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Quarterly Report on Current Developments in Real Estate Law

January 1, 2006 to March 31, 2006

Sponsor:

ABA Section of 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. Contributor, Fellows of the American College of Mortgage Attorneys, 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 Editor hopes to provide a comprehensive review of significant new developments, but obviously he 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.

The editor of the Report alone controls the content of the case reports section of the Report and, for the most part, prepares the comments and criticisms added to the case summaries. The views expressed in the Report have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association. Similarly, they are not the views of the Section of Real Property, Probate & Trust Law or of the Fellows of the American College of Mortgage Attorneys.

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

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ADVERSE POSSESSION; ESTOPPEL OF ADVERSE CLAIM: Adverse possessor claimant may be estopped from pursuing claim when the claimant served as attorney for previous seller of property being claimed and made assertions to a title insurer company that there was no claim against the land. ***Moran v. Gala, 845 N.E.2d 1170 (Mass. App. Ct. 2006).***

Moran and his wife Susan brought this appeal of a grant of summary judgment ordered in favor of defendant Gala. The Gala's title to the property currently includes the area in dispute. Moran's parents lived on the property adjacent to that of the Gala's from 1942 through 1993. Upon his parents' death, Moran bought out the interests of his siblings and moved into the residence Moran filed an affidavit that he or his predecessors openly, notoriously, exclusively, adversely, and continuously occupied the land being claimed, a parcel between the two residences upon which the Gala's built a driveway, for a period exceeding 20 years.

The Gala's purchased their lot (neighboring Moran), including the land in question, from the Stowe family in 1997. Moran, a family friend of the Stowe's and a lawyer, represented the Stowe's in their sale of the property to the Gala's. In the course of his representation, Moran filed a Mechanic's Lien Certificate on behalf of the Gala's with the title insurance company averring that there were no "unrecorded matters" connected to the title. In that certificate, Moran neither asserted no claim of adverse possession against the Stowe's.

During the course of the negotiations, Moran attempted to arrange for changes in the boundary, but the parties rejected his proposal. Further, Moran made no attempt to assert changed boundaries of his property when he applied for a special permit to build on his property in 1994.

The Court of Appeals affirmed the trial court's granting of summary judgment in favor of the Gala's. The Court found that equitable estoppel barred Moran from bringing his claim in this case as a matter of law. "Circumstances that give rise to an estoppel are (1) a representation intended to induce reliance on the part of a person to whom the representation is made; (2) an act or omission by that person in reasonable reliance on the representation; and (3) detriment as a consequence of the act or omission."

The Court found that Moran's assertions to the title company, although not directly to the Galas, induced the Galas to purchase the land in question by allowing the title insurance company to issue the policy.

In response, Moran argued that, although he was an attorney, he was not a property specialist and knew virtually nothing about the law of adverse possession. He was aware of the overlap, but did not know that adverse possession might supply a solution to the issue. He did not take action until after the sale by the Stowe's and the death of his own parents because of the long

The court stated that Moran's explanation did not avail and that his filing of the affidavit to the title company was material to the conclusion that he was estopped from asserting his adverse possession claim. A misrepresentation did not have to rise to the level of fraud to qualify under the doctrine of equitable estoppel, rather the proper test is whether "conscience and duty of honest dealings should deny one the right to repudiate the consequences of his representations or conduct."

Further, in the course of the negotiations on behalf of the Stowe's, Moran had proposed an adjustment to the boundaries of the properties. The court found these to be an implicit representation that he was not asserting a claim contrary to the documents that he was preparing in conjunction with the sale. Finally, in applying for a zoning variance, Moran had filed papers asserting his present boundaries as his owned property, without disclosing his claim of ownership of the property next door, although he apparently was aware of the fact that he did have an adverse possession claim.

The Court ruled that Moran's wife was similarly barred from bringing a claim of adverse possession, despite the fact that she was co-owner of their property, because she effectively allowed Moran to act as her agent when she allowed him to sign solely all sign all paperwork in connection with the property. The Galas retained title to the land in dispute.

Comment 1: The editor thinks this to be a much closer case than the court. His clients, the Stowe's, were not aware of the adverse possession facts, and if he had disclosed them on the Stowe's behalf in the affidavit he likely would have "queered the deal" for them. The affidavit was the Stowe's representation, not his.

As to the negotiation concerning the boundaries, the cases are full of statements that negotiations to clear a boundary dispute do not detract from a later claim that adverse possession has arisen from continued occupation over the boundary.

The zoning matter, in the editor's view, has virtually nothing to do with the case at all, since it was addressed to the technical issues concerning the zoning agency and not to the neighbors. It did not constitute any abandonment of Moran's physical occupation of the Galas' land, which remained, open, notorious, unpermitted and, by the ruling of most courts – hostile.

Comment 2: Was there anything about Moran's ethical duties as an attorney? To avoid misleading the other side, should Moran have simply pushed the affidavit back to the Stowe's for them to sign themselves? Remember that at the time he did not have a direct plan to seek an adverse possession claim and admitted only to a "general knowledge" of the doctrine.

Comment 3: Would the issue be any different if Moran had served as a broker, rather than a lawyer? How far do we go with this? Does any professional who represents others in real estate transactions have a duty to disclose any adverse claims he *may* have at some future time to both parties – even non-clients? The editor understands the court's feelings here, but he thinks the court has leapt onto a slippery slope that it might better have avoided.

ADVERSE POSSESSION; REQUIREMENT OF HOSTILITY; COTENANT'S POSSESSION: Tenant in common's exclusive use of property was not enough to establish adverse possession. ***Preciado v Wilde (2006) 139 CA4th 321, 42 CR3d 792 (Cal. App. 2006)***

Leonard and Elizabeth, his niece, owned two parcels of real property as tenants in common. A house originally stood on the first parcel before it was demolished. The second parcel was a vacant back lot. Elizabeth owned an undivided three-tenths interest in each parcel that she inherited from her father. Leonard decided to purchase Elizabeth's interest in the properties. On September 9, 2002, he wrote Elizabeth a letter describing her ownership interest, which stated that she owned three-tenths of each parcel. Elizabeth and Leonard agreed on the price, but the sale did not take place because Leonard did not pay the purchase price.

Leonard sued to quiet title based on adverse possession. The trial court found that Leonard did not establish adverse possession, and that Leonard's attempt to buy the lots from Elizabeth was inconsistent with a claim of ouster.

The court of appeal affirmed. Each tenant in common has a right to occupy the whole of the property. The possession of one is deemed the possession of all. Each may assume that another in exclusive possession is possessing for all and not adversely to the others. Between cotenants, before title may be acquired by adverse possession, the occupying tenant must impart notice to the tenant out of possession, by acts of ownership of the most open, notorious, and unequivocal character, that he intends to oust the latter of his interest in the common property. Such evidence must be stronger than that which would be required to establish a title by adverse possession in a stranger. One tenant in common cannot, by mere exclusive possession, acquire the title of his cotenant.

Leonard failed to carry his burden on notice. Elizabeth testified she had no notice that Leonard wanted to interfere with her right to possession and title. Leonard admitted he never excluded Elizabeth from the property and never restricted her access or informed her that he was challenging her ownership. Although he constructed fences, they were not designed to exclude family members. Moreover, Leonard undermined his claim of adverse possession when he tried to buy Elizabeth's interest. His September 9 letter was an admission that Elizabeth held legal title. It refuted the allegations of the complaint and impeached Leonard's credibility.

The trial court properly admitted evidence about Leonard's offer to buy Elizabeth's interest. It did not involve an offer to compromise under Evid C §1152, which had no application here; §1152 facilitates candid discussion that may lead to settlement of disputes. Leonard and Elizabeth were not engaged in discussions to settle a dispute over her ownership; Leonard simply offered to buy Elizabeth's interest.

Leonard did not carry his burden of proof concerning his claims of title or color of title. A plaintiff must prove his title in order to recover in a quiet title action; merely challenging defendant's title is insufficient. Leonard did not show that the court erred when it found Elizabeth inherited her tenancy in common interest, and Leonard did not prove title or a claim based on color of title. Elizabeth introduced probate documents and a title expert's testimony to support the origins of her title and the validity of her interest as a tenant in common. Leonard admitted that Elizabeth's father had legally inherited his tenancy in common interest in the two lots. The trial court could have reasonably inferred Elizabeth never abandoned the interest in the lots she inherited from her father.

Comment: How could Leonard's attorneys ever think that they could make out a case of adverse possession by him against his niece Elizabeth? From the appellate opinion, he seemed to have no evidence whatsoever to support that claim. Against outside third parties, Leonard probably did have good adverse possession, since he was in exclusive possession, had paid the taxes, and had color of title. But Elizabeth was not an outsider; she was a cotenant, which changes all of the rules for adverse possession.

Because tenants in common (as well as joint tenants) have undivided interests in property, neither can point to any particular bit of the property and say "this part is mine, so get off it" (unless they have leases or similar agreements to that effect). Since no cotenant can thus claim exclusive possession of all or any part of the common property, that gets shorthanded into the maxim that "the possession of one is the possession of all" (although it is hardly clear just why such peculiar language was chosen or what good it does to say it that way).

In order to start an adverse possession clock running, a cause of action must arise in favor of the plaintiff. That is easy to establish when a stranger takes possession of an owner's property without consent, since that act alone is a sufficient trigger. (Indeed, that seems so evident as to make it unclear why there must be any other requirements – e.g., open and notorious, exclusive, hostile, claim of right – beyond the simple trespass requirement.) But when a possession is in itself lawful, as in the case of a tenant in common, no cause of action in favor of the other tenant in common is generated by taking possession, even if the COTIP (cotenant in possession) goes there exclusively. If neither can tell the other to get out, possession by either one starts no clock running against the other (the COTOP).

What it takes to start the clock against a COTOP, in the case of exclusive possession by a COTIP, is not an entry by the COTIP, but an exclusion of the COTOP; only when the COTIP refuses to let the COTOP into possession-either as a shared or sole possessor-does the COTOP have a cause of action. That is how and when the clock starts.

That explains why the rules of adverse possession against co-owners are different than those of adverse possession against outsiders. Possession by a stranger is ipso facto enough to warn an owner that its rights are in danger, whereas possession by a cotenant, even when exclusive, does not give that warning. To start that clock, the system adds the requirement of ouster-an event that necessarily lets the COTOP know of the threat. Absent an ouster, a COTOP may be more than pleased that the other is in possession of their concurrently owned property, taking care of it for both of them; it would be ludicrous to file suit. Litigation need be considered only when the COTOP learns that the COTIP's possession is hostile and may lead to ultimate permanent exclusion, i.e., that the COTOP has been "ousted." The ouster requirement is the system's way of saying that it, the COTOP, has been notified that it is being excluded. [Just as it does in the case of permissive uses being converted into hostile ones for prescriptive easements, (see *Aaron v Dunham* 137 CA4th 1244, 41 CR3d 32 2006)]. Ouster is thus inevitably a psychological and contextual event. It may be clear when COTIP tells COTOP to get off the property, but not when COTOP is someplace else. Since the real reason for the requirement is to assure that COTOP knows that COTIP claims the exclusive right to possess, equivocal acts may accomplish that and seemingly unequivocal acts may not. Was there an ouster if, as he was storming out of the door, she yelled after him, "And don't come back!"? Was there an ouster if, when he came to the door, she said, "Please come into my house and make yourself at home"?

The hardest cases are when COTIP doesn't even know there is a COTOP. Dad's will left the house to his daughter, but the will was defective; her brother is legally a tenant in common, although neither one knew it. How can we expect her to oust her brother from what she thinks is all hers anyway?

There is CC §843, which clarifies how an ouster may be established; but it really only operates in favor of the COTOP. By complying with it – and if the COTIP thereafter makes the "right" response-COTOP can show that she has been denied possession and thereby gain the right to demand rental value from COTIP. While nothing in that statute tells COTIP how to do it from the other side, one thing is clear: Don't write a letter to the other, as Leonard did, offering to buy her out.

The Reporter for this item was Professor Roger Bernhardt of Golden Gate Law School, San Francisco (reprinted from the Cal CLE Real Estate Reporter).

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; SCOPE OF ARBITRATION PROVISION: A property owner must arbitrate claims against a contractor where the parties contract contains an arbitration clause and it cannot be said with positive assurance that the arbitration clause is not susceptible to an interpretation that covers the asserted dispute. ***Precision Homes of Indiana v. Pickford, 844 N.E.2d 126 (Ind.App. 2006).*** Pickford's, property owners, brought claims against the general contractor, general contractor's president, subcontractor, and concrete supplier alleging fraudulent inducement to enter the contract, fraudulent inducement to agree to arbitration, breach of contract, conversion, slander of title, assault, battery, and false imprisonment.

The defendant, Precision Homes of Indiana, sought to arbitrate the claims under the broad arbitration clause contained in the contract. The trial court found that the arbitration clause was unconscionable on the facts of the case and denied defendant's request for arbitration.

The Court of Appeals of Indiana reversed finding that the arbitration clause was not unconscionable and the disputes in question reasonable fit within the language of the arbitration agreement. The Court found that the claims arose from or related to the property being built and therefore were proper disputes for an arbitrator to decide. As well, the clause itself was not unconscionable because the Pickford's were not fraudulently induced into agreeing to arbitrate any disputes arising under the contract. The parties were on equal grounds and any failure to understand the contract was attributed to the plaintiff's lack of diligence and not the defendants concealment.

The Court of Appeals held that all of the claims alleged by the plaintiffs fit reasonably within the language of the arbitration clause and therefore should have been submitted to arbitration.

ALTERNATIVE DISPUTE RESOLUTION; ARBITRATION; SCOPE OF ARBITRATION PROVISION; THIRD PARTIES: Arbitration clause in house purchaser's contract with builder was binding on purchaser's adult child, even though she was not a party or a signatory to the contract, requiring her to arbitrate her personal injury action to recover for asthma allegedly caused by dust from house repairs. ***In re Weekley Homes, L.P., 180 S.W.3d 127 (Tex. 2005)***.

Vernon Forsting, a seventy-eight year-old widower with significant health problems, contracted with Weekley for the construction of a large home in which he could live with his daughter (Von Bargen), her husband, and their three sons. Von Bargen and her husband negotiated directly with Weekley on many issues, paid the deposit, selected the floor plan, made custom design choices, and signed a letter of intent as "purchasers."Only Forsting, however, executed the financing and closing documents on the home.

Shortly after closing, Forsting transferred the home to the Forsting Family Trust, of which Von Bargen is the sole beneficiary.

After growing unsatisfied with the home and Weekley's efforts to repair it, Forsting, Von Bargen and the Trust filed suit against Weekley. Forsting and the Trust filed claims for negligence, breach of contract, statutory violations, and breach of warranty. In addition, Von Bargen filed a lawsuit only for personal injuries, alleging that Weekley's negligent repairs caused her to develop asthma.

The Real Estate Purchase Agreement contained an arbitration clause which stated that "any claim, dispute or cause of action between Purchaser and Seller…, whether sounding in contract, tort or otherwise, shall be resolved by binding arbitration…. Such claims, disputes or causes of action include, but are not limited to, those arising out of or relating to…the design, construction, preparation, maintenance or repair of the Property." Weekley moved to compel arbitration of all claims under the Federal Arbitration Act. The trial court granted the motion as to the claims filed by Forsting and the Trust, but refused to compel arbitration of Von Bargen's claim because she did not sign the Purchase Agreement.

The Supreme Court, after granting Weekley's request for *mandamus* relief, applied state law to determine whether a nonparty to a contract is bound by the arbitration clause contained in that contract. Under Texas law, "a nonparty may be compelled to arbitrate if it seeks, through the claim, to derive a direct benefit from the contract containing the arbitration provisions." The Court noted that a nonparty may seek or obtain direct benefits from a contract by means other than a lawsuit, and in some cases, a nonparty may be compelled to arbitrate if it deliberately seeks and obtains substantial benefits from the contract itself.

The Court determined that Von Bargen deliberately sought substantial and direct benefits from the contract by residing in the home, directing how Weekley should construct many of its features under authority of the Purchase Agreement, demanding extensive repairs, personally requesting and receiving financial reimbursement for expenses, and conducting settlement negotiations. By receiving these substantial actions from Weekley and demanding compliance with provisions of the contract, Von Bargen could not equitably object to the arbitration clause attached to them. According to the Court, "a nonparty cannot both have his contract and defeat it too."

Thus, the Court held that Von Bargen was bound to arbitrate her personal injury claim and conditionally granted the writ of mandamus, ordering the trial court to vacate that part of its order denying Weekley's motion, and to enter a new order compelling arbitration of Von Bargen's claim.

ATTORNEY/CLIENT; CLOSING ESCROWS: A lawyer directing the closing of a real estate transaction holds money which belongs to another (either a client or a third-party) as an incident to that practice, and must keep that money in an IOLTA account. ***Formal Advisory Opinion 04-1, 626 S.E.2d 480, 280 Ga. 227 (February 13, 2006).***, discussed under the heading: "Closings; Escrowed Funds."

BANKRUPTCY; AVOIDANCE; UNPERFECTED CLAIMS; NOTARIZATION: Bankruptcy courts strike down recorded documents as "unperfected" due to technical deficiencies in execution and notarization. ***In re Helvey (Schlarman v. Suntrust Mortgage, Inc.), 2006 Bankr. LEXIS 1619 (Bankr. E.D. Ky, 8/2/06)***

In re Stubbs (Stubbs v. Chase Manhattan Mortgage Corp.), 2006 U.S. Dist. LEXIS 57267 (U.S.D.C. N.D. Ind., 8/14/06),

In re Bross (Monnie v. Field), 2006 U.S. Dist. LEXIS 57449 (U.S.D.C. S.D. Ohio, 8/16/06)

My favorite horror stories are defective deeds and sloppy paperwork. To the inner title nerd, they are slapstick comedy. These cases provide lots of entertainment.

In *Helvey*, borrower gave a mortgage lender, securing payment of $58,400, in connection with her purchase of real property in Independence, Kentucky. More than two years later, borrower filed Chapter 7 bankruptcy and the trustee in bankruptcy brought an adversary proceeding to avoid the mortgage as an interest in the borrower/debtor's real property.

The witness, or notary acknowledgment, attached to the mortgage failed to show the borrower's name, name of the county, and date of acknowledgment. The trustee argued the mortgage was not properly acknowledged, as required by Kentucky Revised Statutes section 423.130, and, therefore, did not impart constructive notice to the trustee as a hypothetical bona fide purchaser of the property as of the date of commencement of bankruptcy. Thus, the mortgage could be avoided per Bankruptcy Code section 544(a)(3).

The bankruptcy court ruled in favor of the trustee, enrolling mortgagee as an Unsecured Creditor.

In *Stubbs,* the notary acknowledgment to a recorded mortgage failed to show the borrower's name. Almost six years later, borrower filed Chapter 13 bankruptcy and both borrower/debtor and trustee in bankruptcy filed an adversary proceeding to avoid the mortgage as an interest in debtor's real property. Once again, the adversary proceeding was based on Bankruptcy Code section 544(a)(3).

The debtor and trustee argued the mortgage was not duly acknowledged and, therefore, did not impart constructive notice to the debtor or trustee as hypothetical bona fide purchasers as of the date of commencement of bankruptcy. The mortgage holder responded that, under Indiana statutes, a recorded document is conclusively presumed to comply with state requirements for recordation, and a properly recorded document imparts constructive notice of its contents (which, in this case, was a recorded mortgage showing the debtor as the "borrower").

The bankruptcy court ruled in favor of the debtor and trustee, and the mortgage holder appealed.

On appeal, the federal District Court affirmed the bankruptcy court order, saying the mortgage was not duly acknowledged, and therefore not properly recorded, and therefore does not impart constructive notice as of the commencement of bankruptcy.

Bross involved an Ohio residential mortgage in a Chapter 7 action. The mortgage, consisting of eleven pages, contained a signature line with Ms. Bross's named typed underneath but no signature on the line. 544(a)(3) struck again.

The trustee argued that because the mortgage was not signed it created no binding obligation in favor of the mortgage holder. The mortgage holder replied that the mortgage was (a) initialed by borrower on each of its eleven pages, (b) accompanied by condominium and mortgage insurance riders that were signed by the borrower, and (c) notarized with an acknowledgment stating the borrower appeared, signed and acknowledged the mortgage before the notary.

The bankruptcy court ruled in favor of the trustee, and the mortgage holder appealed.

On appeal, the federal District Court affirmed the bankruptcy court order, saying:

> "The Debtor failed to show that she accepted the terms and covenants of the mortgage by signing on the line provided for that express purpose. Her initialing of the mortgage document on a space other than the signature line does not satisfy the purpose of the signature requirement…and therefore does not demonstrate an intent to be bound by the mortgage. For this reason, her initials on a space other than the signature line do not constitute a valid signature."

The Court went on to say signatures on riders did not satisfy the requirement that the mortgage be "executed," because they were not notarized. And, notarization of the blank signature line was not effective because "there is no signature for the Debtor to have acknowledged."

Thus, the mortgage was avoided under Bankruptcy Code section 544(a)(3), because in Ohio "only properly executed mortgages take priority over a bona fide purchaser." And another lender takes a pie in the face…

Reporter's Comment 1: Wondering about equitable issues? After all – the borrower took the money and the parties treated these as valid secured loans for a substantial period of time. A bankruptcy expert would tell you that the number of payments or length of time between mortgage origination and a borrower's bankruptcy are not relevant to operation of Bankruptcy Code section 544.

The purpose of the section (as well as sections 547 and 548) is to avoid one creditor being given favored treatment by a debtor, to the detriment of debtor's other creditors, on the eve of bankruptcy. This had been seen to happen when a debtor would give title to property, or a security interest, to one creditor just before filing bankruptcy, forsaking all others. So it was that drafters of the Bankruptcy Code created remedies to avoid unperfected security interests as of commencement of bankruptcy (section 544), preferential transfers not supported by new value (assets) received the debtor immediately prior to bankruptcy (section 547), and fraudulent transfers by the debtor with the intent to defraud creditors, or while the debtor was insolvent and without reasonably equivalent value (assets) being received by the debtor, within one year of bankruptcy (section 548). While the drafters created a few "safe harbor" defenses to operation of these sections, pre-bankruptcy payments by the debtor is not among them. Again, the purpose is not to cancel the debt (although that may be the result), but is instead to treat all creditors equally and fairly vis-à-vis access to the debtor's assets.

Reporter's Comment 2: Fortunately, when the Bankruptcy Code is not involved courts still try to enforce the legal intentions of parties to a contract or, in the absence of a binding contract, courts will try and do what is equitable. I like it that way, even though we do our best to make sure that formalities are satisfied.

The Reporter for this item was Bert Rush of First American Title Insurance Company, writing in the company publication: "Landsakes."

BANKRUPTCY; AUTOMATIC STAY; FORECLOSURE: Although a state court can decide whether a foreclosing party has complied with the bankruptcy automatic stay and the bankruptcy court will honor that decision, the state court must have expressly addressed the question, not merely suggested the result by inference. ***In Re Steward, 338 B.R. 654 (Bkrtcy. D. N.J. 2006); February 24, 2006.***

A debtor filed for bankruptcy protection. The case was dismissed on the recommendation of the United States Trustee because the debtor failed to make all the required pre-confirmation payments. Shortly thereafter, the debtor filed a second bankruptcy action.

The debtor lived with his sister in a cooperative apartment she owned. When his sister died, he became the executor of her estate and he was its sole beneficiary of her estate. The co-op association disputed the debtor's ownership interests in the co-op and filed an action in state court seeking to have him removed as executor, claiming that certain conditions had to have been met before ownership of the co-operative apartment could be transferred to him.

The debtor's attorney advised the association that the state court action violated the automatic stay provisions under 11 U.S.C. 362(a) of the United States Bankruptcy Code. Nevertheless, the association continued with its motion and an order-to-show cause was issued to remove the debtor as executor of his sister's estate.

The debtor then sought an order in federal bankruptcy court finding that the association violated the automatic stay provisions and the association claimed that the automatic stay was not applicable. First, it argued that the debtor was not eligible to file a second bankruptcy case, since he requested and received a voluntary dismissal of his prior case less than 180 days earlier. The Court, however, found that he was an eligible debtor, noting that for the 180 day rule to apply, the dismissal of the earlier case had to be voluntary. It found that the dismissal of the prior bankruptcy case was not voluntary because it was initiated by the United States Trustee, and not the debtor.

The association then argued that under the *Rooker-Feldman* doctrine, the bankruptcy court could not entertain appellate review of a state court action. According to the association, since the debtor did advise the state court of the automatic stay provisions and the state court did not address the automatic stay, it could be inferred that the state court determined that the automatic stay did not apply. The Court disagreed. It found that the applicability of the automatic stay cannot be determined by implication, and that a state court has to specifically address the automatic stay. Since it did not, the bankruptcy court had the power and authority to do so.

The Court determined that the automatic stay did apply, and that the association violated the automatic stay by filing its motion in state court with knowledge of the bankruptcy filing. Lastly, the association argued that the automatic stay did not apply because the association was suing the debtor as the personal representative of the estate, not in his personal capacity. The Court disagreed, finding that an action to remove a debtor as an executor of an estate is a suit against the debtor and violates the automatic stay.

BANKRUPTCY; LEASES; DAMAGES CAP: When tenant declares bankruptcy, Bankruptcy Code §502(b)(6)'s cap on landlord's recoverable damages, although phrased in terms of rent, does not limit landlord solely to claims for rent reserved, but may support an additional claim for attorney's fees, so long as total claim is within the cap limits. ***Wall Street Plaza, LLC v JSJF Corp. (In re JSJF Corp.) 344 B.R. 94 (9th Cir. BAP 2006)***

Landlord Wall Street was awarded a state court judgment for damages against lessee JSJF for breach of lease. Wall Street also prevailed on JSJF's counterclaim, obtaining a judgment of dismissal with attorney fees to be awarded later. A few days later, before the final entry of the order determining the attorney's fees, JSJF filed its Chapter 11 petition; Wall Street was its primary unsecured creditor.

Wall Street filed three proofs of claim to which JSJF objected on various grounds. One of the objections was that the claims for attorney fees, not "rent reserved" under 11 USC §502(b)(6), and that two were time-barred. The bankruptcy court disallowed all three claims and denied Wall Street's motion for reconsideration. When the state court ascertained the amount of the attorney fee award, Wall Street sought leave to file a fourth proof of claim, either as an amendment to the first timely claim or as late filed, which the bankruptcy court denied. It also denied Wall Street's motion for reconsideration.

Section 502(b)(6) provides as follows:

. . . . if [an] objection to [the] claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that – (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds-

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of-

(i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

The 9th Circuit BAP held that the bankruptcy court's disallowance of the first claim because it was not for rent was an error of law. *In re McSheridan* (BAP 9th Cir 1995) 184 BR 91, 99, articulated a test to determine what charges are "rent reserved" and therefore capped under §502(b)(6).

As the court read this statute, it does not limit lessors' claims only to those items that fall within the cap. Thus, a lessor may have an uncapped claim for something other than damages resulting from the termination of the lease. The landlord's cap of §502(b)(6) may limit the amount of a lessor's claim, but it is not a criterion for its allowance; it becomes significant only if the claim otherwise allowable under nonbankruptcy law exceeds the cap calculated under the statute. In the instant case, the landlord's claim for future rent was relatively small, and there was lots of room within the cap amount to support payment of some or all of the attorney's fee claim. In interpreting *McSheridan* in this way, the court appears to have departed from rulings by several other federal district court in California.

As the lower court had not based its opinion on the grounds that the landlord's claim exceeded the total allowable cap amount, but on the ground that the attorney's fees did not constitute "rent," the court reversed and remanded for determination of whether the landlord's cap applied to some or all of the first claim under *McSheridan* and, if so, what that cap was.

The court further ruled that the trial court abused its discretion in disallowing the fourth claim as an amendment to the first claim. In the absence of prejudice to the opposing party, the Ninth Circuit has a liberal policy permitting amendments to a proof of claim to cure defects in the claim as filed. *In re Roberts Farms, Inc.* (9th Cir 1992) 980 F2d 1248, 1251. The gravamen of the first claim was the assertion of all of Wall Street's rights vis-a-vis JSJF arising out of the lease litigation that resulted in the state court judgment. Because the total amount of attorney fees had not been determined, the amount stated in the claim was incorrect. The fourth claim corrected the error and set forth the proper amount of Wall Street's claim; it did not assert a new theory of relief. As to prejudice, nothing in JSJF's papers suggested any worsening of its position or bad faith or unreasonable delay on Wall Street's part. Prejudice requires more than simply having to litigate the merits of, or to pay, a claim, the mistaken legal premise on which the bankruptcy court denied the claim. There must be some legal detriment to the opposing party. The equities favored Wall Street because JSJF's own plan of reorganization included Wall Street's claim for lease damages. Indeed, Wall Street's successful assertion of these rights triggered JSJF's bankruptcy filing. The panel remanded for determination of the fourth claim and the extent to which it might be limited by the §502(b)(6) cap.

Note: The lease had designated the attorney's fee claim as "rent," but the trial court concluded that it was not rent because it was not "regular and periodic" and the appeals court did not disturb that finding. It simply stated that the claim did not have to constitute rent to be payable as damages on account of the termination of the lease so long as there was room under the cap.

Reporter's Comment: It seems clear that a nonperiodic award of attorney fees entirely unrelated to the value of the premises is not rent, even when it is designated as such in the lease. The BAP here, however, read *McSheridan* to apply only to capping the recovery, and having nothing to do with allowability; attorney fees that do not constitute rent are merely not subject to the cap, they are not therefore disallowable.

Thus, one court [the bankruptcy court] read §502(b)(6) to deny the attorney fee claim entirely, while the other read it to permit it completely. It's not that I like compromises, but I don't know why the section wasn't construed to allow the attorney fee claim, even though it was not for rent, but to subject to the cap, even though it was still not for rent.

Section 506(b) provides that the court shall determine the amount of such claim . . . and shall allow such claim in such amount except to the extent that . . . 6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds – A) the rent reserved by such lease . . . for one year.

Thus, while one needs to determine what was rent reserved for capping purposes, what is capped is not that item, but rather the "damages resulting from the termination of a lease." Damages resulting from termination seem to me to include related attorney fees, whether or not they are characterized as rent by the lease or by a court.

These attorney fees were awarded in an action brought by the lessor (1) for breach of the lease and for lost rent because the tenant abandoned, as well as (2) in defending against the tenant's cross-complaint for constructive eviction. All of that seems to perfectly qualify as damages resulting from the termination of a lease. If so, the syntax of the section seems to require their capping.

I am not a bankruptcy attorney, so probably it is a mistake for me to read the language as if it were written in literate or plain English. Perhaps a true bankruptcy practitioner, who is used to deciphering these mysteries, could help the rest of us out.

The Reporter for this item was Roger Bernhardt Bernhard of the Golden Gate Law School in San Francisco.

Editor's Comment: The editor (hardly a "true" bankruptcy attorney) believes that the court concluded that the attorney's fees did have to fit under the cap, but that there was room under the cap in this case because the claim for damages for breach of the lease – future rent – did not exceed the cap. We are not told what the term was, so we don't know whether the one year limit or the 15% limit applied; but the rent was $7000 per month and the total claim for future rent was $80,000. So obviously there was some room for additional claims for attorney's fees.

In short, the editor thinks the court and Roger are on the same page. Roger doesn't. The editor agrees that the case is confusing in the way that it says things. The editor gets that way himself, sometimes.

BROKERS; MORTGAGE BROKERS; STATUE OF FRAUDS: Brokerage agreements for the sale of mortgages need not be in writing. ***Gebroe-Hammer Associates, Inc. v. Sebbag, 385 N.J. Super. 291, 897 A.2d 353 (App. Div. 2006)***

A buyer utilized the services of a broker in connection with the purchase of a promissory note held by a lender. The buyer and broker entered into an oral agreement, whereby the buyer agreed to pay the broker a commission. The broker forwarded a confirming letter agreement to the buyer, but the buyer never signed it. The buyer then communicated directly with the lender to complete the transaction and never paid the commission. The broker sued and the jury found in the broker's favor. The buyer appealed, arguing that the Statute of Frauds, N.J.S.A. 25:1-16(b), provides that a broker is not entitled to a commission unless there is a written agreement. Under section (d) of that statute, an oral agreement may be enforceable, but only if the broker serves the buyer with written notice within five days after the oral agreement is reached and before the sale is completed, and, before the buyer rejects the arrangement, the broker works to complete the sale. The buyer argued that since the broker never sent the written notice, it was not entitled to a commission. The broker argued that the Statute of Frauds did not apply in this transaction since under section (b) of the statute, the sale of mortgages is excluded from the requirement of a written agreement.

The Court affirmed. It found that the two sections of the Statute of Frauds are to be read together, and that section (d) of the statute that permitted the limited enforcement of oral agreements only applied to instances where the broker's original agreement needed to be in writing. The Court noted that under section (b) of the statute, brokerage agreements for the sale of mortgages were not required to be in writing. Therefore, section (d) providing circumstances for the limited enforcement of oral agreements did not apply.

BROKERS; *QUANTUM MERUIT;* PROCURING CAUSE: A real estate broker must prove that he was the procuring cause of the sale in order to recover in *quantum meruit.* ***Amend v. 485 Properties, 2006 WL 584321 (Ga., March 13, 2006).***

Broker, a licensed real estate agent, was president of a company that was leasing agent of another company that leased space in two buildings owned by Defendant. Because that company's lease was going to expire, Defendant approached the company to negotiate its lease. The company instructed Defendant to deal with its leasing agent.

Defendant and Broker negotiated a deal for the company, and the company signed a lease. But Defendant refused to sign the lease because the company's imminent financial demise by then had become apparent.

When the company filed for bankruptcy, a new leasing agent was appointed to represent the company. This new agent successfully negotiated lease agreements for the company to remain in one of the buildings, but to rent less space.

Thereafter, Broker sued Defendant on both the breach of contract and *quantum meruit* claims. The District Court granted summary judgment to Defendant on both claims and the Eleventh Circuit affirmed the grant of summary judgment on the contract claim, but reserved decision on the *quantum meruit* claim for the Supreme Court of Georgia to decide whether procuring cause is an element of a *quantum meruit* claim under Georgia law.

The Supreme Court found that it was an element.

Comment: The problem arises due to a conflict in Georgia case law. The majority of cases have reiterated the long-held rule that a necessary ingredient in a *quantum meruit* claim by a real estate broker is that a broker must be a procuring cause is. However, a handful of more recent cases would lead one to a contrary conclusion. This case overrules those more recent cases.

BROKERS; REAL ESTATE SALES REPRESENTATIVES; FAIR LABOR STANDARDS: Real estate salespersons hired by a residential home builder to sell homes in its communities are not "outside salespersons" and therefore not subject to the applicable exemption under the Fair Labor Standards Act ("FLSA") and are not exempt from the minimum wage and overtime pay requirements of FLSA. ***Billingslea v. Brayson Homes, Inc., 2006 WL 562198 (N.D.Ga., March 7, 2006).***

Defendant is residential home builder that purchases parcels of land to be developed and subdivided into small parcels of land for form new subdivision communities. Defendant hired Plaintiffs to sell homes in its communities. Each plaintiff was assigned to work in a specific community, and was responsible for selling homes on the various subdivided lots within that community. Plaintiffs were expected to greet potential home buyers at the model home sales centered located in each community. As part of the hiring process, each of Plaintiffs signed an "Independent Contractor Agreement" with Defendant. Based on Plaintiffs' job activities, Defendant classified Plaintiffs as "outside sales persons" exempt from minimum wage and overtime pay requirements of the FLSA. Plaintiffs brought an action to recover unpaid wages and overtime. Defendant moved for summary judgment.

The United State District Court of the Northern District of Georgia denied Defendant's motion for summary judgment because it found that Plaintiffs were not outside salespersons. The District Court concluded this because they found that the evidence showed that Plaintiffs' primary duty was not to make sales away from their employer's place of business, but to assist in making sales within their employer's place of business, which the District Court construed to be the entire subdivision site to which they were assigned and from which they could not leave during the assigned work day.

Comment: Although the editor has listed this case under the "broker" heading, obviously these were not brokers, as they worked for a sole employer for a fixed wage.

Comment 2: The case apparently was not appealed. But the Westlaw entry has the briefs and other related documents for readers who wish to know more about this issue. It is likely that the finding that these parties are not "independent agents" will have consequences beyond wage and hour issues.

BUSINESS ORGANIZATIONS; "PIERCING THE CORPORATE VEIL:" Ohio court finds sole owner of corporation liable for civil fines for failure to comply with state environmental rules solely on the basis of owner's control of corporate decisions, even when all corporate formalities are observed and corporation is adequately capitalized. ***State ex rel Petro v. Mercomp, Inc., 2006 Ohio 2729, 2006 Westlaw 1495230 (Ohio App. 6/1/06)***

Rock was a co-owner of a corporation that owned and operated a landfill for 13 years. During that time, Rock became the sole owner of that company. When the landfill closed, Rock formed a corporation that acquired the landfill property from the other corporation. A few years later, the two corporations merged, with Rock remaining as the sole shareholder. The name of the surviving corporation was Mercomp.

For a number of years following the termination of operations at the landfill, Mercomp attempted to satisfy the requirements of the Ohio EPA regarding the environmental issues surrounding landfill closures. Mercomp clearly undertook a number of activities in an effort to reach compliance, and asked a number of times for continuances in order to meet the EPA demands. Seven years after the closure, and despite many missed deadlines and compliance reports, Mercomp got approval of a report that the landfill was in a "post-closure period." Nevertheless, there were still a number of activities required by Mercomp, perhaps most notably the provision of a financial assurance program to guarantee continued performance of maintenance and oversight activities.

The Ohio EPA soon observed violations of environmental standards in stuff oozing from the landfill, and noted that Mercomp still had not satisfactorily set up a financial assurance program. Ultimately it initiated an enforcement action both against Mercomp and Rock for failure to carry out detection and monitoring, for the late closure of the landfill, and for failure to establish the financial assurance program.

Among other things, Rock contended that the complaint against him as an individual should be dismissed because all of the alleged offenses were committed by Mercomp, if at all. Rock's only activities were as owner and principal officer of Mercomp.

Ultimately, the trial court entered judgment against Rock individually for civil penalties for the various violations, and Rock appealed.

The State argued that piercing the corporation's veil was necessary since Rock's position as the sole officer director and shareholder of Mercomp showed his control of Mercomp's operation. It alleged that "[s]uch control deprived Mercomp of having a separate mind or existence of its own".

Rock argued first that he in fact did not solely control the operations of Mercomp or other entities involved in the closure of the landfill. The trial court held that this was not true – Rock did have such control, and granted summary judgment to the State. The appeals court, reviewing the record, agreed.

But Rock then argued that in fact Mercomp, throughout the operative period, did not exhibit any of the characteristics generally relied upon by courts to justify disregarding corporate form. Here's where things get interesting. The appeals court, affirming the court below, stated that the absence of these indicia really didn't matter if an individual in fact was responsible for controlling the affairs of a corporation. It quoted for an earlier Sixth Circuit Federal Court of Appeals case, in which an individual was held liable for fraud, despite the fact that the actual fraud was done on behalf of the corporation:

> "[the shareholder's] argument, if we adopted it, would straightjacket the courts in situations where equity demands that the fiction of corporate personhood be ignored. Consider, for example, a case in which a corporation with a single shareholder kept immaculate corporate records, observed all the formalities required by corporate law, and was adequately capitalized. The shareholder never commingled funds, and never held himself out as personally liable for the corporation's debts. The corporation even does some legitimate business. Can it be that the shareholder is immunized from personal liability if he causes the corporation to commit an illegal act, no matter the degree of his control over the corporation with regard to the illegal act, no matter the harm to third parties, and no matter the other equities. Neither we nor the Ohio courts hold that such immunity exists."

Consequently, when the corporation here failed to meet the requirements of the Ohio EPA, the sole shareholder could be personally liable for civil penalties.

Comment 1: In a world in which increasingly individuals are relying upon corporate form to avoid liabilities stemming from real estate ownership, and where many such entities are wholly owned by individuals, this holding struck the editor as provocative, unusual, and scary. In checking with UMKC business organizations law scholar Tony Luppino, the editor discovered that Tony, also, found the opinion a few steps beyond where corporate experts believe the law to be.

Tony noted that federal CERCLA rules do not necessarily protect individuals who work through corporations, but this is because of the special definition of an "operator" of a facility, not because of normal corporate common law analysis.

Tony also noted that LLC statutes in many states have distinct language providing insulation from liability, and of course many solely owned corporations that hold real estate as their primary asset now are LLC's for tax reasons.

Nevertheless, many individuals do conduct business through solely owned corporations specifically because they do want to limit their liability to the corporation's assets. This opinion seems to authorize judges to smash through that veil of protection whenever the feel like it, whenever "the equities compel".

Comment 2: In virtually all solely owned corporations, the sole shareholder is going to have a great deal to say about what's going on. Certainly any major decision of the corporation will not be taken without the express or implicit consent of that shareholder. Therefore, even where there are other managers, it still must be said that an argument exists that the sole shareholder in fact is in control of the corporation's actions.

Assuming the opinion should be limited to solely owned corporations, it is possible that we are looking at judicial usurpation of a legislative decision. In many states (Ohio?) the statutes at one time prohibited single owned corporate entities. Those statutes were amended to permit such sole ownership, apparently expressly a legislative judgment that such business formats should be permitted to confer limited liability on their owners. Does the court's decision here pretty much eviscerate that legislative decision?

Comment 3: Note that we are not talking about a situation in which a sole shareholder, acting on behalf of the corporation, individually commits a wrongful act – such as driving the company delivery truck into a school bus while making a delivery. In such a case, the individual may be liable for his own negligence as well as the corporation. Here we are simply talking about the inaction of the corporation in not adequately meeting the

Ohio EPA requirements for cleaning up the landfill. The decisions to do or not do what Mercomp was fined for clearly were made by Rock acting by and through the corporation.

Isn't there a line in there somewhere as to what acts render someone individually liable and what acts don't? If not, should we be strapping on our lobbying boots, because the corporate form we've been selling to our entrepreneur real estate clients for these many years may in fact not provide the protection that was anticipated.

Comment 4: Tony Luppino also raised the question of whether the opinion ought be limited to sole owners. What if there are two or three owners? Aren't they going to collectively control the actions of the corporation? It likely has little independence from them. Should they be jointly and severally liable for civil penalties against the corporation**?**

CONDOMINIUMS; ASSESSMENTS; IMPACT OF FORECLOSURE: If a condominium's organic documents clearly so provide, the association can require that a subsequent purchaser of a foreclosed unit is obligated to pay the arrears even if the lien for such assessment was foreclosed away before the purchaser bought. ***Highland Lakes Country Club & Community Association v. Franzino, 186 N.J. 99, 892 A.2d 646 (2006); March 6, 2006.***

Unit owners defaulted on their purchase money mortgage and failed to pay their community association dues and common assessment fees. Their mortgagee filed a foreclosure action. Separately, the community association obtained and docketed a judgment for the unpaid dues and fees. The lower court ruled that the mortgagee had priority in payment over the association's docketed judgment. In its order requiring sale of the property to pay the mortgagee, the lower court also ordered the community association to be "absolutely debarred and foreclosed of and from all equity of redemption" in the property. The writ of execution authorizing the sheriff's sale did not include any language authorizing payment to the community association in the event of any surplus resulting from the sale of the property for more than the amount owed to the mortgagee. There was no evidence of any surplus available to the community association after the sale of the property and the community association never made application for any surplus.

A new owner bought the condominium unit from the foreclosing mortgagee. The community association sought to compel that purchaser to pay its association dues and common assessments as well as the unpaid membership dues and common assessments attributable to the predecessors in title. The association claimed that the recorded covenants in the community's deeds and bylaws provided adequate notice to the subsequent purchaser that it would be responsible for the arrears. The subsequent purchaser contended that the covenant language was vague and therefore did not provide sufficient notice that it would be responsible for the arrears of the predecessors in title. Further, the subsequent purchaser argued that the mortgage foreclosure, to which the community association was a party, cleared the title of any lien for arrears. The lower court granted summary judgement in favor of the community association, ruling, among other things, that the foreclosure action did not extinguish the community association's contractual right to collect the assessments of prior owners from the current owner.

On appeal, the Appellate Division reversed. First, it ruled that a unit owner's obligation to pay association dues and common assessment fees is based on the association's restrictive covenants as recorded in the deeds and bylaws. In this case, the bylaws stated that unpaid assessments constituted a lien from the date of recording the lien. Since the association never recorded a lien, the Appellate Division ruled, the association could not recover past assessments from the subsequent purchaser. Second, the Appellate Division ruled that the execution of a deed containing covenants compelling compliance with bylaw requirements may create an agreement to pay common assessments and association dues, including arrears of the predecessors in title. Here, however, the Appellate Division found the recorded covenants to be ambiguous and ruled that the ambiguity did not provide sufficient notice to the subsequent purchaser that property purchased in this community would be conveyed subject to a contractual requirement that the arrears of the predecessors in title were enforceable against the subsequent purchaser.

The New Jersey Supreme Court reversed the Appellate Division and reinstated the judgment of the lower court. It held that, even though the association's lien was extinguished by the foreclosure judgment and sheriffs' sale, the underlying debt was unaffected. Extinguishing a lien does not affect the validity of the underlying debt.

A subsequent purchaser takes title subject to the covenants contained in the recorded deeds and bylaws. Provided the recorded covenants are not ambiguous, the recorded language creates a debt for past and present arrears. The Court ruled that the recorded language in the homeowners' association's bylaws was clear and unambiguous, and that therefore nothing relieved the subsequent purchaser of its obligation to inquire as to whether there were any arrears.

An association may collect a previous owner's arrears from a subsequent purchaser, based on contract theory, if the recorded covenant language is clear enough to provide notice to the subsequent purchaser of its obligation to pay such arrears, even if the association does not have a lien against the property.

Comment 1: If the editor understands this opinion properly, it is big news. The opinion does not appear to turn on special language of the New Jersey condominium law, but rather is a common law ruling valid provisions in the Declaration and Bylaws binding subsequent purchaser to pay delinquent charges assessed to their predecessors in interest.

As the Editor understands things, the question of whether claims for prior unpaid assessments have priority as against a foreclosing lender is one that has sparked hot debate for many years between the lending industry and the condominium association interests. A compromise was reached in the Uniform Condominium Act permitting priority of association liens for a relatively short period of time, but subordinating any further balance to the rights of the lender. This compromise influenced FNMA and FHLMC to continue to participate in purchasing mortgage loans on condominium units, and thus significantly increased the value of all condominium units affected by the compromise.

It appears to the editor that the court's opinion, where language of the Declaration and Bylaws suits, undoes the protection for the lender, and thus likely will lead FNMA and FHLMC to refuse to certify loans on communities that have such language.

Comment 2: Although one might argue that the lender need not be concerned, since court recognizes that the lien for unpaid assessments still has no priority over the lender's lien, the fact of the matter is that if the party who buys from the lender is bound by the prior unpaid assessments, this will devalue the unit in the hands of the lender and consequently the assessments do achieve priority over the lender's claim. The editor doubts very much that purchase money lenders in New Jersey have anticipated that unpaid assessments will be able to "back door" their way into priority over the lender's security protection.

New Jersey condominium mavens – help the editor out here. Is this the end of significant secondary market interest in New Jersey condos that have this language?

CONSTITUTIONAL LAW; EXACTIONS; BUILDING PERMITS: Mississippi slams the door – hard – on impact fees associated with building permits. ***City of Ocean Springs v. Homebuilders Ass'n of Mississippi, Inc., 932 So. 2d 44 (Miss. 2006)***, discussed under the heading: "Municipal Law; Impact Fees.

CONSTITUTIONAL LAW; FREE SPEECH; COMMUNITY ASSOCIATIONS: A Planned Unit Development's governing association is the functional equivalent of a government body and cannot deprive residents of their rights to express their views on matters of public or community concern. ***Committee for a Better Twin Rivers v. Twin Rivers Homeowner's Association, 383 N.J. Super. 22, 890 A.2d 947 (App. Div. 2006)***

The New Jersey Supreme Court granted a petition for *certiorari* to review this decision, but it is an important one to watch, so we're posting the lower court decision. The Community Associations Institute filed an *amicus* brief in the lower court case, and the editor suspects that others are joining the fray at the New Jersey Supreme Court level.

The Supreme Court likely could decide this case on state constitutional grounds and immunize it from U.S. Supreme Court appeal, but if the court decides it on the basis of the U.S. Constitution, we may see this case "go big." There is, however, a standing issue that may cause problems, and at least at one time before the decision below, the plaintiff's group had shrunk to three people. It's hard to live where you're not wanted.

Several residents of a large planned unit development (PUD) challenged the manner in which the PUD was administered. The community was organized as a planned unit development by deed to a community trust. The trust was responsible for owning, operating, and maintaining the common property. The management of the common property was delegated to a homeowners' association. The PUD was similar to a miniature town and provided parks, pools, ball fields, and other amenities exclusively to its residents. There was a privately owned shopping center and a security force that provided first aid and other services often provided by police departments.

Several residents attempted to change the manner in which the PUD was administered and attempted to publicize their position to the other residents. Those residents challenged the association's policies that restricted their rights to place signs on residents' lawns. They charged that the association charged excessive fees for use of the community room, and denied them access to the financial records and equal coverage in the community newspaper.

The lower court held that the homeowners' association was not subject to the constitutional limitations that are imposed on the public sector. It found that the homeowner's association did not have governmental powers delegated to it and did not perform governmental functions. The lower court agreed with the association's argument that, as a private condominium association, the homeowners' associations decisions were to be upheld under the business judgment rule unless the residents could show that those decisions were fraudulent, self-dealing or unconscionable. Since the residents asserted that they could not demonstrate that the association's restrictions were unconscionable or as a result of self-dealing or fraud, the lower court found those restrictions acceptable.

On appeal, the Appellate Division disagreed and reversed, noting that the New Jersey Supreme Court had adopted a balancing test for resolving the conflict between the protections private property owners are entitled to and the rights of expression on private property. *In State v. Schmid*, 84 N.J. 535, 423 A.2nd 615 (1980), the New Jersey Supreme Court set the following standards to be considered: (a) the nature, purposes, and primary use of the private property; (b) the extent and nature of the public's invitation to use the property; and (c) the purpose of the expressional activity on that property in relation to the private and public use of that property. The Court found that the PUD was a quasi-municipal entity that provided many of the basic services a governmental entity would normally perform for its residents. As such, the association was the functional equivalent of a government body and could not deprive the residents of their rights to express their views on matters of public or community concern.

Comment: New Jersey is far more liberal on issues of this sort than most other states. It is one of the few states that has recognized free speech rights in private shopping centers and also has had a number of decisions involving certain kinds of special protections for political action in community associations. *See, e.g. Guttenberg Taxpayers and Rent Payers Association v. Galaxy Towers Condominium Association*, 688 A.2d 156 (N.J.Super.Ch. 1996) (the DIRT DD for 10/30/97) (Condominium association that had actively endorsed certain political candidates by distributing campaign flyers, effectively dedicated otherwise private property to political and thus public use, and therefore could not deny access to its privately owned property to citizens group that wished to distribute the same type of literature.)

The difference between the shopping center cases and this case, however, is that here the association did not invite the public into its community. The sole question addressed was the rights of the community residents and the power of their own association to regulate them.

The case is different from *Galaxy Towers* because the public voting franchise was not at stake here. The disputes involved internal association disputes.

Comment 2: An interesting side issue was the question of voting rights. The dissidents argued that it was unconstitutional, in light of the "public functions" performed by the association, for voting rights to be weighted in proportion to the value of the units in question. The court disagreed, noting that public corporations are permitted to weight their votes, and noting further that the dissidents still were not arguing for "one person/one vote," but for "one unit/one vote." There was nothing inconsistent, in the court's view, with recognition of free speech rights and upholding the private voting arrangements for control of the association's activities. The New Jersey Supreme Court denied *certiorari* on the cross appeal of this issue.

CONSTITUTIONAL LAW; TAKINGS; "PUBLIC PURPOSE;" OPEN SPACE: Conservation of land for open space is a public use, even though a condemning public agency acquiring the land has no plans to put the property to any active use. ***Mount Laurel Township v. Mipro Homes, L.L.C., 379 N.J. Super. 358, 878 A.2d 38 (App. Div. 2005); August 2, 2005.***

Mount Laurel, a frequent party to exclusionary zoning litigation, undertook to identify all remaining open space in the municipality to determine which parcels would be appropriate for acquisition and could qualify for Green Acres funding.

A developer's 16.3-acre parcel, in an area zoned for residential use and occupied by a single house, was not initially included "in the list of properties sought to be acquired for open space because [the developer's] predecessor in title planned to construct an assisted living facility on the site that would have included units affordable to low- and moderate-income residents." The developer, however, acquired the site with the intention of building twenty-three homes.

It obtained preliminary subdivision approval for its planned development. When the municipality's governing body became aware that the proposed use of the site had changed to a single family housing development, "it decided to add the site to the list of parcels to be acquired under its open space acquisition program". It sent the developer a letter to that effect, stating that the property had been "preliminarily listed as a potential parcel to be included in the [municipality's] Recreation and Open Space Plan". About eight months later, the developer obtained final subdivision approval. When the municipality was unable to obtain the site by voluntary acquisition, it filed a declaration of taking. During the period between "the grant of final subdivision approval and the filing of the declaration of taking, [the developer] performed a significant amount of site preparation work on the site".

The developer's reaction to the condemnation action was that "the purpose of the condemnation action was to stop residential development and that this [was] an unlawful purpose". During the pendency of the law suit, the municipality's planning board "adopted an amended master plan, which stated that the goals of the recreation and open space plan included acquisition of 'the maximum amount of open space remaining in the [municipality] that can be achieved with sound use of financial resources' and reduction of traffic congestion and costs of municipal services."

The lower court, in its opinion, recognized that the municipality "had initiated proceedings to condemn [the developer's] property 'for a facially valid purpose, namely, the acquisition of [the developer's] tract to be held in perpetuity as a passive open space.' Nevertheless, the [lower] court concluded that [the municipality's] 'real purpose' in condemning [the developer's] property 'was to prevent yet another residential development in a [municipality] already under severe development pressure.'" It held that "the public purpose articulated for the taking of [the developer's] property for passive open space was not based on a true public need but solely in response to the community's sentiment expressed at the polls, coupled with clear indications from [municipal] officials that the property be acquired to stop residential development". Accordingly, the lower court "entered summary judgment dismissing [the municipality's] action to condemn [the developer's] property". The municipality appealed.

The Appellate Division agreed with the municipality and concluded "that a municipality has statutory authority to condemn property for open space; that a municipality may exercise its authority even though it does not presently have a plan to devote the property to active recreational uses; that the selection of properties for open space acquisition on which residential development is planned does not constitute an improper exercise of the eminent domain power; and that [the developer] did not present evidence that could support a finding that [the municipality's] decision to condemn its property constituted an abuse of the eminent domain power."

Its decision was based on the New Jersey Constitution which "recognizes that private property may be condemned for 'public use'." Further, it pointed out that the "Legislature has long recognized that preservation of open space constitutes a public use, and therefore municipalities may utilize the eminent domain power to acquire property for this purpose".

In support of that goal, the Legislature reaffirmed that statutory authority and established a funding mechanism for the purpose of acquiring open space. Voters approved an amendment to the New Jersey Constitution dedicating sales and use tax funds for the acquisition of such land. As to the question as to whether the municipality could exercise this eminent domain authority even though it does not presently have a plan to devote the land to an active recreational use, the Court said that "[t]he short answer is that the conservation of land for open space is a public use, even though the government agency acquiring the land has no plans to put the property to any active use".

DEEDS; STATUTE OF FRAUDS; ORAL GIFTS: An oral gift of real property is effective without a deed, notwithstanding the Statue of Frauds, where the grantor places the grantee in possession of the property with intention to make a gift***. Troxel v. Bishop, 2006 Westlaw 2348934 (Tex. App. 8/18/06) (not yet approved for final publication)***

Troxel met Bishop while he was recovering from open heart surgery. Reports are that he viewed her as a "surrogate daughter". Troxel resolved to buy her a home. Bishop selected a house (complete with swimming pool). In fact, her name was on the original purchase agreement. Bishop was obtaining a divorce, however, and Bishop and Troxel apparently concluded that it would be unwise to deed the property to Bishop immediately. Consequently, Troxel paid for the home and arranged for the deed to be conveyed to Greenburg, his close friend, for later transfer to Bishop.

There is no direct discussion as to why Troxel didn't have the house transferred directly to his own name, but there is mention in the case in another context that Troxel may have had IRS problems and was seeking to hide the asset and also there is a suggestion that he was not interested in his wife finding out about his fatherly relationship with Bishop.

Although Bishop did not move into the house for two years, she kept some personal belongings there and kept the fact of the house secret from her husband until she was divorced. Troxel paid the taxes. One assumes that he was in the house also from time to time. Allegedly (this is a summary judgment case) Troxel and Bishop shared the expense of maintaining the house, and allegedly Bishop paid to recondition the pool.

Bishop completed her divorce and moved into the house in 2000. She claimed that at that time Troxel told her that he was arranging for a deed to the house for her. Troxel in fact verbally instructed Greenburg first to make out a deed in blank, which Greenburg gave him, and later asked Greenburg to make out a deed showing Bishop as the grantee. Somehow this second deed wound up recorded, with instructions to the recorder to return the deed to Bishop. The record states only that Greenburg never delivered the deed to Bishop, and says nothing more about how Bishop got the deed. Greenburg never considered the property to be his own, and viewed his preparation of the deeds as the completion of the gift from Troxel to Greenburg that Troxel first had discussed with him some years before.

Troxel died in 2001. His estate contested Bishop's title to the property. Although it first claimed that the entire arrangement with Greenburg and Bishop was a subterfuge to hide Troxel's assets from his creditors, or from his wife, this assertion later was withdrawn. Instead, the estate argued simply that the Statute of Frauds requires a written transfer of ownership, and that Greenburg never asserted ownership and Troxel never made any written grant of his own ownership. As to Greenburg's title, the estate argued that Greenburg held the property as a constructive trust, and that Greenburg had no power to convey the property except pursuant to a writing executed by Troxel.

The court upheld the deed, regardless of evidence of written instructions to Greenberg, because Troxel ratified the delivery of the deed to Bishop. Although the original recitation of the facts does not indicate that Greenberg actually gave to Troxel the deed Greenberg made out to Bishop, this later discussion apparently assumed that is what happened, and that Troxel either recorded the deed and instructed that it be sent to Bishop or that Troxel gave the deed to Bishop himself. Either action would have ratified the preparation and delivery of the deed, and obviate any need for a writing.

The court further held that the question of whether a writing was required to instruct Greenburg to convey to Bishop, in any event, would be beside the point, because a gift of the property had already been carried out by Troxel's words and actions in placing Bishop in possession of the property with the expressed intent to give her a gift, acquiescence in her continued possession, and further acquiescence in her permanent improvements to the property (in the form of the rehabilitation of the swimming pool). Even without improvements, a parole gift will be upheld if the other factors or satisfied and denial of the gift would result in injustice.

Comment: The editor has no quarrel with the analysis upholding Troxel's ratification of the deed, even on summary judgment.

The editor finds more interesting the holding on the parole gift. The court held that Bishop owned the property by parole gift, and would have done so, even if there had never been a deed.

People say a lot of things to other people in personal relationships, and sometimes have fingers crossed behind their back. The way one delivers ownership of real estate is by delivery of a deed. Troxel knew that, and likely Bishop did as well. Prior to the delivery of such deed, the editor believes that there was substantial question as to Troxel's true intent. Although there is an explanation of the delay in delivery of the deed that is consistent with Bishop's position, perhaps there are other explanations as well.

The typical third element of a parole gift – apparently a form of reliance-based estoppel – is somewhat sketchy here. Shared maintenance costs (remember Bishop was living there) and very vague testimony about monies spent on a pool. But the appeals court is reviewing the lower court's findings of fact, so perhaps we just have to accept the notion that there was sufficient basis for such estoppel here.

The important lesson is that an adequate basis for some kind of estoppel or other equitable foundation needs to be present in order for a parole gift to be upheld.

EASEMENTS; CREATION; PRESCRIPTION; PUBLIC ROADS: A governmental entity can acquire a prescriptive easement to a roadway; and once such an easement is acquired, a later permissive allowance of use will not alter or destroy it. ***Wood v. Village of Kipton, 828 N.E.2d 173 (Ohio App. 2005).*** Landowners filed suit against the Village seeking to quiet title to a paved road that ran through property the Landowners owned. The Village claimed the road as a section of public roadway, or in the alternative that a prescriptive easement had been obtained. The County Court of Common Pleas granted declaratory judgment and quieted title, granting a permanent enjoinment against public use of the road.

The Village appealed, asserting that the trial court had improperly excluded county records dating to 1861 which purported to show the roadway had been established as a public road. The Appeals Court granted the appeal, allowing the admission of the documents, and remanded to the trial court. The trial court again ruled for the Landowners against the Village. The Village again appealed on several grounds, and the Appeals Court sustained the Village's assertion that as a matter of law, a prescriptive easement had been established.

Citing *State ex. rel. AAA Investments v. Columbus*, 478 N.E.2d 773 (Ohio St. 1985), for the proposition that "governmental entities may acquire title to land by adverse possession," the court noted that the elements for a prescriptive easement are identical: use that is open, notorious, adverse, continuous, and exceeds the statutory temporal requirement. Where testimony showed that the town had used the road for at least fifty years, the town had paved and plowed the road, and no permission had been given for its use, a prescriptive easement had been established as a matter of law. This was held true despite the fact that use of the road became permissive in 1979 because the prescriptive easement had already been established at that time. Acquiescence to use will not negate a claim for an earlier prescriptive easement.

EASEMENTS; CREATION; PRESCRIPTION; REQUIREMENT OF HOSTILITY; PERMISSION: Where use satisfying required elements of prescriptive easement have continued for the statutory period, the fact that the servient owner thereafter gives permission to the use does not affect the hostile character of the easement, and the prescriptive easement, already, established, continues. ***Delancy v. Mallette, 912 So. 2d 483 (Miss. App. 2005)***

Comment: The case is also noteworthy because of the terrible hash made of the case by the trial court, which found an implied easement without any evidence of common ownership, and denied the claimed prescriptive easement because the use had not claimed "ownership". What are they teaching young law clerks in the Mississippi law schools???

EASEMENTS; DUTIES OF DOMINANT TENANT: Provision in grant of easement stating that easement shall be "maintained" by dominant tenant does not require tenant to keep condition of easement in original condition, or even to keep it safe or sightly, but only to preserve its character as a means of access and egress: ***Jackson Motor Speedway, Inc. v. D.L. Ford, 914 So. 2d 779 (Miss. App. 2005)***

EASEMENTS; SCOPE; "AGRICULTURAL PURPOSES:". "Timbering" is within the uses allowed under an easement that permits use for "agricultural needs" of the dominant estate. ***Potter v. Houston, 847 N.E.2d 241 (Ind. Ct. App. 2006).***

Potter filed suit against Houston regarding an easement that Houston claimed against Potter for travel by foot, horseback, truck, and hay machine. The easement was allegedly created as the result of an agreement signed in 1986 between Mrs. Royer, the predecessor in interest to Houston, and Potter exchanging the easement for the withdrawal of Mrs. Royer's remonstrance against Potter's attempt to vacate the Artbutus Road. The easement in dispute is located on this road. A series of encounters then ensued in which Potter attempted to obstruct the path of the easement, and Houston retaliated by clearing the obstructions. In 2003, Potter initiated the current action.

The trial court found, after narrowing the issues, that there was an implied easement created by the 1986 agreement that was not destroyed by any attempted adverse possession by Potter to reclaim the easement. The trial court ordered a single-lane path, primarily for travel by foot or horseback that is wide enough to "accommodate the occasional truck or hay machine" to be maintained.

Potter then sought and obtained an order for clarification limiting the use of the easement to foot, horseback, and "other agricultural equipment reasonably necessary to serving the agricultural needs of the valley portion of Houston's real estate, such as cutting hay". Potter then filed this appeal alleging that Houston's use of the easement for "timbering" is not within the definition of "agricultural needs" of the easement. "Timbering" apparently, means what the term suggests – harvesting and extracting timber – logging.

Houston counterclaimed for attorney's fees resulting from this action. The Court of Appeals denied Potter's appeal and remanded the case to the trial court for calculation of attorney's fees. Agriculture should be defined broadly to include timbering, or logging, to be in accord with both the case law and Congressional Acts. The record of this case also dictates that timbering is within the purview of "agricultural needs" because the trial court found that this specific activity was within those carried out on Houston's land.

In addition, Potter requested the "agricultural need" language and then sought to narrowly redefine the term. The Court ruled that the trial court's conduct did not constitute invited error, which is not reviewable on appeal, because Potter did not offer language, when given its ordinary meaning, that restricted the use of the easement in his motion for clarification

> "[W]hen assessed against the backdrop of the trial court's specific finding that historically the area of the easement had been used as "an access point from which hay and timber could be extracted from [Houston's] property once harvested . . . unquestionable, 'agriculture' or 'agricultural needs' are readily defined to include logging or extracting timer – at least in the context of this case."

EASEMENTS; SCOPE; MAINTENANCE: Where power line easement does not state express width, the width will include a dimension sufficient to provide proper and safe maintenance as the voltage of the line grows with development in the community. Here the court approved a fifty foot wide easement that had to be kept free of trees that might at some future time interfere with maintenance. ***Tubb v. Monroe County Electric Power Assoc., 912 So 2d 2006 (Miss. App. 2006)***

The court characterized the easement for maintenance as an "easement of necessity," but clearly it was not – since it was implicitly part of the original grant of easement, and there was no showing of common ownership of the servient and dominant parcels. Once, again, what's happening to legal education in Mississippi? The courts are showing virtually no understanding of some very basic concepts. Once assumes that clerks are responsible for some of this lose verbiage, so one can ascribe the problem to the law schools.

EASEMENTS; TERMINATION: Driveway easement is not extinguished replacement of original residential garage with commercial parking lot but access right is limited to number of cars that original garage could accommodate. ***Hamouda v. Harris, 845 N.E.2d 374 (Mass. App. Ct. 2006).***

Hamouda, owner of the servient estate, sued Harris, owner of the dominant estate, asserting that an express driveway easement was extinguished by the destruction of the garage that the easement was created to service and the conversion of the property from residential uses to commercial. In addition, Hamouda alleged that the easement was overburdened by the increased traffic across the easement from the commercial use.

In 1954, a predecessor sold the two lots involved in this case with an express easement reserved in favor of Harris' predecessor. The easement referred to a diagram that was part of the record, and the diagram showed the garage and a maneuvering area in front of the garage. Some of the language of the grant suggested that the easement was expressly for access to the garage, while other language suggested that the easement provided access to the entire lot.:

> "Included in this conveyance as an appurtenant to the above described premises is a right of way for motor vehicle travel from the garage located on said premises . . . over that portion of the grantor's adjoining land . . . marked 'right of way" as shown on said plan."

As noted, the garage – a two car structure already in existence for some time in 1954 when the deed was written – ultimately was torn down. Cars were then parked on the garage "footprint" to serve the residential premises on the lot. Ultimately Harris converted that premises into an office facility, and began parking three cars in the rear of the building, using the right of way for access. This was the only access to the rear area of Harris' building.

The court noted that the term "premises" in the grant referred to the entire parcel conveyed.

The trial court held that the easement was unambiguous and valid for use by the entire Harris estate. The language concerning the garage was merely a "locator."

The Court of Appeals affirmed in part, but modified the lower court decision. The Court found that the easement did not serve the entire estate. Instead, the Court held that the document was ambiguous and had to be construed in light of the circumstances under which it was created. It indicated that the trial court's construction would render superfluous the multiple references to the garage in the easement to documents.

Although the appeals court's emphasis on the use of the word "garage" might indicate that the destruction of the garage might destroy the easement, the court moved away from that conclusion. Because the driveway had a defined location, the Harris property would be landlocked without the easement, the Harris garage required maneuvering space to access it, and both lots supported residential uses, the Court found that the easement should continue in the manner it was allowed when the garage was still in existence on the property. The presence of the garage itself was not material to the way the space was used for the storage of two vehicles. The court therefore limited the use of the easement to provide access for only two vehicles, and only to the area identified as the garage "footprint."

Furthermore, the Court found no reason to distinguish between commercial and residential uses of the servient estate for the purposes of the easement.

Comment: Solomonic, perhaps, but kind of dumb. It gives neither party what arguably they expected. What if the dominant owner started using smaller cars, three of which might fit into the original garage space? What if the dominant owner had expanded the size of the original garage? Would a court have limited the use of the easement to only two cars under those circumstances?

The general rule is that express easements can change over time to fit changes in neighborhood land use patterns. We're talking here about going from two cars to three cars after fifty years. This certainly was not an unreasonable expansion. It is absurd to believe that the grantor here, who sold both properties at the same time and created the easement at that time, intended to limit the use of the easement to a garage that already was of some age at the time the easement was created. (The garage had been constructed "long before" 1954.) If the garage didn't provide a limit, why should it's footprint?

In light of the fact that the benefitted parcel was landlocked, the trial court's view of the reference to the garage as simply a locator was the correct one, even though the parties also used a diagram showing the location of the right of way.

EASEMENTS; SCOPE; UTILITY SERVICE; PRESCRIPTIVE EASEMENTS: Mississippi holds that prescriptive easement for access and egress can later be used for installation of utilities. ***Keener Properties, L.L.C. v. Wilson, 912 So. 2d 954 (Miss. 2005)***

Plaintiffs claimed that the had established a prescriptive easement for ingress and easement along a road across defendant's properties through long use and maintenance of the road, by them, their predecessors in interest, and their lessees. Apparently the road had been in existence since the 1830's and the court had little problem affirming the findings of the lower court that a prescriptive right had arisen. Although the general public used the land, the court concluded that the plaintiffs used the land as an independent personal claim of right, and that therefore any requirement of "exclusivity" had been satisfied.

The real zinger in the case, however, comes at the end, in only a few paragraphs. The Chancellor below had also found that one of the plaintiffs could run utility lines along the road. The court does not reveal whether the proposed utilities would be underground or above ground.

The court cited one Mississippi appeals court decision as authority for the proposition that a prescriptive easement holder has the right to expand its rights by installation of utilities. That case, *Bivens v. Mobley*, 724 So. 2d. 458 (Miss. App. 1998) stated that "uses that are reasonably necessary for enjoyment of an easement change over time as technology changes and as use of the dominant and servient estates changes." *Bivens* involved easements obtained through negotiation between the parties, the but court here comments that the concept stated in *Bivens* ought not to be limited to such easements, but "reflect the attitude of the court on the issue as a whole – technological advancements can effect an easement in such a way as to make the advancements essential to the use and enjoyment of the easement."

Comment 1: It is interesting that the Supreme Court of Mississippi is so scrupulous in evaluating the meaning of a prior precedent from a lower appeals court within its own jurisdiction, but there you are.

Comment 2: The court's holding on the issue of "exclusiveness" of the claimant's rights essentially reads the requirement of exclusivity right out of the list of elements of a prescriptive easement. The editor has no quarrel with this conclusion, as the difference between easement rights established by the public and those held by an individual have always been rather murky, and it is difficult to know why the question of whether the continued use of an easement by an individual party has anything to do with whether other parties use the easement.

Comment 3: But, as noted, the notion that the holder of a prescriptive easement can expand the very nature of its use to include the right to install utilities is another question entirely. In fact, the court's holding in favor of such a right may be unprecedented. Bruce and Ely, in their treatise on the Law of Easements and Servitudes in Land, discuss the issue in section 8.9:

> In general, courts construe prescriptive easement more narrowly than express servitudes. Hence, a change in the character of the surrounding area from rural to commercial might be relevant in the interpretation of an express easement, but should not be a factor in deciding the use of an existing prescriptive easement. . . .
>
> Examples of conservative interpretations of the scope of prescriptive easements abound. . . [I]t has been held that underground utilities may not be installed in a prescriptive right of way."

The authors cite a number of cases and an ALR annotation (79 ALR 4th 585 (1987)) for their point. They note that some alternation and expansion of the physical activity that gave rise to the use, consistent with carrying out the same purpose, may be permitted, so long as there is no significant increase in burden on the servient tenant. They go on to point out that the courts are not as severe in construing the scope of prescriptive rights of public agencies, and such scope may include "reasonably foreseeable public uses."

Comment 4: The fact that the case appears to be unprecedented on the point doesn't make it wrong. Let's assume that there is no increase in burden on the servient tenement. (This is a big assumption, since aboveground utilities are a visual eyesore and present some safety hazards, while underground utilities have to be dug up to be maintained.) If, in fact, there is no increase in burden, one might argue, as the court essentially does here, that plaintiffs' prescriptive right should generally be described as "functional access," rather than simply physical access. Functionally, access to other property in a rural area without the right to deliver utilities is a significantly less valuable right in the modern era. Does this mean that decades ago tolerance of horses or cars is acquiescence in a utility connection, justified and defined simply by the dominant owner's needs? Hmmmm.

EMINENT DOMAIN; APPRAISAL: Where settlement agreement resulting from negotiations following "quick take" eminent domain action provides for payment at "appraised value," appraisal should not take into account improvements made by condemnor post taking and prior to and during negotiations, as such practice was manifestly outside the intent of the settlement. ***Tupelo Redevelopment Agency v. Abernathy, 913 So. 2d 278 (Miss. 2005)***

EMINENT DOMAIN; DAMAGES; BUSINESS LOSSES: Business loss evidence may be relevant to determining the value of the property even though there was no business in operation on the property on the date of the taking, but such evidence cannot be used to establish business losses separately form the value of the property. ***Georgia Power Co. v. Jones, 626 S.E.2d 554, 277 Ga.App. 332 (January 24, 2006).***

A power company filed a condemnation action as to property intended to become a bed and breakfast. The property owners were awarded damages, and the Court of Appeals of Georgia reversed the ruling, finding that the property owners were precluded from seeking business losses separately from the lost value to their land due to the condemnation, and that the Trial Court abused its discretion in admitting speculative evidence on such business losses.

EMINENT DOMAIN; DAMAGES; LEASEHOLDS; DEFAULT: Tenant has compensable interest in condemnation of landlord's estate despite the fact that tenant is in default and has abandoned the premises at the time of the passing of possession to the condemnor. ***Dames v. 926 Co., Inc., 925 So. 2d 1078 (Fla. App. 2006) (rehearing denied 5/7/06)***

The Dames purchased a coin laundry from another operator in 1998, and gave a chattel mortgage for part of the purchase price. The purchase included ownership of the sellers' corporation, transfer of ownership of all the equipment, and an assignment of the lease to the Dames individually.

The business was failing, and in December of 2002, the chattel mortgagees, in the words of the court "sought to foreclose upon the mortgage." The court is very vague about what this entailed, but it appears that at some point the mortgagee seized all the equipment. The City Redevelopment Agency deposited condemnation funds into an account and, according to the court, thereby obtained the right to possession of the premises, in July 2003. But apparently the agency did not in fact take possession immediately.

The court indicates that at the time the funds were deposited into court, the Dames were in possession of the premises, but were in default for failure to pay property taxes. Thereafter, prior to the compensation hearing, the Dames abandoned the premises. But the landlord never took legal action to terminate their lease. It appears that the landlord may have believed that the foreclosure of the chattel mortgage, which included ownership of the laundry business entity, included the transfer of the lease. But the court found that the lease did not belong to the entity, but to the Dames individually.

The actual hearing on the condemnation award was held in December of that year. The landlord claimed that it was entitled to all the condemnation proceeds (over $650,000), and the Dames objected, claiming an apportionment for the value of their leasehold. Although the trial court agreed with the landlord, the appeals court reversed.

The appeals court found that the operative time for determining valuation of the condemned interests was the time that the agency had the right to possession, and that this was the time that it transferred funds into the condemnation account necessary to carry out the condemnation. At that time, although the Dames were in default, they had not yet abandoned. Their lease was still in effect and they had a right to share in the condemnation award.

Comment 1: In general, this is a straightforward application of existing law, but the hitch has to do with the fact that the landlord may not have been aware of the fact that the city had the right to seize possession of the property as of the date of the deposit of funds, and, had it been so aware, it might have been able to terminate the lease more quickly. The foreclosure of the chattel mortgage, which had occurred seven months before, was an independent event of default, in addition to the tenant's nonpayment of taxes.

Comment 2: The issue of whether post taking events might affect the tenant's right to share in the proceeds is discussed in Friedman on Leases, Randolph Edition, in Section 13.5, at notes 97-100 and accompanying text. In

United States v. 26,699 Acres of Land,, 174 F.2d 367 (5 Cir., 1949), the court found that after the valuation of the property in a condemnation action, but before actual seizure of the property, the tenant and landlord voluntarily cancelled the lease, and that implicitly the tenant assigned his interest in the rent proceeds to the landlord. Milton Friedman appears to have believed that this case states an appropriate rule in such cases, but the Maryland Court of Appeals disagreed in Veirs v. State Rd.s. Comm'n, 143 A.2d 613 (Md. 1958). Of course, in our case, although arguably there might have been a surrender when the tenant abandoned after the state deposited the money, if the landlord took possession, there was no basis to conclude that tenant was waiving any rights to share in condemnation proceeds.

Comment 2: On the point that the tenant's individually, and not their business entity, "owned" the lease, the editor is reminded of the now ancient case of Abbott v. Bob's U Drive, 352 P. 2d 598 (Or. 1960), written by Kenneth O'Connell, one of the editor's mentors. That case found that were a corporation was occupying the premises and paying rent, there was an implied assignment from the "paper" holder of the lease to the true occupant and user. The landlord might have exploited that theory here, had it thought of it. Abbott and other cases on the point are cited in Friedman on Leases, Randolph Edition, at page 7-109 note 430.

EMINENT DOMAIN; SCOPE OF POWER; PUBLIC PURPOSE: Conservation of land for open space is a public use, even though a condemning public agency acquiring the land has no plans to put the property to any active use. ***Mount Laurel Township v. Mipro Homes, L.L.C., 379 N.J. Super. 358, 878 A.2d 38 (App. Div. 2005); August 2, 2005.***, discussed under the heading: "Constitutional Law; Takings; "Public Purpose;" Open Space.."

EMINENT DOMAIN; SCOPE OF POWER; UTILITY COMPANY: Telephone company abused its discretion when it attempted to use its eminent domain power to condemn the entirety of landowner's property in order to expand its adjacent point of presence (POP) facility. ***Leggett v. Sprint Communications Company, L.P., 2005 WL 3244255 (Ky. Ct. App. 2005)***. Sprint attempted to condemn the neighboring property owned by Leggett following failed negotiations to purchase the property for the purpose of expanding its POP facility. Sprint alleged, pursuant to KRS 416.150 and KRS 278.540, that it had the power to acquire real property through eminent domain had the authority to acquire by purchase, lease, gift or condemnation such property or interest therein as it deems necessary, proper and convenient for corporate purposes. Sprint claimed it needed 22,172 square feet for its permanent utility easement, which is exactly the area of Leggett's property, so its petition sought to condemn all of Leggett's land.

The trial court granted Sprint's motion for summary judgment, reasoning that under Kentucky law, Sprint had the power to exercise eminent domain over Leggett's private property. Leggett appealed, arguing that the court erroneously concluded that Sprint had authority to exercise eminent domain over his entire property. The Court of Appeals stated that, under Kentucky law, Sprint, as an appropriate condemning authority, was authorized to exercise its power of eminent domain and that it had broad discretion in doing so. The court noted, however, that the statutory authority given to telephone companies under KRS 278.540(2) and KRS 416.150 limited Sprint's power of condemnation. KRS 278.540(2) limits a telephone company's power to condemn land to a right of way for the purpose of constructing, maintaining and operating telephone lines.

Under both statutes taken together, Sprint was authorized to contract with Leggett for a right of way across his property, and after failing to reach an agreement, had the power to condemn the right of way. A strict interpretation of these statutes, however, leads to the conclusion that Sprint did not have the power to condemn the entirety of Leggett's property, nor did it have the statutory authority to condemn Leggett's property for the purpose of expanding its POP facility. The Court of Appeals held that Sprint's petition exceeded its statutory authority to condemn a "right of way" by attempting to obtain a fee simple interest in the entire property for the purpose of expanding its POP facility. Thus, it reversed and remanded the case to the circuit court for further proceedings.

FAIR HOUSING; DISABILITIES; REASONABLE ACCOMMODATION: Zoning authority may be required to permit owner of residentially zoned property to operate care facility for a group of aged clients because this is a "reasonable accommodation" to such clients required by the Fair Housing Act. ***Akridge v. City of***

Moultrie, Georgia, 2006 WL 292179 (M.D.Ga., February 7, 2006).

City staff told Plaintiff that nothing in the zoning code prohibited her proposed plan of opening her home to care for disabled elderly individuals. As a result of the favorable information that she received from City, she purchased a residence. After receiving several complaints from city residents about having a retirement center in the middle of a residential district, Plaintiff was contacted by Defendant's city planner. The city planner commented that the city's current zoning ordinances did not address the proposed use of the Plaintiff's property, but in his opinion, Plaintiff's proposed use was essentially a single family dwelling under the city's current zoning codes.

Later, however, the City Manager Plaintiff that her intended use of her property was prohibited by the city's zoning code and Defendant instituted a criminal proceedings against Plaintiff for allegedly violating the city's zoning code, *i.e.* allegedly operating a personal care home in a residential area.

Plaintiff filed FHA and ADA claims based on intentional discrimination, claims pursuant to 42 U.S.C. Section 1983 based on the intentional discrimination under the FHA and ADA, and claims under 42 U.S.C. Section 1983 based on equal protection violations. Since the United States District Court did not find evidence of intentional discrimination, these claims were dismissed with prejudice. Plaintiff also filed FHA and ADA claims based on Defendant's failure to make a reasonable accommodation and claims pursuant to 42 U.S.C. Section 1983 based on Defendant's failure to make a reasonable accommodation under the FHA and ADA. These claims were not dismissed.

In order to establish a *prima facie* case under the FHA or ADA for failure to make a reasonable accommodation, Plaintiffs must show that the accommodation requested was reasonable and necessary to afford handicapped or disabled individuals equal opportunity to enjoy the housing of their choice. Whether a requested accommodation is reasonable is highly fact-specific and determined on a case-by-case basis. Generally, an accommodation is reasonable if the requested accommodation does not impose significant financial or administrative burdens upon the defendants or substantial modifications to existing programs or policies that would fundamentally change the nature or function of the program or policy. A plaintiff must also show a direct link between the proposed accommodation and the equal opportunity to be provided to the handicapped person.

The Court found that a reasonable jury could conclude from these circumstances that Plaintiff's requested accommodation was reasonable. Therefore, Plaintiff's claims regarding Defendant's failure to make a reasonable accommodation pursuant to 42 U.S.C. Section 1983 and under FHA and ADA remain.

FAIR HOUSING; DISABILITIES; REASONABLE ACCOMMODATION; PARKING: Although the Fair Housing Act, in certain circumstances, may entitle a handicapped tenant to a reserved parking space adjacent to the tenant's dwelling, such a space is required only where it is necessary for the tenant to use and enjoy his or her dwelling, not where it is simply more convenient. ***United States of America v. Port Liberte Condo I Association, 2005 WL 3500801 (U.S. Dist. Ct. D. N.J. 2005), Unpublished; December 21, 2005.***

FRAUD; MORTGAGES: The recording of a deliberately misleading mortgage instrument in the public record constitutes actionable mortgage fraud, even though there is no direct communication of a fraudulent statement to the victim of the fraud. ***ABN AMRO Mortgage Group, Inc. v. Maximum Mortgage, 2006 WL 1128648 (N.D. Ind. 4/26/06),*** discussed under the heading: "Mortgages; Fraud."

GUARANTEES; DISCHARGE; ALTERATION OF OBLIGATION:: The execution of an escrow agreement implementing a purchase contract results in a novation that releases guarantor if the changes are "material," even if the changes potentially operate to the benefit of the guarantor. ***Thomas-Sears v. Morris, 2006 WL 573293 (Ga.App., March 10, 2006).***

Plaintiff, a licensed real estate agent, executed a sales contract with a third-party under which the third-party was to purchase Plaintiff's house and the adjacent land. Plaintiff owned the Property subject to an existing security deed (mortgage)..

The Purchaser lacked the funds to close, and the parties fell upon an agreement by which the Plaintiff took back a purchase money obligation secured by a "wraparound" security interest, incorporating the first mortgage, which remained on the property.

Defendant agreed to guarantee the Note which of course stated both the additional credit toward the purchase price given by the Plaintiff and the principal and interest under and secured by a recorded mortgage. Prior to closing, defendant indeed did execute a very simple guarantee agreement, referencing the closing documents as they then existed.

At the closing of this transaction, the third-party did not have sufficient cash to fully satisfy the cash terms of the sale agreement. As a result, Plaintiff and the third-party executed an Escrow Agreement, which conditioned the purchase and sale of the Property on the occurrence of several additional enumerated contingencies. In addition, Plaintiff and the third-party both initialed the handwritten guaranty signed by Defendant two days earlier and the third-party signed the Note and the Security Deed. Guarantor did not sign anything at that time.

The transaction closed, but the third-party failed to secure financing to make the final balloon payment on the Note, and went into default. Plaintiff sought recovery for the balance of the Note from Defendant, as guarantor.

The Trial Court granted Defendant summary judgment and released him from the guaranty.

The appeals court affirmed. It noted that a Georgia statute provides that, a change in the nature or terms of a contract is considered a novation and discharges the guarantor in the absence of the latter's consent. The court indicated that Georgia decisions have stated that such a change must be material in order to result in a discharge. But cases have also ruled that a material change releases the guarantor, irrespective of whether the change is to the benefit or the detriment of the guaranty.

The Court found that the Escrow Agreement materially changed the third-party's, and thus the guarantor's, obligations under the note. The enumerated conditions set forth in the Escrow Agreement represented for the first time that payment of the Note was contingent upon the third- party obtaining financing. Neither the Note nor the Security Deed contained any such contingency.

Furthermore, the Escrow Agreement added a liquidated damages provision that materially altered Plaintiff's liability exposure. Both of these changes were material, and either was sufficient to constitute a novation to the Note.

Comment 1: The case is based upon Georgia statute, and most readers will want to know what the common law says about all this.

In fact, the common law is in the process of evolution here, and the editor's research turned up a pretty good discussion of the new developments in Madison and Dwyer, The Law of Real Estate Financing (Warren, Gorham and Lamont), the most recent discussion in which are probably done by Steven Bender at the University of Oregon. The discussion of guarantors is set forth in Paragraph 14 and the discussion of discharge as a consequence of alteration of the guaranteed obligation is set forth in Section 14.04[8][c], although the editor's edition may not have all the most recent supplements.

The discussion here, by the way, is much stronger than in the editor's old standby, Nelson and Whitman, Real Estate finance Law, and the approach of Madison and Dwyer is to include many more forms and practice tips in addition to a discussion of the law.

The Madison and Dwyer treatise reports that, on the question of discharge of the guarantor as a result of unconsented modification of the guaranteed obligation, the old common law differentiated between compensated and uncompensated guarantors. Uncompensated guarantors were released by any material change in the obligation. Compensated guarantors were released only when such change operated to their detriment. But the more recent Restatement of Suretyship will grant discharge to either type of guarantor only to extent that the guarantor is harmed. But the Restatement also provides that there will be a complete discharge if "the modification creates a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed pursuant to the transaction prior to the modification."

Comment 2: Those still reading attentively at this point will notice that there is a blurred distinction among the concepts "material," "harmful to the gurantor's interest," and "imposes risks . . . fundamentally different." The Madison and Dwyer treatise goes on to speculate about how these distinctions might be worked out in practice.

Comment 3: More fundamental, of course, is the fact that all these sorts of "suretyship defenses" can be waived by language in the guarantee instrument. Such waivers are so routine that it is possible that the failure to at least propose such a waiver to a client benefitted by a guarantee might be seen as malpractice. Under the Restatement of Suretyship and Guaranty, the waiver "may be effectuated by specific language or by general language indicating that the secondary obligor waives defenses based on suretyship". But a statement that the guaranty is "absolute" or "unconditional" is ordinarily not sufficient.

Comment 4: So does the Plaintiff have a malpractice remedy here? Dollars to donuts the Plaintiff (a real estate broker) probably figured he knew enough about real estate law to take care of himself and didn't bother to seek an attorney when getting the guarantee. Just guessing. Lawyers and brokers who represent themselves, as they say, have a "fool for a client."

HOMESTEAD; MUNICIPAL LIENS: Under Florida's constitutional homestead protection, a court may not impose either a legal or equitable lien upon homestead property for violation of code requirements, even when the owners have "egregiously" failed to comply with an injunction to carry out the code requirements. ***Pelecanos v. City of Hallandale Beach, 914 S. 2d 1044 (Fla. App. 2005)***

The case includes interesting discussion of the very narrow range of circumstances in which courts will permit liens to attach to homestead property in Florida. Note that in this case the lien did not attach even when the property was sold, as there was no evidence that the sale proceeds were not used to replace the homestead.

HOMESTEAD; PROBATE; PERSONAL REPRESENTATIVE: Florida homestead property is not property of the estate when it passes from decedent to persons statutorily authorized to claim a homestead, whether or not such persons resided on the property at the time of decedent's death; consequently a personal representative may take possession of the homestead property to secure and protect it, but may not sell it, even where the will gives such representative the right to sell estate property. ***Harrell v. Snyder, 913 So. 2d 749 (Fla. App. 2005)***

INSURANCE; CASUALTY; FLOODING: Homeowner's casualty policy does not cover water "storm surge" damage from Hurricane Katrina when the policy specifically excludes damage "directly or indirectly from . . . water . . .even if another peril [such as wind-which is covered by the policy] contributed concurrently or in any sequence to cause the loss". ***Leonard v. Nationwide Mutual Ins. Co., 2006 Westlaw 2353961 (S.D.Miss. 8/15/06)***

This is reported to be the first case of the numerous insurance disputes arising out of the Hurricane Katrina calamity in the Gulf Coast. Plaintiff's residence was damaged extensively by water from the "storm surge" that washed over the Mississippi coast area. Plaintiffs' home was twelve feet above sea level and 515 feet from the shoreline. Their property was not classified in "flood zone A" – the area deemed most susceptible to flooding by federal flood insurance standards. Therefore, their lender did not require them to purchase flood insurance, and they did not purchase it.

It has frequently been reported in the media that the standard homeowner's policies in this area excluded flood damage. But, as this case reveals, the exclusions of this policy, and presumably other policies used in the area, are more express than that.

As the caption above indicates, the policy expressly excluded all damage from water or water-borne material, "even if other perils contributed, directly or indirectly, to cause the loss. Water and water- borne material damage means: (1) flood, surface water, waves, tidal waves, overflow of a body of water, spray from these, whether or not driven by wind".

The policy did cover accident caused loss to structures and, as to personal property, "direct loss caused by rain, snow, sleet, sand or dust driven through roof or wall openings made by direct action of wind, hail or other insured peril," but in plaintiffs' case the primary damages they suffered did not result from wind driven rainwater passing through a hole. Their roof remained intact and they had small wind damage to their upper story. The real damages suffered resulted from water inundating the lower portion of their home.

The federal court judge apparently had little difficult concluding that the policy did not cover the water damages in question. Because of the water damage exclusion language. The insurer had the burden of proof to demonstrate that the damages in question were caused by water within the meaning of the exclusion, but the circumstances of this case made that possible.

The court did note an ambiguity in the policy that it would have been inclined to interpret in favor of the plaintiffs if their claim was affected by that ambiguity. The policy contained an exclusion of "loss to any property resulting directly or indirectly from the following if another excluded peril contributes to the loss: . . . (c) Weather conditions, if contributing in any way with an exclusion listed in paragraph 1 [water is one of these exclusions]. The court noted that if a windstorm caused extensive damage, such as ripping off a roof, and then some water got into the house as a consequence, this language, read literally, would appear preclude coverage. This is notwithstanding the language quoted above by which the insurer agreed to insure against "rain . . . driven through roof openings." The court said that such a broad preclusion of liability is inconsistent with the notion that there is coverage for wind damage, since wind damage almost always is caused by "weather." But the court indicated that the insurer here was not relying upon the weather-related damage exclusion and in fact was not taking the position that it was not liable for such damage.

Faced with such clear language in the policy, it is not surprising that the plaintiffs, represented by a famous trial lawyer who has made a very public cause out of these insurance claims in this region, argued that the policy language was voided by the activities of the company's agent. Apparently that agent had discussed flood insurance with plaintiffs prior to the hurricane and there was some evidence to suggest that he recommended against acquiring such insurance, both with them and with a number of other clients.

The plaintiffs sought to draw the inference that the agent's advice not to get flood insurance amounted to an assurance that their policy protected them against water damages caused by hurricane. But, at least in this case, the plaintiffs were unable to make a convincing factual case for that position. Now, advised by the outcome here, and going before some local juries in the future, the plaintiffs' lawyer in other cases most likely will attempt to muster more evidence that the agents improperly assured their clients that their regular policy provided coverage.

Comment: There are a number of shoes that will be dropping in this litigation, but certainly the policy language here will make it very tough for homeowners' to collect on the basis of the policy language alone. Will Mississippi and Louisiana juries will conclude that insurance agents in those states routinely misrepresented the coverage of the homeowners' policy in order to dissuade their customers from buying flood insurance? The court points out here that the agent earned an additional 15% premium if the customer purchased such insurance, so it does seem that there would be little incentive to make such a misrepresentation. But jury verdicts often don't follow pure logic.

In any event, it does appear that none of the issues considered here would have been susceptible to a class action, so it will be a long and expensive slog through the muck for both plaintiffs' and insurers' counsel down there.

LANDLORD/TENANT; ASSIGNMENTS AND SUBLEASES; LANDLORD'S CONSENT; DELAY: Breach of a lease for failure to consent to a sublease will not be found where the tenant has not produced a ready, willing, and able subtenant to assume the provisions of the lease; and attorney's fees in such an action do not have to be assessed using the lodestar method. ***WHTR Real Estate Limited Partnership v. Venture Distributing, Inc., 825 N.E.2d 105 (Mass. App. Ct. 2005).***

Lessee wished to relocate and determined to sublease the property. Lessee's broker contacted USCO with an 'as-is' offer of sublease, and USCO responded with a counteroffer containing additional conditions.

Lessee did not respond directly to the conditions contained in the counteroffer, but instead prepared a sublease and forwarded it to USCO's in-house counsel, who took no further action. Lessee also forwarded the proposed sublease to Lessor with a request for consent. Lessor requested financial information from USCO's CEO, who did not respond.

At the same time, USCO was negotiating for a different space with another party. USCO did conduct a walk through of Lessee's space, and prepared a list of seventeen items needing "repair/testing prior to signing a lease." Two weeks later, USCO signed a lease for the other space.

The trial judge found that throughout the process, Lessee's responses to Lessor's requests for information and documents were slow, if they occurred at all. Lessee also never fully addressed USCO's counterproposal or the separate list of issues with the property. A signed sublease was never presented to Lessor for approval. Lessor filed suit against Lessee for breach of the lease, requesting rent, attorney's fees, and costs. Lessee counterclaimed alleging Lessor had breached the lease by poisoning negotiations between Lessee and USCO and by unreasonably withholding consent to the proposed sublease. The Superior Court found Lessee in breach and awarded rent, attorney's fees, and costs to Lessor.

Lessee appealed the ruling on the breach, and Lessor appealed the amount of costs and attorney's fees awarded. The Appeals Court held that the trial court had properly found that breach for failure to consent will not be found where the tenant has not produced a ready, willing, and able candidate to take on the tenant's full obligations under the lease.

The court also noted that claims regarding interference with negotiations were too speculative given the uncertain state of the negotiations and a lack of evidence that USCO was ever ready to merely step into Lessee's place under the lease. Likewise, Lessor's appeal for larger attorney's fees was dismissed based on a finding that the trial court had not abused its discretion in finding Lessor's submitted amounts unreasonable. The court held that even uncontroverted submissions must be found reasonable, and the trial court was not required to use the lodestar approach (hours reasonably spent multiplied by a reasonable hourly rate) to test reasonableness. The Appeals Court clarified that *Fontaine v. Ebtec Corp.*, 613 N.E.2d 881 (Mass. 1993) does not require use of the lodestar method, but merely notes that such an approach can prove to be advantageous. The Appeals court found that Superior Court had considered appropriate factors and had not abused its discretion or committed clear error. The lower court's judgment was affirmed in all respects.

LANDLORD/TENANT; ASSIGNMENTS AND SUBLEASES; MERGER: After a tenant has assigned a lease, the tenant remains liable as a "guarantor," and not as a principal obligor. Consequently, the tenant remains liable for rent not paid by the assignee until the lease is terminated, even if termination occurs through merger, but landlord's release of the assignee from liability under the lease will also be a release of the original tenant/assignor. ***CO Lemon, LLC v. Host Marriott Corp., 2006 Westlaw 1485235 (Ohio App. 5/31/06)***

Marriott was the original tenant under a long term lease with CLM. CLM approved an assignment of the lease to Elias in 1985. Elias agreed to indemnify Marriott for any liability it incurred for Elias' breach of the lease, but CLM did not release Marriott from the lease.

In 1999, Elias defaulted on the lease, and in 2000 Elias filed for bankruptcy. Elias attempted to reject the lease, but finally, in a court approved settlement, the court vacated Elias' rejection of the lease, authorized Elias (presumably Elias' bankruptcy estate) to assume the lease and approved the assignment of the lease to CLM, which in turn agreed to waive any and all claims against Elias.

A year later, CLM filed suit against Marriott for the unpaid rentals accruing before and after the assumption of the lease by CLM. It argued that the assumption had no impact on Marriott's continuing liability for unpaid rent.

The court ruled, quite properly, that the assumption by CLM led to a merger of the lease and a termination of any further liability of any party for performance of the lease. But the court held that the merger, in and of itself, did not release Marriott from its obligations under the lease prior to the merger. Those obligations included potential liability for the lease payments that Elias had not paid.

But the court then turned the case around on CLM by holding that more than the merger was at stake. In addition, CLM had released Elias from any liability, both past and future, at the time of the bankruptcy settlement. The court characterized Marriott's liability under the lease, post assignment as that of a "guarantor," and invoked the usual rule that a guarantor is released when the principle debtor is released.

Thus, Marriott was out completely.

Comment 1: Typically, an original lessee is said to continue in liability under an assigned lease because the lessee remains in "privity of contract" with the landlord. This is an interesting jurisprudential concept. Under the ordinary law of real covenants, a party transferring real estate does not remain liable for the performance of the covenants. Thus, an intervening assignee, who did not sign the original lease nor assume the lease, and later reassigned it to another, would not be in privity of contract or privity of estate, and would escape liability for post assignment defaults. But the original lessee is stuck.

Thus, the court was correct in concluding that Marriott has potential liability here and also correct in concluding that the liability would be terminated when the lease was terminated by merger.

What is curious here, however, is the court's characterization of Marriott as a "guarantor." Most theorists would describe Marriott's status as that of a "surety," and not a guarantor. The editor suspects that the distinction doesn't matter much. Sureties also normally get released when the principle debtor is released. But there may be an argument that a creditor could release the principle debtor but reserve rights against the surety. This would make it possible for the surety to have a subrogated claim back against the principle if it were ever forced to pay the creditor. The editor isn't sure that these same concepts of suretyship apply to all guarantors.

Comment 2: In any event, the court suggests that language that often appears in boiler plate in commercial leases would have solved the landlord's problem. This court's recommended language (taken from another Ohio case) reads as follows:

> "[Tenant] may at any time assign this Lease . . . but no assignment or sublease shall reduce or affect in any way any of the obligations of [tenant] hereunder, and all such obligations shall continue in full effect as obligations of the principal and not as obligations of a guarantor or surety, to the same extent as though no assignment or subletting had been made."

The editor has always wondered whether this language really added anything. According to the Ohio court, it does, and one would assume that any Ohio landlord's lawyer ought to be adding this language to every lease at peril of malpractice.

Incidentally, the lease was not silent on the subject of Marriott's continuing liability. It stated "Tenant shall have the right to assign this Lease . . . provided Tenant continues to be liable for the prompt and full payments of the rentals and other payments required hereunder."

In light of the fact that, even if the lease were silent, Marriott would have been liable as a surety, is it really that clear that this language wasn't also an attempt to impose non-surety liability on Marriott? The court thought so.

LANDLORD/TENANT; COMMERCIAL; COTENANCY CLAUSE: Where a lease clause provides that tenant may terminate its lease if an identified co-anchor "fail or cease to lease and pay rent for its store in the Shopping Center . . . ," the tenant has the right to terminate where the co- anchor assigns its lease, even where the co-anchor's lease had no operating covenant. ***Jenkins v. Eckerd Corp., 913 So. 2d 43 (Fla. App. 2005)***

The tenant's lease specifically identified that there was a co-anchor lease and that "the continued leasing and payment of rent for [co-anchor's] store is part of the consideration to induce [Tenant] to lease and pay rent for its store." According to the parties who negotiated this lease, the purpose of the clause was to give assurance to Tenant that the co-anchor would continue to bear its share of the Center's costs during the period of Tenant's lease. At the time it entered into this lease, Tenant was fully aware that the co-anchor's lease was freely assignable and contained no operating covenant.

On the other hand, the Tenant's lease negotiator testified that in clauses of this sort that he had negotiated, usually the parties stipulate if they intend the reference to the cotenant in question to include the cotenant's successor and assigns. Obviously the clause in question did not include that language.

Of course, what happened was that the co-anchor assigned its lease to another grocery store operator, which in fact continued to operate a grocery store and to pay rent. The assignor/co-anchor remained liable for such rent. The Tenant's lease had also passed through several hands, and the present assignee, Eckerd, concluded that it was not desirable to continue to operate at this location and therefore, one year after the co-anchor assigned, Eckerd invoked the termination right described above.

Landlord argued that the co-anchor, as assignor, remained fully liable on the lease, and that, consequently, the only conceivable purpose of the clause – to insure that the operating costs be covered – was satisfied. Landlord argued that, although the language of the termination right appeared to be ambiguous, in context it was in fact ambiguous because it did not identify what happened when the co-anchor assigned.

In the alternative, the Landlord argued that the failure of the co-anchor to continue to be the one actually paying the rent was an immaterial breach. The Landlord noted that the Restatement of Contracts referred to "immaterial conditions" also as "excused" if the invocation of the breach "(a) will involve extreme forfeiture or penalty, and, (b) its existence or occurrence forms no essential part of the exchange for the promisor's performance."

The appeals court panel ruled, 2-1, in favor of Tenant, with a strong and detailed dissenting opinion.

In the view of the majority, the language of the clause was unambiguous, and therefore so was the condition that Tenant was entitled to expect – the continued leasing and payment of rent by the co- anchor. Consequently, the failure of the co-anchor to continue in the premises was material, as it was the performance for which the Tenant bargained.

A very strong dissent argued point by point against this position.

Comment: In the editor's view, this is a very close call, especially on the first argument – that, in context the language of the lease was inherently ambiguous when it failed to address what would happen if the co-anchor assigned. The majority placed the responsibility for addressing the issue directly on the landlord, who knew that assignment was a distinct possibility. As Landlord failed to do anything to protect itself against this eventuality, Landlord should suffer the consequences.

Central to the editor's conclusion on this point would be more and clearer evidence of trade practice with respect to this issue. The only witness, who had negotiated for the tenant, said that in such clauses the parties always stipulate if they intend to withhold the Tenant's "kick out" right in the event of an assignment by the identified cotenant.

The editor agrees that this would be common practice in the more traditional cotenancy clause where the identity of the Tenant is critical because the clause is designed to protect a Tenant from the loss of good will due to its association in the Center with the other identified tenant. But in this case, it was apparently not disputed that good will was not the issue – the original Tenant sought only to protect itself from an insufficiency in maintenance funds resulting from a failure of rent from the co- anchor's space. If this is the case, then the parties might not think to mention assignment because what they were focused on would be interruption in the rent flow. This would not happen in the event of assignment, so they wouldn't talk about assignment one way or the other.

The editor believes the type of cotenancy clause involved in this lease is relatively unusual, and that it likely is difficult to generalize about trade practices about this. Absent a clear trade practice, the editor tilts, ever so slightly, to Landlord's side. But the editor always believes that people should live with the language of their agreements. So it's very close. The editor simply believes that the language of the agreement needed further clarification as applied.

LANDLORD/TENANT; COMMERCIAL; RADIUS CLAUSE: Radius clause requiring that tenant not "during the term of the lease, own, operate, manage or have any financial interest in, any store or business located within a radius of seven miles **. . .** that is similar to that then being conducted upon the demised premises" is ambiguous when applied to tenant's operation of branch of its store after it had gone dark in the shopping center subject to the restriction, and trial court may take additional evidence to ascertain whether parties intended to lock out competing activities even when the protected space was dark. ***Wells Fargo v. Diamond Point Plaza, L.L.P. 2006 Westlaw 2788385 (Md. App. 9/29/06)***

This case makes fascinating reading for anyone involved in shopping center finance or operations. There is interesting discussion of many issues commonly in dispute.

The one selected for the editor here has to do with the interpretation of the clause set forth in the caption. This clause appeared in a lease to Sam's Club. Sam's Club, like all Wal Mart operations, negotiated a tough "go dark" clause in its favor. The clause indicated that Sam's Club made not representation that it would conduct any business at the location and reserved the right to go dark. (In fact, as reported in the second item on this case, Sam's Club assigned the lease to the production company of the hot Showtime series "The Wire," about gangs and drugs in urban Baltimore. But that's another story.)

As it was shutting down the operations at the Diamond Point location protected by the radius clause, Sam's was stocking and preparing to open a store at another location within seven miles, and ultimately did open that location just as it closed at Diamond Point.

The shopping center's lender claimed that it suffered significant damages as a consequence of Sam's Club's violation of the radius clause covenant. Although the trial court found against Sam's Club on many counts, on this issue it granted summary judgment to Sam's Club, on the notion that the clause was not intended to protect dark space from competition. As Sam's Club had the right to go dark, it also had the right to open another location after it had done so.

The appeals court did not agree that this language was so clear. It concluded that summary judgment was inappropriate here. The lender argued that "then being conducted" unambiguously referred to "the term of the lease," and that the radius clause protected the space from competing operations within seven miles whether or not the space was dark. The lender claimed that the court's interpretation rendered the clause "illusory" and couldn't possibly have been the expectation of the parties. It noted that, elsewhere in the lease, the tenant reserved the right to operate other stores "which are in competition with such store" subject to what else might appear in the lease (such as the radius clause). It argued that this permissive language to the tenant somehow bolstered its argument that the radius clause went beyond merely protected against competing store operations, but rather was intended to protect the space itself from competition. Apparently counsel for the lender did a very impressive dance around the word "then" in the above caption that impressed the appeals court, which found that there was sufficient ambiguity in the clause to warrant a trial on the merits.

Sam's Club argued that to protect the operating store from competition was a perfectly valid purpose of the radius clause, and was not "nonsensical." The lease was a percentage lease, and the landlord clearly had an interest in protecting the store from competition while it had the possibility of generating percentage rents. When the store was dark, however, that interest went away.

Comment: The editor agrees with the trial court and Sam's Club here, and is interested in hearing from other interested commentators. He has seen plenty of radius clauses, and knows that those drafting such clauses know how to say it when they are in fact trying to prevent additional branches of the store from springing up so as to draw business away from the shopping center. Here, in the editor's view, the purpose of the clause was to protect the Sam's Club operations from diminution in percentage rent.

As an example – what if Sam's Club, as it might have, had turned the entire store into a greeting card outlet, liquor store, or Halloween and Christmas decoration specialty store? Could it have opened another branch of the Sam's Club within the radius, while excluding only the competing lines. It is hard to see how the court could read the clause as prohibiting such operation. Sam's Club was free to do anything it wanted with its space. If the landlord really wanted to protect against other Sam's Clubs, it should have said so, rather than to try to protect operations that were subject to constant change at the whim of the tenant.

LANDLORD/TENANT; COMMERCIAL; RENT; BONUS RENT: Bonus rent clause stating that a bonus must be paid "for every new car sold" relates only to cars sold on the leased premises, and tenant need not pay bonus when it relocates its new car facility. ***Facilities, Inc. v. Rogers-Usry Chevrolet, Inc., 908 So. 2d 107 (Miss. 2005)***.

Facilities, Inc., as landlord, leased land to Rogers-Usry Chevrolet. The lease stated that the property would be used only as a retail automobile dealership. In addition to the base rent, the lease provided that if the tenant sold more than 100 new cars, the tenant would pay bonus rent of $100 per car. The tenant moved its new car sales to a different location, sold only used cars on the leased premises, and refused to pay any bonus rent to the landlord on the grounds that bonus rent was due only on the sale of new cars, not used cars.

The landlord argued that the lease meant that the tenant owed bonus rent from the sale of any new cars by tenant, even new cars sold at a different location than the leased premises. The tenant filed a declaratory judgment action in the Chancery Court of Rankin County to resolve the issue. The landlord counterclaimed for an accounting of the rent due. The Chancery Court held that the lease only required the tenant to pay bonus rent on new cars, and not on the sales of used cars.

On appeal, the Court of Appeals held the lease to mean that when the tenant sold more than 100 new cars in a month, regardless of the location, then the tenant would owe bonus rent to the landlord. The Court of Appeals reasoned that the lease was not ambiguous, and that the chancellor had inferred a limitation into the lease that bonus rent was only payable on new vehicles sold on the leased premises. The Court of Appeals also noted that the landlord argued that the bonus rent was intended to compensate the landlord for below-market rent.

On appeal: *Held: Reversed.* The Supreme Court, reversed the decision of the Court of Appeals and affirmed and reinstated the decision of the chancellor.

The Supreme Court found that the Court of Appeals had relied on evidence outside of the four corners of the document in its decision. The fact that the lease was silent about whether bonus rent was payable on new vehicles sold at locations other than the leased premises did not make the lease ambiguous so as to justify looking outside the four corners of the document. The ordinary meaning of "rent" means consideration paid for use of land, and the landlord's argument that the sale of vehicles on other land was "rent" was not consistent with this ordinary meaning.

Reporter's Comment 1: In interpreting a contract the courts first look to four corners of the contract; second, if the meaning cannot be determined from the four corners, then the courts apply the Byzantine canons of construction best summarized in *Pursue Energy Corp. v. Perkins, 558 So. 2d 349, 351-53* (Miss. 1990); third, if the contract remains ambiguous or unclear, the courts will consider extrinsic evidence about the parties' intent. Obviously some subjectivity exists in this process. For example, in this case both the Court of Appeals and the Supreme Court determined that the lease was unambiguous. They just determined that it unambiguously meant opposite things.

Reporter's Comment 2: Following the Supreme Court's reasoning, if the bonus rent had been characterized in the lease as a personal payment due by the tenant rather than characterizing it as rent, the landlord probably would have prevailed. By characterizing the payment as rent, the landlord tied the payment to the ownership of the dirt rather than making the payment a general contract obligation of this tenant that would have followed the tenant wherever he went.

Reporter's Comment 3: The editor thinks that the holding that the failure to address an issue does not mean that the lease is ambiguous for purposes of this rule of construction is significant in leasing law because it is impossible to address every possibility in a lease, and thus leases are more likely to not address an issue than to be truly ambiguous. In fact, the longer the lease, the more likely it is that the lease will be ambiguous, as the parties lose track of defined terms.

Editor's Comment 1: The problem with interpreting the clause to mean: "new cars, wherever sold,." is that the tenant could expand into a much larger operation, through merger or otherwise, and grow into a multinational entity, selling millions of cars, and surely the parties didn't contemplate that the landlord would reap a reward on every car. This would be true whether or not the parties characterized the payment as rent or a personal obligation.

For instance, in *Scot Properties v. Wal-Mart Stores, Inc.,* 238 F. 3d 571 (5th Cir. 1964), the lease provided that the tenant would pay percentage rent on "Gross Sales . . . whether such sales be obtained at the Demised Premises or elsewhere." The court found that to apply the percentage to Wal-Mart's worldwide sales would be "preposterous," but it suggested no other convincing rationale for the language.

On the other hand, in *Cissna Loan Co. v. Barron,* 270 P. 1022 (Wash. 1928), the tenant leased premises under a percentage rent clause and then leased and adjacent building, punched through the wall between the two premises, and moved several sales departments to the other building. The only access was through tenant's old space. The court found that the percentage rent clause reached the gross sales in the adjacent premises.

The Editor discusses this issue and collects the cases *Friedman on Lease – Randolph Edition* at Section 6.7. Note that the current edition includes the now reversed Court of Appeals decision here.

Editor's Comment 2: In one fascinating Mississippi case, *Vulcan Materials Company v. Miller*, 691 So.2d 908 (Miss. 1997) (the DIRT DD for 11/17/97) a party transferred an option to acquire certain limestone quarry properties. The option included the right to exploit information the seller had derived about related limestone deposits on nearby properties. The sale of the option included a royalty clause whereby the buyer of the option had to pay the seller of the option a royalty relating to extraction of limestone from any of the parcels, and stated that the royalty obligation was a covenant that ran with the land to successive owners. And then the language became extremely broad: "[Buyer] acknowledges that [Seller] discovered this mineral deposit and has made is possible for [Buyer] to do business in this regard. If [Buyer] should open any other business related to this industry, [Buyer] agrees to pay a royalty of five cents per ton on minerals produced from such other source."

Later Buyer was acquired by another company, which shut down mining operations on the subject property and had other quarrying operations in other states. The new company had assumed the obligations of the covenant concerning royalties. Seller sought to apply the clause to all limestone extractions made by the new owner of the company.

The court held that the covenant did not run with the land because it did not touch and concern the land. But it then proceeded to find (properly) that the "touch and concern" problem is irrelevant if the party in question has assumed the promisor's covenant. Hence, the royalties were payable on the far flung operations of the new owner. Two dissenters.

The Reporter for this item was Rod Clement of Jackson, Miss., writing in the Mississippi Bar Real Property Section Newsletter. The editor has made non-substantive changes, and of course has added his own comments.

LANDLORD/TENANT; CONDEMNATION: Tenant has compensable interest in condemnation of landlord's estate despite the fact that tenant is in default and has abandoned the premises at the time of the passing of possession to the condemnor. ***Dames v. 926 Co., Inc., 925 So. 2d 1078 (Fla. App. 2006) (rehearing denied 5/7/06)***, discussed under the heading: "Eminent Domain; Damages; Leaseholds; Default."

LANDLORD/TENANT; EXTENSIONS AND RENEWAL; EXERCISE; LATE EXERCISE: Maryland continues to demand exact compliance with time requirements for exercise of lease extension option, even if form requirements might slip. ***Chesapeake Bank of Maryland v. Monroe Muffler/Brake, Inc., 891 A. 2d 384 (Md. App. 2006), cert. denied 898 A.2d 1005***

The lease provided that tenant had both options to extend its lease and an options to purchase. The option to purchase provided that, in the event that tenant exercised its option to purchase, possession under the lease would be extended until "settlement" at a pro rate lease rate. The option to renew required that tenant send notice of exercise of the extension option 90 days prior to the end of the original term "or the then current extension." The option to purchase had no specific time requirement for exercise.

Near the end of the first 20 year term, Monroe acquired the tenant, and sent the landlord a nice letter to the effect that "[w]e welcome a long and prosperous relationship with you." A few months later, Monroe sent notice exercising its option to extend for an additional five year term. It send the notice 27 days late. Ooops!!

Landlord responded that it would not extend the lease due to the late notice. There was no showing that the landlord did this because it had leased to another tenant. It just didn't want to extend the lease on the option terms, so far as we know. Tenant then gave notice that it intended to exercise its option to acquire the premises, and the parties entered into negotiations concerning the purchase option. Appraisals were made. But Monroe discovered that it would have had to acquire an adjacent lot as well in order to satisfy county zoning regulations. Apparently the resolution of the discussions of the option to purchase did not occur until more than ninety days after the original option to extend was sent. (You can see where this is going.)

Monroe refused to vacate, and the issue of the validity of the renewal option went to trial. The trial court found for Monroe on two bases: (1) The informal letter from Monroe discussing the "long and prosperous" future relationship amounted to an exercise of the extension option. (2) In any event, principles of equity ought to control, since loss of the valuable option was a forfeiture harmful to Monroe and granting the option, in light of the relatively short delay in notice, did not unduly injure the landlord.
On appeal: *Held: Reversed.*

The intermediate appeals court rules that the informal "exercise" claimed by the tenant was not in fact an exercise of the option at all, as it did not unequivocally commit the tenant to extend the lease. Of course, the tenant would have been arguing the same thing if the shoe had been on the other foot, and it would have been right. So enough of that.

The more interesting discussion has to do with the second basis relied upon by the trial court and a third argument made by Monroe, foreshadowed above.

Many courts, in fact, do permit equity to intervene to forgive a tenant for a late exercise of an extension option. Perhaps the leading proponent of this view is New York. A recent New York case, also involving an acquisition of tenant's business shortly before lease renewal time, proclaimed the established rule that the court will set aside the effect of tenant's late renewal where: (a) the tenant's failure or delay was the result of inadvertence or an honest mistake, (b) the nonrenewal would result in a substantial loss to the tenant , and (c) the landlord would not be prejudiced by the delay in notice. That case cited a long chain of New York cases supporting this view, and in fact permitted the tenant's testimony that its failure to renew timely as "inadvertent" to stand because the landlord had no way to controvert it. ***Popyork, LLC, v. 80 Court St. Copr., 806 NYS 2d 606 (App. Div. 2nd Dept. 2005)***

Maryland doesn't see things the same way as New York. The *Chesapeake* case noted that the option was nothing more than a contract right subject to a condition. The court said that case in Maryland setting aside lease forfeitures even though rent was paid slightly later than required are inapposite. There, a real estate interest had been created, and equity will protect it from unfair forfeiture. Here, there is no real estate right to the extended term unless and until the condition precedent is satisfied – timely notice.

Interestingly, the *Chesapeake* court went on to distinguish earlier Maryland high court authority that had permitted an extension option to take effect where the option notice was timely, but did not meet various technical requirements set forth in the lease. In the prior case, the tenant had not included a statement of net worth, as the lease required, and sent the letter on the wrong stationery, thus suggesting that it was not a valid corporate act of the tenant. The court had concluded that the notice of intent to renew was unequivocally communicated and that the requirement for a statement of net worth was "merely a covenant," not a condition.

The court then turned to Monroe's final, creative, argument that the notice in fact was timely because it had been provided more than 90 days before the actual end of the term, extended, as it had been, by negotiations over the purchase option. There appeared to be no argument that Monroe's attempt to exercise the option was a pure sham. Nevertheless, the court concluded that the intent of the drafters necessarily was that the notice be sent before the end of the original term. The language providing that notice had to be ninety days before the end of the term "or the then current extension" dealt necessarily only with the three five year extension periods that were part of the lease.

Comment 1: Friedman on Leases, Randolph Edition deals with this issue comprehensively, albeit in a somewhat disorganized fashion, in Section 14.2, at note 190 *et seq.* There clearly is a split in the case law, but there are so many special fact variations that it is difficult to generalize. Prior to this case, it would have been difficult to categorize Maryland, in light of the prior authority crediting equitable considerations for nonconforming but timely notices of exercise of an extension option, but not for late exercises. (The editor is citing Friedman a lot because he is about to go to press with the latest supplement.)

Comment 2: In fact, the editor likes the hardball rule here. It is often an easy matter for the tenant to invent some equitable case to support setting aside a late renewal. So any time there is a late exercise, one can expect a dispute, especially when there is money at stake. All this does is cost both parties a lot of money litigating the issue. They both have an incentive to do so, since either side has a "fighting chance" to win on the equities, since the rule isn't clear. A clearer rule brings discipline to the negotiations and in the long run provides the commercial certainty that benefits everyone, even the careless tenant in the particular case (albeit more remotely and less visibly.)

LANDLORD/TENANT; COMMERCIAL; USE CLAUSE: Tenant may be subjected to extensive damages claims for leasing to non-retail tenant when lease requires that premises be restricted to "lawful retail and shopping center purposes." ***Wells Fargo v. Diamond Point Plaza, L.L.P. 2006 Westlaw 2788385 (Md. App. 9/29/06)***

Tenant, as it was permitted to do under the lease, went dark and continued to pay base rent. Then, without landlord's prior knowledge or consent, Tenant assigned the lease to a production company for various production activities relating to the hit Showtime TV series "The Wire," which concerns gang activities and drug trafficking in urban Baltimore.

Landlord's lender, claiming significant damages, was able to bring in witnesses to show that the presence of a non-retail activity in the space was far worse than a dark store, even a dark anchor, such as a Sam's Club. Consequently, the tenant was able to prove damages, upheld here by the trial court, in the order of $1.25 million for the 2 and a half years the arrangement went on.

Comment: There's virtually no law here, but the fact that plaintiffs were able to show so much loss due to a production company in the space, rather than a dark space, struck the editor as noteworthy enough to insert a report item.

LANDLORD/TENANT; EXTENSIONS AND RENEWALS; AUTOMATIC RENEWAL: Where tenant implicitly rejects automatic renewal, as lease permits, but then holds over and pays rent, the automatic renewal takes effect. ***Behlmann v. Weaks, 150 S.W. 3d 153 (Mo. App. 2004)***

The lease provided that it would renew automatically for an additional five years, provided that landlord was obligated to give a thirty day notice to the tenant of the pendency of the renewal and that tenant thereafter had the right to refuse to renew, all more than six months prior to the end of the term.

The landlord sent timely notice. The tenant responded with a notice that stated that "[i]t would be my intent to renew the lease," but asking for a rent reduction because tenant improvements were complete. After the time for rejection of the automatic renewal had passed, the landlord responded with a letter stating that there had been an automatic renewal and stated the rent at an increased amount, apparently according to the cost of living adjustment.

The tenant paid the rent and remained in occupancy for over three years. Then, when it terminated occupancy, it took the position that there had been no automatic five year renewal because it had implicitly rejected such renewal when it proposed to renew only at a reduced rent.

The trial court granted summary judgment to tenant, but the appeals court reversed, finding that the lease was in effect for the full five year renewal term.

For purposes of reviewing the summary judgment motion, the court assumed that ambiguous notice sent by the tenant gave the tenant no more than an option to renew, and did not bind her to an automatic renewal. And tenant's letter certainly did not constitute the need for a "definite and unqualified determination to exercise the option".

The court ruled that when there is a requirement for notice of exercise of an option to renew, and the tenant holds over, the landlord may waive the requirement for notice and deem the lease renewed.

Comment 1: Note that this case depends on the existence of the renewal clause in the lease. Otherwise, if a tenant holds over, the landlord can send notice proposing a new lease, and hold the tenant to that lease if tenant continues to hold over, but such new lease cannot exceed the period defined by the Statute of Frauds, since the new lease is implied, and not written.

Here, the tenant had signed a lease with a renewal clause. Arguably, it was an automatic renewal, but the court assumed that the tenant had validly rejected the automatic renewal, and that this "flipped" the renewal clause into an optional renewal for five years, which the tenant accepted by holding over.

The court admits, however, that if the tenant had unequivocally indicated that her holding over was not an acceptance of the proffered renewal, there would have been no such renewal.

Comment 2: Friedman on Leases, Randolph Edition, at Section 14.2, text accompanying note 172 et seq, states that a tenant's notice claiming to invoke the automatic renewal in a lease, but proposing alternative terms, constitutes a rejection f an offer. But there is authority that the offer remains effective and can be accepted by later action of the tenant, absent estoppel (such as the landlord reletting in reliance upon an apparent rejection). That is apparently the approach taken by the court here. This strikes the editor as a common sense resolution of a tricky technical problem.

Nevertheless, it should be noted that notion that a holdover automatically can bind the tenant to an extended renewal term exposes the tenant to a "gotcha." This lesson deserves attention even though the case is a little older than most "developments."

Also see: Concrete Accessories Co., Inc. v. Moses, 32 Kan. App. 2d 1120, [95 P.3d 658 (Kan App. 2005) Even where lease required notice to effect renewal, holding over and payment of higher rent required under renewal provision effects renewal. Case also involves informal renewal claim, but court appears to discount that.]

LANDLORD/TENANT; TENANT LIABILITY FOR DEFAMATION: Defamatory remarks about a landlord made to the landlord's agents, such as buildings concierge and doorman, are considered to be complaints to the landlord, as principal, and therefore are not considered as having been published. ***30 River Court East Urban Renewal Company v. Capograsso, 383 N.J. super. 470, 892 A.2d 711 (App. Div. 2006)***

The appeals court reversed a finding for the landlord below, relying upon evidence in the record that landlord had encouraged its staff to receive complaints made about landlord, even supplying them with walkie-talkies for that purpose. Consequently, defamatory statements made to such staff members were made to the landlord itself and were not tortious.

The court added that, because none of employees who heard the remarks believed them, there was no harm to the landlord's reputation.

LANDLORD/TENANT; TENANT LIABILITY FOR INJURY TO PROPERTY; NEGLIGENCE; SUB-ROGATION: Tenant is not liable for negligently causing a fire unless the parties' contract expressly provides for tenant liability in the event of damage caused by a fire. ***Cincinnati Insurance Company v. Elda DuPlessis, 848 N.E.2d 220 (Ill. App. 2 Dist. 2006).***

Landlord's insurer, which had paid landlord for fire damages to landlord's property, sued tenant DuPlessis, alleging her negligence caused the fire. DuPlessis argued, that absent express contractual language, a tenant is not liable for damage resulting from negligently causing a fire. The Appellate Court of Illinois agreed, citing *Dix Mutual Insurance Co. v. LaFramboise*, 597 N.E.2d 622 (1992)in holding that a tenant is not liable for negligently causing a fire unless express contractual language provides for liability. *Dix* involved a written lease, which the court examined to determine whether there was an allocation of responsibility. The instant case involved only an oral lease, but the court held that this was a distinction without a difference, carefully interpreting the language of *Dix* and basically broadening it.

Dix had been based on two independent rationales: First, the court held that a tenant entering a lease that is silent as to liability resulting from fire damage would not understand that the tenant might be required to pay thousands of additional dollars to a landlord in the event of a fire. Consequently, the court ruled, the court will not impose such liability, notwithstanding its acknowledgment of the general rule that where the lease is silent, a tenant is liable for negligently caused fires. Note that this aspect of the ruling applied to claims by the landlord itself, and did not involve a subrogated insurer.

The plaintiffs in the instant action urged the court to credit other language in the *Dix* opinion that suggested that the common law rule was that tenants are liable for negligence, suggesting that *Dix* had carved out a narrow exception to that rule, based upon a close reading of the lease in that case. The court disagreed. Although it acknowledged that the court had stated the general old common law rule, it had basically "stood the common law rule on its head," more or less abrogating it in Illinois for residential leases unless the lease is clear that the parties have shifted liability to the tenant for tenant's negligence.

Second, the court ruled that the landlord most likely passes the cost of home owner's insurance onto the tenant and therefore in effect the tenant is a coinsured with the landlord and can expect to benefit from this coverage. This analysis, of course, is relevant only to subrogation claims.

Since the parties in the instant case had not expressly agreed upon tenant liability for damage resulting from a fire, the Court affirmed the judgment of the circuit court dismissing the plaintiff's complaint.

Comment 1: The ruling as to subrogation is consistent with a growing common law majority, but there are significant departures, perhaps most notably in New York. The scores of recent cases are analyzed in the most recent supplement to Friedman on Leases, set forth as new Section 9.11. The older rule is still discussed in Section 9.10.

Comment 2: The rationale regarding the parties' anticipated responsibilities makes sense, perhaps in the residential context, but can it really be said that a commercial tenant ought to feel safe in assuming that it is not liable to landlord for its own negligence? The instant case appears to be limited to residential settings, and that's where it should stay, at least as to claims by the landlord.

As to subrogation claims, even the commercial tenant has the argument that the rental is set where it is in order for the landlord to acquire insurance, and that consequently the cost of acquiring the insurance is actually born by the tenant, who therefore ought to benefit from the coverage. Most of the "implied waiver of subrogation" cases to not draw a distinction between residential and commercial tenants, although it must be admitted that most of the cases involve residential tenancies, if only because allocation of the risk of loss and waiver of subrogation commonly are addressed specifically in commercial leases.

LIENS; EQUITABLE LIENS: Under Florida's constitutional homestead protection, a court may not impose either a legal or equitable lien upon homestead property for violation of code requirements, even when the owners have "egregiously" failed to comply with an injunction to carry out the code requirements. ***Pelecanos v. City of Hallandale Beach, 914 S. 2d 1044 (Fla. App. 2005),*** discussed under the heading: "Homestead; Municipal Liens."

: While the sale of real property by a vendor to a third party precludes an order of specific performance for purchasers, the election of remedies doctrine does not bar purchasers from seeking legal damages.

LIS PENDENS; **APPEALS:** Where a trial court denies specific performance, buyer must seek suspension of the court's order pending an appeal (usually involving an appeal bond) or the seller is able to discharge any pending *lis pendens* and transfer title, even to parties with knowledge of the lawsuit and possible appeal. ***UFG, LLC v. Southwest Corp., 848 N.E. 2d 353 (Ind. App. 2006)*** , discussed under the heading: "Vendor /Purchaser; Specific Performance; Election of Remedies."

LIS PENDENS; **AVAILABILITY:** The denial of a memorandum of lis pendens can properly be appealed under G.L. c. 231, § 118, but a lis pendens will not be granted in the absence of an attachment or other encumbrance. ***Shrewsbury v. Seaport Partners Limited Partnership, 826 N.E.2d 203 (Mass. App. Ct. 2005).***

Trustees of the Seaport Condominium at Marina Bay (the "Condominium") filed suit against the"Developer, and the general partner of the Developer, and Seaport Condominium at Marina Bay, Inc. as the initial trustee of the condominium (the "Initial Trustee") (collectively, the "Defendants").

The Trustees alleged deficiencies and defects in the common elements of the Condominium, failure to construct in a good and workmanlike manner, failure to comply with building code requirements, failure to remedy or cure such defects, and fraudulent transfer.

Trustees alleged that ownership of eight units in the Condominium was transferred from the Developer to entities controlled by Mitchell B. Robbins, who was a principal in both the General Partner and the Developer, for the purpose of defrauding creditors such as the Trustees. Along with other actions, the Trustees moved for authorization to record a memorandum of *lis pendens*. The Superior Court ruled that a fraudulent transfer claim does not qualify under the *lis pendens* statute, G.L. c. 184, § 15.

The Trustees filed an interlocutory appeal, and the Defendants, in addition to opposing the appeal, argued that such an appeal is barred by statute. The Appeals Court found that while G.L. c. 184, § 15 does specifically provide for an appeal by a party denied a *lis pendens* in an *ex parte* hearing, the fact that it omits any other scenario for appeal does not bar such appeals. Rather, in other situations, appeal from a denial of a *lis pendens* is controlled by G.L. c. 231, § 118, which provides a broader right to interlocutory appeal. As such the Trustees' appeal of the denial was proper, although on the merits the Appeals Court denied the appeal.

The court found that G.L. c. 184, § 15 allows the recording of a memorandum of *lis pendens* only where the proceeding "affects the title to real property or the use and occupation thereof." Here, the Trustees' claim was that they might have the right to cause the property to be reconveyed back the Developer at a future date in order to satisfy a judgment. They did not have any actual attachment or encumbrance, and thus were not in a position to move in advance for enforcement. The Superior Court's ruling was upheld.

MARITAL PROPERTY; TENANCY BY THE ENTIRETIES; MORTGAGES; VALIDITY: Where spouse executes a mortgage of property held by entireties, but the granting clause indicates that the mortgage is given by the other spouse only and that mortgage property is his sole property, and the mortgage secures a loan to that other spouse, the non-borrower spouse's signature does not bind her to the mortgage, and the mortgage is void when the borrower spouse dies. ***Ethridge v. Tierone Bank, 2006 WL. 1280957 (Mo. App. 5/11/06) (not yet released for publication.)***

Husband and wife owned property as tenants by entireties. H, who ran the finances for the family, resolved to pay off the first mortgage and obtain funds to remodel an artist's studio into a rental. The lender prepared documents by which husband alone borrowed the money. The deed of trust, consistent with that notion, stated that the property was owned by H, a married man, as his separate property, and there was only a signature line for him. It also had standard language warranting that the grantor of the deed owned the property.

The title report showed the wife's interest, and in fact the wife showed up at the closing. The closing agent (a non-lawyer), noticing the discrepancy between the title report and the deed of trust, asked the wife to execute the deed of trust, which she did, knowing what she was doing and why.

Later, husband died and the wife stopped payment on the note. She pointed out that she had never executed the note, and claimed that the deed of trust was invalid as to her. The court granted summary judgment for the wife, finding the deed of trust invalid as to her, and the lender appealed.

The appeals court here concluded that there was no ambiguity in the signature process, and that there was no question that the wife executed the deed of trust in order to demonstrate that she was "joining" in the deed of trust. Nevertheless, the court agreed with the trial court that the deed of trust did not bind the entireties property because the granting clause failed to indicate the purpose of binding the spouse's entireties interest.

Here is what the court said about the signature:

> ". . . Mary would have been required to "join" in the Deed of Trust, even though the real estate was David's separate property [in light of Missouri's marital rights statutes]. Mary's act of signing and acknowledging the Deed of Trust would have been sufficient to show that she joined in a deed conveying real estate solely owned by her husband. . . . To demonstrate her joinder in the Deed of Trust, it was not necessary that she also be named as a grantor. Furthermore, Mary's execution of the Deed of Trust to convey whatever marital rights she possessed in her husband's separate property would not have caused her to be bound by the covenant of title contained therein. . . . As drafted and executed, the Deed of Trust appears on its face to show that David, acting as the grantor, conveyed real estate solely and separately owned by him and that his wife, Mary, signed the instrument to show her joinder in the Deed of Trust. Accordingly, we do not find the terms of this instrument are susceptible of more than one meaning so as to create an ambiguity.
>
> What the Deed of Trust purported to do, however, is not determinative of what it actually accomplished. The record discloses without dispute that David and Mary owned the real estate as tenants by the entirety. While the Deed of Trust was not ambiguous, it also was not a valid conveyance because, as the trial court correctly observed, Mary was not named as one of the grantors."

According to the court, this argument compelled a finding that there was no ambiguity, and thus there was no possible interpretation of the document other than that the wife was simply waiving her interest in the husband's separate property. The fact that the husband had no separate property (since the property in fact was in tenancy by the entireties) didn't matter. And Missouri law was quite specific that a granting clause must accurately state the interest conveyed. Unless the granting clause stated that the property was a tenancy by the entireties, the court could not construe the document as conveying a mortgage on the interest.

Under Missouri law, then, the mortgage would have been void even as to the husband's interest, since Missouri has that "slippery" kind of tenancy by the entireties that one cotenant has no power to mortgage.

But the court nevertheless reversed summary judgment for the wife because, by granting summary judgment, the trial court also had rejected the lender's claim that it was entitled to equitable subrogation to the position of the first lender that its loan proceeds had paid.

The court concluded that, since equitable subrogation is an equitable doctrine, it is still available even when the legal documents are inadequate to create an interest. The case is not a typical equitable subrogation case, since there is no issue of priority. But equitable subrogation can also be used to avoid unjust enrichment. Here, if equitable subrogation were to be denied, the wife would wind up with a release from the purchase money debt on the property while the lender suffered an inequitable loss.

Most remarkable about the opinion is footnote 7, in which the court notes that the lender's other claims, that the deed of trust should be reformed or that the wife was equitable estopped from denying the validity of the deed of trust, were still alive. The fact that the court did not discuss them on appeal did not mean that it viewed the trial court's summary judgment on these issues to be correct.

Comment: The appeals court ruling on equitable subrogation seems correct. But why in the world didn't it proceed to consider the reformation and estoppel arguments raised by the lender? These would have resolved the case more clearly, and the lender's arguments here seem quite plain. Perhaps the court wanted the trial court to look more carefully at the factual support for these arguments now that it has concluded that equitable arguments are appropriate here.

Ambiguity, of course, is not necessary for a court to grant reformation. There can be an unambiguous document, but the court can still conclude that it is not the right document to carry out the parties' intended purpose. This seems to be evident here.

Estoppel also seems appropriate, based upon unjust enrichment. The wife knowingly accepted the proceeds and they were invested in improvement of her residence to create a rental unit out of an abandoned studio. We'll have to wait and see, one supposes, on these issues. But the editor suspects that the court is hoping that the lender will accept "half a loaf" and take the subrogated claim and not push any harder to punish the widow. Maybe this was rough country justice, but it was hardly good precedent for our commercial system.

MORTAGES; DEFICIENCIES; STATUTE OF LIMITATIONS: A mortgagee has the full mortgage period of limitations to claim a deficiency despite an earlier foreclosure sale. ***The Cadle Company v Dejadon, 2006 Westlaw 1042083 (New Hampshire 4/21/06)***, discussed under the heading "Statute of Limitations; Mortgage Notes."

MORTGAGES; EQUITABLE SUBROGATION; EQUITIES OF SUBROGATING LENDER; VOID MORTGAGE: Where lender's mortgage is void because of failure to comply with Texas home equity loan restrictions, lender nevertheless will be subrogated to the lien of the mortgage it refinanced. ***LaSalle Bank N.A. v. White, 2006 WL 1152337 (Tex. App. 5/3/06) (not yet released for publication)***

The Texas constitution prohibits use of a home equity loan on homestead agricultural property. The kind of agricultural property that is protected is outlined in the Texas statutes. Lender, asked to refinance a first mortgage loan on certain property used for agricultural purposes, but was assured that the property would be reclassified so that it did not fall under the home equity prohibition. The lender advanced $266,000, of which $185,000 was used to finance the original purchase money mortgage.

Later, when the borrower defaulted, the borrower argued that the mortgage was void because it was illegal under the Texas Constitution. The court agreed, interpreting the statutory categories protected by the Constitutional restriction more broadly than the lender would have liked. Nevertheless, the court held that this lender, that had made an illegal mortgage loan, nevertheless could benefit from equitable subrogation. Thus, its position was protected to the amount of the original first mortgage refinanced.

The court noted that to hold that a void homestead mortgage could not be the subject of equitable subrogation might frustrate the ability of a homesteader to get good loans.

> "To hold otherwise, in fact, would defeat the very purposes of the homestaed protection. Homestead owners must have the ability to renew, rearrange, and readjust the encumbering obligation to prevent a loss of the homestead through foreclosure."

Hmmmmm.

Comment 1: Note that the borrower wasn't estopped from asserting the invalidity defense because she was not the party who failed to reclassify the property. She requested reclassification, but the ball got dropped, apparently, by the local County appraiser, as reported by The Title Insurance Law Newsletter in its June, 2006 edition.

Comment 2: For another case involving subrogation following the voiding of a mortgage, see ***Ethridge v. Tierone Bank, 2006 WL. 1280957 (Mo. App. 5/11/06),*** discussed under the heading "Tenancy by the Entirety; Mortgages," the DD for 8/16/06..

MORTGAGES; EQUITABLE SUBROGATION; EQUITIES OF SUBROGATING LENDER; NEGLIGENCE: Lender that refinances prior loan after intervening loan is recorded only five days before recording of refinancing mortgage is not negligent in failing to identify intervening loan, and is entitled to equitable subrogation. ***GMAC v. Massimo, Docket No. F-5394-05 (Sup. Ct. N.J., Cancery Division, Somerset, Hunterdon & Warren Counties, 5/26/06)***

Although only a trial court decision, this case has some interesting facts worth noting in this rapidly developing area.

Borrower had mortgaged his property first to Ivy, and only a few months later executed another mortgage to Advantage. A year later, Borrower wished to refinance the Ivy Mortgage, and Advantage agreed to cancel and later rerecord its mortgage so that Ivy could record a new, refinance mortgage. Apparently Ivy did so. Borrower then executed a new mortgage in favor of Advantage in November, 2002, but advantage didn't record it until May, 2003.

After the first refinancing with Ivy was complete, Borrower, seeing that rates were still dropping, asked if Advantage would refinance the Ivy mortgage. Advantage, perhaps because it was not in the business of being a first lien lender, referred Borrower to GMAC. GMAC then refinanced the Ivy Mortgage Five days after the this refinancing, Advantage recorded. GMAC did not record its mortgage until a few weeks after that.

Thus, at the time that GMAC refinanced the Ivy mortgage, Advantage had a lien on the property. After Borrower stiffed everybody, Advantage claimed it had a lien prior to that of GMAC.

The court noted that the agreement that Advantage had made to withdraw its mortgage from the record to facilitate refinancing of the Ivy loan was an agreement that did not include GMAC, and GMAC was not an intended beneficiary. Therefore, there was no contract subordination.

But GMAC claimed a right of equitable subrogation to the amount of the Ivy mortgage that it had refinanced, approximately $502,000 of its total $606,000 loan. The court agreed. It noted that in New Jersey, equitable subrogation is not available to a negligent lender. But Borrower had warranted to GMAC that there were no prior mortgages on the property, and apparently the court was of the view that it was too much to expect GMAC to be on notice of a mortgage that had been recorded only five days before it refinanced the Ivy mortgage.

Comment 1: Although the court states that GMAC's mortgage in fact secures $502,000 in a position prior to Advantage, the classic rule would be that GMAC is subrogated to Ivy's mortgage, including Ivy's terms.. But if this technical distinction likely is moot where the whole property is in foreclosure and the terms of the mortgages are not materially different for these purposes.

Comment 2: Keeping in mind that the real party in interest here likely is the title insurer that insured GMAC's priority, is it appropriate to conclude that a lender should be aware of documents recorded five days earlier than its deal? Well, doesn't that depend upon the indexing practices of the local recorder, the standards of the trade, and the care taken by the title examiner? If we say that the Lender's practices are at issue, and not those of its title examiner, then we should only look to whether it retained a title company to search title and insure. The court seems to be of the view that the state of the record matters, and that the bank is not scot free just by relying on a title insurer. But where do we go from there?

MORTGAGES; FRAUD: The recording of a deliberately misleading mortgage instrument in the public record constitutes actionable mortgage fraud, even though there is no direct communication of a fraudulent statement to the victim of the fraud. ***ABN AMRO Mortgage Group, Inc. v. Maximum Mortgage, 2006 WL 1128648 (N.D. Ind. 4/26/06)***

This case is still alive, and in the pleadings stage. The allegations of the complaint are that Wells inveigled ABN/AMRO to make a series of mortgages through a Wells-controlled mortgage broker. The loans were purchase money mortgages, but Wells and related entities made it appear to ABN/AMRO's that they were refinancing mortgages. ABN/AMRO contended that it would not have made the loans had it known that they were purchase money mortgages, perhaps on the theory that there was less liklihood of artificial inflation in value when the original purchase money loan had "ripened" for a while and then was refinanced. In fact, these acquisitions were 100% debt financed. ABN/AMRO would never had loaned 100% of the purchase price of the properties, but was led to believe it was refinancing loans already made on properties of a value higher than the amount of the mortgages.

The 149 loans were made to two different borrowers. All of the properties, apparently, were owned originally by Wells (or Wells controlled entities) and being sold to the borrowers as part of single overall transaction. The court refers to the borrowers themselves as "innocent" of the fraud. During the course of the transaction, however, Wells allegedly induced these borrowers to execute mortgages to a Wells-controlled entity. These mortgages actually did not secure any loan, because the mortgagee – the Wells- controlled entity, did not advance any funds. Instead, these mortgages were recorded to create the appearance that the loans later made by ABN/AMRO were refinancing these loans rather than financing the original purchase of the property. (The court's sketchy report in this opinion on the pleadings doesn't indicate the sequence of dates during which all this occurred. It may be difficult for ABN/AMRO ultimately to prove that it in fact was defrauded and suffered losses as a consequence – but that's for later.)

Apparently there is no allegation that Wells made any express representation to ABN/AMRO that it was making refinancing loans. The only act that Wells took was to cause the execution and recording of these "phony" mortgages in the land records. The question at issue in this case is whether such acts could constitute a fraudulent representation within the meaning of Indiana's civil fraud law. The court held that they could, even though Indiana fraud pleadings have to be made with some particularity.

ABN/AMRO began by alleging that Wells controlled all the "Wells entities" and that their actions were attributable to him. The court agreed that such an allegation was an acceptable basis for a fraud complaint here, where each of the actions, regardless of what entity performed them, was alleged to have been performed in fact by Wells.

Some of the alleged fraudulent representations were in fact made directly by Wells or his alleged co-conspirators to ABN/AMRO – such as representations as to the date that the properties in question were acquired, representations as to acquisition price, and representations as to income from the properties – all contained on loan applications. It is interesting that the court refers to the owner/loan applicants as "innocent," as this would suggest that their loan applications were "doctored" after they provided them.

But, apparently concerned that all of the above misrepresentations might not be pinned on Wells, as opposed to the other conspirators, ABN/AMRO also focused on the public recordation of the phony mortgages (from the borrowers to Wells) as an independent fraudulent act. Finding these mortgages in the record, ABN/AMRO apparently funded into escrow monies to pay these mortgages, which monies apparently were then allegedly used instead, directly or indirectly, to acquire the properties.

The court held that, if true, these allegations described a direct fraudulent communication from Wells to ABN/AMRO, since they were intended to lead ABN/AMRO to believe that it was refunding existing mortgages. The fact that the communication was made indirectly through the title company's report of the record to ABN/AMRO did not prevent this from being a deliberate communication.

Finally, Wells argued that ABN/AMRO had not suffered losses due to the fraud, but rather to the subsequent default of the borrowers. The court responded that the exposure to loss occasioned by inducement of ABN/AMRO to make loans it otherwise wouldn't have made was a direct cause of it's loss.

Comment 1: Just in case the editor hasn't said "allegedly" often enough above, he reiterates that Wells and his co-defendants may prove to be as pure and innocent as driven snow. All we know are allegations in a lawsuit – words on a page. The allegations are discussed in order to understand the legal issues.

Comment 2: Apparently there are lots of ways to sue for fraud in Indiana, and some provide better avenues for relief than others – such as the bank fraud statute. This elaborate exercise was designed to invoke the elements of the appropriate statutes so that ABN/AMRO could pursue its claims with greatest advantage.

MORTGAGES; GUARANTEES; DISCHARGE; ALTERATION OF OBLIGATION:: The execution of an escrow agreement implementing a purchase contract results in a novation that releases guarantor if the changes are "material," even if the changes potentially operate to the benefit of the guarantor. ***Thomas-Sears v. Morris, 2006 WL 573293 (Ga.App., March 10, 2006)***, discussed under the heading: "Guarantees; Discharge; Alteration of Obligation."

MORTGAGES; PREPAYMENT; "LOCK OUT:" A lock-out clause that prohibits prepayment without the lender's consent, may not be enforceable***. Littlejohn v. Parrish, 839 N.E.2d 49 (Ohio Ct.App. 2005)***

The mortgage in question was held by an individual mortgagee, not an institution, and the mortgagee insisted on language that stated that the mortgage could not be prepaid without the mortgagee's consent. Note that if the mortgagee had been well advised, it might have left the instrument alone, since in most states, including Ohio, the "perfect tender in time" rule is that a note cannot be prepaid unless the document expressly provides for prepayment rights.

The trial judge held that the lenders under this language had the right to refuse prepayment. Note that the note was high, at 9 %, and still had three years to run. The mortgagee had refused a cash premium in an undisclosed amount to accept prepayment. On the other hand, the mortgagee had permitted the borrowers to substitute security a number of times.

In reversing the trial court, the Ohio Court of Appeals made a number of analytic leaps to conclude that the borrower ought to have the right of reasonable prepayment. In doing so, it upset a number of other apple carts that ought to give Ohio lawyers fits. Ironically, in the end it remanded with a comment that it doubted that

The court held that ever contract in Ohio contains an implied covenant of good faith and fair dealing, even mortgage contracts (although it declined to conclude that such duty would sound in tort.) Under this duty, the mortgagees here had a obligation to consider the requests for prepayment, and to accept them if they were accompanied by a reasonable offer of a fee to represent the lenders' damages. The court noted:

> "[A]nything involving only money can be reduced to present value. That is, a nine percent interest rate on the remaining balance payable over the remaining period can be valued and used to pay off the loan reasonably. If this was offered and refused, then the [lenders] were not dealing fairly, and their refusal to release the loan would have been an unreasonable restraint on alienation. If the [borrowers] simply insisted on paying off the loan without accounting for the now generous interest rate, then their actions were unreasonable. The trier of fact should be able to figure this out."

As indicated, the court record does not show whether a proper premium had ever been offered, and thus the case was remanded.

The court, however spent a good part of the opinion dwelling on the question of whether there ought to be an analogy between the prepayment situation and the question of whether a landlord has an implied duty of good faith to consent to an assignment or sublease under a clause giving the landlord the right to withhold consent, but not stating that consent can be arbitrarily withheld. The court acknowledged that a 2-1 Ohio appeals court decision about 20 years ago upheld the landlord's right in such cases, but opined here that it thought the dissenter correct when he argued that the Restatement rule ought to apply, which requires the landlord to be reasonable except when a "freely negotiated" provision in the lease gives the landlord the right to be arbitrary.

Comment 1: The editor is not certain that the universal rule is that lenders owe to borrowers a duty of good faith and fair dealing in financial papers. But he believes that the general recognition of such a duty likely is consistent with developing precedent.

Comment 2: According to mortgage law maven Dale Whitman, this case is "an extremely unusual holding" … "a rare case." Keep in mind, however, that part of what makes it rare is the amateur language of the prepayment language. An institutional prepayment clause would give the borrower the right to prepay only upon payment of a premium, or else it would deny prepayment entirely. There is no reason for the lender to reserve discretion. Of course, the lender has discretion even if the note doesn't say so, but such unstated discretion typically does not give rise to a duty of good faith. For a post-*Littlejohn* case upholding this principle, but otherwise unrelated to the facts here, see *Diamond Triumph Auto Glass v. Safelite Auto Glass Corp., 2006 Westlaw 2129493* (M.D. Penn. 7/31/06) (applying Pennsylvania and Ohio law and limiting the reach of *Littlejohn*).

Comment 3: In the area of lease assignments, however, courts around the country have recognized that the very well established precedent has been that landlords do have the right to be unreasonable in refusing to consent when they have a right to consent to assignments or sublets. The court's assertion in this case that the law is trending the other way is a myth propounded by thoughtless law professors who would like the law to be as they want it, rather than as it is. Because of this sloppiness, the editor believes that ultimately landlords will lose the battle here. Most likely this simply will require much clearer language protecting the landlord's discretion (and that's not such a bad thing.). But for an analysis of the "non trend" see the editor's piece on the DIRT website, which notes that there have been just as many recent cases denying the duty of good faith in the lease assignment situation as there are finding that such a duty exists. http://dirt.umkc.edu/files.htm#pat The piece is twelve years old, but the editor has been watching the case law, and writing about it in Friedman on Leases. There hasn't been much change.

Bankruptcy courts strike down recorded documents as "unperfected" due to technical deficiencies in execution and notarization.

MORTGAGES; PREPAYMENT; PREPAYMENT PREMIUM; ACCELERATION;: Express bargained-for provision in promissory note that acceleration of the debt constitutes an involuntary prepayment requiring payment of the prepayment premium, is enforceable. ***Feinstein v. New Bethel Missionary Baptist, 2006 Fla. App. LEXIS 14624, Sept. 1, 2006***

The mortgage in question was held by an individual mortgagee, who obtained it through an assignment from an institution, GMAC. The promissory note prohibited partial prepayments, but permitted prepayment in full under a "declining rate" schedule during the first four years of the loan. If the mortgagor had sought to prepay the note in September, 2004, the required prepayment fee would be $12,328 (four percent of the original principal balance). But instead, the mortgagor at that time defaulted under the mortgage in an apparent (and foolish) attempt to avoid payment of the prepayment premium.

Unfortunately for the mortgagor, the note contained an express provision stating that acceleration of the debt "constitutes an involuntary prepayment for which the prepayment fee provided for elsewhere herein shall be due and payable. This clause was bargained for as consideration for the extension of credit based upon the interest rate granted by lender".

Because the promissory note contained an explicit provision providing for the imposition of a prepayment fee upon acceleration, the Florida appellate court reversed the trial court's foreclosure ruling, which had refused to let the mortgagee collect the prepayment premium as part of its damages. Although acknowledging that it was "unable to find a Florida case that expressly so holds", the appellate court (citing applicable Florida case law) noted that "both the Florida Supreme Court and this court have indicated that such would be its holding if presented with our facts".

This holding by the appellate court is certainly not surprising, based on the fact that almost all courts that have faced this issue have ruled similarly, where the note and/or mortgage contained language similar to that set forth in the note in this case, with respect to acceleration constituting an involuntary payment of the debt and requiring payment of the prepayment premium.

What is unusual about this case is that the mortgagee "satisfied the judgment on appeal, which satisfaction was "recorded between the date of the final [foreclosure] judgment and the date scheduled for the foreclosure sale." This was done because the mortgagor obtained "eleventh-hour" refinancing to satisfy the foreclosure judgment and retain title to the property (apparently another ploy by the mortgagor to avoid payment of the prepayment premium). Therefore, according to the court, "[The mortgagee] was required by [Florida] law to satisfy the judgment" within 60 days of receipt of payment (thirty days under the law in effect at the time).Failure to do so is (according to the court upon citing to the applicable statute) considered a misdemeanor under Florida law.

The court noted that in Florida the general rule is that if a defendant voluntarily pays an adverse judgment against him "the case is moot; but, if the payment is involuntary, it does not result in a waiver of the right to appeal."Although the court acknowledged that the general rule may not apply to a situation such as occurred in this case, where the plaintiff has satisfied a judgment, "we need not reach that issue because it is clear [the mortgagee] was required by law to satisfy the judgment, placing this case in the 'involuntary' category." . The appellate court therefore reversed the final judgment of foreclosure entered by the court below and ordered that it be amended to include the prepayment premium.

Reporter's Comment 1: This is another case of a mortgagor being "too cute by one-half." Try as it might, the mortgagor could not overcome the fact that the prepayment-premium language in the note was crystal clear. The court easily saw through and thwarted the borrower's attempt to avoid payment of the premium it had expressly bargained for. The attempt by the mortgagor to prepay after entry of the judgment and force the mortgagee to record a release (upon penalty of being slapped with a misdemeanor) was especially crafty (and idiotic).

Reporter's Comment 2: Prepayment provisions, both yield-maintenance and otherwise (including "declining rate" clauses), have often been challenged in the past by borrowers on the basis that the prepayment was "involuntary" and therefore not covered by the provision. Intelligent lenders long ago learned, from a drafting standpoint, to specifically state, in the prepayment provision contained in the loan documents, that the lender will be entitled to collect the contracted-for prepayment premium in the event of an acceleration of the loan upon default by the borrower.

Courts have almost universally upheld the enforceability of a prepayment provision where the clause clearly states that it applies if the loan is accelerated as the result of the mortgagor's default under any of the terms and conditions of the loan documents. *See, e.g., Parker Plaza West Partners v. UNUM Pension and Ins. Co.*, 941 F.2d 349 (5th Cir. 1991); *AE Venture v. GMAC Commercial Mortgage Corp.*, 2006 U.S. Dist. LEXIS 2040 (Jan. 26, 2006)

Reporter's Comment 3: But if the right to collect a prepayment premium upon acceleration of the loan is not clearly stated in the loan documents, courts generally will not permit the lender to collect it. *See, e.g., In re LHD Realty Corp.*, 726 F. 2d 327, 330 (7th Cir. 1984) (refusing to permit the lender to collect prepayment premium after borrower's default because prepayment clause did not clearly provide that premium could be collected upon acceleration after default); *In re McMurray*, 218 B.R. 867, 874 (Bankr. E.D. Tenn. 1998) ("Prepayment and acceleration are not synonymous, but are diametrically opposite").

Reporter's Comment 4: See also Restatement (Third) of Property: Mortgages § 6.2 comment c (1997) (permitting collection of prepayment premium upon acceleration of the loan unless found to be "unconscionable or to violate the duty of good faith and fair dealing"); Annotation, Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt, 86 A.L.R. 3d 599 (2003).

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

MORTGAGES; PREPAYMENT; PREPAYMENT PREMIUM; ACCELERATION: A payment of a loan balance following default and acceleration is not a "prepayment," and therefore a prepayment premium clause characterizing the payment due following acceleration as a "prepayment" and not a "repayment" is not enforceable. ***The Northwestern Mutual Life Insurance Company v. Uniondale Realty Associates,11 Misc.3d 980, 816 N.Y.S.2d 831 (N.Y.App. 2006)***

The note in question, drafted in 1996 or thereabout, contained a relatively standard prepayment clause for that time:

> "Borrower shall have the right, upon thirty (30) days advance written notice, beginning December 15, 2003 of paying this note in full with a prepayment fee. This fee represents consideration to Lender for loss of yield and reinvestment costs. The fee shall be the greater of Yield Maintenance or 2% of the outstanding

> principal balance of this note on the date of prepayment (emphasis supplied)."

But the note also included a novel statement concerning the obligation to pay the prepayment premium following default and acceleration:

> "In the event of a prepayment of this note following (i) the occurrence of an Event of Default . . . followed by the acceleration of the whole indebtedness evidenced by this note . . . such prepayment will constitute an evasion of the prepayment terms . . . and be deemed to be a voluntary prepayment . . . and such payment will, therefore, . . . include the prepayment fee required under the prepayment in full privilege recited above . . . "

Perhaps this language was inserted because of some uncertainty about whether a court would enforce a prepayment penalty following an acceleration and default. We don't know, but clearly it turned out to be an unfortunate phrasing. The interest rate on the note was 8.16%, and the default rate was 13.16%, and the claimed prepayment premium on a $11 million loan exceeded $2 million.

The court stated that the apparent purpose of the language of the clause was to impose a prepayment penalty when the borrower adopted the tactic of initiating a default solely to induce an acceleration and thus preclude a prepayment premium:

> "The court concludes that the latter quoted clause is intended to prevent evasion of the premium required for prepayment simply on grounds that a default and acceleration have occurred, or that the prepayment is involuntary. Those instances where a prepayment is considered involuntary, e.g. a sale in condemnation, are not at issue here [citation omitted]. The function indicated by the language used, particularly the word "evasion" which means "to escape or avoid, especially by cunning or trickery" (WordPerfect dictionary), is to prevent avoidance of the premium by an intentional default. In relevant part, the thrust of the evasion clause is to penalize any attempt on the part of the borrower to prepay without including paying the premium."

The court admitted that, under modern authority, an attempt to evade a prepayment premium by such a tactic would be viewed as triggering a "standard" prepayment premium clause, even if it did not refer to acceleration, and cited cases so holding. It further admitted that, under the most recent articulated view, a prepayment premium clause that applied to acceleration following *any* default, voluntary or involuntary, would be enforced as liquidated damages if it met the "fair estimate" test. Thus, the lender might have phrased its prepayment penalty language more broadly and have succeeded, since its yield maintenance clause probably would have met the "fair estimate" test in most jurisdictions (query whether the alternative 2% premium would have done so.)

Significantly, the court here cautioned New York lenders that it is not confident that a yield maintenance liquidated damages clause would succeed in New York:

> "Because both actual and liquidated damages are recoverable damages when the predicate for the awards "differ in kind" [citations omitted], if it is possible to ascertain actual damages for unaccrued interest, liquidated damages for costs in relending, which may be difficult to estimate, can be provided for separately. These issues have not been addressed in a State of New York court. The question crucial to a "yield maintenance" recovery in foreclosure in New York, is whether the court will enforce an agreement which provides for collection pursuant to a formula which frequently and significantly allows for a sum greater than that contracted for, i.e., accrued and unaccrued interest plus liquidated damages to cover the cost of relending, in addition to other penalties in foreclosure such as late payment fees and default interest rates. The question raised by defendant Uniondale also is significant, as New York does not permit collection of unearned (unaccrued) interest as damages after acceleration [citation omitted] Such questions would present themselves if the subject clause were worded differently. However, this court need not reach such issues at this time, as the subject clause is not applicable in foreclosure."

But, as the court indicated above, the court decided it was not necessary to reach the general question of enforcement of prepayment liquidated damages provisions in New York, since it interpreted the clause in question as not supporting the imposition of a prepayment premium here. The court stated that *"[t]he wording of the subject clause does not reveal any intent to provide for enforcement in foreclosure,* whether in redemption or sale, particularly when compared to other post acceleration liquidated damages clauses providing for collection of a yield maintenance premium." (Emphasis in the original.)

To demonstrate the difference between the instant clause and one that, in the view of the court, might satisfy as a an appropriate requirement for liquidated damages, the court included the text of several model clauses, including the following, which it particularly commended:

> "(a) Any tender of payment by Borrower or any other person or entity of the Secured Indebtedness, other than as expressly provided in the Loan Documents, shall constitute a prohibited prepayment. If a prepayment of all or any part of the Secured Indebtedness is made following (i) an Event of Default and an acceleration of the Maturity Date, (ii) the application of money to the principal of the Loan after a casualty or condemnation, or (iii) in connection with a purchase of the Property or a repayment of the Secured Indebtedness at any time before, during or after, a judicial or non-judicial foreclosure or sale of the Property, then to compensate Holder for the loss of the investment, Borrower shall pay an amount equal to the Prepayment Fee."

The feature differentiating this clause and the other model clauses and the clause under review, the court contended, is that the comparison clauses all provide that the premium is automatically payable, or payable at option of the mortgagee, immediately upon default and acceleration. The clause in question, however, does not state expressly when the prepayment clause is triggered. This led the court to conclude that the prepayment premium is triggered only upon redemption or payment from foreclosure proceeds, and at these times the debt is already accelerated, so there technically could be no "prepayment."

The court acknowledged that the probable purpose of the clause was to preclude deliberate defaults to avoid prepayment premiums, but indicated that there was no evidence that this was the case here (the mortgagor lost a prime tenant) and stated that, in any event, no special language would be necessary to apply the premium in the event of a clear attempt to evade (as stated above.) Thus, the language here was a superfluity and a nullity. The lender took nothing by it.

The court also indicated another concern, one that the editor finds somewhat obscure, having to do with New York procedure. It contended that the foreclosure referee would be unable to set a redemption price including the premium, because the premium could not be computed until the redemption were made. Hmmmm.

Comment: So it appears mortgagee's counsel was "too clever by half" in drafting this clause. It would have been better off just using the meat cleaver approach, declaring a premium payable on every prepayment, voluntary or involuntary, and immediately collectible as liquidated damages upon acceleration.

MORTGAGES; PREPAYMENT; PREPAYMENT PREMIUM; "PENALTY" ANALYSIS: Federal judge concludes that standard yield maintenance clause using treasury rate as discount is invalid as a penalty in Illinois. ***River East Plaza, LLC v. The Variable Annuity Life Company, 2006 WL 278243 (N.D. Ill. 9/22/06)***

This case, obviously, is just in. The facts report a very common scenario that has happened around the country in the last few years, and likely will continue to happen, albeit with not quite the same "bite" as federal interest rates creep up.

Borrower entered into a $13 million, 20 year mortgage loan (amortized at a 28 year schedule, with a balloon) in 1999. The lender required a provision for a prepayment "fee" that required the borrower to pay, in connection with any prepayment, the greater of one percent of the then outstanding balance or, essentially, the present value of the interest payable for balance of the original loan term less what the lender could earn by reinvesting at the treasury rate prevailing at time of prepayment for the same term. The borrower was required to give 60 days notice prior to such prepayment.

Borrower had a chance to resell the property three years later, when $12.3 million of the loan was still outstanding. The buyer required that the loan be released, and, as there was apparently no defeasance clause, this meant the mortgage had to be paid. But treasury rates had plummeted, and continued to plummet as the parties discussed the deal. At the time of the sale, the estimated prepayment fee calculation was $3.8 million. The borrower balked, and discussions ensued, and the number just got bigger and bigger as treasuries dropped. Ultimately, the lender demanded, and the borrower paid, in protest, a prepayment fee of $4.76 million. (This was erroneously overstated, and a reduced claim was stipulated in the trial.)

The court found that Illinois, unlike most other states, analyzes prepayment premiums as a liquidated damages issue, rather than just a fee for a choice of an alternate payment schedule. In fact, some Illinois mortgage experts dispute this interpretation of Illinois law. Anticipating the liquidated damages construction, counsel for the lender refused to opine at the time of the loan that the prepayment language was enforceable, expressing the view to the other side that she regarded the fee as an unenforceable penalty.

The trial judge, relying on bankruptcy opinions in Kansas and Missouri (both of which have been generally discredited in their own jurisdictions) concluded that the prepayment fee was a penalty, and order a refund of the fee, less the one percent that the alternative fee calculation permitted the lender. Of course, the attorney's fees also will be a big number.

The court had before it, but did not cite, the federal district court opinion in In re CP Holdings, Inc., 2005 U.S. Dist. LEXIS 24461 (W.D. Mo. 9/30/2005), the DIRT DD for 11/05/05, affirming a bankruptcy court ruling in which the editor testified. (The prepayment – due to acceleration on default – was pre-filing, and state law liquidated damages analysis was used in that case.)

The court found that the lender should have fixed the hypothetical reinvestment rate at the same spread over treasuries that existed at the time that the loan was made. It pointed out that the lender did in fact reinvest monies in the same amount at or above that rate shortly after the prepayment.

Bite-your-tongue department: The Director or Mortgage Loans for the lender's parent is quoted by the court as testifying that the prepayment provision was "very, very punitive," serving only to punish nonperformance." The court dryly notes that it drew an adverse inference from the lender's failure to recall this witness to explain his remarks when it presented its case.

Comment 1: The editor believes, although the opinion doesn't say so, that this loan was securitized after it was made. In the *CP Holdings* case, the editor emphasized that repayment schedule, in addition to overall interest return, was critical, and that it would be a complex and difficult process to replace a prepaid loan with a set of investments that performed in the same way. If there is not a perfect match, some of the securitized investors could be wiped out completely.

Further, it is always difficult to project what the mortgage market will be in the future. A liquidated damages calculation doesn't have to be perfect, just a good try. Using the treasury rate uses a stable rate that gives some protection to the lender against the uncertain future.

Even a nonsecuritized loan is faced with uncertainty as to whether other real estate loans in fact present the same risks as the one prepaid. This was a nonrecourse loan on a building that became a Costco. Haven't we seen a lot of these "big boxes" empty around the country – former hardware superstores and the like? Each location presents different risks. Why isn't the lender entitled to some "play" in computing the risk of replacing the loan?

Comment 2: Some jurisdictions take a "second look" at the factors influencing the reasonableness of the liquidated damages computation at the time of default. This is a bad idea in general, but Illinois, the editor is informed, doesn't do that. So, although the lender may have reaped a windfall due to the index chosen when the loan was prepaid very early in a low interest market, this formula was going to operate long term, and likely wouldn't always have been so generous.

Comment 3: The question now for this lender, and significant for many others, is whether this decision – clearly out of step with what most lawyers now believe the law to be – should be appealed to the Seventh Circuit, inviting a possibly more authoritative affirmance or saving the day with a ringing reversal.

Comment 4: My own thought , when I heard the number – more than 30% of the loan balance, was that settlement was better than litigation. It is difficult to convince a trial court judge that such a large number is not punitive, no matter how much one talks about the uncertainties of money markets over a projected 20 year loan life. But maybe settlement just wasn't an available option. In fact, the lender had miscalculated the premium (its way) and was demanding an even higher amount than the court found the formula produced until after the suit was filed. But my thoughts were "after the fact" analysis. When you really think the law is on your side, even if the facts aren't, it's hard to tell your client to walk away from a $3.8 million claim.

MORTGAGES; STATUTE OF LIMITATIONS; DEFICIENCIES: A mortgagee has the full mortgage period of limitations to claim a deficiency despite an earlier foreclosure sale. ***The Cadle Company v Dejadon, 2006 Westlaw 1042083 (New Hampshire 4/21/06)***, discussed under the heading "Statute of Limitations; Mortgage Notes."

MORTGAGES; TENANCY BY THE ENTIRETIES; EXECUTION: Where spouse executes a mortgage of property held by entireties, but the granting clause indicates that the mortgage is given by the other spouse only and that mortgage property is his sole property, and the mortgage secures a loan to that other spouse, the non-borrower spouse's signature does not bind her to the mortgage, and the mortgage is void when the borrower spouse dies. ***Ethridge v. Tierone Bank, 2006 WL. 1280957 (Mo. App. 5/11/06) (not yet released for publication.)***, discussed under the heading: "Marital Property; Tenancy by the Entireties; Mortgages; Validity."

MORTGAGES; WASTE: Mortgagor's failure to conduct reasonable maintenance on roof constitutes tortious waste, not just a breach of contract (and collectible even where there is a judgment for the debt!!!) ***Wells Fargo v. Diamond Point Plaza, L.L.P. 2006 Westlaw 2788385 (Md. App. 9/29/06)***

This is still another issue arising in this case rich with issues, which has already been discussed in the DD for 9/4/06 under the heading "Landlord/Tenant; Commercial; Radius Clause." This aspect of the decision affirms an award of $1.9 million against the mortgagor for tortious waste for, inter alia, its failure to maintain and repair roofs at the shopping center.

Preliminarily, the editor must acknowledge some confusion here about the procedural posture of the waste claim. The opinion is voluminous, and perhaps the editor has missed something, but it does not appear that the mortgagee in fact foreclosed this loan, but rather began collecting the rents, sued for return of some inappropriately applied rents, and then sued everyone in sight for injury to it as well as for a judgment for the debt. It got a judgment against the borrower for the full amount of the loan, and against the principles of the borrower under the non-recourse "carve outs" also for the full amount of the loan (based upon their alleged fraud in representations made to the lender and its agents before the loan was made.) It also will get a huge attorney's fee award.

Given all of the above, it is difficult for the editor to see where a waste claim comes in. Perhaps the mortgagee included it as an alternative approach if the court did not permit it to invoke the "carve out" for fraud, thereby entirely avoiding the non-recourse provisions of the loan. But once the carve out was invoked (for pre-loan fraud – as indicated above), it would appear that the waste claim is moot.

A claim for waste normally can only be based upon a diminution in the value of the security to the injury of the secured party. But if the secured party already has a judgment against a waste defendant for the entire amount of the debt, then it would seem that such judgment would encompass entirely any waste claims. A tort claim for waste might be useful if the plaintiff were seeking punitive damages, but that is not the case here. Perhaps someone with familiarity with the case can clarify to the editor and his readers why there is even a waste claim here.

In addition, the court holds that the waste award is equal to the "costs to replace and repair the roofs that [mortgagor] failed to maintain." Again, the editor is befuddled, since this appears to say that the mortgagee gets these damages in addition to a judgment for the debt, as if it is the owner of the shopping center and the mortgagor injured it as owner. The mortgagee's interest in compensation for waste is only as a mortgagee.

The opinion is so sketchy on these items that the editor is hard pressed to describe what happened, but it does seem that what happened was unusual. The printed opinion in the editor's possession does not indicate who served as counsel for the mortgagee, but perhaps someone can clarify this and we can get a report.

Having discussed these preliminary issues, we can move to a holding in this part of the case that does clearly state law that will be useful as precedent. The court holds that the mortgagor had a duty, *sounding in tort* and apparently regardless of its contractual maintenance duties under the mortgage, to maintain the roof properly in order to prevent roofing problems. It cites for support the new Restatement of Mortgages, which indeed states, in Section 4.6, that "[w]aste occurs when, without the mortgagee's consent, the mortgagor: . . . fails to maintain and repair the real estate in a reasonable manner, except for repair of casualty damage or acts of third parties not the fault of the mortgagor; . . . (4) materially fails to comply with covenants in the mortgage respecting the physical care, maintenance, construction, demolition or insurance against casualty of the real estate or improvements on it . . . ."

In the comments, the authors of the Restatement comment that the traditional distinction between active waste and passive waste is a dead letter. Failure to maintain is tortious, except in the event that there is a damage to the property through casualty or vandalism. In the latter case, the duty of the mortgagor remains limited to preserving the property wind and weather tight. The Restatement cites a number of cases in support of its view that failure to maintain is waste, and cites no cases contra. Some of the cases indeed involve roof repairs.

Comment 1: Although the court appears to have studied the Restatement, it apparently missed that part of Section 4.6 that states that any recovery of damages for waste is limited to the extent that the waste has impaired or threatens to impair the mortgagee's security interest. When there is a judgment with recourse against the mortgagee for the entire amount of the debt, it would not appear that a waste claim should be added to the top.

Even if a mortgagee is not also suing on the debt, and claims that waste has occurred, the Restatement states specifically that there must be an impairment of the lender's security interest.

Note that this must be coupled with the Restatement's definition of such impairment, which basically says that the mortgagee is entitled only to the original loan to value ratio, and not to any absolute value in the security. If the duty to maintain truly is an expansion of the traditional limitations on recovery for "passive waste," the editor can't see how any court could properly cite the Restatement on waste without also accepting the Restatement's definition of "impairment of security."

Comment 2: According to the Restatement, a mortgagor always has the "public" duty, sounding in tort, to maintain the property to proper standards, at least to the extent that failure to maintain would impair the mortgagee's security interest. This is an important concept, and bears emphasis. The court holds that even where the mortgage says nothing about maintenance, the mortgagor has a duty, sounding in tort, to maintain the mortgaged property in good repair. But, the editor emphasizes, so far as the Restatement is concerned, failure to perform that duty is actionable only when the loan to value ratio is affected. That is not what the court appears to find here.

Comment 3: Although the Restatement clearly states that "reasonable" maintenance is required of the mortgagor, and that failure to provide such maintenance sounds in tort, note that it also says that it is tortious waste to fail to perform the "covenants in the mortgage." How can this be? If the contract defines the duty, the remedy should lie in contract. Many states have adopted this principle as a general principle of remedies law, and certainly it should be considered as controlling in this instance. Consider, for instance, the context of this case. The parties agreed that the mortgagee would not have recourse liability for breach of the mortgage except in the case of a limited range of exceptional circumstances, one of which was the commission of waste. But if we define failure to perform the mortgage covenants in itself as waste, we have a circular liability. You're not liable for failure to perform the covenants except that you are if you fail to perform the covenants. This cannot be what the parties to this agreement actually intended.

The editor strongly disagrees with the Restatement on this point, and is interested in knowing what others have to say on the point.

Comment 4: The editor also wonders whether the same standard for waste – duty to maintain – ought to be applied to life tenants and lessees, parties who also have responsibilities concerning waste. Note that the common law rule for leases states that lessees have no duty to maintain except as stated in the lease. Is this all changed? The editor feels like Rip van Winkle. He didn't notice all this change occurring, but there it is, in the Restatement.

MUNICIPAL LAW; IMPACT FEES: Mississippi slams the door – hard – on impact fees associated with building permits. ***City of Ocean Springs v. Homebuilders Ass'n of Mississippi, Inc., 932 So. 2d 44 (Miss. 2006).***

City adopted ordinances imposing impact fees as a condition of obtaining a building permit or filing a final plat. The Homebuilders Association of Mississippi, Inc. and a number of individual builders filed a bill of exceptions in the Circuit Court of Jackson County challenging the adoption of the ordinance.

The City argued that the imposition of impact fees was a permissible exercise of its police power, was within the authority granted to the City by the home rule statute, and also was authorized by the general planning and zoning statutes. The homebuilders argued that municipalities did not have the authority to impose impact fees. In particular the homebuilders relied on Article 4, Section 80 of the Mississippi Constitution, which has been interpreted to mean that the taxing authority is reserved to the legislature and that the power to tax must be specifically granted and never inferred.

The Circuit Court held that the impact fee ordinance imposed a tax and that the City did not have the authority to impose such a tax. The Circuit Court enjoined further collection of the tax. The Circuit Court also ordered the City to submit an accounting of fees already collected and a plan for refunding the fees, which here affirmed.

Reporter's Comment 1: The City did everything that a municipality could do to try to make its impact fee valid. The City hired prominent national consultants to prepare a report evaluating the city's existing facilities and needs and established impact fees proportionate to those needs. The impact fees were deposited into a separate account. And of course there is a natural sympathy for all of the municipalities along the Coast following Hurricane Katrina and a recognition that these municipalities face staggering costs in rebuilding infrastructure damaged by the storm. The Mississippi Supreme Court nevertheless found that the impact fees were taxes rather than fees because the impact fees were not based on the administrative expense the City incurred in issuing building permits and because there was no specific benefit conferred on the developer. Lest someone try to draft around this decision, the court stuck the fork into impact fees generally: "We conclude there is no constitutional basis, legislative enactment, or common law doctrine, which empowers cities to adopt and impose development impact fees".

Reporter's Comment 2: Litigation over the authority of municipalities to impose impact fees is a national phenomenon. The Supreme Court's decision cites a number of these cases. The decision also gives an overview of the bitter litigation in the state and federal courts between homebuilders and the City of Madison over impact fees.

Reporter's Comment 3: According to newspaper reports, municipalities are working to get the legislature to authorize municipalities to impose impact fees. Legislators also undoubtedly are hearing the homebuilders' position. This should be a hot topic in the next legislative session. Hurricane Katrina will have an impact. In footnote 3 of the decision, the Supreme Court quoted a portion of Governor Barbour's State of the State speech on January 6, 2006, in which he stated he would ask the legislature to authorize the southernmost six counties to impose impact fees to help recover from the hurricane.

Reporter's Comment 4: The City's obligation to refund impact fees seems like a really big deal to the Reporter. Homebuilders probably will use this case as a basis for demanding refunds from other municipalities that have collected impact fees for years. Without having researched the issue, it seems to the editor that the legislature cannot do anything to help municipalities with this problem of refunding impact fees illegally collected. In most cases, haven't homebuilders passed the impact fees on to the people who purchased the homes and so recovered all or part of this cost?

Editor's Comment: These impact fees were tied to building permits. Is it a separate question is impact fees are tied to zone changes? Building permits usually are mandatory – in the sense that the developer gets one if it meets set clear conditions. Zoning changes and variances usually are not required to be granted at all or, in the case of variances, are often subject to such broad requirements that they might as well be completely at the option of agency. Can a developer tie granting of such permissions to payment of sums necessary to alleviate the impact of the proposed project on the community? The editor thinks this may be seen by some courts as a separate question from the one addressed here.

The Reporter for this item was Rod Clement of Jackson, Miss., writing in the Mississippi Bar Real Property Section Newsletter. The editor has made non-substantive changes.

NOTARIES; DEFECTIVE DOCUMENTS; BANKRUPTCY: Bankruptcy courts set aside recorded mortgage liens because of minor defects in notarization and signature, even where mortgage has been existence for many years and parties have acted as if it were valid. ***In re Helvey (Schlarman v. Suntrust Mortgage, Inc.), 2006 Bankr. LEXIS 1619 (Bankr. E.D. Ky, 8/2/06)***

In re Stubbs (Stubbs v. Chase Manhattan Mortgage Corp.), 2006 U.S. Dist. LEXIS 57267 (U.S.D.C. N.D. Ind., 8/14/06),

In re Bross (Monnie v. Field), 2006 U.S. Dist. LEXIS 57449 (U.S.D.C. S.D. Ohio, 8/16/06) discussed under the heading: "Bankruptcy; Avoidance; Unperfected Claims; Notarization."

NUISANCE; STATUTORY IMMUNITY; AFFIRMATIVE DEFENSE. The affirmative defense of statutory immunity for nuisance claims for qualified agricultural districts is waived by a failure to raise this defense in pleadings or in an amendment to the pleadings. ***Eulrich v. Weaver Brothers, Inc., 846 N.E.2d 542 (Ohio App. 3 Dist. 2005).***

Homeowners, Eldon and Charlotte Eulrich, brought a nuisance action against defendant Weaver Brothers, Inc. resulting from the operation of the defendant's adjacent egg farm. The defendant's farm was located one half mile to the west of the Eulrich's property and it produced eggs, chicken manure, and egg rinse water which the Eulrich's claimed resulted in a nuisance to their property.

The trial court entered judgment in favor of defendant Weaver based on the affirmative defense contained in R.C. 929.04 protecting qualified agricultural districts from nuisance claims. The Court of Appeals of Ohio reversed on the ground that Weaver's affirmative defense under R.C. 929.04 had been waived. An affirmative defense, unlike a complete defense, must be raised either by a prepleading Civ.R. 12(B) motion to dismiss, a responsive pleading filed under Civ.R. 8(C), or amendment pursuant to Civ.R. 15. Since defendant Weaver failed to properly raise the affirmative defense under R.C. 929.04, the court considered the defense waived. The Court reversed the judgment of the trial court and remanded for further proceedings.

OPTIONS; EXERCISE Where agreement states date by which option must be exercised, the only requirement is that optionee indicate by that date its intent to exercise. Option need not tender purchase price at that time, as the exercise converts the option into a purchase agreement, and implicitly a reasonable time thereafter is permitted to complete the closing. ***Creely v. Hosemann, 910 So. 2d 512 (Miss. 2005)***

Compare Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Center Assoc., 2005 N.J. Lexis 7 (½5/05), the DIRT DD for 2/4/05, where the New Jersey Supreme Court upheld a ruling that exercise of the option in that case required tender of the purchase price, but then went on to hold that the optionor had deliberately misled the optionee concerning whether the exercise (without the check) had been appropriate until after the deadline for exercise had passed, thus breaching an implied duty of good faith and rendering the option enforceable notwithstanding the failure to tender the check.

OPTIONS; RIGHTS OF FIRST REFUSAL; STATUTE OF FRAUDS: Options and rights of refusal are not subject to the Statute of Frauds. ***Bero Motors, Inc. v. General Motors Corp., LC NO. 98-014256-CK, 2006 Westlaw 2312182 (Mich. App. 8/10/06 (unpublished opinion)***

General Motors was interested in realigning its dealerships to combine different lines of cars within single dealerships than had previously been the case. Bero operated a dealership that included two of the three car lines, and desired to add the third line – GMC trucks – that was part of the new General Motors scheme.

General Motors had another dealer in the same general area that operated a GMC truck franchise, among other lines. Bero was interested in acquiring that franchise, including the real estate of the related dealership, which real estate was leased to the dealership by its owners. General Motors had a right of first offer (characterized by the court as a right of first refusal) for the franchise. He had negotiated with the owners of that franchise, but had not been successful.

General Motors had a right of first offer on the other franchise. After failing in his own negotiations to purchase that franchise, Bero agreed verbally with General Motors that General Motors would assign its right of first offer in the other dealership, and Bero agreed to realign his own sales activities by selling to another dealer the franchises for two lines of cars that the acquired dealership had been selling and by offering any remaining franchise cars through a separate showroom.

Later, Bero learned that General Motors had permitted the owners of the other franchise to sell their dealership, including the real estate, to a third party. It had not given Bero the right of first offer. The third party, in fact, paid a price that was lower than that which Bero had been willing to pay. Bero sued General Motors for damages and won a jury verdict for over $3 million.

On appeal, General Motors argued that its agreement to transfer the right of first offer constituted a contract involving the sale of land and that it was unenforceable because it was not in writing. The court expressed some doubt that it even had a contract for the sale of land here, but held that in any event the Michigan Statute of Frauds did not apply to option contracts or rights of first refusal, even if the underlying subject was land.

The court's analysis was virtually non existent. It cited a precedent case that had refused to apply the Statute of Frauds to options, and held that, perforce, the same reasoning should apply to refusal rights.

The court further held that the promises made by Bero to realign his own sales activities should he be permitted to acquire the dealership in question constituted consideration for General Motor's promise.

Comment 1: It would have been quite easy for the court to characterize Bero's "agreement" to reshuffle his sales activity after acquiring the other dealership as a condition on his acquisition, rather than as a separate promise. Bero did not promise to do anything before he acquired the other dealership, and everything he promised to do afterwards was a working out of the acquisition and the dealership plan. But Bero did not offer to change his own dealership as it existed prior to the acquisition. This distinction was considered by the court, but it upheld the trial court that the promises did constitute consideration.

Comment 2: The reasoning for refusal to apply the Statute of Frauds to option contracts comes, as stated, from a precedent case. That case stated simply that the option contract itself does not create an interest in land, but, apparently, only a contingent right to enter into a contract for the sale of land. It, in turn, cited a 1937 Michigan Supreme Court decision that held that an option contract to acquire the stock of a corporation, which corporation owned land, did not constitute a contract to acquire the land. The 1937 opinion did not hold, as the instant court said it held, that an option to purchase land is not within the Statute of Frauds. A 1917 case on which the 1937 case relied, however, did appear to make such a holding, again in a very sketchy case with no analysis.

The more recent authority cited by the court, *Marina Bay Condominiums, Inc. v. Schlegel,* 423 N.W. 2d 284 (Mich. App. 1988) does indeed make a holding as to options that, the editor agrees, ought to apply with equal force to rights of first refusal:

> "The court found that the parties had entered into an option agreement that gave defendants the right to purchase property at a fixed price within a specified time. An option is a preliminary contract for the privilege of purchase and not itself a contract of purchase. It is a contract collateral to the offer to sell whereby the offer is irrevocable for a specified period. It involves the privilege of buying property at a fixed price within a specified period of time. An option contract does not create an interest in land. Id. Therefore, it is not subject to the statute of frauds. (Citations omitted)."

Comment 3: If the court bears hostility to the Statute of Frauds, and therefore is choosing to limit its scope by implication, then perhaps these opinions can be understood. Further, it is a commonplace that an option does not create an interest in land *per se.* This, in fact, was the underlying reasoning to the extent there was any, in *Marina Bay.* But don't all the policy reasons for requiring a writing for a contract involving a transfer of real estate apply with equal force to an option in real estate? Isn't it an important undertaking that the public has an interest in being stated with clarity and precision?

The editor has been too lazy to explore whether this holding on the Statute of Frauds is universal, He does note that the general rule is that an option, once exercised, becomes a contract for the sale of land. At that point, the option should be in writing. Why not impose the requirement earlier. He also notes that options, at least in most jurisdictions, are subject to recording requirements, precisely on the notion that, contracts or conveyances, they clearly affect ownership of land and ought to be made subject of the recording acts.

RECORDING ACTS; FRAUD: The recording of a deliberately misleading mortgage instrument in the public record constitutes actionable mortgage fraud, even though there is no direct communication of a fraudulent statement to the victim of the fraud. ***ABN AMRO Mortgage Group, Inc. v. Maximum Mortgage, 2006 WL 1128648 (N.D. Ind. 4/26/06),*** discussed under the heading: "Mortgages; Fraud."

SERVITUDES; SUBDIVISIONS: Original developer that sold partly completed subdivision to successor does not owe existing lot owners any duty actionable in tort or contract to ensure that successor will comply with restrictive covenants. ***Paniaguas v. Endor, Inc., 847 N.E.2d 967 (Ind. App. 2006).***

Appellants filed suit against Aldon, a developer, alleging that Aldon was both negligent and in breach of contract for failing to adequately protect Appellants' interests in certain real covenants when Aldon sold the balance of the subdivision property and assigned such obligations to Endor, a purchaser of the subdivision property.

Appellants purchased two lots in a subdivision managed by Aldon. The purchases came with numerous covenants concerned the use of the property, including a restriction to ensure uniform quality of development throughout the subdivision. Aldon later sold its rights to the lots to Endor, and Appellants claimed that Endor developed homes of poor quality, thereby causing a diminution in value of Appellants' homes.

The Superior Court dismissed both claims for failure to state a claim upon which relief could be granted. The Appeals Court here affirmed.

The Appeals Court first considered Appellants' contention that Aldon be held liable in tort for the negligent breach of their sales contracts by the successive owner. The Appeals Court held that this claim could not provide relief because Aldon no longer had a duty to Appellants once it sold its interest in the property. The court noted that the relationship between Aldon and Appellants was entirely contractual, Aldon could not reasonably foresee that Endor would renege on the contractual obligations, and public policy counseled against imposing a duty on developers to ensure that subsequent owners adhere to the real covenants.

The court emphasized that tort law does not generally interfere in duties that arise by contract, especially when the alleged losses are purely economic.

The Appeals Court also considered Appellants' breach of contract claim, which asserted that Aldon had a continuing obligation to enforce the covenants upon Endor. The court disagreed with Appellants' assertion, and found that Appellants' potential remedy could only be achieved against Endor. The court noted that parties may delegate their contractual duties, particularly when the contract is not premised on any personal relationships or unique skills. Here, Aldon's status as developer was not so essential that the contract was incapable of being completed without its presence. Aldon had acted in compliance with its promise to ensure high standards of development during the time period that it was obligated to do so. The Superior Court's ruling was affirmed.

Comment 1: The editor certainly concurs that there is no basis for tort liability here. But contract liability may be another matter.

Comment 2: Is it possible that the Appellants failed to marshal all the evidence of the special character of the developer that might have been available in the sales literature? Sometimes developers will emphasize in brochures and other advertising their well established reputation for quality – "you can depend on Aldon." When that kind of representation enters the mix, it is possible that a court could conclude that Aldon itself made its special skill and experience a material element of the transaction, and that the buyers should have been able to count on Aldon's carrying out the development or insuring that any successor would meet Aldon standards. Perhaps the buyers just didn't have that kind of evidence here.

Comment 3: It is true that, with respect to fee covenants, the original covenantor does not remain liable when it transfers the property. Compare to assignments of leases, where the original lessee serves as a surety for the performance of the assignee, even where the documents are silent. Also, it appears to be the rule that a land contract purchaser is viewed as remaining liable on the contract even if it assigns the right to purchase to another (if the assignee defaults). In short, the conclusion that an contracting party does not remain liable on the contract following assignment is not universal in real property transactions. The editor, however, has no quarrel with releasing most covenantors from their obligations when they transfer the land. As the covenants usually run with the land forever, this seems only practical.

But here, the covenants were expected to be performed in a relatively short period of time and had a quite specific purpose. Given the right case, the editor would have no problem with a court concluding that the original developer does not get off the hook. A case involving representations by the developer of special skill and reliability in the carrying out of the development might be the right case.

SERVITUDES; DECLARATIONS; AMENDMENT: Amendments of a declaration, even when the declaration expressly permits amendment, must be reasonable based upon circumstances surrounding original creation of the declaration and other factors. Court limits reach of expansion of association's assessment authority. ***Armstrong v. The Ledges Homeowner's Assoc., 633 S.E. 2d 78 (N.Car. 2006)***

Developer created a subdivision in 1988. The original scheme called for lots located along an arterial road with some cul-de-sacs attached. There originally were no common areas or amenities.

The Declaration contained extensive restrictions, including architectural control and other use limitations. It dedicated the roads to public use (the Developer later transferred them to the State Department of Transportation, and provided for the creation of a homeowner's association. The association, at the outset, had no maintenance responsibilities and no assessment authority. The Declaration stated the function of the Association to be "to administer and enforce the provisions of this Declaration of Restrictive Covenants as the same no exists or may hereafter from time to time be amended. Another provision of the Declaration provided that "any portion of the restrictive covenants may be released, changed, modified or amended by majority vote of the ten property owners within this subdivision."

During the course of development the Developer determined to add a light at the entrance to the Subdivision, and added to subsequent deeds a requirement that the owners pay their pro rata share of the cost of operating the light to the developer and, when formed, to the association. The plaintiffs in this action took their lots with this language in their deeds, but some lot owners did not. No mention of the duty of the association to pay for lighting or to assess for lighting appeared in the Declaration.

The Association's Article weren't filed until 2004, and at that time the filed Articles did provide that its function was broader than simply enforcement of restrictive covenants. The Articles provided that the Association had the function of upkeep, maintenance and beautification of the "amenities" at the development and "engaging in any other lawful activities of non profits".

It appears, however, that the Association already was engaged in activity at that time, and a the three member board of directors had already determined that they wanted more amenities and greater powers for the Association. First, they voted to amend the bylaws to provide the authority to the association to establish assessments and carry out maintenance and operation of common areas. At the first meeting, in 1995, the bylaws were amended to provide an lien right to collect assessments. Shortly thereafter, assessments went out for mowing the grass along the roadside (on private property), snow removal (from public roads), legal and administrative expenses.

All along, since before the first meeting, plaintiffs had made clear by letters to the Association that they objected to the reformation of the Ledges into a "planned unit community." They said that they chose The Ledges specifically for the lack of amenities, and did not expect that it would immediately be reformed into something more like other gated and coddled residential subdivisions in the area. In fact, the Association Board appeared to be of the view that it was operating under the Planned Community Act of the state, although that Act had not been adopted at the time The Ledges was developed..

The Board apparently had a majority of the meeting attenders on its side, and ultimately a majority voted to amend the Declaration to vest in the Association broad powers of operation and maintenance, assessment and lien collection. The Trial Court and North Carolina Court of Appeals concluded that the association had the power to amend as it saw fit, and the granting of summary judgment to the Association as to the validity of the amendments was appealed to the North Carolina Supreme court.

Held: Reversed. "Because covenants originate in contract, the primary purpose of a court when interpreting a covenant is to give effect to the *original* intend of the parties; however, covenants are strictly construed in favor of the *free use of land* whenever strict construction does not contradict the plain and obvious purpose of the contracting parties.

The court took note of the fact that many communities are amenity loaded luxury developments, and that extensive power to amend the function of the Association powers and functions over time ought to be expected as the continued needs of the community for broad services continues to change. Thus, community declarations commonly have amendment provisions. The court noted, however, "that such provisions give rise to a serious question about the permissible scope of amendment, which results from a conflict between the legitimate desire of a homeowners' association to respond to new and unanticipated circumstances and the need to protect minority or dissenting homeowners by preserving the original nature of their bargain."

Here, the court concluded that the broad authorization of assessments to "promot[e] the safety, welfare, recreation, health, common benefit, and enjoyment of the residents of Lots in The Ledges . . . " contained in the amendment was invalid, even though validly adopted according to the amendment provisions the Declaration contained.

> "We hold that a provision authorizing a homeowner's association to amend a declaration of covenants does not permit amendments of unlimited scope; rather, every amendment must be reasonable in light of the contracting parties' original intent."

The court, in fact, appeared to go even further, as it established an independent filter of "reasonableness" in its review of such amendments. Original intent appeared to be only part of the inquiry.

> "The court may ascertain reasonableness from the language of the original declaration of covenants, deeds and plats, together with other objective circumstances surrounding the parties' bargain, including the nature and character of the community."

Interestingly, the court seized upon rental restrictions as an example (these are a hotly debated issue in the "amendment wars." It stated that if the declaration prohibits, rentals, a majority ought not be able to permit them by amending the declaration *and vice versa.*

Here, of course, the original concept of the community appeared to be a "no frills, no amenities" situation. Although the plaintiffs did take deeds permitting assessments for the cost of maintaining the community's entrance light, the court ruled that the language permitting such assessments was distinctly limited in character and did not change the overall nature of the original scheme. Although the holding was simply to strike down the general permissive language of the amendment, the court went on to note that it had in mind that the grass mowing on the land of private individuals and the snow removal on public roads likely were beyond the original conception of the community, and remanded for a broader consideration of the disagreements between the association and the objecting minority.

Comment 1: This is an important new battle in the ongoing war between associations and their minority members to control what some would call "communazism" and others would call "reasonable planning and management for a happy future." The editor has already weighed in in favor of some limitation on the broadest reading of amending provisions. He believes that there often is an "founders intent" argument about what the basic nature of the community in question is, and that changes should not be made in such original conception without unanimous consent. It is a real estate community after all, and property rights are valued and recognized there.

Here, the Community Associations Institute filed an *amicus* brief, the editor assumes on the side of the association, and he anticipates having to dodge brickbats from the communitarian advocates who argue that the protection of individual rights in these communities is an antiquated notion – that everyone moving into a commonly restricted community should understand that it is, in fact, a community, and that they should abide by the reasonably formulated plans of the community to conform to changing times. That's OK. He's been brickbatted before. Plenty.

Comment 2: Several recent cases would permit broad amendments pursuant to broad permissions. *Evergreen Highlands Assoc. v. West,* 73 P. 3d 1 (Colo. 2003) (the DIRT DD for 6/19/03) held that an association has power to add new provisions to declaration pursuant to a general power to amend, including provisions authorizing, for the first time, mandatory assessments. But the facts of that case were more compelling, as it is probable that the "original intent" of the development was for a funded, full service association.

Thus there is still an open question as to what kinds of amendments the Colorado court was prepared to allow. Would it, for instance, allow the creation of a new association with the power to pave a road and impose significant assessments to pay for that road when there never was any association with maintenance authority or responsibility in the original assessment? Another recent case *Windemere Homeowner's Assoc. v. McCue,* 990 P.2d 769 (Mont. 1999) (the DD for 10/25/00), does just that. The editor believes that there is a Texas case to the same effect, but right now he can't find it.

Comment 3: For a case consistent with the conservative approach espoused in this case, see eland Property Owners Ass'n v. Larson, 459 N.E.2d 1164, 1167 (Ill.App.Ct.1984), which held that a provision permitting an amendment to "change the said covenants in whole or in part" did not permit the conferring of an assessment right on an existing association.

STATUTE OF FRAUDS; CONSTRUCTIVE TRUST: Due in part to the policies of the Statute of Frauds, a mortgagee's verbal promise to allow a borrower to continue to occupy the mortgaged property, notwithstanding a default, does not entitle the borrower to a constructive trust following foreclosure. ***Parris v. Liefels, 280 Ga. 135, 625 S.E.2d 390 (2006).***

A father gave his son and daughter-in-law an undeveloped parcel of property and the couple built a home using the proceeds of a construction loan. The father then loaned his son and daughter-in- law proceeds to pay off this construction loan and, in return, they executed a security deed on the property in favor of the father. The couple made nine payments and stopped making payments on the loan, but continued to pay the property taxes.

The couple encountered marital difficulties; and the father promised the daughter-in-law that, if she ever got divorced, she could continue to use the marital property for herself and her children. After the daughter-in-law in fact filed for divorce, however, the father began to demand the mortgage payments, although she lived on the property with at least one of her children. The divorce court ordered the husband to make the mortgage payments as part of the divorce order, but apparently he did not do so. The daughter-in-law ultimately remarried and moved off the property. The father then foreclosed on the property and bought the property himself.

The daughter-in-law filed a request that a constructive trust be imposed over the property alleging only that equitable principles would be violated if the father were allowed to remain the sole owner. The Trial Court ruled in favor of the daughter-in-law, finding that the imposition of a constructive trust was necessary to prevent the father from being unjustly enriched. The father appealed.

The Supreme Court of Georgia reversed.

The court, in general, found that the facts did not support the imposition of a constructive trust. More specifically, however, the court stated that, with regard to interests in real property, a constructive trust generally may not be imposed based solely on a broken verbal promise to hold or transfer the land for the benefit of other. To hold otherwise would wholly undermine the Statute of Frauds. A broken verbal promise may be the basis of a constructive trust, however, if it was fraudulently made "with the intention of being broken and for the purpose of obtaining title."

The court did note an exception to the application of the Statute of Frauds to void verbal promises respecting real property in equity cases. It said that if the father had made the statement in question intending to break it, then such fraud was so inequitable that it would be taken into account in establishing the equities. But, the court concluded, such was not the case. There was no indication that the father was not sincere when he made the promise. Further, although he may have threatened the daughter in law by demanding payment (she was a co-borrower so far as he was concerned), he did not in fact initiate foreclosure until she had left the property. Consequently, it was difficult for the court to conclude that the father in fact had violated his promise.

Comment: This exception to the Statute of Frauds in real estate matters is not often mentioned, but is generally recognized. A parole statement that purports to bind one to transfer property is not generally honored, but if the parole statement itself is a fraud, because the party making it has no intention of honoring it, then it may be actionable as fraud and one remedy in equity may be enforcement of the statement.

Compare: ***Troxel v. Bishop, 2006 Westlaw 2348934 (Tex. App. 8/18/06) (not yet approved for final publication)***, discussed under the heading: "Deeds; Statute of Frauds; Parole Gifts." (An oral gift of real property is effective without a deed, notwithstanding the Statue of Frauds, where the grantor places the grantee in possession of the property with intention to make a gift.)

STATUTE OF FRAUDS; OPTIONS: Options and rights of refusal are not subject to the Statute of Frauds. ***Bero Motors, Inc. v. General Motors Corp., LC NO. 98-014256-CK, 2006 Westlaw 2312182 (Mich. App. 8/10/06 (unpublished opinion),*** discussed under the heading: "Options; Rights of First Refusal; Statute of Frauds."

STATUTE OF FRAUDS; PAROL GIFTS: An oral gift of real property is effective without a deed, notwithstanding the Statue of Frauds, where the grantor places the grantee in possession of the property with intention to make a gift. ***Troxel v. Bishop, 2006 Westlaw 2348934 (Tex. App. 8/18/06) (not yet approved for final publication)***, discussed under the heading: "Deeds; Statute of Frauds; Oral Gifts."

STATUTE OF LIMITATIONS; MORTGAGE NOTES: A mortgagee has the full mortgage period of limitations to claim a deficiency despite an earlier foreclosure sale. ***The Cadle Company v Dejadon, 2006 Westlaw 1042083 (New Hampshire 4/21/06)***

This mortgage, recorded in 1989, secured an indebtedness of $223,000. In 1993, the mortgagor defaulted and the property was sold at a nonjudicial foreclosure sale to a third party for $97,000. In 2004, eleven years later, the mortgagee sued for a $249,000 deficiency. (The long delay is explained by the fact that the lender went into receivership and substantially later the FDIC assigned the note to Cadle). The question was the whether this action was barred by the 6 year statute of limitations on negotiable notes.

The trial court ruled that the foreclosure discharged the mortgage, and that thereafter the mortgagee had six years to collect on the note. The trial court apparently applied the statute of limitations on a negotiable note. The court indicated that the record did not show that the note was a negotiable note, but that in any event that statute would not supercede what it regarded as established case law regarding the statute of limitations on notes secured by mortgages.

New Hampshire has a 20 year statute for an action to recover real estate and another statute providing that an action on a mortgage note may be brought within the period when the plaintiff is entitled to bring an action on the mortgage. New Hampshire courts have ruled that this combination amounts to mortgagees having twenty years to sue on their mortgages.

Case law also provides that an action may be maintained on a mortgage note after the limitations period for an unsecured note has expired. That has been held to mean "if the note remains unpaid by foreclosure of the mortgage or otherwise, and the mortgage is not discharged, an action may be maintained upon the note. . . until such time as the statute of limitations might be properly pleaded to any action upon the mortgage."

The Supreme Court read these authorities to allow this mortgagee 20 years to sue for its deficiency despite its foreclosure sale eleven years earlier, at which time the property had been sold free and clear of the mortgage. The court ruled that "discharge" of the mortgage can occur only upon full performance and satisfaction, whether or not foreclosure has occurred.

> "We conclude that absent full payment of a note or an express discharge of the mortgage by the mortgagee, merely foreclosing upon the mortgage cannot void or discharge its by operation of law."

So the note remained "live" for the full statute of limitations period on the mortgage, even following foreclosure.

Comment: OK, so the statutes can be read this way. But isn't this a ridiculous reading? What possible policy benefit is served by extending the period for collection of a note for so far after the foreclosure? All the reasons supporting reasonable limitations periods apply here, at least once the mortgage has been foreclosed.

Maybe one could argue that the mortgagor ought not to be entitled to clear title of the property from the mortgage, assuming that the mortgagee requires it. But that issue can be addressed in a different way than by extending the limitations period on the debt without the security.

TRUTH IN LENDING; RIGHT OF RESCISSION: Borrowers are not precluded from rescinding a consumer credit transaction secured by their residence and subject to Truth in Lending Act merely because they have already refinanced that loan. ***Pacific Shore Funding v Lozo 138 CA4th 1342, 42 CR3d 283 (2006)***

Note that this California decision appears to run contrary to a Ninth Circuit interpretation of the TILA.
On August 7, 2000, the Lozos obtained a nonpurchase-money mortgage, secured by a deed of trust against their home, from Pacific Shore, a residential mortgage lender. The loan, subject to the disclosure requirements of the Truth In Lending Act (TILA) (15 USC §§1601-1693r), as amended by the Home Ownership and Equity Protection Act of 1994 (15 USC §§1602(aa), 1639), violated certain of TILA's disclosure mandates. In June 2002, the Lozos obtained a second loan from Pacific Shore that was used, in part, to pay off the outstanding balance of the first loan; they were also charged a prepayment penalty. In April 2003, the Lozos attempted to rescind the first loan by notifying Pacific Shore. Pacific Shore rejected the demand.

Pacific Shore sued for a declaration that the August 2000 loan agreement was valid and binding according to its terms, and that the Lozos were not entitled to rescind it. The Lozos cross-complained, asserting that (a) the first loan was subject to the disclosure reporting requirements of TILA and (b) Pacific Shore had failed to properly and timely provide mandated disclosures and had rejected their attempt to rescind the first loan agreement. The trial court granted Pacific Shore summary judgment under *King v California* 784 F2d 910 (9th Cir 1986) , which held that a loan that had been refinanced could not be rescinded under TILA because there was nothing to rescind.

The court of appeal reversed. TILA requires that specific disclosures be provided to borrowers of qualifying consumer credit transactions secured by the borrower's residence. The remedies under TILA include civil liability and damages. If any required disclosures are not given, the borrower's right to rescind is extended from three days to three years after the date of consummation of the transaction. 15 USC §1635(a), (f). As a consumer protection statute, TILA is to be liberally construed in favor of borrowers.

Because of Pacific Shore's violation of TILA's disclosure mandates, the Lozos argued they had a continuing right to rescind the first loan transaction for three years-until August 2003-so their June 2003 notice of rescission was timely. In ruling as a matter of law that the Lozos had no right to rescind the first loan, the trial court relied on *King*. The appellate court declined to follow *King* for two reasons:

> "First, apart from King's lack of analysis, its conclusion was not supported by the language of TILA and implementing Reg Z (12 CFR §226.1). Regulation Z lists the events that cut off rescission rights, but does not include payment in full of the loan. There is no statutory authority for concluding that a refinance terminates a consumer's right to rescind the original loan. . . .
>
> Second, King was distinguishable. Title to the borrower's residence in King remained vested in the bankruptcy trustee, whereas the Lozos continued to hold title. Thus, unlike King, something remained to be rescinded here."

Under TILA, rescission is a remedy that restores the *status quo ante*. After a TILA rescission, borrowers are not liable for any finance or other charge such as interest, commissions, or extra payments. In contrast, a refinance may not reimburse borrowers for the down payment, finance charges, commissions, or fees paid in connection with the first loan. A refinance does not return borrowers to the *status quo ante*. After the refinance, something remained to rescind-namely the interest, fees, penalties, and charges that the Lozos paid under the first loan.

Accordingly, the Lozos were entitled to rescind the first loan at the time they notified Pacific Shore that they were exercising their rescission right, notwithstanding that they had refinanced that loan. Because Pacific Shore unlawfully declined the request to rescind, the trial court erred in granting it summary judgment.

However, the Lozos' claim for damages (as opposed to their claim of rescission) under 15 USC §1640(e) was barred by TILA's one-year statute of limitations. The alleged violation here was the failure to make proper and timely disclosures at least three days before consummation of the transaction, i.e., August 4, 2000. Thus, the Lozos had until August 3, 2001, to file their complaint. Their September 4, 2003, complaint was therefore time-barred.

Reporter's Comment: The California state court here has elected to stand up to our federal courts and choose contrary principles. Since each are entitled to make up their own minds, we the public now live in an environment of coexisting rival rules, and it should not be too difficult for litigants to decide which one they like, and therefore which court to choose-if they can get in.

In Truth in Lending Act (15 USC §§1601-1693r) cases like *Lozo*, borrowers who refinanced and still want to rescind those loans will surely choose state over federal courts, at least when they are in California. I don't know enough about removal jurisdiction to know whether their lenders can get their defenses heard by King-controlled federal judges instead. Please, someone, tell us.

The Reporter for this item was Professor Roger Bernhardt of Golden Gate Law School, San Francisco (reprinted from the Cal CLE Real Estate Reporter).

VENDOR/PURCHASER; CLOSING DATE: The fact that the contract was signed after the closing date set forth in the contract does not, in and of itself, render the contract void. ***Kennedy v. The Droughton Trust,627 SE 2d 887 (Ga. App. 2006)***

The court reasoned that there was no contract prior to execution that could be deemed to have expired. Therefore, presumably, execution of the contract indicated agreement to a new contract with a reasonable closing date. The usual rule is that a specified closing date is not required to satisfy the Statute of Frauds or to create a valid sale agreement.

VENDOR /PURCHASER; SPECIFIC PERFORMANCE; ELECTION OF REMEDIES: While the sale of real property by a vendor to a third party precludes an order of specific performance for purchasers, the election of remedies doctrine does not bar purchasers from seeking legal damages. ***UFG, LLC v. Southwest Corp., 848 N.E. 2d 353 (Ind. App. 2006).***

In a specific performance action, Buyers alleged that Seller wrongfully refused to follow through on its promise to sell the Property to Buyers, and Buyers also requested monetary damages as a result of the failed transaction. Buyers filed a *lis pendens* at that time. The Superior Court found in favor of Seller, holding that there was not an enforceable contract between the parties.

The Seller then applied for a discharge of the *lis pendens*, which the trial court granted. The appeals court, in discussing this issue indicated that the Buyer could have asked for a suspension of the trial court's ruling pending appeal, but did not do so, presumably because it did not wish to provide an appeal bond. Therefore the lifting of the *lis pendens* was proper. Seller immediately sold the Property to a third party, and Buyers filed thereafter a notice of *lis pendens* pending the appeal.

Ultimately, the Appeals Court reversed, holding that there was an enforceable contract between the parties. On remand, the trial judge retired and a replacement judge found that there was no basis for an equitable accounting because specific performance was no longer available, and entered an order in favor of the Seller. The Superior Court also precluded Buyers from a hearing on damages.

In a second appeal, Buyers contended that the trial court erred (1) in finding that specific performance was no longer possible; and (2) in holding that Buyers elected specific performance as their remedy and therefore abandoned any claim for damages. With respect to the first claim, the Appeals Court held that Seller's sale of the Property to a third party necessarily precluded an order of specific performance to Buyers. The court noted that specific performance is unavailable when the subject matter of the contract is beyond the control of the parties. Here, the property at issue had been sold to an unrelated third party at a time that there was no *lis pendens* in existence and before the Appeals Court remanded the case to the Superior Court. Thus, specific performance was incapable of being performed.

The appeals court acknowledged that the Buyers argued that the trial court should order specific performance both against the Seller and against the new owner of the property, Tycor, on the ground that Tycor purchased with actual knowledge of the pending appeal, notwithstanding the discharge of the *lis pendens*. Amazingly, the appeals court hardly touched on this issue, and the editor surmises because Buyers had not in fact brought Tycor into the case as a party defendant. The court upheld the refusal to grant specific performance on the grounds that the named defendant, the original seller, no longer owned the property.

Under the second claim, Buyers attested that they never elected to pursue the remedy of specific performance to the exclusion of legal damages. Seller countered that Buyers could not seek damages on appeal because of the election of remedies doctrine, which provides that a party that has two inconsistent remedies and elects to prosecute one such remedy to a conclusion may not thereafter sue on the other remedy.

The court held that Buyers were entitled to an opportunity to prove any damages they suffered as a result of Seller's breach of contract. Relying extensively on an analogous case, *Hudson v. McClaskey*, 597 N.E.2d 308 (Ind. 1992), the court found that it would be a miscarriage of justice for the court to allow Buyers to choose between two inconsistent remedies, then waiting until after Buyers had elected one of the remedies to inform them that the preferred remedy was not available and, furthermore, that the alternate remedy was no longer available once they had stated their preference. Affirmed in part, reversed in part, and remanded with instructions.

Comment 1: The court noted that some of the problems arose from confusion over the distinction between equitable compensation that might be associated with a specific performance award – such as compensation for damages occasioned by the delay in performance, and damages for failure to perform the contract at all. The former – the equitable relief, was not relevant because specific performance was not granted. But, since the contract had been ruled binding, albeit not subject to specific performance, damages were still available and to deny such relief based upon an argued election of remedies would be a miscarriage of justice.

Comment 2: It strikes the editor as odd that a plaintiff who brings a specific performance lawsuit must file an appeal bond or risk the loss of the protection of a *lis pendens.* But the editor doesn't litigate, and can't be sure that this isn't the universal rule. If it is, then this case serves as a universal warning. If you lose at trial, preservation of the *lis pendens* is going to be pricey. If you are the defendant, and you win at trial, force the issue and seek for discharge of the *lis pendens.*

Compare: *Slachter v. Swanson,* 2000 WL 1187811, 25 Fla. L. Weekly D2008 (Ct. App., Fla., 3d District, 82300). (The DIRT DD for 10/30/00) Transferee of real property is on constructive notice of fact that any judgments shown in the record might be subject to appeal, and has duty to inquire of court records to determine status of any such appeal. Transferee therefore will be bound by the outcome of any such appeal. In *Slachter* the purchaser bought in reliance on the record of a dismissal of a mortgage, but the mortgagee had appealed that dismissal and obtained a reversal, which was not entered into the record.

WORDS AND PHRASES; "AGRICULTURAL PURPOSES:" "Timbering" is within the uses allowed under an easement that permits use for "agricultural needs" of the dominant estate. ***Potter v. Houston, 847 N.E.2d 241 (Ind. Ct. App. 2006)***, discussed under the heading: "Easements; Scope; 'Agricultural Purposes.'"

ZONING AND LAND USE; ADULT USE ZONING: An adult use zoning restriction will be upheld if the city can show a substantial government interest in the subject matter of the regulation to justify the restriction on protected speech. ***For the People Theatres v. City of New York, 843 N.E.2d 1121 (N.Y. 2005).***

In 1995, the City of New York issued a zoning ordinance that prohibited anywhere in the city an establishment where a "substantial portion", defined as at least 40 percent, of the floor and cellar area accessible to customers was available for adult use.

In 2001, the city amended the ordinance in an alleged attempt to prevent sham compliance with the 1995 order. The legislature outlawed practices such as stocking non-adult videos in a back room in order to meet the 60/40 compliance standard. The changes resulted in many businesses which technically complied with the original 60/40 standard to fall within the zoning ordinance.

Plaintiffs, For the Peoples Theatres of N.Y., Inc., and Ten's Cabaret, Inc., argued that the amendments to the 1995 ordinance were unconstitutional as they infringed on protected speech. Further, Plaintiffs argued that the amendment to the 1995 order was unsupported by secondary-effect evidence which is necessary to show a substantial government interest in the regulation.

The Court of Appeals of New York began by noting that Legislative zoning decisions are generally upheld on a rational basis standard. The Court concluded that the city had satisfied its burden to justify a secondary-effects rationale for the city's 2001 Amendments. Despite this, the Court found that the Plaintiffs had offered evidence that rebutted the city's evidence of secondary-effects and therefore the burden shifted back to the city to show that the businesses' compliance with the 1995 order was merely sham compliance.

The Court remanded to the lower court to determine if, after review of the evidence, the city had fairly supported its position of sham compliance. If the city had supported its position of sham compliance, then judgment should be issued upholding the city's 2001 amendment to assure real compliance with the 1995 ordinance. If the city could not support its position of sham compliance with the 1995 ordinance then judgment should be issued for Plaintiffs. The Court of Appeals of New York therefore remanded to the Supreme Court of New York for further proceedings in accordance with this opinion.

ZONING AND LAND USE; BUILDING PERMITS; IMPACT FEES: Mississippi slams the door – hard – on impact fees associated with building permits. ***City of Ocean Springs v. Homebuilders Ass'n of Mississippi, Inc., 932 So. 2d 44 (Miss. 2006)***, discussed under the heading: "Municipal Law; Impact Fees.

ZONING AND LAND USE; GROUP CARE HOMES: Zoning authority may be required to permit owner of residentially zoned property to operate care facility for a group of aged clients because this is a "reasonable accommodation" to such clients required by the Fair Housing Act. ***Akridge v. City of Moultrie, Georgia, 2006 WL 292179 (M.D.Ga., February 7, 2006).***, discussed under the heading: "Fair Housing; Disabilities; Reasonable Accommodation."

ZONING AND LAND USE; IMPACT FEES: Mississippi slams the door – hard – on impact fees associated with building permits. ***City of Ocean Springs v. Homebuilders Ass'n of Mississippi, Inc., 932 So. 2d 44 (Miss. 2006)***, discussed under the heading: "Municipal Law; Impact Fees."

ZONING AND LAND USE; VESTED RIGHTS; BUILDING PERMIT: Reversing prior authority, Indiana Supreme Court concludes that a building permit on file does not create a vested right that cannot be overcome by a change in zoning law; suggests that there must be a material expenditure of "money, time or effort," and that vested rights can come into being even before a building permit, but not necessarily upon issuance of such a permit. ***Metro. Dev. Comm'n of Marion County v. Pinnacle Media, LLC, 846 N.E.2d 654 (Ind. 2006).***

Pinnacle asked the Supreme Court to reconsider its opinion in *Metro. Dev. Comm'n of Marion County v. Pinnacle Media, LLC*, 836 N.E.2d 422 (Ind. 2005), in which the Court held that a change in the zoning ordinance of Marion County concerning billboard location permits applied to Pinnacle's plan to erect ten billboards in Indianapolis.

Pinnacle sought to construct billboards in interstate highway rights-of-way in the county and applied to the state highway department for building permits. At the time the applications were filed, Marion County did not require billboard location permits for billboards erected in interstate highway rights- of-way. Ultimately, following litigation, the State granted permits for ten of the billboards. Before Pinnacle began construction of the billboards, however, the county enacted an ordinance that required billboard location permits for billboards erected in interstate highway rights-of-way. Pinnacle argued that its filing for state building permits prior to the enactment of the ordinance immunized its billboard plan from the zoning change.

The court found that, while changes in zoning ordinances were subject to any vested rights in the property, the mere filing of a building permit did not grant a vested property right in this case. First, the court observed that the new ordinance was in effect for eleven months prior to Pinnacle beginning construction, and prior to the time that the State issued building permits. Pinnacle argued that the State colluded with the City to delay the State permits. The court doubted that there was evidence to support this contention, but in the end the court concluded that it really didn't matter, because issuance of a building permit, in and of itself, would not longer create vested rights in Indiana.

The fuller discussion of this issue appears in the decision which this case affirms on rehearing, *Metro. Dev. Comm'n of Marion County v. Pinnacle Media, LLC,* 836

N.E. 2d 422 (Ind. 2005). In that case, the court discussed what it viewed as two developing lines of authority as to what will establish a "vested right" that cannot constitutionally be overturned by subsequently enacted zoning laws, at least without compensation.

The first line of cases was, in the court's view, epitomized in *Lutz v. New Albany City Plan Comm'n*, 230 Ind. 74, 101 N.E.2d 187 (1951). There, the court held that for a vested right to exist where a developer has made taken significant and extensive steps in carrying out a proposed development in reliance on existing zoning laws:

> "As a general proposition, the courts have been willing to hold that the developer acquires a "vested right" such that a new ordinance does not apply retroactively if, but only if, the developer "(1) relying in good faith, (2) upon some act or omission of the government, (3) . . . has made substantial changes or otherwise committed himself to his substantial disadvantage prior to a zoning change." . . . Indiana law, as enunciated in Lutz, is consistent with these principles."

In *Lutz,* the developer had acquired the property, cleared the ground (including demolishing existing improvements), secured a mortgage commitment and entered into a long term lease contemplating the erection of a service station, all before the local government changed the zoning laws to prohibit a service station on the site. But, notwithstanding this reliance, the court affirmed the lower court's rejection of the developer's vested rights claim.

> "The zoning ordinance herein is, of course, subject to any vested rights in the property of appellants acquired prior to the enactment of the zoning law. But where no work has been commenced, or where only preliminary work has been done without going ahead with the construction of the proposed building, there can be no vested rights. The fact that ground had been purchased and plans had been made for the erection of the building before the adoption of the zoning ordinance prohibiting the kind of building contemplated, is held not to exempt the property from the operation of the zoning ordinance. Structures in the course of construction at the time of the enactment or the effective date of the zoning law are exempt from the restrictions of the ordinance. The service station was not in the course of construction so as to give to appellants vested rights, and was not a nonconforming use existing at the time of passage of the ordinance."

The Indiana court in the first *Pinnacle* case concluded that the principles followed in *Lutz* remained good law and that vested rights could be acquired through significant reliance.

In the second line of cases, the court said, the Court of Appeals had interpreted its decision in *Knutson v. State ex rel. Seberger,* 239 Ind. 656, 160 N.E.2d 200 (1959) (on reh'g) to mean that vested rights are established automatically upon the issuance of a building permit, apparently on the assumption that prior to the issuance of a such a permit the developer necessarily must carry out much preparation work to secure the permit, even though it may do nothing on the ground.

> "The Court in Knutson said that 'a municipal council may not, by the enactment of an emergency ordinance, give retroactive effect to a pending zoning ordinance thus depriving a property owner of his right to a building permit in accordance with a zoning ordinance in effect at the time of the application of such permit.'

But the first *Pinnacle* opinion ruled that this statement in *Knutson* had led to results that were inconsistent with its authority in *Lutz:*

> "If 'there can be no vested rights' where 'no work has been commenced, or where only preliminary work has been done without going ahead with the construction of the proposed building,' then in logic, the filing of a building permit—an act that must be done before any work is commenced—cannot alone give rise to vested rights.
>
> Furthermore, at least as to building permits, Knutson is out of the mainstream. 'In most jurisdictions it is clear that, as a general rule, . . . a zoning regulation may be retroactively applied to deny an application for a building permit, even though the permit could have been lawfully

> issued at the time of application.' (Citing cases) With respect to building permits, then, Knutson's suggestion that having a building permit on file creates a vested right that cannot be overcome by a change in zoning law is overruled."

The court addressed an *amici* brief that criticized the court. the *amici* alleged that the court's decision would serve to effectively subject property owners with permits to the whims of the legislature until construction actually begins. The court dismissed the contention as both incorrect and speculative, noting that the focus in the case at hand was on whether or not vested rights existed, not whether some filing had been made with the government.

> "We acknowledge, as perhaps our original opinion should have, that vested rights may well accrue prior to the filing of certain applications."

Comment 1: Obviously, this last quote is absolutely contradictory to the above quoted language in *Pinnacle I*, and consequently it must be said that the *amici,* representing a number of important real estate developers, among others, scored some kind of victory. But what did not happen here was any distinct clarification of what kind of activity in reliance on existing zoning is enough. We sort of know what's *not* enough, but, of course, that's not of great help.

Comment 2: Many jurisdictions in fact require "permit plus reliance." Others are satisfied to protect the permit alone, recognizing that a city that has issued a permit necessarily is contradicting its own land use policies in attempting to override that permit. Further, it must be said that the "permit plus" notion may compel developers to expend time and effort in implementing work on the ground much more quickly and expensively than they otherwise might have, for the sole purpose of creating (hopefully) the necessary reliance. That can't be a good thing.

Comment 3: The court is hopelessly vague about what kind of pre-permit reliance might satisfy its vested rights test. Further, even what constitutes satisfactory post-permit reliance is a shot in the dark. It's out there someplace, and maybe we'll hit it if we're lucky.

Comment 4: Indiana recently enacted a statute repudiating this case. Developers with permits can rely on them for two years.