and its report to Doe recommended further investigation. 500 received a copy of this initial assessment and claimed that this was its first notice of contamination at the Site. 500 claimed that it contacted VAC after receipt of the report and requested information regarding the contamination. VAC provided no information and maintained that it did not have any spills or releases during its operations that might have contaminated the Site. 500 did not contact the Cabinet regarding ECRE's findings and did not take any remedial action at the Site.

One year later, 500 hired a second consulting firm to conduct soil sampling, which confirmed the presence of hazardous substances on the Site and indicated that the contamination was likely caused by another property. Once again, 500 did not report the results to the Cabinet nor take remedial action. However, Doe withdrew from the purchase contract.

Three years later, the Cabinet conducted its own investigation of the Site which confirmed the existence of contamination of the Site and the groundwater. The Cabinet informed 500 and VAC of their obligations under KRS 224.01-400 to characterize and remedy the releases on the Site; both parties denied responsibility and refused to perform remedial work. This enforcement action followed, with the Cabinet alleging that both parties were strictly liable for the contamination. The Secretary of the Cabinet assessed civil penalties against VAC and 500 and found both parties jointly and severally liable for the releases of hazardous substances into the environment, with VAC bearing 95% responsibility and 500 bearing 5% responsibility for the costs and characterization of the cleanup.

Both VAC and 500 filed petitions of review with the circuit court. The circuit court held that while the Secretary did have the authority to assess penalties against both VAC and 500, it did not have the power to determine matters of contribution, and the court remanded the matter of the response costs and characterization of the cleanup to the Secretary with the instruction to impose liability on one of the parties.

The court rejected all of 500's arguments and concluded that it was not an innocent purchaser of the Site. The court also held that it was proper to take judicial notice that 500 had affirmatively contributed to the migration of the hazardous materials by trenching and exposing the contaminants to rainfall and, therefore, affirmed the penalty assessed against 500. Both VAC and 500 appealed.

In its appeal, 500 argued that (i) it was improper to take judicial notice of a scientific fact regarding the effect of rain water on contamination of soil, and (ii) there was no evidence that it caused any of the contamination at the Site. After reviewing the evidence regarding 500's activities at the Site, the appellate court concluded that even without taking judicial notice, there was substantial evidence and testimony to support the finding that 500's actions contributed to the contamination.

The appellate court also rejected 500's innocent purchaser defense. The court noted that because it was asserting an affirmative defense, 500 had a very "heavy burden of proof to avoid liability" and there is a "high duty of inquiry attached to commercial transactions." The court pointed to evidence of 500's lack of due care in demolishing a portion of the Site and its failure to abate the contamination once it received notice of the problem to negate this defense.

VAC argued in its appeal that (i) it was improper to penalize VAC for failing to provide an adequate site characterization report because the Cabinet did not provide guidelines for such reports and (ii) it is clear that the only reason for penalizing VAC was based on the inadequacy of the report. The appellate court rejected these arguments, stating that the Hearing Officer stated in great detail its reasons for assessing the penalty against VAC, which included VAC's economic benefit derived from its failure to remedy the contamination, its wanton disregard for the Cabinet's direction to remedy the contamination and its failure to cooperate with the Cabinet during the investigation process. Thus, the Court of Appeal affirmed the judgment of the circuit court.

LANDLORD/TENANT; ESTOPPEL; GOVERNMENT LANDLORDS: Estoppel or other equitable doctrines will not be applied to create or modify rights involving government entities as landlords. ***Odessa Texas Sheriff's Posse, Inc. v. Ector County, Texas, 2006 Westlaw 3030541 (10/26/06) (opinion not yet approved for publication) (appeal filed),*** discussed under the heading: Landlord/Tenant; Assignments."

LANDLORD/TENANT; ASSIGNMENTS; IMPLIED ASSIGNMENTS: If an unincorporated tenant incorporates, and later is dissolved, any lease rights it has remain with the inactive and powerless corporate entity, and consequently the tenant has no lease, even though it continues to function as lessee for over 30 years thereafter. ***Odessa Texas Sheriff's Posse, Inc. v. Ector County, Texas, 2006 Westlaw 3030541 (10/26/06) (opinion not yet approved for publication) (appeal filed)***

In 1954, a unincorporated organization known as the Ector County Sheriff's Posse, a riding club, leased seventy nine acres of land from Ector County for 99 years for a total lease of $10. The club took possession and commenced building improvements.

The Ector County Posse was incorporated in 1959, but in 1963 the Secretary of State dissolved the corporation for failure to pay taxes. In 1986, the Ector County Posse again incorporated itself, and in 2003 changed its name to the Odessa County Posse.

For over 50 years, club members used the property and improved the grounds. By 2005, the value of the improvements on the grounds was estimated at over $300,000.

In 1999, Ector County determined that it needed the land for an airport extension and demanded that the club leave the property. The club did so, but demanded that it be compensated in inverse condemnation for loss of the valuable lease and improvements. A trial court granted summary judgment to the County, apparently on the ground that the Club lacked standing, and this appeal followed.

The court first upheld the trial court's ruling that the entity now known as Ector County Posse was not the originally incorporated Ector County Posse, as the original Posse had forfeited its right to do business when its franchise was revoked in 1963. Nevertheless, the Posse argued that it had standing because, in its own right, it had a property interest under one of four notions: (1) that a lease existed with the County based upon the conduct of the parties; (2) that the present Posse was a successor in interest to the original Posse in the lease; (3) that there was an express or implied assignment of the lease to the present Posse, or (4) that the County was estopped to deny the Posse's lease rights.

The appeals court serially gunned down each of these claims and upheld the trial court.

The club's first argument was that a lease ought to be viewed as existing because of the conduct of the parties. The club occupied the property and its activities and its improvements were accepted by the County and indeed were beneficial to the County. The court construed this argument to be tantamount to "lease by estoppel." Although, it indicated, a court might conclude that a lease existed between private parties on the basis of such an argument, it concluded that equitable estoppel ought not to interfere with a public agency's use of its property for governmental purposes. Governmental agencies "cannot be divested of their rights in real property by estoppel, laches, adverse possession, dereliction, or the acts or conduct of their officers or agents." A prior case had permitted a tenant to reform a lease executed by a public agency on the grounds that the public agency had originally intended a broader property description. Although this appeared to apply equitable doctrines to correct the legal rights set forth in the agency's lease, the appeals court here distinguished that case by observing that under the instant facts the court was not construing the County's original actions, but determining whether subsequent actions, long after the original lease, compromised the County's land rights. It also commented that the original case involved public land held in a proprietary, rather than a governmental, capacity. That was not the case here, the court stated, but did not indicate why this was true as of the time the alleged lease had arisen.

The club next argued that it was the lawful successor to the original Ector Count Sheriff's Posse. Here, the trial court relied heavily upon findings of fact made by the trial court, even though it acknowledged that typically the law does not permit trial courts to find facts on a summary judgment motion. The trial court first found that there was nothing that Ector County had ever done that recognized the present club as a successor to the original lessee. The court went by this one very quickly, as it does seem contrary to the record, but it accepted the trial court's conclusions without further comment because, it claimed, appellants had not directly challenged it.

The court stated that, although the new club, when it incorporated in 1986, believed and intended that they were taking over the functions, assets and liabilities of the original 1959 corporation, and although County employees had in fact acknowledged this, the mere intent to take over the role of the old entity established nothing, and the County could not be estopped by the statements or actions of its employees. As the two corporations were in fact distinct entities, the court commented, some further evidence of succession was necessary.

As to the notion that there was an oral assignment of the lease. The court commented that this was not possible. When the original corporation was dissolved, it had no right to "reincorporate" itself at some later time, unlike what would be the case modernly. Thus the legal title to its assets remained with the corporation, while "the beneficial title vested in the shareholders." But this legal ownership was ineffective, as the corporation lacked any power to conduct business. The court also alludes to a Statute of Frauds argument concerning the oral assignment, but says nothing more about this issue.

The final argument, based upon estoppel, was similarly dismissed out of hand. As indicated, the court concluded that equitable estoppel cannot lie against the County. And, it stated, that even if it was wrong on this point, there were no affirmative statements made by County officials upon which the club members could rely that would give rise to an estoppel by reliance.

Comment 1: To the editor's mind, blessedly free of any knowledge of the niceties of corporate dissolution law, this appears to be one royal Texas screwing.

The original lease was with an unincorporated entity, represented by individuals carrying out certain activities. As the lease was for 99 years, clearly those individuals were not going to be the ones expected to continue the activities – so the County conferred the lease rights on a group that was continuously remaking its membership, formed around a series of activities involving horsemanship. It appears, even from the court's self serving summary of the facts, that these activities were in fact carried on continuously with the County's knowledge and without the County's objection for over 50 years. We don't have to talk about estoppel here. All we have to say is that both sides to the arrangement in fact recognized the unincorporated association that continued to act after the 1959 dissolution as the true lessee, and that this lessee later incorporated and became the instant plaintiff.

There is lease law to support this conclusion. In a number of cases, some of them discussed on DIRT in the past, corporate entities occupied space leased by other corporate entities involving the same principles, and the court concluded that the occupying entity was in fact a effective assignee of the lessee. No writing was required.

Comment 2: The critical notion here is the statement that there was nothing that Ector County had ever done that recognized the new corporation as the successor to the old. The court, of course, accepts this finding of fact because, it claims, it was never challenged on appeal, even though the court's own statement of the club's arguments appear to reveal that the opposite is true.

In any event, is this even the right question? Shouldn't the question be whether the group of individuals that carried on the riding club activities after the 1959 dissolution, before being reincorporated, were effectively the continuation of the group that originally obtained the lease? The original tenant was not a corporation. It strikes the editor as bizarre that the tenant's rights completely dissolved when it lost the corporate status that it later undertook, even when there was no change in function.

MORTGAGES; FORECLOSURE; STANDING TO FORECLOSE; MERS: MERS wins first round of Florida foreclosure litigation – nominee that is in possession of note has standing to foreclose, even it is not beneficial owner. ***Mortgage Electronic Registration Systems, Inc. v. Azize, 2007 Westlaw 517842 (Fla. App. 2/21/07)***

What a remarkable piece of litigation. Mortgagor defaulted on a note, a foreclosure was instituted in the name of MERS, nominee of the lender, and the mortgagor did not show up to defend. Nevertheless, *sua sponte*, the trial court, apparently irritated about lawyer's practices in a number of MERS related foreclosures, dismissed this foreclosure proceeding and, while he was at it, many others, on the grounds that MERS did not allege or prove that it was in fact the beneficial owner of the note. The trial court also made a number of other observations about the practices of lawyers who alleged that MERS had lost the note and simultaneously alleged that it possessed the note. But this case focuses only on the nominee issue.

Although, as indicated, the mortgagor was not represented either at trial or on appeal, MERS had illustrious counsel at the appellate stage, and *amicus* briefs were filed by Foley and Larneer, Greenberg Traurig, Akerman Senterfitt, FNMA counsel, and Powell Goldstein, all supporting MERS position, one assumes. Balanced against all this firepower, which certainly cost far more than the balance owing on the contested mortgage, was an *amicus* brief from Jacksonville Area Legal Aid, Inc., written by formidable DIRTer April Charney.

The case has to be regarded as a ringing victory for MERS. Although the case was remanded for further proceedings on the question of whether MERS in fact has possession of the note, the appeals court unequivocally indicated that a corporate nominee that is the holder of a note could bring a foreclosure action for another corporate beneficial owner of a note. Further, if, indeed, the note is lost, MERS will be permitted to demonstrate this fact and to "reestablish" the note.

Comment 1: In light of the sweeping and nasty ruling by the trial court in this case, MERS has to be very gratified by this ruling. As noted earlier, it does not address issues concerning MERS functions as a debt collector under numerous consumer protection acts, but it does recognize, as did a recent New York decision, that there is nothing improper about MERS serving as nominee of a beneficial owner, which is the fundamental principle at stake for MERS here.

Comment 2: The court emphasized that the mortgage itself stated that borrower understood and agreed that MERS held only legal title to the mortgage but that it might exercise the remedies available to mortgagee, including foreclosure, as nominee of the true owner of the note. The mortgage also stated that "MERS is the mortgagee under this Security Instrument."

How important is this language? The court doesn't allude to it later. The editor understands that MERS practices have varied from jurisdiction to jurisdiction and from time to time. Not all MERS foreclosed mortgages will contain this language. We don't know whether it's vital. The New York decision, the editor recalls, made nothing of such language.

Comment 3: In comments sent to the editor, April Charney commented that in her view the court still confuses the issue because it seems to be of the view that MERS alleged itself to be the "owner" of the mortgage, but doesn't say how it reached that position when it was not beneficial owner. In the editor's view, the court does not assume nor require that MERS be the beneficial owner of the mortgage, but only the legal owner, which it was because it was the named owner and because subsequent transferees of the note acquiesced in MERS' continued legal ownership of the mortgage rights.

The editor acknowledges that the court in the opinion states that 'MERS alleged that it is the owner and holder of the note and mortgage and that allegation has not been contested by responsive pleading. Assuming that the complaint properly states a cause of action to reestablish the note [the editor assumes – in those instances in which the note in fact is not in MERS' possession] and that MERS can show prima facie proof of such allegations, MERS would have standing as the owner and holder of the note and mortgage to proceed with the foreclosure."

Ms. Charney reads this language to suggest that the court is of the view that MERS must be the "owner" of the note and mortgage. But other language in the opinion makes clear that all the court is requiring is that MERS be the holder of the note and legal mortgagee, even though it is performing these functions as nominee for the beneficial of these interests. In the case of a securitized pool, the court acknowledges that the beneficial owners could be legion.

MORTGAGES; PRIORITY: Timber deed of trust has priority over subsequent UCC filing. ***Feliciana Bank & Trust v. Manuel & Sessions, L.L.C., 943 So. 2d 736 (Miss. 2006).***

Feliciana Bank & Trust Company loaned money to Ducote and secured the loan by a deed of trust on land in Wilkinson County, Mississippi. Ducote subsequently contracted to sell the timber on the land to Manuel & Sessions, L.L.C. (there are some factual questions about whether Manuel & Sessions was the real purchaser, but those questions are not relevant to the real property issue.)

Manuel & Sessions cut and sold the trees and paid the proceeds from the sale to Ducote and others involved in the cutting. Ducote did not apply the proceeds from the sale to his loan.

The bank subsequently foreclosed on the land. The proceeds of the foreclosure sale were less than Ducote's indebtedness to the bank. The bank brought an action for waste against Manuel & Sessions.

Although there are numerous cases decided prior to the enactment of the UCC which followed the common-law rule that the timber remains part of the realty until severed, there are no cases in Mississippi that address this issue after the enactment of the UCC.

Manuel & Sessions argued that, under the Uniform Commercial Code as in effect in Mississippi ("UCC")(all relevant provisions of the UCC are the uniform versions), the security provided by the bank's deed of trust was extinguished as to the timber when Ducote signed a contract to sell the timber. They claimed that the UCC changed the law and that once a contract for the sale of the timber existed, the only way for the bank to obtain security interest in the timber was to file a financing statement. The bank asserted that it had filed a financing statement, but the court characterized the bank's compliance with the UCC as "questionable." The trial court held that once the contract had been signed, the UCC cancelled the bank's interest in the timber under the deed of trust, and the only way for the bank to perfect a security interest in the timber to be cut was to file a financing statement. Since the bank's deed of trust apparently did not meet the requirements of a financing statement covering timber to be cut, the trial court reasoned, the buyer took free of the bank's interest.

The definition of "goods" in Article 9 of the UCC includes "timber to be cut and removed under a conveyance or contract of sale." Subsection (2) of Section 2-107 of the UCC provides in relevant part, "A contract for the sale apart from the land of … timber to be cut is a contract for the sale of goods within this chapter…even though it forms part of the realty at the time of contracting, …" Subsection (3) of Section 2-107 provides, "The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale."

On appeal the Mississippi Court of Appeals reversed the trial court on this issue. Once a lender has filed its deed of trust on the land and timber, the execution of a contract to sell the timber does not cancel the lender's interest; rather, the purchaser of the timber takes subject to the lender's deed of trust. The UCC does not evince any intent to terminate the interest of an existing deed of trust in the timber. Section 9-2-107(3) of the UCC indicates that the intent was that the existing interest in the timber created by the deed of trust would continue and maintain its priority in the timber to be cut after the contact to sell was signed.

Reporter's Comment 1: The Reporter did some quick research under Section 2-107 of the UCC, and this case appears to be one of first impression on this issue. The reason for this may be that the result should be obvious; any other result would greatly diminish the value of timber lands as collateral. The intersection between the UCC and real property law in this context is sufficiently murky, however, that able defense counsel was able to convince an experienced trial judge to reach a different result in this case.

Reporter's Comment 2: In addition to filing a financing statement, a lender loaning money secured by timber lands can protect itself by making sure that its deed of trust also qualifies as a financing statement covering timber to be cut. The UCC expressly contemplates in Section 9-502 (c) that a deed of trust can serve as a financing statement covering timber to be cut, as well as as-extracted collateral, and also serve as a fixture filing. It is important, however, to distinguish between a deed of trust serving as a financing statement and a fixture filing. When a deed of trust serves as fixture filing, the fixture filing does not lapse until the deed of trust is cancelled. UCC 9-515(g). A deed of trust that also is a financing statement covering timber to be cut or as-extracted collateral is subject to the general five-year lapse rule as to that type of collateral.

Reporter's Comment 3: In this case Manuel & Sessions did not file a copy of its contract. Would that have made a difference? Under the court's ruling, the result in this case should have been the same. If the purchaser had filed a copy of its contract, and then a judgment was filed against the owner/seller of the timber before the sale is finalized, would the filing of the contract permit the purchaser to take free of the judgment?

Reporter's Comment 4: The statement in Section 2-107(3) that the buyer can protect itself by filing the contract for sale in the land records raises a number of questions. Is the buyer protected if it files only a memorandum of the contract rather than the contract itself? The seller and buyer may want to keep the financial terms of a contract confidential. What if the buyer filed a financing statement in the land records giving notice of the sale-would that be sufficient? Also, how does this statute work with other statutes that require that every instrument to be recorded in the land records must meet certain requirements? For example, Mississippi requires that every instrument to be recorded in the land records must identify the preparer of the instrument, show the indexing instructions so that the instrument can be properly indexed, and be acknowledged by a notary public. A typical contract for sale of timber would not meet these recording requirements. Is there any possibility that such a contract would be considered a "record" under Section 9-516 of the UCC, which limits the grounds on which a clerk can refuse to record a document?

Reporter's Comment 5: The Feliciana court stated, "Under the UCC, though, if a typical deed of trust is executed after a contract for the cutting of the timber has been executed but before the actual harvesting of the trees, the deed of trust will either not apply to the timber at all because the timber is now personalty, or else the deed of trust will be subordinate to a prior UCC filing." If the owner of the land and a buyer execute a contract for sale of timber, but do not file the contract (or otherwise give notice of their contract) before a deed of trust is filed, shouldn't the beneficiary of the deed of trust have priority? Would it make a difference if an inspection of the property would have shown evidence that someone was about to cut the timber?

The Reporter for this item was Rod Clement of the Jackson, Mississippi, Bar. The editor has made changes.

LANDLORD/TENANT; DEFAULT; WAIVER: Under form lease guarantee that states that guarantor's obligations will terminate if the tenant is not in default during the first three years of lease, tenant will not be regarded as in default if it habitually pays rent within a 20 day "grace period" following due date if landlord consistently accepts such payment without objection. ***Madison Avenue Leasehold, L.L.C. v. Madison Bentley Associates, L.L.C. 2006 WESTLAW 3716035 (12/19/06)***

This decision affirms the decision reported as the Daily Development for 4/20/06. I'll repeat some of my comments from that report and add some new commentary. One of the Appellate Decision judges vigorously dissented below, and we got an uncharacteristically lengthy opinion. The Court of Appeals decision is unanimous, but still does a more thorough job than many such decisions from New York in explaining its reasoning.

The lease was an extensively marked up version of the Standard Form of Store Lease published by the Real Estate Board of New York, Inc. Presumably the guarantee came from the same source, although we're not told.

The guaranty stated that the guarantors were relieved of their guaranty if the tenant "shall not have been in monetary default . . . at any time during the first three years of the lease." Tenant routinely paid rent late, but within 20 days of the due date.

The default language, which the lower court correctly noted was "not a model of clarity" on the issue of when a default occurred, read as follows:

"It tenant defaults in . . . the covenant for the payment of rent . . .and if tenant shall not have diligently commenced curing such default within such twenty (20) day period . . . then owner may serve a written three (3) days notice of cancellation of this lease upon tenant."

Tenant quit the lease three years and three months following commencement (what a coincidence!!). In fact, after three years, the rent subsidy that tenant was receiving from the manufacturer of its Bentleys, Rolls Royce, expired. The court notes that the landlord refused to permit tenant to sell any cars other than Bentleys or Rolls Royces in the premises.

Obviously, the fight was about whether the guarantee had been released.

The court acknowledged, as the dissent asserted, that it was likely that the failure to pay rent on the original due date ought to be regarded as a "default." But it held that the landlord's consistent pattern of accepting late payments without comment constituted a waiver of its right to declare a default.

In the lower court decision, Justice McGuire, in dissent, took the position that in fact the interpretation of the majority was not what the parties probably expected – in fact it was far from it:

"[T]his waiver analysis ignores the economic realities of the lease in light of the guaranty. The guaranty effectively shifted the ultimate risk of [tenant's] non performance of the obligation to make rent payments from [Landlord] to the [guarantors.] Accordingly, [Landlord] had no economic reason to notify [tenant] of [tenant's] own habitually late payments during the very period in which [landlord] allegedly waived its rights by failing to do so. To insist on pain of waiver that [landlord] formally advise [tenant] of what it already knew makes little sense. On the facts of this case, in particular, that the [guarantors] are [tenant's] principals, the waiver analysis is all the more confounding, for it reduces to this: [Landlord] waived the rights it bargained for under the guaranty by failing formally to belabor the obvious both to [tenant] and [guarantor.]"

Judge McGuire was perfectly willing to concede that the Landlord might have waived its rights against Tenant to terminate the lease for late payment of rent. But, he asserted, this does not mean that Landlord ever waived its right to assert against guarantors that a default had occurred. The editor also felt the waiver reasoning was incorrect, referring to the case as "Phoenix poop." DIRT reader Manuel Fishman, who characterized himself as a "landlord's lawyer," disagreed. He felt that the landlord should have declared a default if it later intended to rely on the default in pressing the guarantors. He characterized the landlord's behavior as "stupid."

The Court of Appeals, perhaps recognizing the flaws in the reasoning of the appeals court, extending the meaning of "waiver" beyond its usual bounds, and also recognizing that the lease contained an "anti-waiver" clause, elected to decide the case on different grounds.

The Court of Appeals made a very fine reading of the term "monetary default" as used in the Guaranty. It stated that the meaning of the term would be assumed to be the same for both the guaranty and the lease, and it therefore looked to the lease for guidance as to meaning. It concluded that the terms "default" and "monetary default" were not just different kinds of default, but in fact occurred at different times for nonpayment of rent. The parties had included a "second notice" requirement before the landlord could terminate the lease for nonpayment of rent. After the first notice, the tenant had seven days to cure the defaulted rent payment, and after that the landlord still had to give a second three day notice before resorting to remedies. The court appeared to be of the view that only after the first notice and failure to cure did a nonpayment of rent become a "monetary default." Before that, it was just a plain ole' default.

The court characterized its interpretation as "common sense," as it was of the view that the guarantors should not lose their three year window as a consequence of a late payment that in fact had caused no real injury to the landlord. It reasoned that only continuing defaults ought to serve that function (although it doesn't say what would have occurred if the tenant had been egregiously late and the landlord forgave the lateness only on the steps of the courthouse. In such case, the landlord still got all its money, but under the technical reading by the court, a "monetary default" would have occurred.

Comment 1: The editor was concerned with the lower court opinion because it characterized the landlord's acceptance of late payments as waiver of rights created by the guarantee, which certainly would have been news to the parties drafting the lease and also inconsistent with the "anti-waiver" language in the lease. This kind of interpretation, in the editor's view, was poisonous enough to create uncertainty in the precedent, and the editor is happy to see it dismissed by the upper court. Let's hope that those looking at precedent understand the differences between the analysis of the two courts.

The Court of Appeals decision, in the editor's view, is pure sophistry, twisting the language of the lease in ways certainly the parties never thought about at all. But give me sophistry over bad policy every time. The Court of Appeals outcome can be limited to the facts of this case, and thus causes less harm overall. And it punishes the "stupid" landlord for not reacting in a more definitive way to repeated late payments.

Comment 2: The editor repeatedly warns his students to tell their clients of the dangers of too much "nice guy" in dealing with deadbeats. Formality is everything here if you want to preserve your rights. The warning letters and demands should be clear, succinct, as unconditional as possible, avoid extraneous issues, preserve all existing rights and insist on timely performance in the future. The lawyer, and not the client, should write them, at least in the case of persistent late performance. And the late performance itself should be followed by a letter.

LANDLORD/TENANT; CONSTRUCTIVE EVICTION; LANDLORD HARASSMENT: New Jersey common law does not recognize a claim for constructive eviction based on a landlord's malicious of an eviction suit, but even if it did, it is likely that there must be substantial and repeated acts of bad faith and malice by the landlord in order for a tenant to prevail. ***J.S. Properties, L.L.C. v. Brown and Filson, Inc., 2006 WL 3780560 (N.J. Super. App. Div. 2006); December 27, 2006.***

Tenant complained that the roof over its premises leaked repeatedly. It and its landlord entered into a settlement agreement whereby Tenant was permitted to deduct, from the rent owed, the cost of its repairs and lost merchandise due to the leaks. When the lease expired, the parties entered into a new lease that incorporated the terms of the prior settlement with respect to roof leaks. After the roof continued to leak, the landlord replaced the roof and sued Tenant for unpaid rent. The amount of unpaid rent represented the amount of Tenant's deductions for leak-related damages. The matter was removed from landlord-tenant court to the Law Division on Tenant's motion, and Tenant filed an answer and counterclaim.

Six months later, Tenant vacated the premises, returned the keys, and amended its counterclaim to add a claim that the landlord deprived it of its right of quiet enjoyment and that the premises' unsuitability for the purposes for which it was leased constituted Tenant's construction eviction from the premises. The lower court dismissed Tenant's constructive eviction claim, noting that the roof repairs had been completed more than a year before Tenant vacated the premises, and that Tenant's decision to vacate after the roof was replaced, and not during the many times the roof leaked prior to its replacement, was unreasonable. The lower court did not address Tenant's claim that it was constructively evicted based on the landlord's filing of the eviction suit.

On appeal, the Appellate Division agreed that Tenant's decision to vacate more than one year after the roof was replaced was unreasonable, but the Court did not decide whether a tenant can claim constructive eviction based on the landlord's filing of an eviction suit. The Court noted that in jurisdictions that recognize such a claim, it is generally understood that the mere filing of the eviction suit is not sufficient, and that there must be substantial and repeated acts of bad faith and malice by the landlord in order for a tenant to prevail.

The Court found that even if New Jersey common law should recognize a claim for constructive eviction based on a landlord's malicious filing of an eviction suit, such a claim would not succeed in this case based on the tenant's actions. It noted that the tenant did not leave when the suit was filed, but rather fought the eviction for more than six months before leaving. To the Court, that delay was unreasonable. It held that even if the tenant could file a claim for constructive eviction, its case failed due to the tenant's unreasonable occupation of the premises for more than six months after the eviction suit was filed.

Comment 1: What would have happened if the landlord had wrongfully demanded that the tenant leave the premises for nonpayment of rent, and the tenant did leave, but then thought better of its decision and claimed that the landlord had no right to demand possession? Here, very likely, we'd have an actual eviction. Don't need to call it "constructive," and presumably the tenant would have damages? Or would it be denied damages on the grounds that it should have resisted the landlord's demands in the first instance? Hmmmmm.

Comment 2: There have been a few cases in which a tenant has been able to raise a commercial retaliatory eviction claim based upon the tenant's public objection to aspects of the landlord's conduct pertaining to the lease. *See, e.g.* Port of Longview v. International Raw Materials, Ltd., 979 P.2d 917 (Wash. App. 1999) (DIRT DD for1/ 26/00) (Tenant of government-operated port facility can raise, as an affirmative defense to eviction, argument that port authority was evicting it in retaliation for exercise of right to free speech.) Also see Windward Partners v. Santos, 577 P.2d 326 (Haw. 1978) (retaliation for participating in a zoning hearing contrary to landlord's interest). The doctrine is discussed generally in the Randolph Edition of Friedman on Leases at Section 14.7.1. In *1266 Apartment Corp. v. New Horizon Deli, Inc.,* 368 N.J. Super. 456, 847 A.2d 9 (App. Div. 2004) (the DIRT DD for 9/28/04), a New Jersey court found that the concept was not quite ready for prime time in New Jersey. It held that the claim is not available where the landlord allegedly retaliated against a tenant who filed a personal injury action against the landlord.

LANDLORD/TENANT; LANDLORD'S LIABILITY FOR INJURIES TO GUESTS; CRIMINAL ATTACKS: Texas appeals court lowers the bar for proof of prior acts – prior robberies become reason to anticipate murder that was apparently retaliatory. Shopping center landlords must provide "deterrent" – highly visible – security guard presence. ***Trammell Crow Central Texas, Ltd. v. Gutierrez, 2006 Westlaw 3725248 (12/20/06) (not yet approved for final publication – petition for review filed)***

The jury here returned a verdict of over $6 million against the landlord for a wrongful death in which the landlord was charged with providing inadequate security at its mall. The verdict later was reduced to over $5 million.

The victim had recently been arrested in connection with his activities in fencing the spoils of some "smash and grab" burglaries. His confederates in those burglaries became aware that he was cooperating with the police in return for a lighter sentence, and started leaving him threatening phone messages. He was sufficiently concerned to ask the police for money to relocate, which money he had recently received. Nevertheless, he elected to attend a late movie with his wife.

As he was leaving the movie, the victim was shot at, chased, and eventually killed with two bullets in the shoulder, one in the back, and one in the back of the head. Allegedly, his wallet was taken, but other valuable items were not, and there is even some substantial doubt about the wallet. Nevertheless, the appeals court, 4-3, concluded that it was appropriate for the jury to conclude that a robbery was intended, and not a targeted "hit" to prevent the defendant from testifying against his confederates.

The court pointed to a series of robberies involving some level of violence and threat during the prior two years. There had been no murders, and indeed no shootings, and little actual violence. Nevertheless, the court concluded that there was a sufficient basis from which the jury could conclude that there was a history of violent crimes so that the landlord should anticipate that a murder was likely to occur and that therefore the landlord should provide adequate security protection.

Although the landlord routinely provided security in the form of two off duty policemen, the court noted that the policeman patrolled often in unmarked cars. Although they testified that they put their arms on the window sill so that their police insignia could be seen, the court pointed to expert witness testimony to the effect that this was not sufficiently "deterrent" security, and instead was "preventive" security, which was inadequate for the situation at hand. The court noted that Wal- Mart operated a security system with golf carts with flashing lights that constituted a very visible deterrent.

A stinging dissent argued that the result ran counter to established precedent in Texas that required clear evidence of prior similar crimes in order to support the finding of a duty to protect against violent crimes. The two opinions are worth reading. They certainly provide two very different views of the same facts.

Comment: As there doesn't seem to be any allocation of damages here – the landlord appears to be held liable for the whole $5 million, one must wonder just where the courts are going. Where there are lots of people, there will be crimes. Landlords can't prevent all of them. The jury will look at the injury, and at the deep pockets of the defendant, and that's it. The result is that a great deal of wasted money and effort will be invested in security measures that are highly unlikely to prevent this kind of crime, but otherwise will have the impact of intruding on shopping experience and adding to the costs of shopping, and expense borne by all. This kind of situation cries out for responsible judges monitoring runaway juries. In the editor's view, we didn't get that here.

LANDLORD/TENANT; LANDLORD'S LIABILITY FOR INJURY CAUSED BY TENANT CONDUCT; DOG ATTACKS: Party injured by tenant's dog may not recover from landlord where landlord had no prior knowledge of dangerous propensities of dog. Fact that rental is of a condominium unit that has CC&R's indicating that landlord remains liable for tenant's use of common areas does not create separate cause of action in individual tenants. Provisions are designed to impose liability on unit owner to association only. ***Chee v Amanda Goldt Prop. Mgmt. 143 CA4th 1360, 50 CR3d 40 (2006),*** discussed under the heading: "Condominiums; Liability of Unit Owner to Fellow Unit Owners; Attorney's Fees."

LANDLORD/TENANT; LANDLORD'S LIABILITY FOR INJURY TO TENANT EMPLOYEES: Even though a lease may include a landlord's disclaimers as to responsibility for its tenant's construction and design work, such provisions will not relieve a landlord from its duty to assure that its review of its tenant's construction plans adheres to the principles of safety. ***Geringer v. Hartz Mountain Development Corporation, 388 N.J. Super. 392, 908 A.2d 837 (App. Div. 2006); October 24, 2006.***

A landlord leased the entire floor of a building. The lease stated that the tenant was responsible for maintaining the premises, and for completing all repairs arising out of alterations the tenant made to the property. The tenant modified the property by elevating a portion of the floor, and by adding a staircase to reach the newly elevated portion. It hired its own architect and contractor to design and construct the stairway, and the landlord, pursuant to its reserved right under the lease, approved the plans.

An employee of the tenant fell on the stairs and was seriously injured. She filed a personal injury action against the landlord, claiming that as the property's owner and lessor, it had been negligent in the design, construction, maintenance, and repair of the stairway. The lower court granted summary judgment in favor of the landlord.

The employee appealed from the lower court's decision, and the Appellate Division affirmed in part and reversed in part. It affirmed the determination that based on the terms of the lease, the landlord did not owe a duty to the employee with respect to the maintenance and repair of the stairway. It reversed the determination that the landlord did not owe a duty to the employee with respect to the stairway's design and construction.

The Court began its discussion by explaining that whether or not a landlord owes a duty to someone injured on its property is based on a consideration of the relationship of the parties, the nature of the attendant risk, the landlord's opportunity and ability to exercise reasonable care, and the public interest in the proposed solution. The Court found that after viewing the lease, it was clear that the landlord did not have a duty to maintain or repair the stairway, as those responsibilities were allocated to the tenant. It cited precedent holding that a landlord is not liable for personal injuries suffered by a commercial tenant's employee on the leased property due to the lack of maintenance or repair, when the terms of the lease place the responsibility for maintenance and repair on the tenant. Considering the tenant's complete use of the property and the roles of the parties with respect to repairs and maintenance expressed in the lease, the Court found no public interest reason to impose a duty on the landlord to ensure that its tenant fulfilled its obligation to maintain the stairway. It also found that the attendant risk did not warrant imposing the duty.

With regard to the stairway's design and construction, however, the Court found that the landlord was substantially involved, and therefore was potentially liable for injuries caused by the same. It found that the lease provided for the landlord's substantial role in the design and construction of alterations to the space. The alterations could not have proceeded without the landlord's approval of the plans, and the landlord encouraged the tenant to use its in-house subcontractors. Therefore, the Court found that the landlord had an essential role in designing and constructing the staircase. It further found that while the lease included attempted disclaimers as to responsibility for construction and design work, such would not relieve the landlord from its duty to assure that its review of the construction plans adhered to the principles of safety. Therefore, the Court remanded the case for trial as to whether the landlord breached its design and construction duties and caused the employee's injuries.

Comment 1: Although the court discussed the landlord's pushing the tenant to use the landlord's subcontractors, the editor, having studied the case, does not conclude that this fact was essential to the court's finding of a duty here. The court was simply emphasizing that the landlord in fact actively and extensively exercised its right to review the proposed construction.

An inference might be drawn that if a lease provides for a duty on the part of a landlord to review and inspect proposed tenant improvements, and the landlord fails to do so at all, it is not, in fact, "extensively involved" in an alleged negligent construction, and might not have liability. The editor is not completely comfortable that this is an appropriate inference. The court first discussed the provisions in the lease giving the landlord the right of inspection, and then the fact that the landlord took full advantage of those rights. It is unclear whether the mere right, without the follow up, would be free of any duty. Where the landlord has no other reason to believe that the tenant will do something dangerous to the public, it may not be unreasonable to dismiss with a plan review and thus to avoid liability when the plans prove faulty.

Comment 2: The case is a useful cautionary tale. Although a party might not have a duty to perform certain actions, if it elects to perform them anyway, the party will be liable for its negligence.

Comment 3: Of course, here the landlord was somewhere between a rock and a hard place. Clearly it had an interest in reviewing and approving permanent improvements to its building. Therefore, it necessarily had to undertake a review of proposed plans. Thus, as a practical matter, it could hardly avoid the public responsibility to review these plans carefully.

Comment 4: In any event, the editor concurs that a party to a lease may not disclaim liability to third parties. One can seek indemnification, of course, from the other side of the lease (assuming that public policy concerns about waiver of negligence do not arise), but the lease should not permit a negligent party from avoiding its duty of care to prospective third party victims of its negligence.

LANDLORD/TENANT; LANDLORD'S REMEDIES; DAMAGES; MITIGATION: Although landlord's failure to mitigate is an affirmative defense that tenant must allege and prove, once tenant shows that landlord has not fully mitigated damages, landlord has burden to show that it was reasonable in its efforts to mitigate. ***Manor Park Apts. L.L.C. v. Delfosse, 2006 Westlaw 3772214 (Ohio App. 12/22/06)***

This is a residential case, but there is no reason to believe that the Ohio appeals court won't work the same magic with a commercial landlord.

Tenant failed to pay rent, received a notice to vacate, and complied. Landlord proceeded to advertise the apartment for rent, but did not relet the apartment, and sued tenant for damages for the balance of her one year lease term, a period of about 7 months. A magistrate recommended to the trial court that the landlord recover only for two months rent. Upon request by the trial court, the magistrate wrote an opinion explaining the magistrate's conclusion. The opinion stated that "it was unclear" to the magistrate whether the landlord had made reasonable efforts to relet the apartment for the entire term.

The gist of the factual finding was that the landlord did not provide evidence as to how it had dealt with this apartment in its stock of empty apartments. Further, the magistrate stated, the landlord had a significant number of vacancies for the period of tenant's lease, but few thereafter.

Not surprisingly, the appeals court accepted the view that the trier of fact was the best party to judge the actual facts of the reasonableness of landlord's efforts. But there were still significant issues of law to discuss.

First, there was the question of whether the conclusion that whether a landlord reasonably mitigated damages was "uncertain" justified a finding against the landlord. The landlord noted that prior Ohio authority had suggested, at least, that the tenant, and not the landlord, has to duty to allege and prove that the landlord did not mitigate damages.

The court, however, affirmed the trial court's conclusion of law that the landlord had the duty to prove that it had taken reasonable steps to mitigate damages.

The court first had to deal with the fact that the tenant hadn't even raised the issue of mitigation at trial. But the court held that the landlord's introduction of evidence going to show that it had taken steps to relet the apartment put the question at issue.

As to whether the landlord had the burden of proof, the court disregarded language from another Ohio appeals circuit that stated expressly that the tenant had to show that the landlord had not used reasonable efforts to mitigate.

The court stated that general rules of allocating the burden of proof support the notion that the burden ought to be borne by the party asserting the affirmative and the party with peculiar knowledge of the facts and circumstances. Here, the court concluded that was the landlord all the way.

The court took the view that showing the landlord had not been reasonable was the "proving of a negative." Rather, it held the landlord should show that it **was* reasonable. And, the court continued, the landlord's agents were the ones attempting to relet, and the landlord had all books and records supporting the reletting effort. So the landlord, not the tenant, has unique access to critical information.

A strong dissenting opinion accused the majority of "judicial activism." The dissent argued that this was not the typical case that might arise in which the issue of burden of proof was somewhat neutral and balanced. Rather, the tenant was a wrongdoer – she had breached the lease. In such cases, the appropriate and widespread public policy conclusion, according to the dissent, was that the tenant should have the burden of proof to show that the injured party failed to mitigate.

Contrary to the majority, the dissent argued that no other Ohio case supported the conclusion that the landlord had any original burden with respect to the showing of mitigation. The dissent scoffed at the argument that the tenant would be forced to prove a negative. Parties in litigation have to do as much all the time, the dissent maintained. As to the "unique access to critical information," the dissent commented, that's what discovery is all about. Through discovery, the tenant has the same access to the landlord's business records as the landlord has.

Comment: Of course, the dissent overstates things a bit when it maintains that the landlord and tenant are on equal footing with respect to their knowledge of the landlord's mitigation efforts. Nevertheless, the dissent's point that it is appropriate for the tenant to bear the burden of demonstrating that the landlord's claimed damages cannot be legally justified.

This is a very good case to illustrate the point. The magistrate made a big deal of the fact that the records did not show specifically whether the landlord showed tenant's apartment to prospective tenants. Although the court does not tell us the size of Manor Park's complex, the suggestion is that there are quite a few units. Should landlord really be held to a duty of punctilious record keeping as to how many times any individual unit is shown? The likely only benefit that would be derived from this exercise is to show satisfaction of landlord's mitigation burden in court. But landlord cannot charge the tenant for the cost of this additional record keeping.

In any event, is it likely that the landlord would not show a prospective tenant the old tenant's apartment if it were likely that the prospective tenant would be thereby influenced to rent from the landlord? The landlord has little motive to build up a claim against tenant in this case. The claim may not be collectible, and the landlord is certainly better off with cash flow than with a lawsuit against a defaulting tenant.

LANDLORD/TENANT; RESIDENTIAL; ALTERNATIVE DISPUTE RESOLUTION; MANDATORY ARBITRATION: A mandatory arbitration clause in a residential lease is void as against public policy when statutes create a specific housing court to hear housing complaints.. ***D'agostino v. Forty-Three East Equities Corp., 820 N.Y.S.2d 468 (N.Y. City Civil Ct. 2006)***.

A tenant under a life estate lease requested the landlord to repair damage that had been caused by a leaky roof. The landlord failed to make the repairs and the tenant commenced a Housing Part proceeding. One month later, the New York City Department of Housing Development and Preservation ("HPD") issued a violation against the owner for defective ceilings and walls within the tenant's apartment, thereby becoming a party to the proceeding.

The tenant's lease contained an arbitration provision mandating that all controversies arising out of the lease be settled by arbitration. Landlord therefore filed a motion to dismiss or stay the proceedings in order to compel arbitration.

The court held, that Although arbitration is generally a favored method of dispute resolution, a compulsory arbitration clause in a residential lease is void as against the public policy creating the Housing Part. The Housing Part hears all disputes regarding housing standards and has the equitable power to issue an order to correct a housing code violation. In addition, HPD is often a necessary party to the lawsuit but because it is not a party to the arbitration agreement it cannot be compelled to arbitrate.

LANDLORD/TENANT; RESIDENTIAL; IMPLIED WARRANTY OF HABITABILITY: A landlord has no duty to insure that bath water in tenant's apartment is not so hot as to scald an infant bather. ***Williams v. Jeffmar Management Corporation, 820 N.Y.S.2d 212 (A.D. 1 Dept. 2006).*** An infant tenant developed second and third-degree burns while bathing in water that was approximately 140 degrees. The tenant brought a negligence action against the landlord. The court found that the landlord was not negligent because the relevant statute, Building Code Reference Standard RS-16, §P107.6[i], stating that temperature control valves must be equipped to reach no more than 120 degrees, did not apply to the tenant's apartment. The court further held that the landlord did not violate any common law standard of care because water temperature fluctuations are to be expected and piping water above 120 degrees into an apartment is beneficial as very hot water kills microorganisms.

LANDLORD/TENANT; TENANT LIABILITY FOR DAMAGES TO PREMISES: A provision in a lease which holds the tenant liable for all damages, "intentional or non intentional" does not impose strict liability on that tenant without additional evidence that the parties intended to impose such liability. ***Allstate Ins. Co. v. Watson, 195 S.W.3d 609 (Tenn. 2006)***:

The defendant in this case is the tenant under a lease of a duplex in Nashville, Tennessee. In 1998, a fire caused damage to the duplex in the amount of $25,788.47. Allstate paid the loss to its insured, the landlord/owner of the duplex, and brought suit against the tenant asserting subrogation rights as the landlord's insurer. The language of the lease provided that the tenant was "responsible for all damages to the apartment, intentional or non intentional." The trial court ruled that the tenant did not intentionally or negligently cause the fire damage but held the tenant strictly liable for the damage under the terms of the lease. The Court of Appeals reversed, holding that the insurer had no right of subrogation against a tenant because the tenant and landlord are deemed co-insureds. Allstate appealed to the Supreme Court. The Court concluded that the phrase "intentional or non intentional" is ambiguous and applied established rules of construction and parol evidence to determine the intent of the parties. It relied on statements from the defendant and the non-lawyer who drafted the lease on behalf of the landlord that it was not their intent that the tenant be strictly liable for damage to the property. The drafter stated that the intent was to hold the tenant responsible for damages resulting from some degree of fault on the tenant's part. Therefore, the Court held that the damage provision of the lease only provided for liability in instances of intentional or negligent damage by the tenant. Because tenant was not liable to landlord under the lease, there was no basis for subrogation, and the Court did not reach the issue of whether the landlord and tenant are co- insureds.

"Any grant by the Mortgagee of any extension of time for the payment of any obligations secured hereby, either to the Mortgagor or to any other maker, endorser or other person, or the taking of other or additional security for any such obligation, or Mortgagee's waiver of or failure to exercise any right hereunder, including the right to accelerate the whole or any part of the debt secured hereby, shall not in any way affect this mortgage, nor the rights of the Mortgagee hereunder, nor operate as a release from any personal liability upon the obligations secured hereby or under any covenant or stipulation herein contained."

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MORTGAGES; ACCELERATION; WAIVER: When mortgage borrower is aware that lender is refusing to reinstate debt and insisting on acceleration, borrower cannot reinstate the loan by paying the arrearages in response to a computer generated demand for them. ***Buckeye Retirement Co., LLC, v. Walling, 2006 Westlaw 3849683 (Ohio App. 12/29/06)***

Borrower entered into a mortgage loan in 1991. Borrower was frequently late in payment, and periodically brought payments up to date with a large "catch up" check which lender had accepted in the past. After about eight years of this, Borrower was late four months in payment. Lender sent a notice that the loan was accelerated.

Borrower sent a letter to the party that wrote the Bank's letter to Borrower, enclosing a check for the back payments and late charges. The letter state that the Bank "may endorse and negotiate the check only with the understanding that such endorsement, presentment and negotiation removes the loan from default status." The Bank, apparently advised that negotiation of the check under such circumstances might constitute an accord and satisfaction that would compromise its rights to foreclose, and apparently determined to foreclose, did not negotiate the check. Borrower subsequently sent in another monthly payment along with another proposal to remove the default and make the loan current. Again, the Bank did not negotiate the check or respond to the letter.

Ultimately, Borrower did speak to the Bank officer who had been receiving the checks, and the officer informed Borrower that, in the court's words, "the matter had been turned over to an attorney and the Bank was awaiting a response as to how to proceed."

Then came the computer generated demand letter, and the Borrower promptly fired in a check for the demanded arrearages (this time with no proposal for accord and satisfaction." But, according to the court, the letter said that a payment of $4,026.13 was needed "to make the account current."

Then, incredibly, the Borrower did not make payments for the next two months. Then the Bank filed a foreclosure action.

Borrower argued that proceeding with the acceleration and foreclosure under these circumstances was inequitable. The trial court disagreed, and this appeal ensued.

The appeals court concurred that a foreclosure is an equitable proceeding and that a lender's actions in accelerating and foreclosing may be reviewed for "abuse of discretion." The court then proceeded to analyze Bank's conduct here.

First, the court concluded that Lender was under no duty to accept the tendered checks for payment of the defaulted debt. Although there was precedent where a lender was prevented from foreclosing when the borrower had sent checks in envelopes that the lender left unopened, the court held that the present situation was different, because the tendered accord and satisfaction would have forced the lender to "give up a number of rights, such as the right to enforce for prior defaults." The court didn't explain exactly how this situation differed from the prior case, where the unopened checks also would have reinstated the account, but the court saw a difference.

The court went on to point to the significant difference that the Borrower in the instant case in fact had missed two subsequent payments by the time the foreclosure was brought. So even acceptance of the checks would not have cleared the record. But it should be noted that by this time Borrower had brought up to date all prior defaults in response to the computer demand letter. Consequently, the negotiation of the checks would have more than covered the existing defaults. Still, there were conditions attached.

The court also saw a significant difference in that in the case of the Bank's mortgage, unlike in the precedent case, there was an "anti wavier" clause. Since it is a rare case where an anti-waiver cause actually provokes a court to ignore evidence of waiver, it is worth quoting the clause at length.

"Any grant by the Mortgagee of any extension of time for the payment of any obligations secured hereby, either to the Mortgagor or to any other maker, endorser or other person, or the taking of other or additional security for any such obligation, or Mortgagee's waiver of or failure to exercise any right hereunder, including the right to accelerate the whole or any part of the debt secured hereby, shall not in any way affect this mortgage, nor the rights of the Mortgagee hereunder, nor operate as a release from any personal liability upon the obligations secured hereby or under any covenant or stipulation herein contained."

The court cited this language, and cases relying upon similar language, to reject Borrower's argument that its prior acceptances of late payments created a situation in which the Bank had a duty to "reinstate" the prompt payment requirement before it could rely upon a default to justify acceleration without further notice. But it does not really say what relevance the language has to a situation in which the lender proceeds to foreclose when the unpaid payments are sitting on the Lender's desk.

Further, in the precedent case, the borrower had kept current on the mortgage all during the time it was wrestling with the Lender over the foreclosure for the prior default. Borrower, you'll not be surprised to learn, did not behave that way here, but made no further payments once the Lender indicated it was foreclosing.

An interesting byplay between the majority opinion and the dissent has to do with the new Restatement of Mortgages. Section 8.1 of the Restatement embraces the "waiver of acceleration" doctrine, including waiver due to frequent acceptance of late performance. But the Restatement emphasizes that an anti waiver clause might tip the scales against waiver. The editor is not certain that the Restatement reporters intended to state conclusively that there can be no waiver in the face of an anti-waiver clause (as the court suggests here). The dissent points out that the Restatement makes an anti-waver clause only a factor in determining whether waiver has occurred, and not a bar to such a determination. But certainly the overall thrust of the Restatement is to give greater weight to language in a commercial mortgage.

Finally, the court noted that the Lender had no contract duty to notify the Borrower in the event of default, and therefore was perfectly justified in proceeding to foreclose without notice due to the two missed payments following the last reinstatement.

A dissenting opinion noted that the Bank had tolerated lateness and unpaid balances from the Borrower for 66 out of the 78 months of their relationship, and then proceeded to accelerate without prior notice.

Comment: How much is left of that case that held that a lender can't accelerate when it has the checks in hand to cover the balance owed? Not much, the editor thinks. Unless there is an argument based upon waiver, it appears that Ohio will permit a lender to reject a tendered reinstatement if it has concluded "enough is enough."

If lenders routinely were beating up borrowers with vicious acceleration practices, the editor would conclude that courts should fashion a broad and flexible waiver doctrine. But the fact is that borrowers who suffer defaults usually have been late frequently for substantial periods, and the lender has lost hope that the loan will be paid properly in the future. The lender has the right to look at the situation from this perspective.

It is true that often, from the standpoint of the borrower, foreclosure will lead to great hardship. It is also true that sometimes the originating lender (often someone other than the foreclosing lender) should not have permitted the borrower to get in so deep, and that default was almost an inevitable consequence of the origination of the loan itself. But in order to give people freedom of choice, we must also accept that they will live with the consequences of their choices. Outside of a narrow band of transactions involving unsophisticated consumer borrowers and rapacious lenders, the editor feels that equitable discretion in setting aside acceleration should be used rarely. It is best to establish uniform rules by statute for acceleration notice in consumer lending, and permit lenders to proceed after complying with such rules.

MORTGAGES; ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION: The New Jersey Supreme Court analyzes whether a subprime mortgage's arbitration agreement, or any of it, is unconscionable, under New Jersey law. ***Delta Funding Corporation v. Harris, 2006 WL 2277984 (N.J. 2006)***

A mortgage lender in the sub-prime lending market entered into a mortgage loan contract with a seventy-eight-year-old woman. She had a sixth-grade education and little financial sophistication. The loan was secured by a mortgage on her home. The loan had an annual percentage rate of fourteen percent. The consumer owned her home outright and had lived in it for more than thirty years. The mortgage lender subsequently assigned the loan to a bank as a trustee.

The loan had an arbitration agreement that allowed either party to elect binding arbitration as the forum to resolve covered claims. The agreement excluded from arbitration "any action to effect a judicial or non-judicial foreclosure or to establish a deficiency judgment." It also excluded a number of similar actions. Further, the agreement provided a cost allocation mechanism, including a provision that stated the costs for an appeal would be borne by the appealing party regardless of the outcome of the appeal.

When the consumer, whose only source of income was social security payments, was unable to make the required loan payments, the assignee bank instituted a mortgage foreclosure action. The consumer responded, alleging violations of the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), and the state Consumer Fraud Act (CFA). The mortgage lender filed a petition in the United States District Court seeking to compel arbitration of the consumer's claims against it.

The consumer filed a motion contending that the arbitration agreement was unconscionable and unenforceable.

The District Court granted the mortgage lender's motion to compel arbitration. The state court presiding over the foreclosure action then dismissed the consumer's third-party complaint against the mortgage lender, which had been held in abeyance. The consumer appealed to the United States Court of Appeals. That Court issued a petition order to the New Jersey Supreme Court in which the panel certified the question: "Is the arbitration clause at issue in this case, or any provision thereof, unconscionable under New Jersey law and if so, should such provision or provisions be severed." The Supreme Court granted certification, reformulating the question as follows: "Is the arbitration agreement at issue, or any provision thereof, unconscionable under New Jersey law, and, if so, should such provision or provisions be severed?"

First, the Supreme Court discussed the procedural posture of the matter. It noted that because the Federal Court of Appeals asked the Court to answer a discrete question of state law, the Court's inquiry was limited. It was ordinarily the role of an arbitrator and not the courts to interpret ambiguous provisions of an arbitration agreement. The Court explained that for purposes of answering the question of state law posed by the Court of Appeals, it would address how the ambiguous provisions, if interpreted and applied in a manner detrimental to the consumer, could be unconscionable.

Turning to the principles of unconscionability, the Court explained that when a party to an arbitration agreement argues that the agreement is unconscionable and unenforceable, that claim is decided using the same state law principles that apply to contracts generally and contract defenses, such as duress, fraud, and unconscionability, to the extent those principles can justify judicial refusal to enforce an arbitration agreement. The defense of unconscionability specifically calls for a fact- sensitive analysis in each case, even when a contract of adhesion is involved. In determining whether to enforce the terms of a contract of adhesion, a New Jersey court looks not only to the take- it-or-leave-it nature or the standardized form of the document but also to: (1) the subject matter of the contract; (2) the parties' relative bargaining positions; (3) the degree of economic compulsion motivating the "adhering" party; and (4) the public interests affected by the contract.

Several provisions of the agreement were alleged to raise unconscionability concerns because they had the effect of limiting the substantive statutory rights and remedies available to a consumer. Related to that assertion was the claim that it is unconscionable for an arbitration agreement to include a "cost-shifting" provision that allows an arbitrator unfettered discretion to allocate the entire cost of arbitration to a consumer. The Supreme Court first addressed these provisions as they related to the consumer's claims of unconscionability and unenforceability under state law.

The arbitration agreement stated that "at the conclusion of the arbitration, the arbitrator will decide who will ultimately be responsible for paying the filing, administrative and/or hearing fees in connection with the arbitration." Thus, the consumer would be entitled to costs if she prevailed. If, however, the consumer did not prevail in arbitration, then she could be forced to bear the entire cost of arbitration. The Court stated that it is well understood that fee-shifting provisions can deter a litigant from pursuing a claim. The Court reasoned that the prospect of having to shoulder all the costs of arbitration could chill this particular consumer and similarly situated consumers from pursuing their statutory claims through mandatory arbitration. The Court found that although the public policy of the state would permit an arbitration agreement to shift costs and attorney's fees to a consumer who brings "frivolous" or "bad faith" claims, no such limitation was evident in the cost- shifting provision applicable to the consumer. The Court also reasoned the agreement as written, and possibly as interpreted by an arbitrator, could force the consumer to bear the risk that she would be required to pay all arbitration costs. The Court concluded that such a risk was unconscionable in that it was a deterrent to the vindication of her statutory rights.

The arbitration agreement also stated that "unless inconsistent with applicable law, each party shall bear the expense of that party's attorneys', experts' and witness fees, regardless of which party prevails in the arbitration." The Court concluded that the mortgage lender could not limit a consumer's ability to pursue the statutory remedy of attorney's fees and costs when it is available to prevailing parties. The relevant statutory provisions provided mandatory attorney's fees and costs to prevailing parties. The Court found that the arbitration agreement suggested that the arbitrator might not have the power to award attorney's fees when that statutory remedy was merely discretionary. Thus, the Court concluded that to the extent this provision in the consumer's contract would prevent the borrower from recovering discretionary attorney's fees and costs under the relevant statute, it was unconscionable.

With respect to appeals, the arbitration agreement stated that "[t]he costs of such an appeal will be borne by the appealing party regardless of the outcome of the appeal." Like the attorney's fees provision, the Court concluded that the appeals provision was unconscionable to the extent that it would bar the consumer from being awarded costs if she prevailed on her appeal.

The Court also held that following the interpretation of the arbitration provisions by an arbitrator, if the agreement was held to permit the shifting of arbitration costs to the consumer, then the unconscionable cost-shifting provision could be severed from the agreement.

Next, the Court turned to the arguments raised by the consumer in support of her claim of unconscionability.

In respect of the arbitration agreement's class-arbitration waiver, the Court found that the consumer's claim was not the type of low-value suit that would not be litigated absent the availability of a class proceeding. The Court reasoned that the consumer had adequate incentive to bring her claim as an individual action. Not only were her damages substantial, but the fact that her home was at stake in the foreclosure proceeding made it likely that she would contact an attorney. Accordingly, the Court concluded that the class-arbitration waiver was enforceable in the context of this litigation.

In respect of the foreclosure action brought by the assignee bank, the arbitration agreement excluded any foreclosure actions that might be brought against the consumer. Thus, foreclosure had to proceed in court pursuant to the arbitration agreement. The Court stated that consumer's defenses to the foreclosure action tracked her affirmative claims against mortgage lender; thus, she would be forced to litigate those substantively similar claims in two different forums. The Court concluded that such a result was burdensome; however, it was not unconscionable. Moreover, the Court noted that the consumer's burden of having to litigate in two forums was alleviated by the fact that attorney's fees and costs were available under relevant statutes if she successfully asserted certain defenses in the foreclosure action.

Lastly, the Court addressed the consumer's argument that other clauses of the arbitration agreement were unconscionable, specifically the discovery and confidentiality provisions. She also argued that it was unconscionable for an arbitration agreement not to require a record of the proceedings or a reasoned and publicly available award. The Court noted that neither the arbitration agreement, nor the rules of the potential arbitration administrators, prevented the consumer from obtaining a record of the proceeding or a reasoned award. Additionally, there was nothing in either the arbitration clause or the rules of the arbitration administrators requiring that arbitration awards be kept confidential. Accordingly, the Court concluded that it was not unconscionable to require that the proceedings before the arbitrator be kept confidential when the arbitrator's written award was not required to be kept confidential.

Comment: The editor has left the discussion of the case entirely to Ira's capable keyboard. But he steps in with a comment only to note that in a consumer adhesion contract, any provision that significantly disadvantages the consumer ought to be invalidated. Clearly the court agrees that the "two forum" litigation is such a provision. He doesn't understand why the lender should be able to dictate unilaterally additional legal burdens for the consumer.

Alternative dispute resolution, of course, has been a favored child of the courts generally, as it tends to reduce their workload, and thus they tend not to regard commitments to arbitrate as inherently unfair. But in consumer foreclosures, an argument exists that they might be just that. It seems absurd to deprive the trial court of jurisdiction over important matters in an equity proceeding in which, normally, the court would have broad discretion to take into account all manner of issues in reaching a fair decision.

Normally, the editor criticizes the New Jersey courts for their activism and bleeding heart efforts to help disadvantaged parties at the expense of predictability and efficiency in the system. But here, the editor is surprised to find himself wanting even more liberalism from the court.

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

MORTGAGES; ASSIGNMENT; MERS: Divided New York High Court comes down for MERS on all counts – MERS may record as "nominee" and may execute discharges even though assignments of the beneficial interest are unrecorded. ***In the Matter of Merscorp, Inc. v. Romaine, 2006 N.Y. Slip Op. No. 09500, 2006 WESTLAW 3716017 (N.Y. 12/19/06)***

Although the opinion is a bit vague on the point, it appears that the original mortgage was executed to MERS as nominee of a named lender, and that the first recording was of this mortgage. Thereafter, of course, MERS maintained on its electronic records information pertaining to the successive assignment of the debt, with the accompanying mortgage. The case does not indicate, nor would it likely be relevant, whether the note was kept by the original lender as trustee, by the trustee of a securitized fund held by a special purpose vehicle, or physically transferred from one assignee to another. All the likely assignees participated in the MERS master agreement, and they agreed to look to the MERS records as the final determinant as to who held the rights under the mortgage.

Recorders across the nation have viewed MERS as nothing short of the devil incarnate because it has stripped them of an extremely lucrative business in accepting recordings of successive mortgage assignments, which in the modern context of accumulating mortgages into pools for securitization purposes, can occur multiple times for any one mortgage in a short period. Not all assignees in fact recorded their mortgages, but many did. After MERS stepped in, almost all such recordings stopped, as did the revenue from them, to which county recorders had become accustomed.

The county recorders argued that MERS should not be permitted to record as owner of the mortgage when it was not. The consequence of their prevailing on such an argument would have been that the mortgage assignments on the books of MERS would be vulnerable if not recorded, since the original mortgagee would be shown as the owner of the mortgagee, and persons taking an interest from that mortgagee, or modifying the mortgage with that mortgagee, or obtaining judgments against that mortgagee (in some states) would prime any assignees recorded only with MERS.

To be fair, the county recorders, depending upon custom in individual areas, also argued that they were the proper guardians of information concerning ownership of land recorders, that their function was more than simply custodial and that both statute and policy dictated that their records have a complete record of ownership. This tends to ignore the fact that even before MERS, many assignments had not been recorded.

But in addition to arguing that MERS should not record as owner when it was not the owners also argued that New York state law, like many other state's laws, requires that the current owner of record be the party to grant and record any discharge of the mortgage. They claimed that even if MERS were permitted to originally record its "representative ownership," it could not make an argument that it was empowered to grant a discharge, since it was not in fact the "current owner," as almost invariably many assignments, albeit unrecorded, would have occurred.

The trial court bought this latter argument, although it permitted MERS to record as original representative owner. But this result was reversed in the intermediate appeals court and the New York Court of Appeals here sealed that result by concluded that New York law permitted MERS, as owner of record, to record a discharge of the mortgage even where subsequent unrecorded assignments had occurred.

The court took pains to note the legislative history of the language of the discharge statute. Where assignments had been recorded, the statute required that all recorded assignments be listed in the discharge, including book and page of recording, in order to demonstrate that the current party executing the discharge was the "true owner." The statute had recorded that if no assignment had been made, the discharge could simply state that. This would have been a problem for MERS, of course, since in fact assignments admittedly had been made, and MERS was not anxious to record in each case all such assignments in order to validate the discharge by giving the proper recording information. Language had been added to the statute to provide that where no assignment had been made **and recorded*,* the discharge could simply state that fact. MERS relied on this language and stated simply in its discharges that no assignment had ever been recorded. The Court of Appeals concluded this was proper.

Comment 1: This was not exactly a complete policy victory for MERS, although it was a complete legal victory. A concurring judge noted that the narrow issue resolved here did not necessarily answer all the questions posed by MERS' business model, and that legislation should be undertaken if, as MERS argued, recognition of its function is in fact in the public interest.

Comment 2: Perhaps even more troublesome is the opinion of a dissenting judge, who carefully parsed the discharge statute to demonstrate that the rest of the statute is inconsistent with MERS reading, and that at best the statute is ambiguous and at worst does not validate the recording of a discharge without recording all intervening assignments. In fact, in the editor's view, the dissenting judge has a very strong interpretative argument, even the editor really would like MERS to walk away with a complete victory.

The fact of the matter is that the discharge statute was not written with MERS-like operations in mind, and it would not be surprising if it failed to fully support MERS operations. Although, in New York, MERS seems secure, the fact that the New York opinion did have a concurrence and a dissenter and the fact that it is based upon questionable reasoning might influence other courts to give the opinion less credence than they otherwise might.

Comment 3: In the editor's view, MERS wins the policy battle and courts ought to conclude that, in this context at least, the function of the recorder's office is as a mere records custodian and that the public interest is best served by permitting recording by nominees and discharges by nominees of record. Here is the counterargument, voiced by the dissenting judge:

"Although creating efficiencies for its members, there is little evidence that the MERS system provides equivalent benefits to home buyers and borrowers – and, in fact, some evidence that it may create substantial disadvantages. While MERS necessarily opted for a system that tracks both the beneficial owner of the loan and the servicer of the loan, its 800 number and Website allow a borrower to access information regarding only his or her loan servicer, not the underlying lender. The lack of disclosure may create substantial difficulty when a homeowner wishes to negotiate the terms of his or her mortgagee or enforce a legal right against the mortgagee and is unable to learn the mortgagee's identity. Public records will not longer contain this information as, if it achieves the success it envisions, the MERS system will render the public record useless by masking beneficial ownership of mortgages and eliminating records of assignments altogether. Not only will this information deficit detract from the amount of public data accessible for research and monitoring of industry trends, but it may also function, perhaps unintentionally, to insulate a note holder from liability, mask lender error and hide predatory lending practices. The County Clerks, of course, are concerned about the depletion of their revenues – allegedly over one million dollars a year in Suffolk County alone."

The editor has refrained from contacting MERS directly before writing this, as the editor wanted to maintain what objectivity he has on these issues. But the editor believes that it is MERS' position, not categorically denied by the dissenting judge, that evidence of the true ownership of any MERS mortgage is in fact available to anyone who asks, even if it is not on the website or the 800 number. The editor would also note that persons inquiring about ownership by contacting MERS are far more likely to get accurate and timely information about the ownership of any given mortgage than they would have had from an examination of a typical public land record, with the uncertainties of the indexing system, the slowness in indexing in general, and, most important, given the fact that many assignees in fact never recorded in the old days.

Of course, naysayers could argue that we are not talking about MERS as it now does business, but about whether a nominee can serve as a public record representative of a true owner, even if that nominee did not provide the information that MERS does as to beneficial owners. In short, does the argument for MERS prove too much? The answer, of course, ought to be legislation that gives nominees the right to serve as land record placekeepers, but only when the identity of beneficial owners is readily available.

Comment 4: As to the lost revenue to the county recorders, the editor doesn't believe that judicial interpretation or public policy ought to be guided by a desire to increase cash flow to these offices. Recorders should get the money to do what needs to be done, but shouldn't be able to charge fees for useless functions.

MORTGAGES; CONSTITUTIONAL LAW; SECURITIZED LENDING: Trustee in securitized lending arrangement is not by that function subject to process in North Carolina in class action involving alleged usurious character of the underlying loan.

Skinner v. Preferred Credit, 638 S.E. 2d 203 (N.Car. 2006)

The case was decided December 20 of last year. The North Carolina Attorney General is aghast at this 4-3 decision and is seeking rehearing. The AG's office views the outcome as contrary to the public policy of North Carolina and has distributed a memo asking that all similar thinking North Carolina attorneys join in the rehearing effort.

The case involves a pretty stinky subprime loan that got sold into a securitized trust. The loan, made in 1997, was for $45,000, and carried over $5000 in up front fees and an interest rate of 14.75% and a term of 180 months. It apparently is the centerpiece of a class action alleging breaches of the North Carolina Deceptive Trade Practices Act and the North Carolina Usury Laws.

The defendant is a Trustee in a securitized loan arrangement. The court noted that less than 3% of the mortgage loans held by the trust originated in North Carolina, and the loan passed into the trust, of course, after it was originated by third parties. A separate loan servicer, Chase Bank, serves as servicer of the loans, and has, the court notes, complete discretion as to how to manage the loan account, including when to foreclose. The servicer pays loan proceeds to the trustee, which distributes the proceeds in accordance with the securitization arrangement to investors in the capital market.

North Carolina loans use the deed of trust device, and the Trustee is acknowledged to be the beneficiary (by assignment) of the Deed of Trust.

In a relatively brief opinion, relying on a prior North Carolina case involving an individual purchase money loan held by an out of state beneficiary and other lower court cases involving securitized lending arrangements in Tennessee, the court ruled not only that the Trust did not fall under any of the three bases for jurisdiction under North Carolina statutes, but that, if the statutes did apply, this outcome would violate the Due Process Clause of the United States Constitution because there were insufficient "minimum contacts" on which to predicate a claim of jurisdiction.

The court ruled that the Trust had undertaken no "substantial activity" in North Carolina, as all the acts by which it became owners of the 114 North Carolina loans that it held occurred outside of the state and after the loans were originated. The Trust had no other activities in North Carolina.

The court then ruled that the case did not involve "goods, documents of title, or other things of value shipped from [North Carolina] by the plaintiff to the defendant at his direction." The payments under the loan were sent to the servicer which, as noted, had complete discretion in managing the account. The fact that the servicer shipped them on to the Trust did not make the Trust the direct recipient of the payments.

Perhaps most significantly, the court ruled that the Trust's status as the beneficiary of the deed of trust securing the loan did not render it the holder of "local property" sufficient to make it subject to North Carolina jurisdiction. The court here relied almost exclusively on precedent in North Carolina and elsewhere, and did not separately analyze the policy ramifications of this decision.

In its discussion of the question of whether Due Process would permit the State to exercise jurisdiction over the Trustee, the court also referred to authority from other jurisdictions, including Kansas, Michigan and Rhode Island, involving similar arrangements. But it distinguished a 9th Circuit decision that did impose jurisdiction in a similar case involving a Washington loan alleged to be usurious. The distinction is important because it tends to narrow the Due Process decision made here. In the Ninth Circuit case, the court noted, the claim was that the trustee benefitted by the *receipt of usurious interest payments*. Here, the court stated, the claim was that the *original fees* charged at inception of the loan rendered the loan usurious. Of course, those fees were paid prior to the transfer of the loan to the Trust.

Comment: This strikes the editor as an important decision, albeit 4-3, and the editor is not surprised to see the North Carolina Attorney General so exercised about it. Note that the interpretation of the application of the North Carolina statute tends to immunize the Due Process discussion from further appeal. Further, note that the distinguishing of the 9th Circuit decision occurs only in connection with the Due Process analysis. The editor has not studied the 9th Circuit case to determine whether the Washington statute had a broader basis for jurisdiction than the North Carolina case, but the fact that the North Carolina court did not discuss the 9th Circuit case in deciding on its own statute certainly suggests that the court viewed the statutes as different.

Comment 2: The memo from the North Carolina Attorney General notes that the loans in the Trustee's portfolio amount to $4 million in 114 loans emanating from North Carolina, and that the sheer size of the investment renders the case distinguishable from the prior North Carolina case involving a single beneficiary, even though in the other case there was no separation of trustee from servicer. It is interesting that the court in the case chose to note at several points that the total North Carolina investment was less than 3% of the trust portfolio, suggesting, indeed, that size matters. So there is a line somewhere, but the court didn't feel that it was crossed here.

MORTGAGES; DUE ON SALE; BANKRUPTCY: Non-assuming grantee can reinstate home mortgage in face of default, but can it be done in face of "due on sale" acceleration? ***In re Ramos, 2006 Westlaw 3733252 (Bankr. S.D. Fla. 2006)***, discussed under the heading: "Bankruptcy; Chapter 13; Reinstatement of Home Mortgage."

MORTGAGES; FORECLOSURE; SHERIFF'S FEE: Where, after obtaining judgment but before foreclosure sale, mortgagee reaches settlement with the mortgagor, sheriff's fee for conducting the sale is limited to the amount actually collected by the mortgagee, rather than computed on the amount of the judgment or the value of the property. ***Regency Savings Bank, F.S.B. v. Southgate Corporate Office Center, 388 N.J. Super. 420, 908 A.2d 854 (App. Div. 2006); October 25, 2006.***

A mortgagee obtained a final foreclosure judgment against a mortgagor for nearly $36 million. The mortgagee sent a writ of execution to the sheriff, who scheduled a sale of the foreclosed property. Before the sale took place, however, the mortgagee entered into a settlement agreement with the mortgagor, whereby the mortgagor would make a nonrefundable payment of $250,000, and the mortgagee would cancel the sheriff's sale and give the mortgagor ninety days to refinance. If the mortgagor successfully obtained refinancing, it would pay the mortgagee $32 million, and if not, it would transfer its property interest to the mortgagee's designee.

After entering the agreement, the mortgagee asked the sheriff to cancel the sale and return the writ of execution.

The sheriff responded by asking how much money the mortgagee had received in consideration for canceling the sale so that he could calculate his fees and commissions. The mortgagee told the sheriff that it had not received any amount in satisfaction of the debt, and had only received $250,000, which was being held in escrow and which would later be applied to payment of outstanding real estate taxes on the property.

The sheriff still refused to return the writ of execution. He demanded a fee of $732,000 based on the contention that the settlement was for the amount of the foreclosure judgment of $36 million. The sheriff filed an action to compel the mortgagee to pay the amount he demanded. Meanwhile, the settlement option expired, and the property deed and $250,000 were released from escrow.

Here's what the statute says:

"When a sale is made by virtue of an execution the sheriff shall be entitled to charge the following fees: On all sums not exceeding $5,000.00, 6%; on all sums exceeding $5,000.00 on such excess, 4%; the minimum fee to be charged for a sale by virtue of an execution, $50.00.

. . . .

When the execution is settled without actual sale and such settlement is made manifest to the officer, the officer shall receive 1/2 of the amount of percentage allowed herein in case of sale."

The lower court rejected the sheriff's assertion that his percentage fee should be based on a settlement amount equal to the total foreclosure judgment. Instead, it found that the settlement amount was $250,000, making the fee $5,050.

On appeal, the Appellate Division affirmed the lower court's determination. The Court found that the statute was unclear on its face, in terms of who should pay the fee, and whether the percentage should be applied to the value of the property or the amount of the settlement. It also noted other ambiguities in the statute. Therefore the Court looked to legislative history and judicial precedent to guide its decision.

Prior New Jersey cases had held that a sheriff is not to receive a fee on amounts received at the sale in excess of the amount of the claimant's judgment. If the foreclosing party must pay the fee, and doesn't get the surplus, then this seems to be reasonable.

But the court interpreted other earlier cases to mean that if the mortgagee bids only a nominal amount and purchases the property then the fee is payable only on that amount, and not on the whole debt that is wiped out by the property. This of course, is striking, because the mortgagee gets the property and pays no fee for that value.

Examination of those factors demonstrated that the legislature had not intended to give the sheriff a commission for sales in excess of the amount required to satisfy the execution. The Court found that the sheriff's commission should be based on the amount that the creditor actually recovered, or the amount of the underlying settlement. It stated that if it read the statute to mean that a mortgagee had to pay the sheriff a commission based on the judgment or the property value, regardless of the settlement amount, there would be no incentive for the mortgagee to settle. Since settlement is always encouraged, the Court held that the sheriff's fee must be based on the amount of cash the mortgagee receives in the settlement agreement.

Comment 1: Although this case involves interpretation of a specific state statute, the policy analysis reported at the end of the report is relevant to other jurisdictions in the interpretation of their statutes.

Comment 2: Note that neither side got what it wanted. The mortgagee's position was that it owed nothing because it got nothing on its debt – the unpaid taxes exceeded the amount that it received. It lost, and should have. The mortgagee's position strikes the editor as pretty dumb. It would mean that the mortgagee would get a free foreclosure sale in order to get taxes and other expense items covered. The sheriff clearly is entitled to some fee when the mortgagee gets some return.

Comment 3: But is it right that the mortgagee only realized $250,000 from the threatened foreclosure? The settlement agreement rolled over into a deed in lieu of foreclosure, essentially. The property was to be transferred to the mortgagee's designee. The sheriff argued that this was a benefit resulting from the settlement of the foreclosure to the same extent that the escrow payment was a benefit, and that the sheriff's fee should be based upon the value that the mortgagee would up controlling. What's wrong with that argument? True, it discourages settlements, but where the settlement is simply a naked dodge to avoid the foreclosure sale already ordered, isn't the sheriff entitled to the statutory fee?

The court analogized to cases in which the mortgagee bid only a nominal amount to buy the property at foreclosure. Those cases had limited the sheriff's fee to an amount based upon the amount bid. But the difference between those cases and this one is that in those cases there was an auction. No one else chose to bid at the auction, but if they had, the mortgagee would have had to bid higher to get the property. Thus, we must presume, taking into account the special nature of foreclosure sales, that the nominal bid of the lender was what the property was "worth."

This is not true in a deed in lieu. The lender is getting the property in satisfaction of the debt. No one has the right to bid for it against the lender. Logically, the court should take the property value into account in figuring the sheriff's return. The case is wrongly decided.

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

MORTGAGES; FORECLOSURE; SURPLUS: Identity theft victim whose personal information was used without authorization to obtain loan secured by purchase money deed of trust to acquire real property may recover undistributed surplus proceeds that remained after trustee sale of property and satisfaction of creditors. ***CTC Real Estate Servs. v Lepe 140 CA4th 856, 44 CR3d 823 (2006)***

In an act of identity theft, an unknown perpetrator used Lepe's name, personal information, and credit to purchase real property and obtain a loan secured by a purchase money deed of trust. Without her knowledge, title to the property was taken in Lepe's name and her name was signed on a promissory note as the maker and on a deed of trust as trustor.

The beneficiary under the deed of trust foreclosed. CTC Real Estate Services (CTC), the trustee, sold the property at a trustee sale. Surplus funds remained after payments to the lienholders. CTC petitioned the trial court under CC §2924j(c) for an order allowing the deposit of the balance of the surplus proceeds less attorney fees and costs and discharging CTC from any further responsibility. CTC explained that while it believed the equitable and fair result would be to have Lepe receive the surplus funds, it was unable to distribute them to her because she was not the actual trustor of the foreclosed deed of trust as required by CC §2924k(a)(4). The trial court discharged CTC from further responsibility and approved its request for attorney fees and costs.

Lepe submitted, under CC §2924j(a)(4), (d), what turned out to be the only claim for the undistributed surplus funds, asserting the right under a constructive trust theory because her name and Social Security number had been used fraudulently by the wrongdoer to obtain funding for the purchase of property. She added that the foreclosure damaged her credit record and required her to spend considerable time dealing with the consequences: A bankruptcy proceeding had been filed in her name without her knowledge; her credit card accounts had been closed; and she was unable to borrow money for a home she intended to purchase. Thus she should be entitled equitably to the funds taken out in her name. The trial court rejected Lepe's claim, ordering the surplus to be paid into the county general fund.

The court of appeal reversed. Personal identifying information can be the object of theft. Lepe established that her personal identifying information was misappropriated and used to obtain the property. The lending institution would have paid the surplus to the identity thief had he or she continued in the fraudulent activity. In that circumstance, Lepe would have been able to recover the surplus from the identity thief because the thief engaged in a fraudulent transaction by which he or she would have been unjustly enriched.

The mere fortuity that the wrongdoer disappeared without receiving the surplus and was not subject to legal action should not, as a matter of equity, have precluded Lepe from recovering the funds not in the thief's possession. Lepe had an equitable interest in the surplus funds from the foreclosure sale to which no one else asserted a claim or interest. Because a crime victim is entitled to trace stolen assets into other assets and obtain the final product, even though it may exceed the value of that which was stolen, Lepe was entitled to the product of the identity theft. Moreover, Lepe suffered substantial damages as a result of the identity theft.

The appellate court directed the trial court to enter an order granting Lepe's claim for payment of the undistributed surplus funds remaining after the award to CTC of its attorney fees and costs.

Reporter's Comment: The court of appeal's outcome was so sensible that it was a shame that Lepe's attorney had to go that far up the chain to reach it. But obviously, both the trial and the appellate court took the matter seriously, as is shown by their shared refusal to accept the easy way out that a constructive trust explanation would provide and the reviewing court's invention of a more complicated restitution and unjust enrichment analysis to get the same result.

The appellate court's theory also has more far-ranging consequences than Lepe's straightforward constructive trust claim, since it should also work to protect other unpaid creditors victimized by the same scam and entitle them to share in the surplus along with Lepe. I can think of three possible other parties who might claim some part of the surplus as restitution for their losses:

1. The thief has disappeared and we cannot know precisely how his scheme worked, but it would not have made sense for him to have made a downpayment out of his own pocket; he somehow or other must have obtained 100 percent or 100 percent plus financing. Was this from the seller? (There were two mortgages on the property; it is unlikely that the second one was hard money.) Could the seller make some kind of claim to the surplus, over and above payment of her note and deed of trust? She was the last identifiable owner of the property (the predecessor, if not the successor in interest), and that perhaps should count for something.

2. Was the thief's bankruptcy filing done only to stall the foreclosure, or were other creditors listed on the schedules? If they were victimized by theft of the same identity, even if in other transactions, might not they claim this surplus as restitution, since constructive trust (and its tracing requirement) was not the theory used?

3. It is unlikely that the thief went through all of this effort just to own empty property, which makes me suspect that he was probably rent skimming as well. See CC §890. If tenants were defrauded out of security deposits or subsequently evicted by the foreclosure, then they too should have some claim to that surplus.

Anyway, if the thief is still around, I'd like to propose my name for his next acquisition. As long as he sticks to acquiring single family houses, where I will have antideficiency protection if the market turns down, I would even be willing to split any surplus with him if it goes up instead.

The Reporter for this item was Professor Roger Bernhardt of Golden Gate University Law School in San Francisco, writing in the California CLE Real Property Reporter (excerpted with permission).

MORTGAGES; OPTIONS; "RELATION BACK:" Where real property is subject to a recorded option interest, any party subsequently obtaining an interest in the optioned property obtains that interest subject to the option rights. Nevertheless, such party's rights are valid against the title of the original optionor prior to transfer of title pursuant to the option, even though the optionee has given notice of exercise of the option. ***Wachovia Bank v. Lifetime Industries, Inc., 145 Cal. App. 4th 1039, 32 Cal. Rptr. 3d 168 (Cal. App. 2006)***

An optionee holding a recorded option to purchase certain real property sued a building contractor that had recorded a mechanic's lien against the property. The optionee sought specific enforcement of its purchase option. The appellate court held that there was insufficient evidence to establish that the optionee obtained title to the property pursuant to the option or that such title extinguished the contractor's lien.

Kmart Corporation sold an estate for years on property in Perris, California to Shawmut Bank ("Shawmut") Shawmut (as owner of the estate for years) leased the property to Kmart. Kmart also deeded the remainder interest ("Remainder") to an entity called FGHK. FGHK in turn then sold to Shawmut Bank ("Shawmut") options (1) to lease the land after the estate for years expired and also (2) the option to purchase the Remainder. Shawmut paid $12,843 for the options. The options (at least) were set forth in a single "option and estate for years agreement" ("Option Agreement"). The Option Agreement was recorded on January 3, 1994.

The option to purchase the Remainder could be exercised upon the occurrence of any of several specified events, including default of FGHK's duty to "keep the property 'free and clear of Optionor liens.'" This option was to be exercised by the optionee notifying the optionor of its "desire to exercise" the option. Upon the closing of the purchase of the Remainder, title was to be "conveyed by special warranty deed free and clear of all Liens, except Permitted Liens."

In addition, Shawmut executed a deed of trust in favor of Bank of New York by which Shawmut mortgaged its interest in the property, and a trust indenture by which Shawmut assigned its interest in the Kmart lease and the Option Agreement to Bank of New York. Bank of New York subsequently assigned the beneficial interest under the deed of trust to Wachovia, as the Asset Trustee for Property Acquisition Trust 1993-22 ("PAT").

In 2002, Defendant Lifetime Industries, Inc. ("Lifetime") recorded a mechanic's lien against FGHK's remainder interest in the property.

In 2003 there was a foreclosure of the deed of trust given by Shawmut Bank, and the purchaser of Shawut Bank's estate for years and option rights was PAT. FGHK at that time continued to own the Remainder.

In January 2004, Lifetime obtained a judgment from the County Superior Court against FGHK in the amount of $837,795, including a lien upon the ownership interest of FGHK in the property and an order that the interest of FGHK in the property be sold at public auction ("Lifetime Judgment").

PAT then served on FGHK a written notice of its intent to exercise the option to purchase the Remainder pursuant to the Option Agreement, due to the fact that FGHK failed to release, vacate, or fully bond the Lifetime Judgment. FGHK argued in response that the Kmart lease had terminated and that PAT, as the optionee and owner of the estate for years, had the duty to protect the property against Lifetime's mechanic's lien. PAT, in turn, argued that this response amounted to a rejection of the Option Agreement. PAT then filed a complaint in state court against Lifetime and FGHK, which contained the following causes of action: declaratory relief against Lifetime; quiet title against all defendants; and specific performance against FGHK. PAT also asked the court to compel FGHK to deliver a special warranty deed of the Remainder upon PAT's tender of the purchase price, which title to the Remainder PAT alleged would relate back to January 3, 1994, the date the Option was granted, free and clear of any subsequent liens.

FGHK answered the complaint by alleging that PAT had breached the Option Agreement and that FGHK was not obligated to convey title to the Remainder to PAT. PAT sought a declaration that its interest in the Remainder, as represented by the Option Agreement, the exercise notice, and the FGHK deed (when executed), was prior and superior to Lifetime's purported interest in the Remainder, as represented by the Lifetime Judgment. FGHK further argued that PAT's title to the Remainder related back to the date the option was granted in 1994 and therefore extinguished Lifetime's interest in the Remainder under the Lifetime Judgment.

The matters in dispute between PAT and FGHK apparently were never litigated, and were settled, as they were withdrawn, and PAT and FGHK seemed to be working in concert as of the time of the argument in this case. Thus, this discussion focuses solely on the priority dispute between PAT and Lifetime.

After reviewing the respective parties' arguments and assertions, the trial court granted PAT's motion and entered judgment against Lifetime. On appeal to the appellate court, PAT asserted that the quitclaim deed to the Remainder from FGHK to PAT, which was dated two months after the hearing on the summary judgment motion, triggered the relation-back doctrine, but the appellate court stated that "PAT submitted no evidence showing that its receipt of the quitclaim deed was pursuant to its exercise of the option."

The appellate court noted that under California law, it is the title received by the optionee (and not the mere exercise of the option) that relates back to the date the option was given and extinguishes the interest of the intervening party. According to the court, "Until title is transferred, the optionee, after exercising the option, holds only a right to complete the purchase, enforceable by specific performance; intervening interests, while subject to this right, are not yet extinguished." The court noted that "PAT does not state that FGHK ever delivered a deed to the Remainder to PAT or that PAT otherwise has obtained title to the Remainder . . . At most, the evidence submitted to the trial court shows that PAT gave notice that constitutes an exercise of the option to purchase." The court noted further that "the mere exercise of the option, without the consummation of the purchase and sale transaction, does not provide PAT with title to the Remainder."

The court, relying on PAT's own admission that the Remainder continued to be held by FGHK, ruled that

Lifetime's lien against FGHK's interest in the Remainder had not been extinguished. With regard to the quitclaim deed from FGHK to PAT, the court ruled that this deed, without more, was insufficient to support a finding in favor of PAT. The court noted the title that relates back to the option must bear some relationship to the option. The court stated that "while the relation-back rule is well settled, the nature of this rule has not been clearly explained by the California cases that have relied on it." Id. at 1054. The court reasoned that "something more than the mere fact that the optionee subsequently acquired title is required before the purchaser has the benefit of the relation-back rule." Id. at 1054. The court stated that "justification for the relation-back rule does not apply when the optionee obtains title to the property despite the failure of a condition, expiration of the option, or a material breach by the optionee that would preclude specific performance.".

Here, according to the court, the evidence of the quitclaim deed (if the court even decided to take such evidence) did not necessarily comply with the requirements for application of the relation-back rule. This was so because (1) FGHK initially denied PAT's right to acquire the Remainder because PAT had allegedly breached the Option Agreement and was not entitled to specific performance (although the issues in this action were never determined), and (2) FGHK eventually issued a quitclaim deed to PAT, rather than the special warranty deed required by the option agreement. According to the court, "PAT could not have obtained the deed from FGHK by operation of the terms of the option, but was required to fulfill an additional condition – the resolution of the PAT-Lifetime dispute – as part of a new agreement between the parties." Id. at 1056. Based on the record before the court, the court held that there was insufficient evidence that PAT had obtained title pursuant to the option or that the acquisition of such title extinguished Lifetime's recorded mechanic's lien.

Finally, the court rejected Lifetime's argument that a California statute, which protected lenders that granted purchase options in connection with loans secured by real property, applied in the present case. The court held that "there is nothing to indicate that the legal relationship between FGHK and Shawmut Bank was anything more than optionor and optionee under the Option Agreement." The court noted further that the word "collateral" referred to in this statute refers to collateral that secures a debt owed by the debtor-optionor to the secured party-optionee, which was not the case here where no debt between the parties existed.

As noted above, the court ruled that the mere exercise of the option, without consummation of the purchase and sale transaction, did not provide PAT with title to the Remainder — even with the subsequent delivery of a quitclaim deed to the property. The court, while perhaps reluctant to reach this conclusion, reasoned that otherwise a judgment in favor of PAT based on facts similar to this case could foster collusion on behalf of the optionor and optionee, which should not be encouraged as a matter of public policy. The court gave as an example a situation where PAT exercised its option and was deemed thereby to have extinguished the intervening Lifetime lien, yet subsequently failed to tender the purchase price for the Remainder, or was unable to obtain title to the Remainder because of a failure of a condition to closing or a contractual breach by PAT. Under such circumstances, the court believed that FGHK would unjustly retain title to the Remainder free and clear of the Lifetime lien. The court reasoned that in this case PAT took title to the property "outside the purview of the option," i.e., when the optionee would not have been entitled to specific performance, and therefore the relation-back rule should not apply and "the optionee should be in the same position as any other purchaser of the property, and the ordinary rules of priority should apply." Also, as noted earlier, the court found that PAT had submitted no evidence showing that its receipt of the quitclaim deed was pursuant to its exercise of the option.

Reporter's Comment 1: It was certainly counter-productive of PAT in this case to (1) not resolve the initial issues (the claims were dismissed in a separate action) regarding FGHK's original denial that PAT was entitled to acquire the Remainder pursuant to its option right because PAT allegedly breached the Option Agreement and was not entitled to specific performance; (2) obtain from FGHK a quitclaim deed to the Remainder instead of the special warranty deed required by the Option Agreement; (3) wait to obtain the quitclaim deed until two months after the hearing on the summary judgment motion, and; (4) not specifically state in the deed that it was being granted and delivered pursuant to PAT's exercise of its option right as set forth in the Option Agreement.

Reporter's Comment 2: The court appears to have stretched for an "equitable" result in this case, and was given leeway to do so because of the carelessness and neglect of FGHK and PAT with respect to the exercise and finalization of the option right to purchase the property. This result highlights the importance of carefully drafting option rights and agreements, and strictly complying with the requirements stated therein to exercise the option and actually complete the transaction (including preparing and timely delivering the correct form of deed) to obtain the benefit of the relation-back rule (at least in California).

Reporter's Comment 3: In a footnote, the appellate court states that, "The parties do not dispute that Shawmut Bank's interest in the Option Agreement could be the subject of a deed of trust or mortgage," and noted that "[a]lthough California cases have repeatedly stated that an option to purchase real property does not constitute an interest in real property (citations omitted), there is some authority that an option is nevertheless a mortgageable interest (citations omitted)." But the court did not decide this issue because it was not raised or briefed by any party.

The majority rule, as noted by the court, is that an option to purchase real property, by itself, is not an interest in real estate. Section 9-109(d)(11) of Revised Article 9 of the Uniform Commercial Code provides that (with certain limited exceptions) Article 9 does not apply to "the creation or transfer of an interest in or lien on real property." If an individual or entity acquires an option to purchase real estate (i.e., an option unrelated to any other existing interest in the real estate), that individual or entity may be deemed by a court not to have acquired an interest in the real property that is the subject of the option.

For an example of a decision holding that the optionee can only obtain an interest in the real estate at such time as the option is exercised according to its terms, and therefore any security interest granted in an unexercised option to purchase would be deemed to be personalty rather than realty and would be governed by Revised Article 9, see *In re Merten,* 164 B.R. 641, 643 (Bankr. S.D. Cal. 1994). The ability of the holder of a security interest in the optionee's right to purchase real property to retain its security interest in proceeds of the collateral is of special importance if a subsequent bankruptcy proceeding is filed by or against the optionee. If the bankruptcy court permits the debtor-optionee either to sell the option right to a third party or to exercise the option right and then resell the property to a third party, the cash proceeds thereof would be subject to the secured lender's UCC security interest only if it were deemed to be an interest in personal property that remained perfected upon the exercise of the option (as opposed to an interest in real property that would require a filing in the real estate records).

Reporter's Comment 4: In setting forth the "general principles" applicable to the issues raised by this case, the court in *Wachovia Bank* defines an option (and the rights of the parties thereunder) as follows (by reference to California cases and commentary): "An option to purchase real property, supported by consideration, is a contract by which the owner of the property (the optionor) gives another (the optionee) the exclusive right to purchase the property in accordance with the terms of the option (citation omitted"); An option may provide that it can be exercised only upon the existence of specified facts or the occurrence of specified events (citation omitted); "An option is not a sale of the property, but a sale of a right to purchase the property (citations omitted)"; "Upon exercise of the option, the option ceases to exist and is transformed into a contract of purchase and sale; the optionor becomes a seller and the optionee a buyer (citation omitted)"; "If, after valid exercise of the option, the optionor refuses to perform (i.e., fails to deliver title to the optionee), the optionee-buyer may sue to compel specific performance (citation omitted). However, if an optionee is in default under the option agreement, the optionee is not entitled to specific performance and obtains no interest in the property (citation omitted)"; "Although an option gives the optionee the contractual rights to purchase the property, it is 'merely an offer to sell and vests no estate in the property to be sold'" (citation omitted; emphasis in text); an option contract relating to the sale of the land . . . conveys no interest in [the] land (citation omitted; emphasis in text); "an option 'is not a transfer of the title or any estate in the property.' However, when the option is exercised, the right to purchase the property relates back to the time the option was made (citations omitted)"; "Thus, subsequent purchasers of the property with notice of an option to purchase take subject to the right of the optionee to complete the purchase (citation omitted).

According to the *Wachovia Bank* court:

"The effect of these rules with respect to competing claims to title to property is summarized by Miller and

Starr: "When a purchaser or encumbrancer acquires an interest in the property after the option is given but before it is exercised, and he or she has notice of the option, when the option is exercised the title received by the optionee relates back to the date the option was given and extinguishes the interest of the intervening party." (5 Miller & Starr, supra, § 11:108, pp. 283, 285, italics added.) Implicit in this relation-back rule is the fact that the optionee has actually received title to the property pursuant to the exercise of the option. Until title is transferred, the optionee, after exercising the option, holds only a right to complete the purchase, enforceable by specific performance; intervening interests, while subject to this right, are not yet extinguished."

Editor's Comment 1: Readers may be wondering: "And ? . . . So? . . . ." What is the consequence of all of this? It would appear that Lifetime, if it manages to complete its mechanic's lien foreclosure prior to exercise of the option, is entitled to receive any option price. If not, then it must figure out a way to attach the option price pursuant to collection of its judgment. Perhaps the interests of third party creditors will interfere with Lifetime's rights to do one of these things, but not the other.

It may be, also, for reasons internal to PAT, that it has to take title directly from FGHK in order to work out the details of what was almost certainly the satisfaction of a debt, as the court acknowledges. That may be what the fussing is all about. But the editor is just speculating.

Editor's Comment 2: The question of whether an option is mortgageable is indeed an interesting one. Here, the parties originally had a deed of trust on the real estate interest (the term of years) and an assignment for security of the option rights. Later, the amended the deed of trust to include the option rights, and then foreclosed, apparently, only the deed of trust. They seemed of the opinion that this accomplished a valid transfer of the option rights. As they also had an assignment for security, which not treat this as a UCC financing agreement and foreclose that pursuant to Article 9 in addition to the foreclosure? Normally, not a problem – but remember we're in California here – the strange and colorful world of the "one form of action rule." Did that affect the parties' thinking here?"

The Reporter for this case was Jack Murray of the First American Title Insurance Company, Chicago Office.

MORTGAGES; PREPAYMENT; REFINANCING; CONSUMER LOANS: Lenders may not collect "early closure fee" in consumer refinancing when loan agreement prohibits prepayment penalties – a ringing opinion condemning major lender consumer mortgage practices. ***Bonior v. Citibank, N.A., 2006 N.Y. Misc. LEXIS 3862, 236 N.Y.L.J. 117 (Dec. 7, 2006)***,

The court ruled that Citibank and Municipal Credit Union ("MCU") were not entitled to, and wrongfully collected the early closure fees from borrowers in connection with the borrowers' refinancing of their home equity line of credit. The fee was designated by MCU as reimbursement of MCU's original closing costs. (The refinancing loan from Citibank was used to pay off the borrowers' existing home equity line of credit loan with MCU.) This fee, which was provided for in the MCU Home Equity Mortgage document signed by the borrowers, became due if the borrowers repaid the original MCU loan and requested a release of the mortgage during the first 36 months of the loan term.

The court viewed the early closure fee as a prepayment penalty, which was unenforceable because the MCU mortgage and the home equity account agreement both explicitly prohibited prepayment penalties. According to the court, "The name given to the clause does not control. The effect it has is what is determinative. In addition, MCU drafted the documents. Any ambiguities in the documents must be presumed against the drafter." The court further noted that "[l]abeling the payment a reimbursement did not transform the essential nature of these funds from a penalty. It is a penalty and cannot be collected."

The court ordered that the funds representing the "early closure fee," in the amount of $4,927.50, be reimbursed to the borrowers by MCU. The court further found that because of the ambiguous and contradictory paragraphs in the loan documents, which stated that there was no prepayment fee for early prepayment yet required the borrowers to pay the early closure fee(described above), "the documents are confusing at best and constitute a deceptive practice under the [New York deceptive business practices] statute." The court therefore also fined MCU $50 (the statutory penalty) for "engaging in deceptive business practices in violation of [the New York deceptive trade practices act]."

Turning to the claim against Citibank, the court noted that "The Citibank documents suffer from the same infirmities as those of MCU in that the forms state that there is no prepayment penalty but provide for an Early Closure Release Fee . . . in the event the event the credit line is closed within the first thirty-six months . . . As stated above, no matter what the lender seeks to label this, it is a prepayment penalty. Since the document was drafted by Citibank, any ambiguous term must be presumed against Citibank."

The court seemed particularly irked by the fact that the borrowers were not represented (nor informed or their right to representation) by counsel at the closing. According to the court, "Had claimants been represented by counsel, this litigation would probably not be before the court." The court noted several material errors in the Citbank's closing papers, namely: that the equity source agreement and the mortgage were to be interpreted under the laws of different states, New York and California respectively; an incorrect reference to a prior "Master Mortgage"; and that neither Citibank's nor MCU's mortgage contained a description of the property. According to the court, "[t]hese documentary errors amount to a deceptive practice." The court did acknowledge that Citibank was not responsible for the refunding of the MCU closing costs, but held that it did engage in deceptive practices in connection with the closing of the refinancing loan. But the judgment against Citibank under the applicable New York statute, as noted above, was only $50.

The court noted that no persons other than the borrowers "without counsel and the representative of United [United Land Services ("United")], who was not an attorney attended the closing."(The court also noted that no "title closer" was present.) United's employee attended the refinancing closing on behalf of Citibank solely to take and notarize signatures, collect and transmit final documents and disburse the mortgage funds; the court also rendered judgment against United for $50 under New York's deceptive business practices act.

The court reasoned that because of all the documents to be signed prior to and at the closing, at a minimum a disclosure of the legal implications of the documents should have been made to the borrowers and they should have had the opportunity to waive affirmatively the right to have counsel of their own present. The court stated that "Perhaps it is time for the New York State Legislature to require that a disclosure be executed at all closings when real property is being used to secure a loan which would inform the borrowers that they have the right to counsel," and that "[f]or some inexplicable reason, a myth has been created around the mortgage refinance-second mortgage industry that borrowers do not need lawyers at these transactions."

Reporter's Comment 1: I have no quarrel with the court's ruling, given the facts of this case. It does appear that Citibank and MCU were trying to pull a "fast one" on unsophisticated borrowers who were not represented by counsel. (The court notes sarcastically – and frequently — in the opinion that "a home equity line of credit is a simple transaction and you do not need an attorney.")

Reporter's Comment 2: Lenders are currently using other substitutes for prepayment fees, such as defeasance provisions and exit fees, in an attempt to avoid characterization as a prepayment "penalty." The efficacy of this approach has yet to be determined, but there is some law in this area. (For a discussion of these and similar-type provisions that are intended to substitute for prepayment premiums, see my article entitled "Enforceability of Prepayment Provisions in Mortgage Loan Documents," which is accessible at the following link: http://www.firstam.com/listReference.cfm?id=5574, at pages 83-97.)

Reporter's Comment 3: Several court decisions have dealt with the issue of whether certain other fees and charges, such as amounts charged for or in connection with loan payoff statements, are "prepayment penalties" under mortgage notes. In *Goldman v. First Fed. Sav. & Loan Ass'n*, 518 F.2d 1247, 1252 (7th Cir. 1975), the court stated that a charge is a prepayment penalty if the "charge imposed at the time of prepayment [was one] that would not [have been] imposed if the note were paid at maturity instead of at an earlier date."

In *Krause v. GE Capital Mortgage Service, Inc.*, 314 Ill. App.3d 376, 382-83 (Ill. App. 1st Dist. 2000), the court held that certain fees charged by the mortgagee in connection with a mortgage payoff request, *i.e.*, the mortgagee's quote fee of $15 for requesting more than one written payoff statement and $10 for facsimile transmissions of the payoff statement, were not "prepayment charges" within the meaning of residential mortgages and promissory notes prohibiting prepayment charges. According to the court, "[a] prepayment penalty is one that is peculiarly associated with prepayment alone, it is assessed at the time of prepayment, and it would not be charged if the loan was paid at maturity" [citing *Goldman v.First Fed. Sav. & Loan Ass'n, 518* F.2d at 1252]. The court found that the fax and quote fees could be charged for reasons other than prepayment, that a mortgagor does not even need to obtain a payoff statement to prepay a mortgage loan, and that these service charges are not incurred only when a mortgagor is paying a loan before its maturity date. The court also noted that the quote and facsimile fees were charged only to mortgagors who requested more than one payoff statement and/or ordered a facsimile delivery of the statement. See also *Cappellini v. Mellon Mortgage Co.,* 991 F.Supp. 31, 38 (D. Mass. 1997) ("fax and statement fees are not prepayment charges, but are rather charges for special services outside of the basic service agreement provided to the borrower by [the lender] with respect to – but not exclusively related to the prepayment of a loan"); *Colangelo v. Norwest Mortgage, Inc.,* 598 N.W.2d 14, 16-17 (Minn. App. 1999) ("[t]he fact that a cost is imposed on the borrower at the time the loan is prepaid does not render the cost a penalty; a charge is a prepayment penalty if the cost 'would not be imposed if the note were paid at maturity instead of an earlier date' " [quoting *Goldman v. First Fed. Sav. & Loan Ass'n*, 518 F.2d at 1252]); Pechinski v. Astoria Fed. Sav. & Loan Ass'n, 238 F.Supp. 2d 640, 644 (S.D.N.Y. 2003), *aff'd* 345 F.3d 78 (2nd Cir. 2003) (charges that do not fit in the definition of "finance charges" under Truth in Lending Act cannot be considered prepayment penalties). *Cf. Rumford v.Countrywide Funding Corp*., 287 Ill.App.3d 330, 222, 678 N.E.2d 369 (1997) (where mortgage payoff statement specifically listed and charged a $15 "prepayment penalty or other charge," notwithstanding affidavit by officer of mortgagee that contradicted the language in the payoff statement, court ruled that fact question was raised that precluded summary judgment for mortgagee); *McCanney v. Astoria Fin. Corp*., 327 F.Supp. 2d 578, 587 (E.D.N.Y. 2005) (additional charges imposed in connection with prepayment of loan for "attorney document preparation fee," "facsimile fee," and "recording fee" were included within total amount "necessary" to pay off mortgage debt and "appear to be a condition to prepayment in full an charged before the payoff of the loan," and constitute violation of Truth in Lending Act for failing to disclose prepayment penalties).

Editor's Comment: I'm sorry, but, even in New York, $5,000 is a bit much for a "processing fee." This was a profit item, plain and simple. Big time lenders who abuse their customers in this way deserve to be spanked, and spanked especially hard from their colleagues in the lending industry, because this kind of behavior begets the kind of scrutiny invited by the court here. Then the industry and consumers will be doubly burdened with the cost and time delays occasioned by complex federal and state consumer regulations to prevent lenders from doing what they should have had the good sense not do in the first place.

The Reporter for this item was Jack Murray of the First American Title Insurance Chicago office. The editor has edited, of course.

MORTGAGES; PRIORITY: Where real property is subject to a recorded option interest, any party subsequently obtaining an interest in the optioned property obtains that interest subject to the option rights. Nevertheless, such party's rights are valid against the title of the original optionor prior to transfer of title pursuant to the option, even though the optionee has given notice of exercise of the option. ***Wachovia Bank v. Lifetime Industries, Inc., 145 Cal. App. 4th 1039, 32 Cal. Rptr. 3d 168 (Cal. App. 2006)* ,** discussed under the heading: "Mortgages; Options; "Relation Back.."

MORTGAGES; PRIORITY; PURCHASE MONEY PRIORITY: Complex Virginia decision evaluates scope of Virginia title searches, after acquired property doctrine, purchase money priority, inquiry notice, agent notice, and more, and more and more. ***Wilson v. Moir (In re Wilson), 2006 Westlaw 3804543 (Bkrtcy E.D. Va. 12/27/06)***, discussed under the heading: "Recording Acts; Priorities; Chain of Title."

MORTGAGES; STATUTORY REDEMPTION; ASSIGNMENT OF RIGHTS OF REDEMPTION; COTENANT BORROWERS: Parties to whom tenants in common assign their rights to redeem property following foreclosure take their assignments as tenants in common. A redemption by one tenant in common inures to the benefit of all the other cotenants, subject to the right of contribution. ***Bankers Trust Co. v. Woodall, 2006-NMCA-129, 140 N.M. 567, 144 P.3d 126 (8/23/06).***

Following the Woodalls' divorce and the subsequent foreclosure and sale of real property they had purchased during their marriage, each assigned their respective right of redemption to a different assignee. The first assignee to file a petition to redeem the property, Tierra Casa Investments, L.L.C., appealed from the district court's order allowing the other assignee, the Welches, to redeem the property equally with Tierra Casa as tenants in common. Tierra Casa argued that the first in time rule for redemption applies because: (1) the cotenancy that existed between the Woodalls ended with the foreclosure sale, or in the alternative, (2) the cotenancy that existed between the Woodalls ended with their individual assignments to others of their rights of redemption. Tierra Casa further argued that, as the first to redeem, it should have been allowed to redeem to the exclusion of the Welches. In essence, Tierra Casa argued that the cotenancy was extinguished; and therefore, its redemption of the property was not subject to the Welches' right to contribution as cotenants. The New Mexico Court of Appeals rejected Tierra Casa's arguments and affirmed the district court's decision.

The mortgage on the property was foreclosed and on January 5, 2005, a special master sold the property to Tierra Casa. On January 6, Mr. Woodall assigned his right of redemption in the property to Tierra Casa and Ms. Woodall assigned her right of redemption to the Welches. On January 27, the foreclosure sale was confirmed by the district court, and on that same day, Tierra Casa filed its petition to redeem the property. The next day, January 28, the Welches filed their petition to redeem. Both Tierra Casa and the Welches asserted a superior right to redeem the property. Additionally, the Welches proposed that they and Tierra Casa be allowed to contribute half of the redemption price as cotenants. The district court agreed to this proposal. Subsequently, the Court of Appeals decided *HSBC Bank USA v. Fenton*, 2005-NMCA-138, 138 N.M. 665, 125 P.3d 644, "which held that, generally, the first to file a petition to redeem property following a foreclosure sale has priority with respect to redemption." 2006-NMCA-129, ¶ 4 (*citing* 2005-NMCA-138, ¶¶ 1, 10). In light of *HSBC Bank USA*, Tierra Casa asked the district court to reconsider its earlier decision. The district court later reaffirmed its decision that Tierra Casa and the Welches were to be allowed to equally redeem the property. Tierra Casa appealed to the Court of Appeals, which affirmed the district court's decision.

The Court of Appeals noted that "[s]ome authorities assert the blanket proposition that a foreclosure sale terminates the cotenancy," but "in New Mexico, a foreclosure sale is always subject to the owner's right of redemption." *Id.* ¶ 8 (citations omitted). At the time of the foreclosure sale, the Woodalls were cotenants. The foreclosure sale did not terminate their cotenancy. "[U]nder the doctrine of inurement, a redemption by one cotenant would inure to the benefit of the other cotenant, triggering the latter's right of contribution." *Id.* ¶ 9. The Court of Appeals held that "a foreclosure sale does not extinguish a cotenancy until the time for redemption has passed, and that one cotenant's redemption inures to the benefit of the other cotenant." *Id.*

Tierra Casa also argued that the parties were "strangers" because each assignee derived its right of redemption from a different source, and as strangers, the cotenancy was destroyed for lack of a confidential relationship. *Id.* ¶ 10. The Court of Appeals disagreed and reasoned that cotenancy interests are freely alienable and a tenant in common may convey his or her own interest in the common estate to a stranger without the knowledge or approval of the other cotenants. The only unity that a tenancy in common requires is unity of possession. Additionally, "the confidential relationship does not create the cotenancy, but [] the cotenancy creates the confidential relationship." *Id.* ¶ 13. Furthermore, Tierra Casa had actual knowledge of the cotenancy.

The Court of Appeals distinguished *HSBC Bank USA* from the present case to reach its conclusion. *HSBC Bank USA* involved a race to redeem between the assignee of a lien creditor and the assignee of the owner, while the present case only involved one redemption. Therefore, *HSBC Bank USA* did not apply to the present case. Instead, Tierra Casa's redemption inured to the benefit of the Welches, and no additional redemption was necessary. The Welches, as cotenants, must give contribution to Tierra Casa to rehabilitate their interest in the property. The Welches need not redeem the foreclosed property as additional redemptioners.

MORTGAGES; SUBPRIME LENDING: The New Jersey Supreme Court analyzes whether a subprime mortgage's arbitration agreement, or any of it, is unconscionable, under New Jersey law. ***Delta Funding Corporation v. Harris, 2006 WL 2277984 (N.J. 2006),*** discussed under the heading: "Mortgages; Alternative Dispute Resolution; Arbitration."

MUNICIPAL GOVERNMENT; "AFFIRMATIVE HOUSING DUTY; MUNICIPAL DISCRETION; ROAD VACATION: A municipality may not use its discretion by refusing to vacate unneeded roads where the purpose or effect of such a refusal is to interfere with the quick and cost efficient construction of affordable housing. ***Menk Corporation v. Township Committee of Barnegat, 2006 WL 3849001 (N.J. Super. Law Div. 2006), Unpublished; March 24, 2006.***

A developer sued to compel a municipality "to vacate three unimproved paper streets so that [the developer could] proceed with a 347-unit inclusionary development that [would] provide thirty-five affordable housing units." The municipality's planning board granted final approval for the development, but made it "subject to the condition that [the municipality] would vacate three paper streets located within [the developer's] property." Despite some early indication that it might vacate the roads, eventually the municipality decided it would not. That is why the developer sued. In its suit, the developer "contend[ed] that the paper streets within its subdivision [were] not needed for any public purpose ... [and that the municipality's] refusal to vacate the streets inpede[d] the creation of affordable housing because it would require complete re-engineering of the project to accommodate the [existing] street layout thereby causing delay and significant cost generation and because the resulting street system would violate the Residential Site Improvement Standards." Further, when the municipality suggested that if it were required to vacate the roads, the developer would have to pay for the value of the underlying property, the developer responded that it had no such obligation. In its defense, the municipality claimed that it had "an absolute right to decide whether it should vacate a street and the court[s] simply cannot interfere with that exercise of discretion." Its other argument was that its refusal did not have *Mount Laurel* implications "because [the developer] could redesign its subdivision so as to incorporate [the existing] roads."

The Court recognized that "most of the cases relating to street vacation disputes [had] arisen in the context of a challenge to the affirmative exercise of that power as opposed to a refusal to exercise it." Nonetheless, it believed that the same principles applied. First, "[t]he general rule is that the decision to vacate lies in the sound discretion of the governing body and that power is subject to limited review by the courts.... Vacation of public streets is essentially a legislative function. Therefore, it is a plenary power which is only subject to judicial review based on constitutional claims, those instances tainted with fraud or palpably not in the service of a public interest, or when there is a clear perversion of power itself." Thus, the Court was faced with the need to decide whether to "vindicate the Mount Laurel doctrine," it could interfere with the municipality's discretion. In answering that question, the Court looked to an earlier New Jersey Supreme Court decision which stated: "Negatively, [a municipality] may not adopt regulations or policies which thwart or preclude" the opportunity for affordable housing. Prior case law also taught that where a road vacation does not serve the public interest under the vacation statute, such an ordinance can be voided by a court. There was even a case where a municipality vacated roads and because that vacation interfered with the municipality's reasonable efforts to satisfy its *Mount Laurel* responsibility, the road vacation was set aside. Here, it was evident to the Court that the municipality's "refusal to act affirmatively to vacate the streets in [the] factual context [presented had] constitutional implications when viewed within the framework of the *Mount Laurel* doctrine." In its mind, the Court believed that is was "not necessary to demonstrate that [the municipality was] willfully delaying [the developer's] project or that it [was] affirmatively placing obstacles in the path of the opportunity to produce affordable housing." In fact, the Court held that there was "simply no sustainable public interest in maintaining the three unused and unneeded streets. To the contrary, there [was] a strong public interest in eliminating them so as to promote the construction of affordable housing quickly and without delay or unnecessary cost generation." For that reason, the Court ordered the municipality to vacate the roads.

As to whether the municipality was entitled to compensation for the roads, the Court could not find "a single case in which a municipality [had] received compensation for vacating a paper street located in property the municipality did not own at the time of the road vacation." Generally, "a municipality has no interest in the bed of streets. Instead, the presumption is that title to one half of the road bed lies in the abutting property owner subject to whatever public right of way or easement may exist." Since the developer owned land on both sides of the public street, the municipality was not entitled to compensation.

Compare: ***Mount Laurel Township v. MiPro Homes, L.L.C., 910 A.2d 617 (N.J. 2006); December 7, 2006.*** A municipality's condemnation action to further its Green Acres open space program is valid even if the developer demonstrates that the real motive behind such action is to slow residential development.

A developer purchased a sixteen-acre site in order to build twenty-three single family homes priced between $400,000 and $450,000 each. The municipality learned of the developer's plans and added the entire parcel to its list of sites to be purchased as part of the municipality's open space program. By the time the municipality added the property to its list, the developer had received final approvals and commenced site preparation work in anticipation of beginning construction. When the developer refused to sell its property to the municipality, the municipality began condemnation proceedings to acquire the property through eminent domain.

The lower court dismissed the condemnation proceeding, finding that the municipality's true purpose was not to promote open space, but rather to slow residential development which, according to the lower court, was an inappropriate use of the power of eminent domain. The Appellate Division reversed, finding that a municipality's condemnation action for open space is valid even if the developer demonstrates that the real motive behind such action is to slow residential development. The Supreme Court affirmed, noting New Jersey's strong public interest in acquiring and preserving open space, further noting the Green Acres Program and other statutes enacted for recreational and open-space purposes. It also noted that the municipality's desire to limit development, because of the strain on its resources (i.e., overcrowded schools, traffic, and pollution), was consistent with the public interest in acquiring open spaces.

Editor's Comment: What the editor finds of interest in these cases is the fact that neither of them involves specific land use regulatory decisions, but other municipal actions. Nevertheless, the court applies "affirmative zoning" requirements popularized as "*Mount Laurel"* duties. The imposition of these duties appear to be general statements of public policy imposed by the courts, and not specific statutory requirements.

The Reporter for the above items is Ira Meislick of the New Jersey Bar

OIL AND GAS; LEASES; ESTABLISHMENT OF SUBSURFACE BOUNDARIES: In determining each party's rights in an oil and gas lease, the court must look to the intent of the parties as expressed in a written agreement rather than either party's contention of what the parties intended; consequently, a claim boundary set at "100 feet below the deepest producing interval as obtained in the test well," is established based upon a specific drill site, rather than an entire formation. ***EOG Res., Inc. v. Wagner & Brown, Ltd., 202 S.W.3d 338 (Tex. App. 2006)***:

In this case, both parties sought a declaration of the proper construction of certain language defining EOG's ownership interests in several oil and gas leases. In 1984, Longhorn Oil and Gas Company ("Longhorn") owned rights in two oil and gas leases covering minerals located under a tract of land in Corpus Christi, Texas. Longhorn hired REH Energy, Inc. ("REH") to explore this prospect and executed a Farmout Agreement (the "Agreement") under which REH could earn an assignment of a portion of Longhorn's interests in the leases by drilling a test well and drilling and completing a producing well. The assignment was limited to "100 feet below the deepest producing interval as obtained in the test well" and reserved all rights below that depth to Longhorn.

REH fulfilled its obligations under the Agreement and earned an assignment of the interest in the leases. In 2002, after Longhorn was acquired by Wagner & Brown, Ltd. (W&B) and REH was acquired by EOG Resources, Inc. ("EOG"), a dispute arose when EOG sought to drill a second well. In researching title, EOG discovered two unrecorded assignments from Longhorn to REH in 1985 that lowered the boundary line established by the Agreement by 50 feet.

The parties executed the Correction of Assignments of Oil and Gas Leases and Recognition of Reversionary Interests (the "Correction") and changed the language in the 1985 assignments to conform to the language in the original Agreement. In addition, the Correction specified that the deepest producing interval was measured at a depth of 9,679 feet to 9,729 feet subsurface. According to EOG, Well #1's deepest producing interval is located in the subsurface geologic formation known as the Morris Sand.

In October of 2002, EOG drilled Well #2 into the Morris Sand, and the well began producing at depths between 10,230 feet and 10,266 feet subsurface due to geological faulting and a structural dip in the Morris sand formation. EOG contended that because Well #1 produced from an entire underground formation, its ownership interests should follow the formation to its deepest part, plus 100 feet. EOG sent W&B a notice of election to participate in the completion of Well #2 and reduced W&B's

participating interest from approximately 18% to 4% based on its perception of the boundary line establishing each party's ownership interest. The following month, W&B sought a declaratory judgment of the proper construction of the Agreement and the Correction establishing the boundary line.

The parties filed competing summary judgment motions, and the trial court ruled in favor of W&B and limited EOG's interest in the leases to those depths lying between the surface and a subsurface depth of 9,829 feet. On appeal, EOG argued that when the parties executed the Correction, they intended the phrase "deepest producing interval" to mean an entire formation rather than a specific vertical depth. W&B countered that the Correction did nothing more than correct the 50-foot error in the 1985 assignments. The appellate court looked to the intent as it was expressed in the Correction and agreed with W&B. EOG asserted that as used in the industry, the term "deepest producing interval" supported its position; however, the court noted that EOG was ignoring the qualifying language "as obtained in the test well" that followed that term in the Agreement. Also, the court stated that the parties could have used terms such as formation, horizon, field, reservoir or stratigraphic layer to express the intent described by EOG, but the parties chose not to use such language.

Thus, the court overruled EOG's issues on appeal and held that the trial court did not err in granting summary judgment in favor of W&B and denying EOG's motion.

OPTIONS; PRIORITY: Where real property is subject to a recorded option interest, any party subsequently obtaining an interest in the optioned property obtains that interest subject to the option rights. Nevertheless, such party's rights are valid against the title of the original optionor prior to transfer of title pursuant to the option, even though the optionee has given notice of exercise of the option. ***Wachovia Bank v. Lifetime Industries, Inc., 145 Cal. App. 4th 1039, 32 Cal. Rptr. 3d 168 (Cal. App. 2006)*** **,** discussed under the heading: "Mortgages; Options; "Relation Back.."

OPTIONS; REFUSAL RIGHTS; BAD FAITH: Party subject to an refusal right may be guilty of bad faith when it contracts to sell property to a third party subject to a condition that has the primary purpose frustrating the intended purposes of the optionee, and is otherwise of little benefit to the parties. ***Bramble v. Thomas, 2007 WL 49255 (Md. 1/08/07)***

Bramble, a company in the sand and gravel business, acquired certain property for quarry purposes and also obtained an assignment of a right of first refusal on an additional adjacent parcel. It commenced extraction activities on the property it owned

Like most, the right of first refusal stated that the optionees had the right to acquire the property by matching any offer the sellers intend to accept, which offer sellers have tender to with thirty days to react. The optionees were to match both the price and the terms of the intended sale.

Later, Lanes, the owner of the parcel subject to the right of first refusal tendered to Bramble a contract that contained an offer from a Thomas, a local real estate broker, to buy the parcel for $105,000. The contract contained an agreement that the property would be subject to a condition prohibiting mining activities. Buyer was a licensed real estate broker.

Bramble responded by sending a written acceptance of the offer to meet the contract except that it excluded the restriction on mining.

Later, without responding further to Bramble's acceptance, Lanes renegotiated with Thomas to sell the property to Thomas for $120,000. The court's statement of facts does not indicate whether the restriction on mining was present in this renegotiated contract, but it can be inferred that it did not. Lanes then tendered this contract to Bramble, which indicated that its prior acceptance of the $105,000 offer constituted a binding contract, and that therefore the renegotiated contract was a nullity that did not affect Bramble's rights.

Bramble then retendered its acceptance of the first offer, for a price of $105,000, including the mining restriction. This acceptance was more than thirty days after the original tender of the first Thomas offer, so was, technically at least, not in compliance with the right of refusal.

Lanes then took the position that they couldn't sell to anyone due to all the confusion, and attempted to tender back to Thomas her $1,000 deposit. Thomas sued for a declaration that the first Bramble acceptance was invalid because not in compliance with the use right. In other counts, it sought to enforce its other rights versus Lanes.

The trial court granted summary judgment for Thomas, holding that Bramble's original acceptance was not in compliance with the refusal right terms. The Lanes and Thomas settled other aspects of the lawsuit, but Bramble appealed the summary judgment against it.

On appeal, *held*: Reversed. Summary judgment was inappropriate because a genuine issue of fact existed as to whether the first Thomas contract was tendered to Bramble in bad faith because of the insertion of a condition that was of no consequence to the parties except that it frustrated Bramble's rights under the refusal right.

Thomas first attempted to argue that the Bramble right violated the Rule Against Perpetuities because Bramble and its predecessor both were corporations of potential infinite life. The unfortunate reality for the Lanes, however, was that they were individuals who did not enjoy infinite life, and the language of the refusal right stated that it was triggered if the Lanes themselves received an offer. Thus, the refusal right was limited in time to the lives of the Lanes, who were "lives in being" within the meaning of the Rule.

As to whether the inclusion of the "no mining" clause was a breach of good faith, Thomas argued that the restriction clearly was material, in that the property was worth more without the restriction than with it, and that therefore Bramble would be getting a windfall if it would be able to acquire the property for $105,000 without the restriction.

The court cited authority that a response to a first refusal right that omits even a non-material claim is not a valid exercise of the right. Other authority, the court noted, did permit immaterial variations from the triggering offer where the changes "constitute no substantial departure" from the triggering offer. The court concluded that prior Maryland authority was inconclusive on the question of whether an acceptance to the triggering offer that contained an immaterial omission would be valid.

The court went on to hold, however, that the materiality of the omission from the standpoint of Bramble was not conclusive in this case. It stated that there was a genuine issue of material fact whether "the Lanes and the Thomases … inserted, in bad faith, the 'no mining' clause as a 'poison pill' in order to discourage or frustrating Bramble from exercising its right of first refusal."

The court characterized the original contract creating the refusal right as a bargained-for exchange, which Lanes had a duty to carry out in good faith. A party in such a situation "should not be permitted to engage in any subterfuge or devious means to prevent the other party from performing, and then use that as an excuse for failing to keep his own commitment."

It noted that one form of such bad faith, arising in a prior case, might be where the optionor includes the parcel subject to the refusal right in the sale of a larger parcel, and then demands that the optionee match the price for the larger parcel.

The court says that in this case it would be up to Bramble to show that the condition was inserted in bad faith, and that then the burden would shift to Tomas and Lanes to justify it.

Comment 1: It was argued, and now will be reargued that the restriction prohibiting mining was in fact inserted at the behest of Thomas, the buyer, so as to impede the exercise of the refusal right. Thomas was a real estate broker, and certainly aware of Bramble's use of the adjacent property, and would have no other real reason to desire such a restriction on its own rights. As Lanes, apparently, were selling out all their property, it is likely that they had no particular reason to include the restriction either, but all of this will be developed below (assuming no settlement.)

Comment 2: Exactly how does Bramble show bad faith? Smell of brimstone? Evil leering glances? Perhaps all it will have to show is the absence of any apparent justification for the restriction other than to frustrate its purchase.

Comment 3: The difference in price, apparently that triggered all of this, was $15,000. How much more than that has each party expended in attorney's fees? And, in Thomas' case, she runs the additional risk of having a court find her to have acted in bad faith – not so good for one's real estate licensee status.

RECORDING ACTS; PRIORITIES; CHAIN OF TITLE: Complex Virginia decision evaluates scope of

Virginia title searches, after acquired property doctrine, purchase money priority, and more, and more and more. ***Wilson v. Moir (In re Wilson), 2006 Westlaw 3804543 (Bkrtcy E.D. Va. 12/27/06)***

In August, 2004, Wilson developed a grandiose plan to acquire a high end home in McLean, Virginia and either to remodel and sell it for a huge and quick profit, or, if she felt she could afford to do so, refinance and reside in the completed luxurious residence. She contracted to buy the house from Toone for $3.68 million and sought bank financing for a combination acquisition/construction loan for $5.9 million. Toone agreed to take back a small purchase money mortgage for $360,000.

Wilson worked with Amendola, a mortgage broker, to arrange the necessary bank financing. According to her mortgage broker, she had a contract to resell the remodeled home for $7.5 million. (In her deposition in this case, she testified that this contract was a sham developed by the mortgage broker to induce the construction lender to loan.) Armed with this purchase commitment, Amendola was able to get Mariner to commit to a one year acquisition/construction loan.

But Wilson apparently lacked sufficient other liquid assets to satisfy Mariner, so Mariner made several conditions on its loan commitment, most important that Wilson provide $700,000 in certificates of deposit as additional security and that she establish an additional $100,000 account at Mariner to pay the interest during construction.

Wilson didn't have this kind of cash. In fact her apparent available cash was the $50,000 that was the sum total of her down payment in this deal. (We said the plan was grandiose.) But she did claim to have $250,000 in certificates of deposit at another bank. A party described as a "friend or business associate" of Wilson's contributed $300,000 or so of the necessary $800,000, but she was still $500,000 short. So Amendola, whose company (he was a junior employee) stood to make $118,000 in commissions on the deal, went to work.

Amendola found Moir, who was otherwise unrelated to this deal, and worked out an "investment plan" by which Moir would provide the needed $500,000. He presented to Moir a document entitled "Investment Synopsis" in which, in addition to describing the apparently fictitious $7.5 million buyer, he represented that the funds would be deposited in a "non-accessible certificate of deposit" at Mariner, and that, after one year, "when either Ms. Wilson provides refinancing to satisfy her debts with Mariner or sells the property, the funds will be distributed back to the investor with a 50% return on investment."

Sounds pretty bullet proof, eh? But Moir wasn't convinced. Moir also wanted a deed of trust on the house securing the "debt" of $750,000 investment return that he was promised, and a guarantee from Amendola and his father of $200,000 of the obligation, as well as a collateral assignment of the $250,000 certificate of deposit that Ms. Wilson had at another bank. Wilson also was required to pay to Moir a monthly "cost of carry" computed at 6.5% per annum (we are not told on what amount – presumably the $750,000). Everything was in fact provided, and Moir did deposit the $500,000 in the bank. One tiny little problem was that Wilson's certificate of deposit had already been pledged to others to secure other debts, but the court does not tell us when this information surfaced.

It first became apparent that Wilson lacked the needed $800,000 at the original scheduled closing, and at that time the parties had conducted a "dry closing," in which the original parties signed all the documents, including the deed, the Mariner Deed of Trust and the Toone Deed of Trust, and left them in escrow pending Wilson's raising the additional $800,000 collateral she needed to provide to Mariner in order for it to fund its commitment. The $800,000 ultimately were wired to the closing agent, an attorney, who recorded the deed and the two mortgages he had. But the closing attorney had no knowledge of all the arrangements between Moir and Wilson and did not know of the Moir deed of trust.

Wilson paid Moir the "cost of carry" payments for seven months, then stopped. She later defaulted on the Mariner loan. Then she declared bankruptcy, listing the value of the home on her asset schedule at $10.6 million. If it had been worth that much, Wilson might have been able to pay everyone their grand expectations. But, alas, the house didn't quite meet these expectations. Wilson did manage to sell the house for $4.560 million, but as she also had not paid over $30,000 in property taxes, she couldn't pay everyone what she owned them. In fact, claims against the estate exceeded the sale proceeds by over $800,000, and there didn't appear to be much more in the estate available for creditors.

As the creditors jostled for priority, an interesting tale was told. On the very day that the closing agent recorded Wilson deed and the Mariner and Toome deeds of trust, Moir's deed of trust was also put of record. The recording of the Moir deed of trust occurred several hours earlier than the other documents and, of course, at that time neither the closing agent, Mariner or Toome know anything about them.

We thus have a fascinating hornets nest of recording issues, the "after acquired title" doctrine, bankruptcy avoidance issues, and equitable subordination thrown in as well.

Wilson, as "debtor in possession" trustee of the estate, sought to avoid the Moir deed of trust as unperfected because it had not been recorded in the chain of title. Note that at the time it was recorded, Toome, not Moir, was shown as the record owner of the property. A 20 year old 4th Circuit decision, however, had held that a debtor in possession with actual notice of a creditor's secured claim cannot invoke the strong arm power to avoid it on the basis that it was not perfected. The instant court noted that this decision has not been followed and that, in fact, most other courts passing on the issue have ignored it and found the opposite. But, as it was a higher court precedent in the Circuit, the bankruptcy court here accepted its teaching. So Wilson, debtor in possession, could not avoid Moir's deed of trust.

Nevertheless, anticipating perhaps that the precedent would be changed on appeal, and also for purposes of resolving other issues, the court proceeded to evaluate whether the Moir deed of trust was in fact "perfected." There is a statute in Virginia codifying the "after acquired title" concept, to the effect that where a party purports to transfer property to another at a time when the transferor does not have such title, if the transferor later obtains good title, it holds such title subject to the rights it had earlier transferred.

Another statute, however, states that third party purchasers are not bound by transfers made by their seller before seller has obtained his title:

"A purchaser shall not, under this chapter, be affected by record of a deed or contract made by a person under whom his title is not derived; nor by the record of a deed or contract made by any person under whom the title of such purchaser is derived, if it was made by such person before he acquired the legal title of record."

The literal language of this statute would seem to tie things up for Mariner and Toome. But not so fast!!! Searching Nineteenth Century legislative history, the court concluded that the statute was not intended to permit third party purchasers to prevail against the prior recorded interest where the subsequent purchasers were on actual or inquiry notice of such interest. The court did conclude that constructive notice alone would not be sufficient to disable Mariner or Toome's claims.

Although it did not appear necessary to decide whether Mariner or Toome had constructive notice of the Moir deed of trust (remember that it was recorded hours before theirs on the same day), the court nevertheless went on to evaluate that question. It concluded that Virginia is a "short up" jurisdiction – in other words the hypothetical chain of title that a search must examine does not require that the searcher look for transfers by a grantee occurring prior to the grantee's obtaining title. It discussed testimony that Virginia title searchers customarily do not inquire for earlier recorded instruments made by grantees prior to their getting title. But, interestingly, the court concluded that there is no way to search a Virginia title without actually looking at instruments recorded on the very day in which a party takes title, even if earlier recorded that day. Hence, the court concluded, a reasonable title search probably would have discovered the Moir deed if it had checked title at some subsequent time.

But were Mariner or Toome on constructive notice of the Moir deed of trust when they took their interests on the *same day* that is was recorded? The court concluded that even though the Moir document had been recorded earlier enough in the day that it probably was available in the electronic data base that is the standard search tool today in Virginia, searchers customarily do not double check for instruments recorded on the day of closing. Maybe this helped Mariner and Toome (because of issues discussed below, it really doesn't matter). But the court's conclusion concerning those two lenders doesn't mean that Moir wasn't "perfected" for purposes of the strong arm power. First, originally, there was the precedent that the power couldn't be invoked by a debtor in possession with notice. Later in the proceeding, however, the debtor in possession was replaced. But even in that case, the court deemed the Moir deed of trust still to be perfected because the test has to do not with an individual lienholder, but a *hypothetical* bona fide purchaser/ judgment lienholder. Any subsequent title searcher (other than on the day of recording) would find mention of the Moir deed of trust recorded on the same day as the Wilson deed, and would have a duty to inquire as to its significance. Thus, versus hypothetical lien creditors and BFP's, the Moir lien was perfected.

Remember, however, the court had already decided that constructive notice wouldn't spoil the priority of Mariner and Toome, so whether they truly were on constructive notice is moot.

Failing as to the signficance of constructive notice, Moir argued that Mariner, at least had actual notice of the Moir mortgage because Mariner's agent, Amendola, the loan broker, knew all about it. Not a bad argument. But the court said that it wasn't ready to conclude whether a loan broker's knowledge binds a lender, and in any event it didn't have to, because although Amendola knew of the Moir deed of trust, he did not know of its recording or that Moir intended to have a deed of trust senior to the Mariner and Toome deeds of trust. So Amdendola lacked critical information.

Further, in response to Moir's claim that the other lienholders were on inquiry notice of Moir, the court again demurred. Even though Mariner and Toome might have had some knowledge that Wilson was getting the $800,000 from somewhere, and could have anticipated that she was borrowing it, they also lacked any basis to inquire whether such borrowing would result in a priority lien claim against them.

If you are a particularly well schooled reader, you might have noticed another basis for Mariner and Toome to argue priority over Moir, even if in fact they had knowledge of Moir. Mariner and Toome were purchase money lenders. Moir was not. The court noted that Virginia recognizes the "super priority" of purchase money lenders against preexisting liens against their mortgagor's interest. It applied that "super priority" here.

At this point, if you're not a true title/recording geek, you're probably asleep. But true geeks, the editor is confident, are finding all of this a rich broth indeed, and we're not done yet.

The court then turned to another series of claims by the trustee – its desire to limit the priority of Moir not only versus Mariner and Toome, but as against unsecured creditors as well. The court first held that the estate was not entitled to Moir's first lien priority. Moir wasn't "strongarmed," rather it lost to the other secured creditors because of their superior status as purchase money lenders. Consequently, Mariner and Toome occupied the first two priority claims. But did Moir come next, or did the estate?

The question likely had little significance, as the state tax lien and the other two lienholders probably would gobble all the available proceeds of the property sale. But the court, likely a geek as well, decided to pursue the question anyway. The court dealt with the estate's claim that Moir's lien should be equitably subordinated to the claims of unsecured creditors.

Typically an secured creditor is subordinated in cases in which the secured claim has resulted from fraud or other inequitable conduct. There was no showing that Moir had done anything so unethical here, other than attempt to circumvent Virginia's usury laws by characterizing the $250,000 "equity kicker" claim as an "investment return." The court decided it would not try to fathom Virginia's usury laws, and didn't specifically hold that there had been a violation. It concluded that Moir had not been guilty of fraud or egregiously inequitable conduct in making the $500,000 loan, and was entitled to third priority secured creditor status as to that amount.

But the court granted subordination of Moir's $250,000 kicker. As noted, Moir himself had stated in some of the loan documents, it was a capital investment, and not a loan. Consequently, to that extent Moir was not a secured creditor. But why should Moir nevertheless be subordinated to unsecured creditors? Again, the typical test of egregious inequitable conduct doesn't seem to apply. But here's what the court said did the trick:

"[T]he court is persuaded that a claim for what amounts to dashed expectations of a large profit rather than out-of-pocket losses unfairly dilutes the claims of creditors who will likely not recover even their principal. For that reason, the court concludes that under the specific facts of this case, the $250,000 "equity return" should be subordinated to the claims of general creditors."

Alternatively, and perhaps more appropriately, the court recharacterize the $250,000 "kicker" as a return of equity, and thus subordinate to general creditors. 'Nuff said about that. The court refused to recharacterize the balance of Moir's $500,000 claim, since it was treated by the parties as an indebtedness with interest accruing and security given. Further, it refused to reduce the secured claim by the amount of the Amandola's guaranty, as there was no evidence that that had yet been paid, or ever would.

Comment: Many of the editor's views are set forth in asides in the discussion above. Of course, the $200,000 guarantee may only be the beginning of Amendola's problems. There are allegations of fraud and misrepresentation. It appears, however, that Moir more or less dug his own hole for some of the bankruptcy conclusions by drafting the documents himself. It's the old rule – can be a bull or a bear, but never a pig.

RECORDING ACTS; TORRENS REGISTRATION SYSTEM; PRIORITY: Purchaser of Torrens property who had actual knowledge of mortgagee's prior unregistered mortgage takes property subject to that mortgage. ***In the Matter of the Petition of Collier, 2007 WL 270435 (Minn. 2/1/07)***

This case has occasioned a lot of discussion in Minnesota, as did the Court of Appeals decision that it reverses. The editor's contacts tell him that half the title mavens in Minnesota think the case is wrong and inconsistent with the whole notion of registered title. The other half think its perfectly OK and a just result.

The case deals with the Torrens property system, a system in use in Canada, but in America, mostly appearing in Minnesota. Torrens is a form of registration of title, a system in widespread use throughout the world. Registered title is not a "civil law" concept – some common law countries (such as Canada) use it, and some civil law countries use an American-style recording system. Under the typical registration system, a party investing in registered land gets a government certificate assuring that party of the state of the title, and usually the registry is regarded as the final source of information about the title. Typically, constructive notice outside of the record, unlike in recording act states, will not detract from one's reliance on the title assurance provided by the land registry.

In Minnesota, an owner of property pay elect to submit it to the Torrens system. In some counties, more than half the total properties are so registered. But there is also a substantial amount of unregistered property, and the county records office maintains a grantor/grantee recording system. There is separate registry for Torrens land.

Here, in brief, a mortgagee obtained a mortgage on land that had been submitted for Torrens registration. Contrary to what a careful mortgagee should have done, the mortgagee recorded its mortgage in the land records, but did not register its mortgage in the Torrens registry.

Subsequently, the mortgagor defaulted and the mortgagee purchased the property at a foreclosure sale. Collier, a local investor, learned of these facts and contacted the mortgagee about buying the property, but the parties could not come together on a deal.

Collier then researched the title to the property and saw that the mortgage had not been registered, although the mortgaged property was registered property. Collier than contacted the original mortgage and offered to buy any interest he still had in the property for $5,000. Upon receiving a quitclaim deed from that mortgagor, Collier quickly borrowed against the property from another party (that party settled out of this case, and his interests are not discussed in this opinion.)

Seeking a declaratory judgment that his interest in the property superceded that of the mortgagee, Collier relied on a provision of Minnesota law stating that a mortgage on registered title must itself be registered, and "take effect upon the title only from the time of registration." Thus, he argued, the mortgage had no validity at all, and consequently the foreclosure also was invalid and he was the owner of the property free of the mortgage.

The Bank relied upon another provision of the Torrens law that stated that a party who acquires registered property in good faith and for valuable consideration takes it free of any unregistered claims. The Bank argued that the term "in good faith" meant that purchasers of property who had actual knowledge of unregistered interest in that property did not take "in good faith" and did not prime the unregistered interests.

The Court of Appeals concluded that summary judgment should have issued for Collier, since the statute clearly invalidated the mortgage. The Supreme Court reversed. It acknowledged prior authority that held that constructive knowledge of an unregistered interest will not affect the title in the hands of a purchaser of registered property. But it held that where, as here, a party taking an interest in registered property has actual knowledge of the mortgage, that party is not a "good faith" purchaser and takes its interest subject to those unregistered interests of which it has actual notice.

The bulk of the court's analysis has to do with close readings of the statute and precedent cases in Minnesota, but as to policy analysis, the court opines (guided from the Registrar of the a major land registration county in the state, who filed an *amicus* brief) that Minnesota lawyers and land investors had assumed that an unregistered interest could not be defeated by a party who took registered land with actual knowledge of such interest. Further, the court held that the statutory construction of the Torrens statutes should take "principles of equity" into account. Of course, there is the underlying reality here that Collier (and others similarly situated) would be reaping a windfall profit from the carelessness of the unregistered mortgagee, and the court didn't seem inclined to let Collier get away with a "fast one."

Comment: Minnesota lawyers in fact do not agree that the opinion reflects their preexisting understanding of the statute, nor that this is the best interpretation of the statute. Although it is limited in application to parties taking with actual notice, they point out that many parties in fact get actual notice of certain unregistered interests, such as tax liens and judgment liens, when they order title reports of registered land. Because of problems of delay in post closing registration, there is reason for the title companies to disclose such information. Such interests might be primed by a party taking registered land without knowledge of them (at least if they are not registered before a certificate is issued), but the title report in fact gives them such knowledge. Consequently, at least with respect to matters reported in a standard title report before acquisition, Minnesota's Torrens system may have been converted to a "race notice" system.

RELIGIOUS ORGANIZATIONS; TRANSFERS OF TITLE: In order for a court to retroactively approve a transfer of real property by a charitable or religious organization, the transfer must benefit the grantor. ***Congregation Yetev v. Congregation Yetev, 820 N.Y.S.2d 69 (A.D. 2 Dept. 2006).*** An expelled board member of a Satmar congregation executed a deed transferring a one-half interest in a cemetery solely owned by that congregation to a rival Satmar congregation vying for leadership of the Satmar community. Under Religious Corporation Law §12(9), a court may only retroactively approve a transfer if the proponent of the deed can demonstrate that the transfer benefits the interests of the grantor by promoting a religious objective. The court held that due to the leadership struggle within the Satmar community, the requisite beneficial interest to the grantor did not exist.

TITLE; QUIET TITLE; PROCEDURE; STATUTE OF LIMITATIONS: In order to challenge a quiet-title decree after the three-year statute of limitation has expired, a party must establish or disclose a connection with a specific heir who should have been but was not named in the original action. ***Verkamp v. Floyd E. Sagely Properties, Ltd., WL 2501417 (Ark. Ct. App. 2006)***: Plaintiff was record owner of certain real estate in covered by a 1976 decree quieting title to both the surface and mineral interests to plaintiff's predecessor in interest (the "Decree").

Sagely was the operator of a gas well located within the same section of real estate and the lessor under an oil and gas lease with XTO executed in November of 1997. In September of 2002, plaintiff filed suit seeking payment of royalties under the oil and gas lease from Sagely and a declaratory judgment stating that plaintiff owned both the surface and mineral interests for the property. XTO and Sagely (collectively, the "defendants") answered by denying the material allegations of the complaint and claiming that plaintiff failed to join all necessary parties.

Both sides moved for summary judgment. The defendants argued that the Decree could not vest title to the mineral interests in plaintiff as a matter of law because it was based on adverse possession of the mineral interests and there were roughly 75 to 100 people with an interest in the subject mineral rights. Defendants asserted that the Decree was ineffective because service to those individuals was had only by publication of a warning order and there was no personal service on Hazell Dell Grissom, one of the heirs of the original owner.

Plaintiff countered that the three-year statute of limitations set forth in Ark. Code Ann. § 18-60-510 barred the defendants' challenge to the Decree. The trial court granted the defendants' motion and denied plaintiff's motion without explanation.

Plaintiff appealed, arguing that the trial court erred in (i) not applying the three-year statute of limitations and (ii) setting aside the Decree without any evidence establishing that the Decree was based on insufficient evidence.

On appeal: Held: Reversed. The appellate court noted that the validity of the Decree was the real issue. The defendants did not ask the court to set aside the Decree but instead asserted that it was void. The defendants also failed to tender the disputed royalties into the registry of the court, as required by statute, or join the other individuals that they claimed may have an interest in the mineral rights. The defendants argued that the three-year statute of limitations did not apply to known heirs to the mineral interests who were not made parties to the earlier quiet-title action; however, the defendants cannot point to any individual whom they claimed was seeking royalties under the oil and gas lease as an owner or point to a predecessor in title adverse to plaintiff's ownership who was known but not named in the quiet-title action. The appellate court held that without such a showing, the three-year statute of limitations does apply and the defendants' claim is merely a collateral attack on the Decree. Thus, the court held that it was error for the trial court to grant summary judgment in favor of the defendants.

SERVITUDES; RESTRICTIVE COVENANTS; PROHIBITION OF "BUSINESS ACTIVITIES:" A restrictive covenant prohibiting business activities within a condominium does not prohibit or restrict unit owners from renting or leasing their units on a daily or nightly term. ***Mullin v. Silvercreek Condominium Owner's, 195 S.W.3d 484 (Mo. Ct. App. 2006)***:

In this case, two condominium owners sought a declaratory judgment against Silvercreek Condominium Owner's Association ("Silvercreek") that unit owners were not restricted from renting their units on a nightly basis. At the time the condominiums were constructed and prior to the plaintiffs' purchase of their units, the plaintiffs were informed by advertisement and by members of Silvercreek, including its president, that nightly rentals were allowed. Both the Mullins and the Overtons (the "Plaintiffs") rented out their units on a nightly or short-term basis.

In 2001, the Plaintiffs received a Uniform Project Questionnaire from Silvercreek which stated that the project permitted daily and weekly rentals. In 2003, however, the Plaintiffs received correspondence from Silvercreek's attorney and the city attorney stating that nightly rentals were in violation of article 6 of Silvercreek's Declaration of Condominium and By-Laws (the "Declaration") and existing ordinances of the property. Silvercreek claimed that it could terminate the Plaintiffs' rights as condominium owners and/or seek an injunction from the court if they did not stop renting their units for overnight tenancy.

The city attorney suggested filing a variance request with the Board of Adjustments if the Plaintiffs wished to continue to use the property for nightly rentals. Several unit owners, including the Plaintiffs, filed for a variance, but they were denied.

The Plaintiffs then filed this action. The trial court found that the Declaration did not prohibit or restrict unit owners from renting or leasing their units on a daily or nightly term.

On appeal, Silvercreek argued that (i) the Declaration reserved the condominiums for single-family residential use, prohibiting businesses and activities that raise the insurance rates for the condominiums, and (ii) the Declaration prohibited illegal use of the units, and the nightly rental activity was a violation of the zoning ordinances of the city of Rockaway Beach.

The appellate court rejected both of Silvercreek's arguments. While the Declaration stated that use of the condominiums was restricted to residential use by a single family, the court pointed to that language in the same section which provided that nothing "is intended to restrict the right of any condominium unit owner to rent or lease his condominium unit from time to time… ." The court held that given the ambiguity created in attempting to reconcile these two clauses and the fact that restrictive covenants are not favored in Missouri, the covenant should be interpreted narrowly in favor of the free use of the property. The court also held that nightly rentals did not violate the R-3 multiple-family dwellings statute, and therefore, the judgment of the trial court was affirmed.

STATE AND LOCAL TAXATION; PROPERTY TAX ASSESSMENTS; CASINOS: A gambling casino is a limited-market property whose real estate tax assessment is to be calculated in a special way that extracts the business value and isolates the value of the real property.

City of Atlantic City v. Ace Gaming, LLC, 23 N.J. Tax 70 (2006); May 12, 2006.

A casino challenged its tax assessments for years 1996 through 1999. In 1996, the entire casino industry in the area experienced a decline in revenue, in part due to harsh weather conditions. This particular casino was particularly hard hit; it never rebounded from the revenue decline. As a result, in 1998, the casino filed for bankruptcy protection.

For tax year 1996, the casino filed an appeal with the county board of taxation. After a hearing was held, the board issued its judgment reducing the subject property's overall assessment. The municipality appealed to the Tax Court seeking review of the board's judgment. The casino then filed its own appeal with the Tax Court also challenging the judgment

For tax year 1997, the casino filed a tax appeal with the board. The municipality filed a direct appeal with the Tax Court seeking to increase the assessment. In response, the casino filed a counterclaim. The appeal before the board was eventually dismissed, leaving the Tax Court to determine the 1997 appeal.

For tax year 1998, after first filing for protection earlier that year under the Federal Bankruptcy Act, the casino commenced an adversary proceedings in the bankruptcy court challenging its 1998 tax assessments, and removed the pending 1996 and 1997 appeals to the bankruptcy court. Upon application of the municipality, the bankruptcy court abstained from exercising jurisdiction over the adversary proceedings and transferred all three matters to the Tax Court.

For tax year 1999, the casino filed a direct appeal to the Tax Court and the municipality filed a counterclaim.

For the trial, the casino and the municipality each engaged the services of its own professional real estate appraisers to provide opinions of value of the subject property for each of the tax years in dispute. The casino expert relied solely upon the income approach. The municipality's expert relied primarily upon the income approach and cross checked it by the market approach. Neither expert used the cost approach to value.

This was a case of first impression. Since the inception of legalized casino gambling in the municipality, no published case had addressed the issue of how to value a casino hotel for tax assessment purposes.

The Tax Court examined the case law in other state courts, in New Jersey courts, and in the federal courts for insight as to the valuation of casino hotels for tax assessment purposes. Upon that review, the Tax Court noted several findings.

First, the Tax Court found that casino hotels were limited-market properties. It explained that a limited-market property is a property that has relatively few potential buyers at a particular time. The Tax Court noted this was not to mean that limited-market property had no market value. In contrast to a limited-market property, a special-purpose property was a limited-market property with a unique physical design, special construction materials, or layout that restricts its utility to the use for which it was built. Accordingly, in light of the expert testimony and case law, the Tax Court found that casino hotels were limited-market properties, but not special purpose, use or design properties.

Second, the Tax Court found that casino hotels were not conventional hotels. The Tax Court discussed how the nature of the casino industry differed vastly from that of conventional hotels. The Tax Court noted the significant financial disparities: unlike hotel properties which can generate 60% to 99% of its income from the rental of rooms, casino hotels derive more than 90% of its income from gaming and derive less than 5% to 10% of its income from the rental of rooms. Further, the Tax Court noted that cash flow in casino hotels was derived from short-term transactions, explaining that revenue and profits in a casino hotel were far more volatile than in a conventional hotel. Accordingly, the Tax Court found that a casino hotel was not a conventional hotel.

In its analysis of the question presented, the Tax Court stated that there was a presumption of correctness in favor of the board's 1996 judgment, which could be overcome by sufficient competent evidence of true value of the property. Similarly, there was a presumption of validity that attached to the 1997, 1998, and 1999 assessments.

Next, the Tax Court considered the case law of New Jersey courts and other state courts in determining the appropriate approach to taken when valuing a casino for the purposes of tax assessment. Specifically, the Tax Court weighed the merits of three approaches: the income approach, the sales approach, and the cost approach. The Tax Court preferred to have had all three approaches to value, given the novelty of the issue. However, because the Tax Court found that the sales approach of the municipality's expert to be insufficient to determine value, and the cost approach was denied to the Tax Court under agreement of the parties, all that remained were the income approaches proffered by each party's expert. The Tax Court decided to substitute its own judgment for that of the respective parties, but was persuaded by the approach proposed by the municipality.

The municipality noted that the challenge in valuing a casino hotel is extracting the business value from the hotel's going concern value produced by capitalization of the casino's hotel income. The municipality had suggested that the Tax Court rely on and adopt the "Rushmore method" to extract the business value and to isolate the value of the real property in a going concern. The Rushmore method treats all payments to the entity that manages and operates the hotel as business income. The method excludes these payments in the computation of realty income subject to capitalization. Additionally, the method excludes the portion of the overall income realized by the employment of furniture, fixtures, and equipment since those items are generally considered personal property rather than real estate. Lastly, the method makes separate adjustments to provide for periodic replacement of the personal property and also to provide a yield on the investment in personal property.

The Tax Court pointed out that there were primarily three contentions advanced by the casino as its justification for a reduction of each year's tax assessment , and rejected two of them for lack of support in the record. The remaining contention was that the casino was a well managed casino hotel. However, based on the testimony of witnesses, the Tax Court found that the casino was poorly managed during the tax years under appeal.

Having rejected the casino's arguments for reducing its tax assessment, the Tax Court concluded that it could not accept the opinions of value offered by the casino's expert because they were substantially predicated upon facts and conclusions that the court had rejected. Further, it found the municipality's expert to be a more reliable and to have presented a well founded basis for determining value under the income approach. The Tax Court then calculated the value of the casino for each of the tax years under appeal.

STREETS AND ROADS; DEDICATION; SUBDIVISIONS: When lands are sold with reference to a map upon which lots and streets are delineated, there is a dedication of such streets to the public and such dedication continues and cannot be revoked except by consent of the municipality; therefore, when those lots upon which the streets are located are sold, even in a tax sale, they are sold subject to the municipality's right to accept the dedication. ***Township of Middletown v. Simon, 387 N.J. Super. 65, 903 A.2d 418 (App. Div. 2006)***

SUBDIVISIONS; SALE OF UNLAWFUL PARCELS: Although contract to sell lots not properly approved for subdivision is not a violation of Subdivision Map Act if buyer's obligation to perform is contingent upon final approval, such contract does violate the Act, and is void, if the contingency benefits only the seller. ***Black Hills Investment, Inc., v. Albertson's Inc., 53 Cal. Rptr. 3d 263 (Cal. App. 2007)***, discussed under the heading: "Zoning and Land Use; Subdivisions; Sale of Unlawful Parcels."

SUBDIVISIONS; STREETS AND ROADS; DEDICATION: When lands are sold with reference to a map upon which lots and streets are delineated, there is a dedication of such streets to the public and such dedication continues and cannot be revoked except by consent of the municipality; therefore, when those lots upon which the streets are located are sold, even in a tax sale, they are sold subject to the municipality's right to accept the dedication. ***Township of Middletown v. Simon, 387 N.J. Super. 65, 903 A.2d 418 (App. Div. 2006)***

TRUSTS; TRANSFERS OF TRUST PROPERTY: A trustee-seller is estopped from asserting a prohibition on oral modification contract clause if an oral modification is made by the settlor of a revocable trust and the purchaser substantially relied on the modification to the purchaser's detriment. ***Kurzman v. Graham, 817 N.Y.S.2d 888 (Sup. 2006)***.

A purchaser entered into a written sales contract with the trustee of a revocable trust to purchase trust property. The sales contract contained an express prohibition on oral modifications. After the original closing date passed, the settlor of the revocable trust, not a party to the sale contract, assured the purchaser that if the purchaser's mortgage pre-approval lapsed prior to the actual closing and the purchaser could not obtain alternate financing, the purchaser would be released from the sales agreement with no further liability. When the closing actually occurred five months later, the purchaser's pre-approval had lapsed and the trustee-seller initiated an action to find the purchaser in default. Although General Obligations Law §15-301 prohibits the enforcement of oral modifications to an agreement with an express prohibition on oral modifications, the court found that the seller was estopped from invoking the clause because the purchaser had justifiably and detrimentally relied on the settlor's assurances.

VENDOR/PURCHASER; CONDITIONS; REPUDIATION: A Purchaser's letter conditioning the validity of a sales contract on the vendor's approval of a modification to the financing condition can be construed as a notice of cancellation for failure of the condition, and, if the letter does not meet the requirements for cancellation pursuant to that condition, seller may treat it as an anticipatory repudiation of the contract. ***Smith v. Tenshore Realty LTD., 820 N.Y.S.2d 292 (A.D. 2 Dept. 2006)***.

Purchaser and vendor entered into a sales contract to purchase a cooperative apartment. The contract included a mortgage contingency provision whereby the purchaser had 20 business days to obtain a loan commitment from an institutional lender. The buyer had up to seven business days following the expiration of the loan commitment period to cancel the contract. The contract required that certain documentation accompany the notice of cancellation. As is typical of New York decisions, the court tells us less than we'd like to know, and does not disclose the nature of the required documentation. Presumably it consisted of evidence that the purchaser had applied for a mortgage loan.

Prior to the expiration of the mortgage contingency period, the purchaser sent a letter requesting an extension of the mortgage contingency period of almost three weeks, and stated that if the seller did not grant the extension, the "contract shall be null and void and neither party shall have any further liability to the other." The purchaser's letter did not include the documentation required by the sales contract for a notice of cancellation. The seller apparently had a better offer, and immediately responded with a notice rescinding the contract and began the process of returning the earnest money. The very next day, the buyer, apparently unexpectedly, did obtain a loan commitment and faxed the seller telling seller to disregard the prior communication. The seller's rescission notice had been sent by overnight courier the prior day, and was effective, of course on sending. (Either courier or fax were permitted forms of notice.) The seller took the position that the contract was at an end.

The New York appeals court agreed with seller, and reversed the trial court's summary judgment for the buyers. In fact, the court indicated that the seller had an even stronger position than the one it chose to assert. The court held that because the notice of cancellation was defective, it could be viewed as an anticipatory repudiation of the contract. One option the seller had in response to such repudiation was to claim a rescission. Seller also could have claimed a default and (presumably) have retained the earnest money.

Comment 1: In New York, typically both buyer and seller is represented by counsel, and thus it's a sorry tale that the buyer (if indeed it did rely on counsel) would have been undone in this manner. The letter, quoted in the opinion, had the earmarks of a lawyer drafted notice.

Comment 2: The editor has no problem with the notice being treated as a cancellation pursuant to the financing contingency. In light of the fact that the contingency period still had a significant time to run, however, it does strike the editor as overly technical for the court to conclude further that the notice could have been viewed as a repudiation, justifying the seller in claiming remedies for breach.

On the other hand, if, indeed the buyer's lawyer drafted the letter, apparently with a "hardball attitude" designed to bludgeon the sellers into agreeing to an extension, perhaps the court's treatment of the letter as what was intended, a threat to terminate if the seller didn't cooperate, was appropriate.

Note that the letter didn't say something like: "If you can't grant the extension, we'll be forced to withdraw." Rather, it stated that the contract would automatically be null and void. Pretty nasty. The drafter of that letter may find a nasty attitude on the part of the buyer clients at this point.

VENDOR/PURCHASER; MERGER BY DEED: Merger by deed does not apply where there is evidence of mutual mistake. Where buyer closes without providing for a change in tax prorations, as provided for in contract, buyer may later seek new proration based upon mutual mistake regarding accuracy of basis for tax proration, even though buyer could have discovered the truth through inspection of public records prior to closing. ***Czarobski v. Latja, 2007 Westlaw 121127 (Ill. App. 1/18/07)***

A residential sale contract provided that general real estate taxes would be prorated as of the date of closing. It went on to provide that prorations would be on the basis of 105% of the "last ascertainable bill. If said bill is based upon a partial assessment, or on an unimproved basis for improved property, a written agreement (with escrow) for final proration when the complete assessment information from the County Assessor shall be available shall be signed at closing by the parties hereto."

In fact, the figures used by the parties were based upon partial assessment figures for 2003. Sellers gave plaintiffs a credits for the 2003 and 2004 tax years, but the credits were only equal to about half of the actual taxes ultimately assessed to buyers. But buyers, unaware that the assessment was partial, did not seek an escrow agreement at closing, and no such agreement was signed.

When the buyers later sought additional payments for the prorated taxes, the sellers defended on the basis of merger by deed – the buyers had closed without an escrow agreement, and that was that, they argued. The buyers argued that there could be no merger by deed in the face of a mutual mistake of fact. The claimed that both partied operated under the belief that the 2003 taxes were a full assessment. The sellers responded that mutual mistake did not prevent operation of the merger doctrine under the Illinois precedent, but that, even if it did, the mutual mistake doctrine ought not to bar merger where the true information was available to the buyer upon inspection of the public records prior to closing.

The trial court agreed with the sellers and granted summary judgment.

On appeal: *Held: Reversed.*

The primary argument made by the sellers was that mutual mistake simply was no defense to the operation of the merger doctrine. Apparently there is a split in the appellate districts in Illinois on this issue, and the court chose to disregard authority from another district that held that mutual mistake did not affect the merger doctrine. The court commented that, although the doctrine of merger by deed is recognized in Illinois, it "is not favored by modern courts." It pointed to a case in which the merger doctrine was not applied where the property being sold was 4.3 acres less than the parties believed. Although the court did not say so specifically, it would appear that the buyer could have surveyed the property and discovered the shortfall. Nevertheless, buyer was not barred by merger from raising the problem after the closing.

In another precedent case, the court permitted a buyer to argue mutual mistake concerning the tax assessment, where, as here, the true tax information was spread in the public records prior to the closing. But another appellate district chose to ignore this case and denied relief concerning an error in tax assessment because, it concluded, mutual mistake was not a defense to application of merger.

In short, the court felt that the argument of mutual mistake was available to buyer, and that mutual mistake existed even when the borrower had constructive knowledge of the true facts.

Comment 1: The court apparently assumed (consistent with the conclusion of an appellate decision from the other district that it rejected in part) that an agreement as to tax prorations was not a "collateral agreement" and was, in fact, subject to the merger doctrine absent misrepresentation or mutual mistake.

Dirter Dale Whitman, author of a casebook on real estate transactions, demurs with this analysis, although he might concur in the result. In his view, the few decisions that go beyond title issues in applying the doctrine of merger by deed are simply wrong. The classic application of the doctrine was only to defects in title that the buyer accepted without objection, even though the contract gave assurances against such defects. Dale would leave things at that.

Dale does agree that waiver or, more appropriately, the contract doctrine of accord and satisfaction, might also apply to the analogous situation of the buyer agreeing to accept at closing a state of facts other than that warranted by seller in the contract. Of course, accord and satisfaction requires a "meeting of the minds – and thus actual knowledge of the defect. So there could be no accord and satisfaction in this case.

For a case that accepts mutual mistake as a defense to merger, but refuses to permit its use in a situation where the parties almost certainly were mutually mistaken, see Groff v. Kohler, 922 P.2d 870 (Alaska 1996) (The DIRT DD for 4/2/970 (Involving a promise in the contract to convey an easement to buyer at closing.)

Comment 2: Although the editor acknowledges that there are a number of cases discussing mutual mistake in the context of merger, he believes that even unilateral mistake on the part of the party asserting merger may in some cases be enough. If a tender at closing does not conform to the contract, and a party accepts it without actual knowledge of the defect, in many cases it would be inequitable to deny that party the right to raise his complaint later. One circumstance in which inequity might arise is where the party tendering performance believes reasonably that the other side will or should accept substandard performance, and otherwise might not tender at all.

In other words, sometimes the party receiving performance might have a duty to identify the problem at closing, to avoid undue reliance and misunderstanding. But, of course, if that party has no knowledge of the problem, it is hard to allocate such a duty to him.

Comment 3: For a case that applies merger, in a way, to title issues, see: . *Richman v. Gehring Ranch Corp.*, 37 P.3d 732 (Mont. 2001) (The DIRT DD for 9/19/02) (Grant by seller, to "future buyers," of access rights to unspecified lands retained by seller, included in real property sales agreement, merged into deed of a portion of seller's land, which deed did not mention any rights. Thus purchaser's successors do not have any such rights against seller.)

For a case that does apply the merger doctrine to non-title issues, see *Warner v. Estate of Allen*, 776 N.E.2d 422 (Ind.App. 2002) (the DIRT DD for 2/21/03). (Under merger by deed doctrine, purchase agreement for sale of residential home merged into general warranty deed at closing; therefore, purchasers could not, pursuant to the purchase agreement, seek recovery of insurance proceeds from vendor's insurer due to hail damage that occurred before offer to purchase was made.) (The editor hated this decision)

Comment 4: Most courts avoid applying merger to non-title issue by concluding that the arrangement in question, although part of the real estate sale agreement, was "collateral" to the main point of that agreement. *See, e.g. Spears v. Warr*, 44 P.3d 742 (Utah 2002). (The DIRT DD for 9/19/02) (Where the parties to a sale of real estate planned on both finalizing an irrigation water agreement and transferring title after the delivery of deeds, the collateral rights exception to the merger doctrine applies to the water agreement.) Also see: Bruggeman v. Jerry's Enterprises, Inc., 583 N.W.2d 299 (Minn. App. 1998). (The DIRT DD for 5/12/99) (Conditional repurchase agreement is a "collateral agreement.")

VENDOR/PURCHASER; MODIFICATIONS; TRUSTS: A trustee-seller is estopped from asserting a prohibition on oral modification contract clause if an oral modification is made by the settlor of a revocable trust and the purchaser substantially relied on the modification to the purchaser's detriment. ***Kurzman v. Graham, 817 N.Y.S.2d 888 (Sup. 2006)***. , discussed under the heading: "Trusts; Transfers of Trust Property."

VENDOR/PURCHASER; SPECIFIC PERFORMANCE; APPEAL; MOOTNESS: Once seller complies with court's specific performance order, seller's appeal of the case is moot, even when seller alleges error in the trial court's refusal to permit evidence of buyer fraud. ***Thorn v. Walker, 912 A.2d 1192 (D.C. 2006)***

Seller executed a contract for the sale of residential property for a price of $190,000. The closing date was more than six months after execution. The contract was subject, apparently, to a financing condition that benefitted both parties. In a timely fashion, Buyer submitted a loan pre-approval letter that satisfied the financing condition, but Seller, who had lived in the home for more than 30 years, changed her mind about selling and attempted unsuccessfully to refund the $1,000 security deposit.

After execution of the contract, the court notes, the value of the home increased in value substantially (we aren't told why – must be a story in there someplace). Buyers brought a specific performance action to compel the Seller to complete the contract. The trial court granted specific performance. About two years later, the trial court awarded specific performance to Buyers. The trial court ordered that the sale occur no later than six months from the date of the order (postponing the original sale to a date more than three years from the execution of the contract.)

A month after the trial court's order, Seller moved for a new trial. She presented a letter from the General Counsel of the lender listed in the "pre approval letter" that Buyer had submitted. The letter indicated that the party shown as the lender's representative in that letter was not shown on the lender's records as ever employed by the company, and opined that it appeared that the pre- commitment letter was a fraud. The employee in question had testified at the trial a few months before, and the trial court commented that it found that party credible, and that this new evidence was not timely submitted, although Seller had adequate time to obtain it before trial. The court concluded that the un-cross examined statement of the general counsel of the lender "does nothing to change the Court's view." Further, it did not itself suggest that Buyers' themselves made any misrepresentation. The court denied the new trial.

Seller did not seek a stay of the court's order pending appeal, and complied with the court's order to sell the property, but also continued the appeal.

The appeals court heard argued on December 5 and issued its opinion less than three weeks later, concluding that the case was moot and non-justiciable. There were no money damages issues, and the entire subject of the lawsuit was the sale of the property, which had now been carried out.

The court distinguished several other precedent cases that seemed to be pretty close – on the grounds that in those cases there was no concrete evidence that the property sale had actually taken place (although the facts before the court suggested that this might have happened).

Comment 1: It seems inescapable that a stay is necessary in order to prevent the carrying out of a judicial decree. Of course, typically a stay will require the posting of a bond, which likely the Seller in this case couldn't afford. Is this a case of "justice delayed is justice denied?" The editor doesn't think so. The court made a point of evaluating Seller's claims supporting her new trial motion, which it didn't have to do, and indicated that the trial judge made the right call. The circumstances surrounding the pre-commitment letter were suspicious, admittedly, but there has to be an end to litigation, and the information could have been produced in the two years preceding the trial.

Comment 2: One of the great war stories the editor knows in this area concerns a law school classmate who is a colorful trial attorney in Sacramento, California. He obtained a substantial judgment against Montgomery Ward (then still active and vital) and the defense filed an appeal, but did not post an appeal bond. Plaintiff's counsel got a charging order for all the receipts from a local Montgomery Ward store and appeared on television inviting everyone in the area to come shop at that location because all the proceeds would be used to pay his client for the injustice Montgomery Ward had perpetrated. A stunt – but makes a good story. It's not his only good story.

VENDOR/PURCHASER; SPECIFIC PERFORMANCE; PAROL EVIDENCE RULE: A buyer may obtain specific performance of a written agreement of sale, notwithstanding parol evidence suggesting different terms, where the court concludes that the contract was integral, despite the absence of an integration clause, and there is no evidence of fraud or misrepresentation. ***Carrow v. Arnold, 2006 WL 3289582 (Del. Ch. Oct. 31, 2006).***

Carrow, as seller, entered into an agreement of sale with Arnold, as buyer, for his 223 acre farm. Carrow asserted that Arnold made certain representations prior to contract execution to induce Carrow to sell, and Carrow sought to admit parol evidence to rescind the contract based on allegations of fraud and misrepresentation. Arnold responded that the agreement of sale was integrated and the parol evidence rule barred consideration of the earlier communications and counterclaimed for specific performance.

It's an old story. Carrow was an aging farmer, and Arnold was a real estate developer. Allegedly, in the course of negotiations, Arnold represented to Carrow that "nothing would change" on the farm for Carrow during Carrow's lifetime, that Arnold was acquiring the farm for a hunting preserve. Carrow alleged a series of statements by which Arnold led Carrow to believe that the property would be developed. Indeed, even after the contract was signed, Arnold, discussing the transfer of portions of the farm to the local Nature Conservancy, discussed the preservation of rights in Carrow during Carrow's lifetime.

While the contract was still executory, Carrow learned that it was likely that Arnold would subdivide and sell portions of the farm right away, and therefore sought declaratory relief establishing that the agreement contemplated that Arnold would retain the property and that Carrow would be able to farm it (by leasing it back). The agreement did contain a statement that Carrow would have a life estate on his home place and small acreage, but the dispute had to do with the farming rights in the rest of the land.

Carrow sought admission of the parol evidence rule under one or both of two exceptions: (1) for instances where the contract language is ambiguous, and (2) when the contract is the product of fraud or misrepresentation. The court determined that neither exception applied to the instant case. In general, the court found that there were no specific representations of fact, and that at best Arnold indicated attitude and conjecture. Further, the court noted, the contract directly contradicted some of the expectations that Carrow claimed he had, and therefore Carrow could not reasonably have relied upon inconsistent statements that he had heard before the contract.

The agreement did not contain an integration clause, and the court acknowledged that the presence of such clause creates a presumption that the written statement is complete, and that such presumption does not exist otherwise. Carrow relied on this to show that other parts of the parties' negotiations should be taken into account in stating their agreement.

But the Court found that other circumstances supported the conclusion that the writing was a final expression of the parties' intent by virtue of the fact that it was formally typewritten, that the signatures were acknowledged by a notary, that Carrow had negotiated certain changes to the contract, that Carrow had the opportunity to consult with other professionals to review the document, and that Carrow had consulted with his accountant and had met with the buyer and accountant at that meeting. (Carrow used his accountant in negotiations, but never hired an attorney.)

Comment 1: The case raises the interesting issue of when a court will find a contract integrated. It's useful analysis for presenting evidence to a court. But note that the court in fact discusses the evidence anyway, since Carrow's lawyer was able to get most of it into court in order to establish the fraud claim. An interesting and effective tactic.

Still, the court used the somewhat common sense approach to conclude that Carrow couldn't have been relying upon these other promises when the contract unambiguously created rights in Arnold that were inconsistent with Arnold's expectations. Thus, in one fell swoop, the court decided the fraud claim and simultaneously rendered moot any argument that Carrow and Arnold in fact had an agreement contrary to what the written contract stated.

Comment 2: The editor is a bit less comfortable with the stress on the presence of notaries and typewritten agreements. A crafty charlatan might indeed use these devices to bootstrap an otherwise shady deal into legitimacy. But the editor, based upon the court's analysis, tends to agree that this probably didn't happen here. Carrow admitted that he should have studied the deal more. Indeed, he should have had a lawyer do so. It's not that there might not have been some aggressive and even misleading promotion of the deal – there very well might have been – the problem is that even aging farmers have the right and responsibility to do business on the basis of formal agreements, and should read what they sign and accept the consequences.

WORDS AND PHRASES; "CLOSING:" A "closing" of a sale is the final meeting between the parties to a transaction, where the obligations created by the contract are fulfilled. The execution of a warranty deed without delivery and prior to the full payment does not constitute a closing. ***Benavidez v. Benavidez, 2006-NMCA-138, 140 N.M. 637, 145 P.3d 117 (9/13/06).***

This action arose from an underlying probate proceeding where Plaintiff had agreed to purchase the subject property from his father's estate. The probate court entered an order allowing Defendant niece to reside on the property until the "closing on the sale of the property."

On February 5, 2003, Plaintiff entered into a purchase agreement with his sister, the personal representative of their father's estate. The purchase agreement provided that the "[b]alance at closing will be paid by purchaser." On December 3, 2003, Plaintiff paid $18,810.20 in closing costs to the title company toward the purchase price of $183,500.00. On December 11, 2003, the personal representative executed a warranty deed, which was never delivered to Plaintiff. Nevertheless, it was not until May 26, 2004 that Plaintiff paid the balance in full. The president of the title company provided the district court with a letter stating that the "December 3, 2003 closing never took place and the documents [prepared in December] have been destroyed." Plaintiff also admitted that "[t]he balance owed, and full balance of the $183,500.00 was paid by [Plaintiff] at the May 26, 2004 closing."

In the district court Plaintiff argued that he had obtained legal ownership of the property, along with the right to evict Defendants, upon the execution of a warranty deed on December 11, 2003. The court rejected Plaintiff's arguments and concluded that the closing did not occur until May 26, 2004; and therefore, Plaintiff had no right to evict Defendants until that date.

On appeal, Plaintiff challenged the district court's ruling as to the date of the closing, the imposition of sanctions, and claimed there was insufficient evidence to support the district court's findings of facts. The Court of Appeals affirmed the district court's judgment in all respects. There was no closing in December because the full purchase price was not paid and the deed was not delivered then. The closing did not occur until May 26, when all of those things finally occurred.

WORDS AND PHRASES; "CONFERENCE AND TRAINING FACILITIES:" A Town Zoning Code permitting "(c)onference and training facilities" on a property permits use of the property for training future priests, even if training programs last up to two years and participants live on the property. ***Town of Mount Pleasant v. Legion of Christ, Inc., 818 N.Y.S.2d 171 (Ct.App. 2006)***, discussed under the heading: " Zoning and Land Use; 'Conference and Training Facilities.'"

WORDS AND PHRASES; "INTENTIONAL OR UNINTENTIONAL:" A provision in a lease which holds the tenant liable for all damages, "intentional or non intentional" does not impose strict liability on that tenant without additional evidence that the parties intended to impose such liability. ***Allstate Ins. Co. v. Watson, 195 S.W.3d 609 (Tenn. 2006)***, discussed under the heading: "Landlord/tenant; Tenant Liability for Damages to Premises."

ZONING AND LAND USE; "CONFERENCE AND TRAINING FACILITIES:" A Town Zoning Code permitting "(c)onference and training facilities" on a property permits use of the property for training future priests, even if training programs last up to two years and participants live on the property. ***Town of Mount Pleasant v. Legion of Christ, Inc., 818 N.Y.S.2d 171 (Ct.App. 2006)***. Town brought an action against Legion of Christ, Inc. ("Legion") to obtain a judgment declaring their use of the property a violation of Town of Mount Pleasant Code. The court, however, chose to interpret "(c)onference and training facilities" broadly. Because the Town Code in no way speaks to the duration of the training programs, even two year courses of study are permissible. Furthermore, such a broad reading does not injure the Town interests being protected by the Zoning Code, and keeping the property in taxpaying hands (as opposed to tax exempt organizations like Legion of Christ), is not a legitimate interest.

ZONING AND LAND USE; EXACTIONS; OFF-SITE IMPROVEMENTS: According to a New Jersey statute, a developer's legal obligation to pay for off-tract improvements that are necessitated by construction is limited to its *pro rata* share of the cost. ***Toll Bros., Inc. v. Board of Chosen Freeholders of the County of Burlington, 388 N.J. Super. 103, 906 A.2d 476 (App. Div. 2006), September 18, 2006.***

A developer prepared a plan that included building a golf course, country club, residential units, retail property, and office space in a rural area. The development site was located within two municipalities, and the developer applied for site plan approval from both municipalities' planning boards. In anticipation of the development's impact on traffic, the planning boards conditioned their land use approvals on the developer undertaking recommended roadway improvements at the developer's own cost. One of the boards stated that until the road improvements were made, it would not permit more than eighteen percent of the project to be built. The developer entered into developer's agreements with one of the municipalities' planning boards, as well as with the county planning board. The eighteen percent requirement was incorporated into the agreement with the county.

After entering into the agreements and constructing the first phase of development, the developer changed its site plan. During the second phase of development, rather than building office space, it decided to build a senior citizen condominium complex which would result in no increase in traffic.

Meanwhile, another developer applied to one of the municipalities' planning boards for approval to build an office park on a neighboring parcel. This project would affect traffic on the same roads as the first developer was using. Consequently, the board required the second developer to contribute its pro-rata share towards road improvements.

The original developer sued the second developer and the planning board which had only required a limited contribution to road improvements from the later developer. The original developer claimed that the board unlawfully discriminated between the two developers by approving the office park without assigning more financial responsibility for the road improvements to the second developer. It also sued the county board, seeking a declaratory judgment that the developer's agreement was void, or that it should at least be revised to require it to pay only its pro-rata share of the cost of the road improvements. Finally, the original developer sued the other municipality's planning board, challenging the condition in that board's approval of the senior citizen housing plan requiring the completion of road improvements before construction could begin. The original developer claimed that the substantial reduction in the project's scale supported its arguments.

The lower court granted summary judgment to the county, the municipalities' planning boards, and the second developer. On appeal, the Appellate Division affirmed the judgment as to the county, one of the planning boards, and the other developer, but it reversed the judgment in favor of the municipality that had required road improvements despite the change in the development plan from office space to less intense-parking senior housing.

First, the Court examined the general principles guiding developer payments for off-tract improvements. According to a New Jersey statute, a developer's legal obligation to pay for off-tract improvements that are necessitated by construction is limited to its pro-rata share of the cost because a developer should not be burdened with a disproportionate amount of the improvement costs. Therefore, the Court found that without the original developer's agreements, the developer could not be required to pay the entire cost of the improvements, since the reduced size of the proposed development did not necessitate such large improvements.

The question then remained whether the original developer's agreements were binding on the developer. The original developer argued that an agreement in which a developer promises to pay more than its pro-rata share is contrary to public policy and therefore void. The Court, however, found that a developer's agreement is not invalidated simply because a developer voluntarily offers to undertake improvements that could not be required by law. The Court further found that the conditions in the agreements did not violate any zoning laws or require any illegal conduct. It stated that basic contract principles apply, and since the terms of the contract were clear, the agreements were to be enforced as written. Therefore, the Court agreed with the lower court's decision that the original developer was bound by its developer's agreement with the county which stated that it must make the road improvements when the development generated more than eighteen percent of the projected traffic for the development.

As to the developer's agreement with the planning board, however, the Court found that the intent of the parties applied to the office space that was originally planned for the property, and not to the senior citizen residential community. While the written agreement did not set forth specific developments for the property which would activate the developer's obligation to complete the road improvements, the Court found that it was "relatively obvious" that the agreement referred to the development of office space. Unlike the agreement with the county, where the improvements were required once the traffic reached a certain threshold, the agreement with the board called for road improvements in stages, as the traffic-generating complexes were built. The first stage of improvements was completed, and the municipality and its planning board did not show that a senior housing development would generate the need for additional improvements. Further, the Court found that the language of the agreement implied that completion of the improvements was conditioned on the construction of buildings that generated the need for improvements. Therefore, the Court reversed the lower court's grant of summary judgment in favor of this planning board.

With regards to the claim against the later developer, the Court agreed with the lower court that the later developer was not contractually obligated to contribute more than its pro-rata share of the road improvements. The original developer claimed that it held documents that formed an enforceable contract committing the second developer to contribute to the cost of improvements. However, when it entered the agreement with the county it made no mention of the second developer, and promised to pay one hundred percent of the costs. Therefore, the Court found that even if an obligation had existed, the original developer had effectively waived the agreement by repeatedly promising to be solely responsible for the improvements. The Court affirmed the lower court's decision in favor of the second developer.

Lastly, the Court found that the second municipality's planning board did not deprive the original developer of its equal protection, substantive due process or procedural due process rights when it approved the second developer's site plan without requiring it to pay a larger portion of the road improvement costs. The claim was entirely unfounded and the Court simply found that summary judgment had been properly granted to the board.

ZONING AND LAND USE; PROCEDURE; CONFLICTS OF INTEREST: Where a member of a land use board is the child of an attorney, even in an of counsel relationship, at a law firm that previously represented an applicant, that board member must recuse himself or herself. ***Haggerty v. Red Bank Borough Zoning Board of Adjustment, 385 N.J. Super. 501, 897 A.2d 1094 (App. Div. 2006)***

Seeking a density variance, a builder submitted an application to the municipality's zoning board. The board chairman recused himself because he was a partner at a law firm that had previously represented the applicant. The vice-chairwoman served as acting chairperson. Her father, a retired Superior Court Judge, served in an "of counsel" capacity at the same law firm as the board's chairman. The board approved the density variance application. Thereafter, the builder submitted applications for site plan and bulk variance approvals, which the board approved. Interveners alleged that the vice-chairwoman should have recused herself, and her failure to do so tainted the process, invalidating the board's approvals.

The interveners filed their complaint more than nine months following the statutory deadline for challenging the approval of the density variance. Nonetheless, the issue of a disqualifying conflict goes to the fundamental integrity of the proceedings and may be raised on appeal, even though no separate appeal was filed at the conclusion of the density variance hearing. In fact, a timely appeal at the conclusion of all of the board's hearings related to the proposed development may raise a disqualification issue that affects earlier board decisions. In each case, the question raised is whether a potential for conflict exists, not whether the conflict actually influenced the board's decision. A conflict of interest arises when a public official has an interest not shared in common with the other members of the public. However, a remote and speculative interest will not disqualify the public official. There are four situations requiring disqualification — when a public official has (1) a direct financial interest (voting on a matter bearing on the official's own property or affording direct financial gain); (2) an indirect financial interest (e.g., financially benefitting someone closely tied to the public official); (3) a direct personal interest (e.g., the matter benefits a blood relative or close friend in a non-financial way); and (4) an indirect personal interest (e.g., the public official's judgment may be affected because of membership in some organization and a desire to help that organization). According to the Court, a person in an "of counsel" relationship with a law firm has a sufficient financial stake in the firm as to impute to such person any disqualification of the firm arising from client representation by partners or associates of the firm. The fact that the vice-chairwoman was an adult living independent of her father did not sever this relationship. Because the retired judge and the board's chairman worked for the same law firm, the vice-chairwoman was on actual notice of the conflict when the chairman recused himself. Consequently, the board's findings were set aside; the judgment of the lower court is reversed; and the matter was remanded to the board for new hearings.

ZONING AND LAND USE; PROCEDURE; STATUTE OF LIMITATIONS: An action seeking to invalidate penalties and fines in a local code can be barred by the statute of limitations. ***P & N Tiffany Properties, Inc. v. Village of Tuckahoe, 817 N.Y.S.2d 245 (A.D. 2 Dept. 2006).*** A commercial property owner sought to invalidate the new fines and penalties in the Village of Tuckahoe local code because the new local laws were enacted without the statutorily required notice. The court held that this claim did not go to the "wisdom or merit" of the law, but rather the procedure, and thus, it functioned as an article 78 proceeding. As such, the claim is subject to a four-month statute of limitations. Here, the four month window had elapsed, and thus the claim is time-barred.

ZONING AND LAND USE; SUBDIVISIONS; SALE OF UNLAWFUL PARCELS: Although contract to sell lots not properly approved for subdivision is not a violation of Subdivision Map Act if buyer's obligation to perform is contingent upon final approval, such contract does violate the Act, and is void, if the contingency benefits only the seller. ***Black Hills Investment, Inc., v. Albertson's Inc., 53 Cal. Rptr. 3d 263 (Cal. App. 2007)***

The California Subdivision Map Act prohibits the sale, lease or financing of any subdivided area of a land parcel prior to proper filing of a subdivision plat or map. Here, seller apparently had a buyer that seller wanted to bind into a contract, but seller had not yet subdivided the property. Seller apparently was concerned that it would not be able to complete the subdivision process satisfactorily, and therefore included in the contract a condition that the contract could be nullified by seller if seller was unable to obtain subdivision approval. The contract provided that seller, at its option, could waive the condition.

Buyer paid earnest money in several installments but then, shortly before the scheduled closing, buyer notified seller that it would not close on the contract and demanded return of its earnest money. By that time, Seller had in fact completed the subdivision process and was ready to close.

The court held that the contract was void because inconsistent with the policies of the Subdivision Map Act.

Although the law provides that contracts of unsubdivided land can be made if conditioned expressly on the completion of the subdivision process, the court read this statutory language to mean that the buyer's obligation to purchase would have to be conditioned on completion of the subdivision. One stated goal of the Act is to protect buyers of subdivided land. Here, the condition relating to subdivision approval was a "seller's condition," and if the seller waived the condition, the buyers would have been bound under the contract to perform.

Reporter's Comment: The seller's attempt at added self protection backfired: the contracts literally gave the seller the right to proceed with the transactions without complying with the Subdivision Map Act. Presumably, the seller did not want this right and was merely concerned with not being burdened by unacceptable conditions of the subdivision. The contracts should have been drafted to make subdivision an express condition for *both parties*, and they should also have given seller separate approval rights over the terms of the subdivision.

Editor's Comment: Void, eh? Well, what happens if the buyer pays the money and takes possession of the property? Does the court "leave the parties where they stand," which is one approach to an illegal contract? Or can the borrower rescind? What if the buyer is innocent of any knowledge of the violation and the seller seeks to rescind at a time when the property value is higher. Has the buyer no rights to benefit from the good investment? The editor guesses that the answer is "no." Buy unlawfully subdivided land at your peril.