ABA Real Estate Quarterly Report

Fall, 2007

Patrick A. Randolph, Jr.
Professor of Law
UMKC School of Law
Editor

Sponsor:
Section of Real Property,
Trust & Estate Law
American Bar Association

Editorial Contributor:
American College
of Mortgage Attorneys

Quarterly Report on Current Developments in Real Estate Law

July 1, 2007 to September 30, 2007

Sponsor:

ABA Section on Real Property, Trust and Estate Law
American Bar Association

Editor: Patrick A. Randolph, Jr.
Elmer F. Pierson Professor of Law
UMKC School of Law

Of Counsel: Blackwell Sanders Peper Martin LLP
Kansas City, Missouri

NOTE: SECTION MEMBERS MAY SUBSCRIBE TO THIS REPORT ($30 FOR TWO YEARS) BY SENDING A CHECK TO MS. BUNNY LEE, ABA SECTION ON REAL PROPERTY, PROBATE & TRUST LAW, 321 N. CLARK STREET, CHICAGO, IL 60610. CONTACT BUNNY LEE AT (312) 988-5651, LEEB@STAFF.ABANET.ORG ABA MEMBERS ALSO CAN ACCESS PRIOR AND CURRENT EDITIONS OF THIS REPORT ON THE ABA RPPT SECTION WEBSITE.

Statement of Editorial Policy:

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

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

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 view of the Section of Real Property, Probate & Trust Law.

Highlights in this Report

Contributors* to this Report

NAME	*TITLE***
LeeAnn W. Aldridge Hunter, Maclean, Exley & Dunn, P.C. Savannah, Georgia	Atlantic (Co-Reporter)
James Bartholomew Debevoise & Plimpton LLP New York, New York	N.Y. Supp. (Co-Reporter)
Jack Burton Rodey Law Firm Santa Fe, New Mexico	Pacific (Co-Reporter)
David M. Carey Katten Muchin Rosenman LLP Washington, D.C.	DC (Co-Reporter)
Edward C. Dawda Dawda, Mann, Mulcahy & Sadler, P.L.C. Bloomfield Hills, Michigan	Sixth Circuit
Samuel A. Evig Sherman & Howard L.L.C. Denver, Colorado	Interstate Land Sale Regulation Act Tenth Circuit (Co-Reporter)
Rebecca Fischer Sherman & Howard L.L.C. Denver, Colorado	Interstate Land Sale Regulation Act Tenth Circuit (Co-Reporter)
Morton Fisher Ballard, Spahr, Andrews & Ingersoll, LLP Baltimore, Maryland	Atlantic (Co-Reporter)
Robert Freedman Carlton, Fields, Ward, Emmanuel, Smith, Cutler, P.A. Tampa, Florida	Eleventh Circuit

NAME	*TITLE***
Catherine Goldberg Rodey, Dickason, Sloan, Akin & Robb, P.A. Albuquerque, New Mexico	Pacific (Co-Reporter)
Frank J. Hammond III Watkins & Eager Jackson, Mississippi	Southern Reporter Probate Cases
Minta Kay Goodwin, Procter & Hoar Boston, Massachusetts	Northeastern
Rick L. Knuth Jones Waldo Holbrook & McDonough, PC Salt Lake City, UT	Utah Reporter
Robert Krapf Richards, Layton & Finger, P.A. Wilmington, DE	Atlantic (Co-Reporter)
Kathleen M. Martin Malkerson Gililand Martin LLP Minneapolis, MN	Section Chair
Bruce B. May Jennings, Strouss & Salmon, P.L.C. Phoenix, AZ	Pacific (Co-Reporter)
Andrew M. McCullough Kennedy Covington Charlotte, North Carolina	Southeastern (Co-Reporter)
Paul J. McNamara Masterman, Culbert & Tully LLP Boston, Massachusetts	First Circuit Court of Appeals

NAME	*TITLE***
Ira Meislik Meislik & Levavy Montclair, New Jersey	Atlantic (Co-Reporter)
John Muri Katten Muchin Rosenman L.L.P. Washington, DC	DC (Co-Reporter)
Janet K. O'Bannon Lewis, Rice & Fingersh, L.C. Kansas City, Missouri	Southwestern Reporter
Professor John Orth University of North Carolina School of Law Chapel Hill, North Carolina	Pacific (Co-Reporter)
Julie C. Panaro, Esq Richards, Layton & Finger, P.A. Wilmington, Delaware	Atlantic (Co-Reporter)
Stacy Posner Debevoise & Plimpton New York, New York	N.Y. Supp (Co-Reporter)
Professor Patrick A. Randolph, Jr. University of Missouri-Kansas City School of Law Kansas City, Missouri	Editor
Howard A. Roston Malkerson Gilliland Martin, L.L.P. Minneapolis, Minnesota	Northwestern (Co-Reporter)
Amanda C. Sanchez Rodey, Dickason, Sloan, Akin & Robb, P.A. Albuquerque, New Mexico	Pacific (Co-Reporter)
Patrick T. Sharkey Jackson Walker L.L.P. Houston, Texas	Fifth Circuit
Kevin Shepherd Venable, LLP Baltimore, Maryland	
Jory P. Shoell Snell & Wilmer LLP Las Vegas, Nevada	Pacific (Co-Reporter)
James R. Stillman Ellman, Burke, Hoffman & Johnson San Francisco, California	Bankruptcy Reporter
Roger D. Winston Ballard Spahr Andrews & Ingersoll, LLP Bethesda, Maryland	Division Chair
Duane Wunsch Commonwealth Land Title Insurance Co. Brookfield, Wisconsin	Northwestern Reporter

*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.

Quarterly Report on Current Developments in Real Estate Law

July 1, 2007 through September 30, 2007

Sponsor:

ABA Section on Real Property, Trust and Estate Law
American Bar Association

Editor: Patrick A. Randolph, Jr.
Elmer F. Pierson Professor of Law
UMKC School of Law

Of Counsel: Blackwell Sanders LLP
Kansas City, Missouri

AGRICULTURAL PROPERTY; FARMLAND PRESERVATION: An owner of land who has signed a farmland preservation agreement pursuant to the New Jersey Agriculture Retention and Development Act, must, upon the execution of a contract of sale, notify the State of New Jersey promptly so that the State may make its own offer substantially similar or equal to that in the contract. ***Bruce Paparone, Inc. v. The State of New Jersey, 392 N.J. Super. 391, 920 A.2d 770 (App. Div. 2007); April 26, 2007.***

APPRAISERS; LIABILITY FOR NEGLIGENCE; PRIVITY: In the context of a divorce proceeding, one party's appraisal expert does not owe a duty of care to the opposing party. ***Marlar v. Daniel, No. 06-386, 368 Ark. 505, —- S.W.3d —-, 2007 WL 114150 (Ark. Jan. 18, 2007).***

John and Brad Marlar ("the Marlars") brought outrage and negligence claims against William Dennis Daniel, an appraiser whom John Marlar's estranged wife had hired to prepare an appraisal report for certain properties in relation to the couple's divorce proceeding. The Marlars claimed that Daniel had been negligent in preparing the report and that consequently his testimony during the divorce proceeding had proximately harmed them. They based their outrage claim on the allegation that Daniel intentionally had issued a false appraisal report to "retaliate" against John Marlar. Daniel filed a motion to dismiss, which the circuit court granted in the form of summary judgment.

On appeal, the Arkansas Supreme Court easily affirmed the dismissal of the outrage claim, succinctly concluding that "there is nothing in the record before us to indicate any evidence of conduct on the part of Daniel that could be construed to rise to the level required to establish the tort of outrage." As to the negligence claim, the court was more considerate, but ultimately found in favor of Daniel on this count, as well. The notion of "duty" lay at the crux of the court's opinion.

The Marlars argued that appraisers should be bound by a broad conception of duty and that "any third party who is injured as a consequence of not complying with the standards should be allowed to bring suit, if, in fact, the lack of adhering to the standards rises to the level of proximately causing damages." To support their argument, the Marlars cited sections 4-86-101, 16-114-303 and 16-22- 310 from the Arkansas Code Annotated, as well as *Suneson v. Holloway Construction Co.*, 992 S.W.2d 79 (1999), for the proposition that privity of contract is not generally required to bring a negligence action. The court, however, distinguished the statutes on the basis that they dealt solely with attorneys or manufacturers and sellers of goods, and it distinguished *Swenson* on the basis that its relevance was limited to the abolition of the accepted-work doctrine.

The court determined that because Daniel was hired by John Marlar's wife in connection with the couple's divorce proceeding and was thus the opposing party's expert, it would not be foreseeable for the Marlars to rely on Daniel's report. Moreover, John Marlar had the opportunity to challenge Daniel's report and subsequent testimony through discovery and cross examination, and any duty to the public at large that Daniel could have breached was vindicated by a fine and reprimand that the Arkansas Appraiser Licensing and Certification Board issued to him following a complaint to the Board from Marlar.

Comment: This decision is consistent with the majority of cases that have ruled that an appraiser who provides an appraisal to a mortgage lender has no duty of care to the borrower.

But are these decisions right? Is appraisal an advocacy function? The editor thinks not. And if the appraiser is aware that various parties will be relying on the appraiser's work in connection with important business decisions (not necessarily the situation in the instant case), shouldn't the appraiser have a duty of care to those foreseeably relying?

The editor has no doubt that this kind of argument will set off alarm bells in the minds of his many title insurer DIRTers, who fear the weight of potential liability for negligent title inspections to foreseeable plaintiffs who are not their insureds. Maybe they should be concerned. But in fact appraisal represents a different situation, because here we are talking about a learned profession that is licensed and regulated and holds itself out as able to provide an educated conclusion upon which parties often will rely. Doesn't some responsibility go along with that kind of position?

The editor understands that appraisal is not a science, but more of an art. But there are standards, and here, he notes the appraiser apparently fell below those standards because he was reprimanded and fined by the state licensing agency. Where a serious injury has been suffered as a consequence of clearly negligent conduct – an injury that almost certainly will not be covered by insurance or any other third party protection – and appraisers can themselves get insurance against their negligence – what is the argument against extending liability here?

BANKRUPTCY; CREDITOR'S CLAIMS; LENDER'S FEES; "REASONABLENESS": When the bankruptcy estate has sufficient cash to pay claims of all creditors, a lender may collect a prepayment premium without regard to whether such premium is "reasonable" within the meaning of Bankruptcy Code Section 506(b). The only relevant question is whether the fee is valid under state law, the test for creditor's claims under Bankruptcy Code Section 502. ***UPS Capital Business Credit v. Gencarelli (In re Gencarelli) 501 F.3d 1, C.A.1 (R.I.) (1st Cir. 8/30/07)***

Debtor, a donut maker, filed a voluntary bankruptcy petition. Apparently, at that time, there was intense competition regarding the donut business in debtor's region, and when Debtor's assets were sold at a bankruptcy auction, a bidding war ensued, and they produced a three million dollar surplus after all creditor's claims were paid (except those at issue here).

UPS claimed that it was entitled to a prepayment penalty as provided in the instruments. The penalty was a sliding scale percentage of principal, declining after the first five years. The trial court ruled that the prepayment fee claim was required to be a "reasonable fee or charge" within the meaning of 506(b), and conducted two hearings in an attempt to give UPS an opportunity to demonstrate the reasonableness of its fee. (*In re Bess Eaton Donut Flour Co.,* 2005 Westlaw 1367306 (1/19/05)). At least according to the trial court, UPS failed abysmally to do this:

"When asked as to how the questioned penalties were calculated or established, [UPS's witness] stated, surprisingly, that he 'had no knowledge', and instead concentrated on the process UPS follows in selling notes in the secondary market. [The witness'] testimony turned out to be completely irrelevant to the issue about which the matter was reopened."

The trial court consequently denied the claim for the prepayment fee and the District Court upheld this ruling.

On appeal to the First Circuit Court of Appeals, *held: Reversed.*

The court ruled that the applicable statutory test for the collectability of a prepayment fee is Section 502, which requires merely that the creditor's claim be valid under state law. The "reasonableness" test of Section 506 (b) becomes relevant only when the question is whether the claim is secured – in other words whether it enjoys the priority of any security interest securing the note containing the fee language.

Here, of course, there was no question of priority. Everyone else had been paid and there was still some pudding in the pot. [Donuts in the box??]

The court noted that this interpretation was a matter of first impression in the First Circuit, but that the question had already been resolved the same way in the Eleventh and Ninth Circuits, and, in *dicta* in the Second Circuit.

"It is apodictic that 'unsecured creditors may recover their attorney's fees, costs and expenses from the estate of a solvent debtor where they are permitted to do so by the terms of their contract and applicable non-bankruptcy law' . . . Thus, under the statutory scheme envisioned by the debtor . . . unsecured creditors would be permitted to reap the full benefit of their contractual bargains through the medium of Section 502, while oversecured creditors would be uniquely singled out for unfavorable treatment by the operation of Section 506. There is no conceivable explanation as to why Congress might have wanted oversecured creditors to be treated in so draconian a fashion. . . .

"Let us be perfectly clear. This is a solvent debtor case and, as such, the equities strongly favor holding the debtor to his contractual obligations as long as those obligations are legally enforceable under applicable non-bankruptcy law."

[The editor larded on this quote largely to write out the word "apodictic" even though he has no idea what it means. Obviously the First Circuit panel did.]

Comment 1: So the lender collects the fee – right? Not so fast, cowboy!!! The court simply remands for a determination of whether state law would permit the fee. An important question for state law is whether the fee ought to be construed as a possible penalty. The answer to that question depends a great deal upon whether the prepayment fee was triggered by default and acceleration under the documents, and whether such default and acceleration actually occurred here. It may be that the note never went into default and was prepaid merely to facilitate the bankruptcy sale. Neither of the opinions the editor has read explains what happened on this score.

If, indeed, there was an acceleration and the fee is payable as a consequence of that, then the creditor in most jurisdictions would have to show that the fee met the test for liquidated damages. As the fee provided for a sliding scale percentage of the loan amount, the lender will have to work relatively hard to demonstrate that the fee approximated any damages to the lender resulting from the prepayment. [Apparently the loan was intended to be sold and was sold on the secondary market, making the problem even murkier.]

If the prepayment could be characterized as "voluntary," then the only question is whether the documents clearly provide for it. Most jurisdictions view a voluntary prepayment as an option for which the parties are entitled to require the borrower to pay an additional fee.

Comment 2: Of course, this is a relatively unusual case because of the surplus resulting from the auction. More typically, secured creditors will have to deal with Section 506(b). On this score, the court holds clearly that 506(b) is an independent federal test. The fact that state law might have authorized the fee, even as a "reasonable" liquidated damages provision, appears to be irrelevant to the First Circuit.

BANKRUPTCY; HOMESTEAD; PERMANENT RESIDENCE: A 68-foot yacht, which debtor used as his permanent residence while dry-docked, did not qualify for homestead protection in his bankruptcy proceeding. ***Norris v. Thomas, 215 S.W.3d 851 (Tex. 2007) (5-4).***

Norris filed for voluntary Chapter 7 bankruptcy and attempted to claim his yacht as exempt property under the Texas homestead exemption. He valued the yacht, which had four bedrooms, three bathrooms, a galley, and an upper and lower salon, at $399,000. Norris listed a street address as his permanent address on his bankruptcy petition but testified at a 2004 bankruptcy hearing that the street address was just for mail purposes and that his true permanent residence had been the yacht since the sale of his previous home in 2000.

At the time Norris filed his bankruptcy petition, the yacht was docked in Port Aransas, Texas. By the time he testified at the 2004 hearing, he had moved it to a marina in Corpus Christi, Texas, where he said he had a month-to-month lease. At the hearing, Norris' lawyer stated that his client primarily lived in the yacht while it was dry docked in Corpus Christi, and that the boat received water, phone, and electricity service.

The bankruptcy court and the federal district court concluded that the yacht did not qualify for the Texas homestead exemption. On appeal, the Fifth Circuit certified the question to the Texas Supreme Court, which affirmed.

The court began its analysis by noting the ambiguity of the Texas Constitution and the Property Code, neither of which defined "homestead" with much specificity nor explicitly excluded boats from the concept's embrace. However, the court concluded that, while ambiguous, the provisions consistently referred to a homestead in terms of land and improvements thereon. Additionally, precedent had established a general notion that "homestead protection turns not on who owns the underlying land, but on the degree to which the residence 'thereon' or 'on the land' is attached to it." The court noted a past case that had held a house trailer to be homestead when the owner had placed it on wooden blocks adjacent to his brick house. The owner had used the house to supply the trailer with electricity and planned on doing the same with plumbing. Meanwhile, a later case held that "house trailers without the characteristics of permanent fixtures attached to realty are not protected homesteads." Using these precedents, among others, the court determined that the proper test for determining "whether a residence attains homestead status is whether the attachment to land is sufficient to make the personal property a permanent part of the realty." The court reasoned that while the yacht was connected to land through its water, phone, and electricity service, its status as a boat justified a different conclusion than what courts had reached in mobile home cases. The court first noted the Texas constitution's requirement that protected improvements be on the land; it then focused on the characteristics of the yacht and on Norris' use of it. Norris tethered his boat to the dock, but the boat retained its mobile character, which Norris had made extensive use of before his bankruptcy petition. And while the boat received utility service from the dock, it was still capable of self-contained utility service. Thus, the court concluded that the boat was moveable chattel and "not sufficiently attached to real property to merit homestead protection."

The court noted that federal bankruptcy courts applying the laws of other states had extended homestead protection to boats in certain circumstances, but these decisions consistently rested on more encompassing state constitutional and statutory language than that present in Texas. The court concluded in definitive terms: "[u]nless and until Texas law changes, a boat can be a home, but it cannot be a homestead." Four justices adopted a dissenting opinion and claimed that the majority's holding "violate[d] the purpose of homestead protection as [the court has] long interpreted it." The dissent advocated a more flexible approach to determining homestead status, still requiring attachment to realty but not necessarily the "permanent" attachment emphasized by the majority. Instead, the dissent would focus on attachment as a means to habitability. Thus, just as connection to gas, water, and sewage facilities was a deciding factor in the mobile home cases, it would also be sufficient to confer homestead status on the yacht. The dissent also disagreed with the majority's emphasis on the mobility of the yacht, noting mobile home cases that had acknowledged the mobility of the homes yet still applied the homestead exemption. The dissent ended with a recitation of more liberal Texas statutes and regulations that had adopted more flexible conceptions of the idea of "homestead."

BANKRUPTCY; LIENS; AVOIDANCE: Bankruptcy trustee, as hypothetical BFP, may avoid a mortgage containing a faulty legal description even if detective work in the information available from the grantor/grantee index might have disclosed the existence of the mortgage. ***In re Colon (Hamilton v. Washington Mutual Sav. Bank., 376 B.R. 22 (Bankr. Ka. 1/26/07).***

Debtor had, some years before, refinanced a home mortgage. The recorded refinancing mortgage contained an error in the legal description. Instead of designating the property as Lot 79 in a certain subdivision, it described it as Lot 29 in the same subdivision. The mortgage, however, contained a three-part description. There was also a street address and a tax locator ID. Both of the latter descriptions were consistent with the property located on lot 79, not lot 29.

When Debtor filed a Chapter 13 bankruptcy, the Trustee sought to avoid the mortgage from its position as "hypothetical" BFP under sec. 544(a) of the Bankruptcy Code.

The issue was whether the trustee was put on constructive notice of the defective legal description contained in the mortgage. The court stated that it must decide what steps a "reasonably cautious person" would take to obtain good title, and held that the trustee was not required to search beyond the grantor/grantee index and examine the text of the mortgage in an attempt to determine if the legal description was correct (and that even if such a duty existed such review of the mortgage would have not have put the trustee on constructive notice of the mortgage). The court stated that the trustee's duty is not that of a title insurer:

"[T]he court is unaware of any legal precedent that would require a BFP to conduct a search equivalent in scope to that a title insurance company would conduct when issuing a title insurance policy, and holds that no such legal duty exists. The Trustee, as a BFP, is only required to take the steps a reasonable person would undertake in an attempt to discover a cloud on the title of property he or she is purchasing, not that of a title insurance company, which has much greater expertise and resources at its disposal than an ordinary BFP, and which, as an insurer, has greater exposure for failing to expose title issues. The Court also finds that a BFP is not required to hire a title insurance company to conduct the title search."

The court noted that, that under Kansas law, "constructive notice" is implied "when it consists of knowledge of facts so informing that a reasonably cautious person would be prompted to inquire further…" The court concluded that, from its reading of all applicable Kansas statutes, "[a] description of the property conveyed should be considered sufficient if it identifies the property or affords the means of identification within the instrument itself or by specific reference to other instruments recorded in the office of the register of deeds. Such a specific description of the property conveyed is required in order to impart constructive notice to a subsequent purchaser."

The court concluded that if a BFP had examined the index kept under the legal description of the lot in the mortgage, it would not have found the defendant's (Washington Mutual Bank's) mortgage, as it was recorded under another lot of the same subdivision.

The court rejected Washington Mutual's argument that even though there was an error in the lot number, the correct street address and tax ID number were contained in the mortgage, noting that "the Register of Deeds does not index or maintain records by street address or tax/Parcel ID number." The Court further noted that even the owners themselves likely would not know this information (regarding the incorrect lot description) without consulting other records, and that "[e]ven if there was evidence of such actual notice, sec. 544(a) immunizes the trustee from such actual notice."

The court stated that "[t]here is nothing within the mortgage itself that would give a BFP constructive notice of those facts, or that would put a reasonable purchaser on notice that something was awry, requiring further investigation." Finally, the Court ruled that, "under the facts of this case, there is nothing within the four corners of the instrument that would put an innocent purchaser researching the title to this property on notice that he needed to check further outside the four corners of the instrument, again assuming a BFP would even have to review the instrument, itself."

Comment 1: There are a number of interesting questions here. The first is the suggestion that a title company has a greater duty to become aware of information concerning title than that measured by constructive notice. Of course, for most purposes, the duties become coextensive because if the title company fails to identify a problem, but there is no constructive notice of that problem, the insured would not be affected by it, and the title company would have no liability. But there may be circumstances where a title company provides some service other than insurance for which a negligence claim may be made. Does it have a broader duty of care? The issue is clearly *dicta* in this case. It's simply food for thought.

Comment 2: The next question is whether a party has a duty to read all documents recorded against a grantor's title in the record and to identify questionable title descriptions that might, on inquiry, turn out to be the property for which the party is searching. The court says that there is no such duty. Apparently, in its view, title searchers are permitted to look to the index legal description, which would have indicated a different lot than the one being searched in this case, and stop there.

Comment 3: The county maintaining property records also maintained a tract index. Typically such indices are maintained for assessing property taxes only. In the editor's home county, however, he understands that the information in these tract indices is deemed to be within the search burden of a title searcher. So sometimes the search burden goes beyond the grantor grantee index. But, although the mortgage in the instant case (not in the editor's county) was in fact recorded in a tract index, it was indexed only under lot 29, and not the correct lot 79.

The only way anyone could have identified the problem in this case, as the court suggests, would have been to note that the borrower, as grantor, had given a mortgage on lot 79, which was identified with street address, and that later the borrower had given another mortgage on lot 29, with the same street address. The court held that, given the uncertainty of street addresses in general, and the somewhat strained comparison necessary to pick up the ambiguity here, there was no constructive notice from this sort of record information sufficient to generate a duty of inquiry. The editor agrees, and he wouldn't hold a title company responsible for identifying such an issue, either. (Note that a title company might have picked the issue up through its own title plant.)

Jack Murray, of the First American Title Office, picked off this case for the editor, and a bit of the report comes from Jack, but the comments are those of the editor, as is a good portion of the report itself.

BOUNDARIES; MONUMENTS: Court may rely upon extrinsic evidence to determine property boundaries in a deed where the boundaries are ambiguous. Further, even though there is a preference to rely on natural monuments so long as their original location can be ascertained, the grantor's intent, where it can be determined, is superior to the noted location of the natural boundaries. ***Stransky v. The Monmouth Council of Girl Scouts, Inc., 393 N.J. Super. 599, 925 A.2d 45 (App. Div. 2007); June 15, 2007.***

BROKERS; LICENSING; OUT OF STATE BROKERS: Federal court invalidates Kentucky "turf state" law prohibiting out of state licensees from practicing real estate or sharing fees with Kentucky licensees. ***River Oaks Management v. Brown, 2007 WESTLAW 2571909 (9/4/07).***

"Turf state" laws prohibit cooperation between in-state real estate brokers and out-of-state real estate brokers. In addition to Kentucky, seven other states have such laws: Nebraska, New Hampshire, New Jersey, Oklahoma, Pennsylvania, Missouri and Utah.

Kentucky's turf state policy required anyone who brokers real estate transactions to possess a valid state real estate license. It further required out-of-state brokers representing clients who wish to purchase property in the state to refer those clients to a Kentucky broker, who must then handle all aspects of the transaction. The Kentucky broker could pay a fee for the referral, but could not share the commission.

In essence, this regulation banned real estate brokers from cooperating with Kentucky brokers in the marketing, leasing and management of commercial property in the state, thereby excluding national brokerage firms from the Kentucky market. The plaintiffs here were customers and brokers in the Kentucky office of a national commercial brokerage firm. They noted that many commercial real estate investors have a buyer's or tenant's broker who regularly represent them and would prefer to continue to work with those brokers in evaluating Kentucky real estate opportunities. They noted further that in marketing Kentucky property out of state, they would benefit greatly from access to cooperative fee splitting agreements with brokers in other states.

The Kentucky court found that the policy's provisions effectively force both owners and purchasers of Kentucky real estate to work with only state-licensed brokers. While this favored in-state interests by ensuring that virtually all commissions from the sale of Kentucky real estate remain with state licensed brokers, the court found that the burden on access to national markets was unacceptable. It ruled that the prohibitions constrain interstate commerce in the purchase and sale of Kentucky real estate, isolating Kentucky from the national brokerage market, a result made unconstitutional by the Commerce Clause.

"The purchase and sale of real estate is often a costly and complex transaction. A consumer who maintains a trusted relationship with a broker should not be compelled to accept the services of a stranger in order to make that transaction."

The state argued that consumer protection considerations supported the law, but the court noted that in fact the statute was more likely to endanger many consumers:

"[T]he complete exclusion of a buyer's broker from the transaction may well render the foreign buyer/lessee more vulnerable to fraud ... [a client] should have the option of engaging the services of a real estate broker in whom one has confidence and trust ... [but] that option does not exist for out-of-state consumers.

... While licensure protects the public from unscrupulous and incompetent brokers, the court cannot discern how prohibiting cooperation between an out-of-state broker and a Kentucky licensed broker reinforces this protection if the Kentucky licensed broker oversees the interstate transaction. It appears that the prohibitions' main purpose is to ensure that virtually all commissions are kept in Kentucky. This is achieved, however, at an unconstitutional cost to interstate commerce."

Comment 1: Note that the ruling does not permit out-of-state brokers to do business in Kentucky without associating with a Kentucky licensed broker. Rather, it permits fee sharing and other accommodations to out-of-state licensees to insure that customers get the benefits of both in-state and out-of-state professionals.

Comment 2: Nothing in the opinion limits the application of the ruling to commercial brokerage, although the arguments that motivated the court largely related to the commercial context.

CONDOMINIUMS; ALTERNATE DISPUTE RESOLUTIONS: Under the New Jersey Condominium Act, although any party to a housing related dispute at a condominium project may demand alternative dispute resolution as a prerequisite to litigation, there is no requirement to first initiate alternative dispute resolution before bringing suit, and absent some compelling circumstances, when any party to such litigation requests alternate dispute resolution, a court should dismiss the matter without prejudice. ***Finderne Heights Condominium Association, Inc. v. Rabinowitz, 390 N.J. Super. 154, 915 A.2d 16 (App. Div. 2007); January 23, 2007.***

CONSTITUTIONAL LAW; DUE PROCESS; PUBLIC PURPOSE: Notwithstanding *Kelo* decision, proposed condemnee is permitted to show that the alleged public benefits for a particular project are a "pretext" and that in fact the real impact of the proposed condemnation is to benefit another private interest. ***Franco v. National Capital Revitalization Corp, 930 A.2d 160 (D.C. 2007).***

Franco owned a store located in a shopping center in D.C. known as Skyland Shopping Center. There were thirty businesses in the center, and from the court's description of them, one can conclude that this was not a "class A" retail mall. There were a national chain pharmacy and national chain auto supply store, a post office, a KFC, and Franco's store, Discount Mart, together with other, likely similar establishments.

A government-created redevelopment corporation was created and given the right to acquire and assemble real estate, including through eminent domain, in order to carry out redevelopment activities. The corporation entered into a development agreement with four developers to redevelop Skyland Shopping Center and five adjacent acres. The idea was to prepare a plan to redevelop the site into a "first-class, quality mixed-use retail center."

A year and a half after this agreement was reached, the corporation introduced a bill to the DC Council to support its exercise of eminent domain. The bill declared that the taking of the properties was "necessary and desirable for the public use," but, as the court noted, did not say why. Perhaps massaged by District counsel, when the bill was actually adopted, it included new language specifically finding that the Skyland Shopping Center "is a blighting factor" in the local community. The bill went on to recite the typical blight findings that the Center was characterized by underused, neglected and poorly maintained properties, fragmented and often absentee ownership, lack of responsibility for safety and the reduction of crime, trash and other blighting factors, and that the local authorities had been unable to secure the cooperation of current owners to deal with problems there.

The bill went on to state that the assemblage of the properties into a new shopping center development "would further many important public purposes," listing garbage and crime reduction, creation of jobs, more retail options, and economic revitalization of the overall community. The process of review of the bill took about six months and there was a committee hearing. But the court took pains to note that all the findings of blight and public benefit did not find their way into the bill until after virtually the entire review process – a month before final adoption and well after the hearing.

Franco filed defended against the condemnation by arguing that the Skyland Shopping Center was not blighted and that there was no carefully considered development plan serving a public purpose supporting condemnation of the Center. (In the meantime, the redevelopers had acquired a good portion of the rest of the Center.) A trial judge dismissed the defenses and authorized an immediate taking. The trial court commented that any inquiry into the legitimacy of the public purpose determination was foreclosed by *Kelo*. Title in fact passed to the corporation, but on appeal Franco was able to stay the order for possession.

On appeal, the D.C. appeals court reversed the trial court's order, concluding that, notwithstanding the decision in *Kelo* v. City of New London, 545 U.S. 469 (2005) , a proposed condemnee still can make a legitimate claim that the local authorities lack a foundation to make a determination that a taking of private property for purposes of redevelopment by other private parties. The court characterized the available opening for the condemnee as the showing that the alleged public purpose is in fact a "pretext" for conferring a private benefit on other parties, and that no true public benefit is being served. In such a case, regardless of whether a condemnee receives an appropriate price, a condemnation should not precede.

By the time the case reached the appeals court, the only issue left to decide was the defense regarding lack of public purpose. The court assumed that the procedure used by the DC government and that Franco received procedural due process. Indeed, he did participate in the hearing that was held.

But the DC appeals court read *Kelo* as leaving open to judicial review the legitimacy of the governmental determination that the taking in question will serve a public, rather than a purely private purpose. It quoted from the *Kelo* opinion the Supreme Court recognition that takings for private purposes are not authorized, including this pithy statement by Justice Stevens:

"Nor would the City [New London] be allowed to take property under the mere pretext of a public purpose, when its actual purpose was to bestow a private benefit."

The court held that this permits a proposed condemnee essentially to challenge the legitimacy of the public agency's assertion that a public benefit is served:

"[T]here may be situations where a court should not take at face value what the legislature has said. The government will rarely acknowledge that it is acting for a forbidden reason, so a property owner must in some circumstances be allowed to allege and to demonstrate that the stated public purpose is pretextual."

The court noted that the concurring opinion of Justice Kennedy went into more detail about the "pretext" issue, but asserted that it was relying primarily on the plurality opinion by Stevens.

The court admitted that the mere assertion that the taking does not meet a public purpose likely was insufficient to overcome the presumption of validity afforded to the governmental decision. But it said that other facts raised by Franco in counterclaims (which may not themselves have been procedurally valid) fleshed out his allegations and permitted the court to decide what Franco intended to prove and then, on the generous standard of a motion to dismiss appeal, indulge all inferences in favor of Franco before deciding that he had no case.

Franco alleged that during the two years before introducing the bill to the DC Council, the redevelopment corporation had refused to discuss redevelopment with any of the extant owners but instead was focused on a "sweetheart deal" with a development group that would in fact share its profits with the redevelopment corporation. Franco claimed that the resale price to the developers was $25 million below true value. He especially noted that the Council itself had never discussed the question of blight, nor evaluated whether the efforts of existing owners might be sufficient to resolve any issues if they existed. The "findings" were tacked on at the end, Franco alleged, without any fact-finding or discussion, just to validate a preordained approval.

The reviewing court admitted that, after *Kelo* at least, redevelopment is a valid public purpose, and can be carried out by the device of condemning private land and retransferring it to other private developers. The court noted that the Supreme Court has cited *99 Cents Only Stores v. Lancaster Redevelopment Agency,* 237 F.S. 2d 1123 (C.D. Cal. 2001), where the court had invalidated a proposed plan to acquire land in a shopping center area for the sole purpose of expanding an existing Costco store. That trial court had concluded, based upon its analysis of the proposed public benefits, that the proposal was a naked power grab.

But the court acknowledged that the concept of "pretext" suggests some element of purpose, motive or intent. But it then concluded that intent can be gleaned from the court's view of the legitimacy of the public agency's determination.

"[A] reviewing court must focus primarily on benefits the public opes to realize from the proposed taking ... if the property is being transferred to another private party, and the benefits to the public are only 'incidental' or 'pretextual,' a 'pretext' defense may well succeed. On the other hand, if the record discloses ... that the taking will serve 'an overriding public purpose' and that the proposed development 'will provide substantial benefits to the public,' the courts must defer to the judgment of the legislature. Harder cases will lie between these extremes."

Comment 1: The court relied upon the Maryland decision in *Mayor and City Council of Baltimore v. Valsmaki,* 916 A. 2d 324 (Md. 2007) (The DIRT DD for 2/9/07). But note that the Maryland decision arguably could be based independently on the Maryland constitution. Can't get away with that in D.C. And, by the way, another federal court had approved the condemnation of Skyland Shopping Center more or less on the same issues in *Franco v. District of Columbia,* 456 F.S. 2d 35 (D.D.C. 2006).

Comment 2: The editor is perplexed. If the court can evaluate the motives of the local government by evaluating the validity of its determination, how can we conclude that the local government is free to make judgments as to what is in the public interest free of substantive judicial review. Aren't we back to the 1930's "substantive due process" debate? The editor is particularly struck that the court is reserving judgments even as to those cases that don't hit the extreme. Even where the public benefit is more than "incidental," the court is free to find a pretext ("[h]arder cases will lie between [the] extremes.") Isn't this a pretty naked end run around *Kelo?* It's one thing for a state court to conclude that its Constitution means something different than the Supreme Court has stated to be the meaning of the U.S. Constitution. It's another thing to buck the Court's very recent so directly in a case applying U.S. Constitutional standards.

In short, whatever good purposes might be served by this case, the editor feels it has not adequately shown how its analysis can be reconciled with the holding in *Kelo*. The window *Kelo* left open cannot be this wide open.

CONSTRUCTION LAW; STATUTE OF REPOSE: The ten year statute of repose on construction projects begins when the protected professional or contractor completes its work relating to the property, not necessarily when a certificate of occupancy for the project is issued. ***Daidone v. Buterick Bulkheading, 191 N.J. 557, 924 A.2d 1193 (2007).***

In anticipation of building a new home, a landowner hired an architect, who prepared and certified architectural plans, including for a foundation piling system to support the house. Once the plans were approved, the architect had no further role in the design or construction of the home. A year later, construction of the home was completed, and a certificate of occupancy was issued.

Five years later, the homeowner experienced many problems caused by settling. The homeowner did not seek expert assistance immediately, but rather waited three years to get an expert's report. The report did not conclude that there was any defect in the design or installation of the pilings, but did opine that the pilings may not have been long enough. The homeowner had the home repaired, but then waited another two years to sue the architect and piling contractor. By the time suit was filed, ten years had passed since both professionals had completed their services. But ten years had not elapsed since the certificate of occupancy had been issued.

The New Jersey Statute of Repose for construction services provides that no action for deficient design or construction of an improvement to real property may be brought more than ten years after the "performance or furnishing" of such services and construction.

The defendants filed a motion to dismiss, arguing that the Statute of Repose barred the complaint. The lower court granted the motion, finding that the architect and the piling contractor completed their work more than ten years before the complaint was filed against them. The Appellate Division affirmed, holding that the ten year statutory period begins when the architect or contractor completes its work relating to the property. The New Jersey Supreme Court granted the homeowner's petition for certification, but proceeded to affirm the judgment for the defendant architect and contractor.

The Supreme Court held that the start date for the Statute of Repose would be the date on which the designer or contractor had completed his or her portion of work on a construction project, and not the date that the certification of occupancy was issued. The Court concluded that the language of the statute was clear, and that ten years and one day after a designer or contractor has performed his or her services, a cause of action for design or construction defects ceases to exist. According to the Court, the Statute of Repose reflects the Legislature's public policy preference for finality in construction-related claims. It noted that if a claimant wants to sue an individual subcontractor, the claimant will have to track when that subcontractor's services were completed and must file a complaint within ten years of that date.

Comment: This obviously is a tremendously important issue for those in construction services, and the language of the New Jersey statute struck the editor as likely to be similar to that in many other jurisdictions, so he thought the case worthy of note.

DEEDS; DEDICATION TO PUBLIC: Deed transferring property to city "for Park purposes only, and none other," was a common law dedication, and City may not terminate use as a park so long as such use is practicable. ***Citizens for the Preservation of Buehler Park v. City of Rolla, 230 S.W.3d 635, Mo. App. W.D. (2007)*** discussed under the heading: "Public Trust; Dedication; Parks."

EMINENT DOMAIN; CONDEMNATION; PUBLIC UTILITIES, RATE-MAKING: School District that condemns water company property may not deduct the amount of a prior "contribution in aid of construction" paid by the District from the condemnation award as this would result in an unconstitutional taking of property without just compensation. ***Bd. of Educ., Moriarty Mun. Sch. Dist. v. Thunder Mountain Water Co., 2007-NMSC-031, 141 N.M. 824, 161 P.3d 869 (6/1/07),*** (the lower court opinion that this case affirms, 145 P.3d 92, was the DIRT DD for 1/30/07).

In 1999, when the School District was constructing a middle school and wished to obtain water for consumptive use and fire protection at the school, it entered into a Construction Contract and Water Service Agreement with the Water Company to obtain water service. Apparently such a contribution was required in order to induce the Water Company to provide such service. The agreement by which the contribution was made was unclear as to whether the facilities thus developed belonged to the Water Company or the District, but the court here concluded that they were the Company's even though they could not be included in the Company's rate base (since built with contributed funds). The School District paid the Water Company over $60,000 for installing the water line extension as a CIAC charge.

In 2002, the School District terminated the Agreement and, later, filed its petition for eminent domain to condemn the water line extension and associated property pursuant to New Mexico law. The School District asserted it was entitled to deduct the CIAC charge from the compensation due to the Water Company. It was stipulated that the value of the facilities was equal to the amount of the CIAC. So the District, under its argument, would have obtained ownership of the facilities at no further cost. The trial court disagreed with the District and granted summary judgment in favor of the Water Company. The School District appealed to the New Mexico Court of Appeals, which affirmed.

The Court of Appeals relied upon condemnation cases and principles, as opposed to rate-making cases and principles, to answer the question presented before it. The Court of Appeals concluded that the School District exercised its right to acquire the water line extension belonging to the Water Company by eminent domain and that, therefore, the Water Company was constitutionally entitled to just compensation, which included "the fair market value of the property on the date of the taking."

The Court of Appeals also held that "[c]ondemnation cases teach that property contributed to the utility by a CIAC is not excluded from just compensation." The Court of Appeals continued its analysis by interpreting, and even relying upon, cases from other states, recognizing that the CIAC is a separate act from the condemnation. Ultimately, the Court of Appeals concluded that deducting the CIAC payment from the condemnation award would unconstitutionally deprive the Water Company of its property without just compensation. The School District appealed to the New Mexico Supreme Court, which affirmed the Court of Appeals.

The Supreme Court concluded that eminent domain principles required the School District to pay the Water

Company the FMV of the disputed property because the Water Company had a fundamental right, under both the federal and New Mexico Constitutions, protecting its property from a taking without just compensation. The CIAC paid to the Water Company and the FMV to be paid to the Water Company were two distinct recoveries, separated by three years. The CIAC was mandated by the Public Regulation Commission, while the FMV was mandated as a matter of constitutional law when the School District elected to initiate a condemnation action. Therefore, just compensation was not a double recovery.

Comment 1: As the editor commented in the earlier DD, this is one for the precedent files. The court cites parallel authority in Maine, Maryland and Florida.

Comment 2: Can the problem be avoided by state legislatures by providing that facilities constructed by utilities for public agencies with agency-donated funds will belong to the public agency from the outset? There is nothing in the opinion to dispute this. The issue may in fact simply arise from the technical differences between rate schedules and eminent domain proceedings, and not from any profound notion of the proper role of such contribution agreements.

EASEMENTS; SCOPE; PIPELINE MAINTENANCE: A pipeline company may be able to compel the removal of well-established trees in order to permit aerial surveillance of the pipeline to identify leakage. ***Township of Piscataway v. Duke Energy, 488 F.3d 203 (3rd Cir. 2007).***

We have here an attempt by a pipeline company to remove 55 shade trees from its high pressure gas pipeline easement adjacent to a residential neighborhood. For purposes of this discussion, we can assume that the question is whether the servient tenant desires to keep the trees and wishes to prohibit the pipeline company from removing them.

The terms of the pipeline easement, first granted in 1944, included the right to "lay, operate, renew, alter, inspect and maintain" two pipelines. The grant further stated that the dominant tenant was required "to bury such pipelines so that they will not interfere with the cultivation or drainage of the land, and also to pay any and all damages to stock, crops, fences, timber and land which may be suffered from the construction, operation, renewal, alteration, inspection or maintenance of such pipelines."

An easement for a third pipeline was added in 1963, subject to the same restrictions. At that time, the servient owner substantially reduced the dominant area to the sixty foot width needed to carry the pipelines as they had been laid. The servient owner then transferred the property to the city to build a road over the pipes, and proceeded to develop a residential subdivision on the balance of its property. Over time, someone (possibly the city) planted a substantial number of trees on the sixty foot strip, and these grew tall and healthy – some as high as 75 feet.

In 2000, the pipeline company, apparently for the first time, objected to the presence of the trees and sought their removal. The township, owner of the road, objected. Ultimately the city settled with the pipeline company, and the neighbors continued the fight, which boiled down to 55s tree instead of the original 80 proposed for removal, but this is largely irrelevant to the issue under discussion here – whether the pipeline easement holder can justify the removal of large shade trees to facilitate aerial surveillance of the pipes.

The pipeline company also argued that the special type of coating that it had placed originally on the pipes grows brittle over time and thus is susceptible to damage from tree roots. The editor suspects, frankly, that the court is unlikely to accept this argument as a basis for removal of the trees, at least now that the appellate court has acknowledged that the trees are worthy of some protection due to the language of the easement right. The short answer to the pipeline company is that it should have used coatings that were resistant to tree roots or else protected itself better in the easement grant. Nevertheless, the court did remand this issue to the trial court for a further hearing, because it concluded that the materials submitted by the company raised a triable issue of fact.

But there were two other discussions in the case worth noting. First, the trial court had held that the pipeline company's failure to raise the question of the trees in the first 55 years of the existence of the pipeline, including during the period that the trees grew up to shade a substantial residential subdivision adjacent to the pipeline, barred the pipeline company from raising its claims now due to the equitable doctrine laches. The appeals court held that new knowledge of pipeline hazards and concerns of public safety have created a new environment for pipeline inspection, and that the company again made out a triable issue that this new environment created a need for higher standards of which the aerial surveillance is an important part. Thus, the company had not been negligent in failing to raise the question of the trees in the past. It is only recently that the aerial surveillance issue has come to the fore. (Note that this might not be true of the tree root concerns.)

As to the aerial surveillance, the pipeline company noted that its nationwide standards for high pressure gas pipelines now restrict the size and amount of foliage that can be planted above pipelines because of the need to inspect the right of way for evidence of leakage. The most common sign of leakage is the development of dead or discolored brush adjacent to the pipelines. But the brush that the inspectors look for, the company argued, cannot be seen through a tree canopy. Drive-by inspections are less reliable and, of course, more expensive. It noted that aerial surveillance of pipelines modernly happens once or twice a week.

It remains to be seen whether the neighbors will be able to refute the evidence adduced by the company on this issue. The only thing that the Third Circuit panel determined was that the reports and testimony produced by the company was sufficient to challenge the neighbors to refute it in some way. It ain't just chopped liver!!!

EMINENT DOMAIN; REDEVELOPMENT CONDEMNATION; "BLIGHTED" AREAS: In order to meet the statutory definition of a blighted area as a basis for a condemnation action, the condemning party must present sufficient evidence that the subject area has become a "social liability," the definition of which includes concerns about the area with respect to the health, safety, and welfare of the public. ***Centene Plaza Redevelopment Corp. v. Mint Properties*, *225 S.W.3d 431 (Mo. 2007) (en banc).***

In this case, the city of Clayton, Missouri, solicited redevelopment plans for one block of a city boulevard. Centene Plaza Redevelopment Corporation submitted a plan, which the city approved and granted condemnation authority. After Centene failed to reach an agreement with all the property owners, it filed a condemnation action. The property owners defended the action on the basis that the property was not blighted as required under the Missouri statute, despite a city ordinance declaring the area to be blighted. Pursuant to the statute, a blighted area "consists of those portions of the city that 'by reason of age, obsolescence, inadequate or outmoded design or physical deterioration have become economic *and* social liabilities, and that such conditions are conducive to ill health, transmission of disease, crime or inability to pay reasonable taxes'."

Note that the court required that both prongs of the definition be satisfied. The designation was not available because the property was merely an economic liability. There had to be a finding of deleterious social liabilities resulting from the property's present condition.

Here, the primary issues in upholding the blighted designation were (1) what constitutes a "social liability"; and (2) whether the area in question met that standard. The Supreme Court of Missouri noted that despite the lack of a statutory or case law definition, historical context suggests that social liability exists when the area constitutes "a menace injurious to the public health, safety, morals and welfare of the residents," presents economic concerns, and serves "as a breeding ground for juvenile delinquency, infant mortality, crime and disease."

With respect to the subject area in this case, the evidence was insufficient to support a finding of social liability under this definition due to a lack of public health, safety, or welfare concerns resulting from the area's condition. Specifically, reports concerning fire and police calls as well as other emergency services did not indicate any significant concerns when compared with other areas in the city. Further, evidence focusing on the prospective benefits of redevelopment and the city's ultimate goals cannot serve as probative evidence of social liability. Therefore, because Centene could not show evidence of social liability in the area, it could not meet the statutory definition of "blighted area."

Comment: Obviously a significant anti-*Kelo* sentiment is at work here. At heart, this is simply a narrow reading of the applicable statute. But it certainly is unlikely that the decision would have come out this way absent the backlash to *Kelo* and the perception that there has been significant overruse of the urban renewal device by local government.

EMINENT DOMAIN; REDEVELOPMENT CONDEMNATION; PUBLIC PURPOSE: Notwithstanding *Kelo* decision, proposed condemnee is permitted to show that the alleged public benefits for a particular project are a "pretext" and that in fact the real impact of the proposed condemnation is to benefit another private interest. ***Franco v. National Capital Revitalization Corp, 930 A.2d 160 (D.C. 2007)***, discussed under the heading: "Constitutional Law; Due Process; Public Purpose."

INSURANCE; MULTIPLE INSURERS; LIFE TENANTS: Holders of life estate and remainder interests in destroyed property were not both entitled to recover full value of property. ***Burns v. California Fair Plan Ass'n (2007) 152 CA4th 646, 61 CR3d 809.***

Burns, the holder of a life estate in a residence, and a trust (Trust) holding the remainder interest, each purchased fire insurance policies on their interests in the residence from different insurance companies. After the residence was destroyed by fire, Burns and the Trust submitted claims to their respective insurers. The insurers determined that Burns and the Trust should recover on their interests on a *pro rata* basis.

Burns and the Trust sued the insurers for breach of contract and breach of the duty of good faith and fair dealing, each seeking to obtain the full value of the residence on their respective insurance policies. Invoking the "other insurance" provision in each policy, the insurers successfully moved for summary judgment on the basis that they fulfilled their contractual obligations by paying Burns and the Trust on a *pro rata* basis according to the value of their insured interests in the destroyed property.

The court of appeal affirmed, holding that multiple insureds cannot recover more than the value of the property destroyed on a fire insurance claim resulting from a single occurrence.

Although Burns and the Trust each held a separately insurable interest in the destroyed property under Ins C §281, it did not follow that they both could recover the maximum allowed under their respective insurance policies without regard to the value of the destroyed property. The nature of insurance does not provide for recovery in excess of the value of the property destroyed when there is one loss. If an insured's interest extends to the whole subject matter of the property, the insured may recover up to the value of the property, subject to any policy limitation. However, if the insured's interest is less than the whole of the property, its right is limited by the value of the interest. The concept of indemnity excludes the notion of profit to the insured.

Neither Burns nor the Trust had an interest that extended to the whole of the property. Had each claimant been compensated for the full value of the residence, recovery would have been far in excess of the loss suffered.

This case did not involve double insurance under Ins C §590 because the same person was not insured by the two insurers and was thus not subject to *pro rata* payments in double insurance cases under Ins C §591. Burns and the Trust pressed for application of the maxim *expressio unius est exlusion alterius* – if exemptions are specified in a statute, additional exemptions may not be implied unless there is a clear legislative intent to the contrary. They argued that *pro rata* payments are only permitted when there is double insurance. The court, however, ruled that the maxim of statutory construction does not apply when, as here, its application would run counter to a well-established rule of law or when its operation would contradict a discernible and contrary legislative intent. The "well-established rule of law" applicable here was that insurance proceeds are to indemnify, not to generate a profit. Moreover, there was a discernible legislative intent to allow for proportionate payment of insurance benefits in cases other than double insurance, such as when there is "other insurance" under Ins C §2070 and §2071, which govern standard form fire insurance policies. Historically, "other insurance" clauses were designed to prevent multiple recoveries when multiple policies provided coverage for the same loss. That is so even when the policies cover different insureds.

The court then proceeded to calculate the amount payable to each claimant by determining the total amount of the two policies, prorate the amount of each policy against the total, and then apply that percentage to the actual loss.

Reporter's Comment: Only an insurance lawyer can make sense out of this decision; I find it quite confounding from a real estate point of view. If a residence is subject to the divided ownership of a life tenant and a remainderman, its value would be divided between them in a partition action by calculating either the value of the life estate (current income times estimated years remaining, discounted to present value) or the present value of the remainder, and then subtracting either number from the total value of the fee.

The same calculation would probably be made if the two owners were suing a third party tortfeasor for causing (permanent) damage to their property.

Nothing like those numbers is mentioned in this case. The life tenant's age is not mentioned, so we have no idea of the potential duration of the life estate. Instead, the court engaged in the *pro rata* analysis described above. The result depends not on the comparative value of the two estates, but on the respective amounts of insurance each party carried.

I am also puzzled by how this court is able to get around three out-of-state decisions awarding insured life tenants 100 percent of the value of their destroyed properties because they had paid full premiums, as was done here. Why would that result change because some remaindermen did the same for their future interests? Why should A's protection be reduced because of the exigency that B independently insured a different interest? But maybe that is how insurance law works.

The reporter for this item was Roger Bernhardt of the Golden Gate Law School, writing in the California CEB Real Property Reporter. Reprinted with permission.

LANDOWNER LIABILITY; FORECLOSURE PURCHASERS: Although the winning bidder of real property at a judicial foreclosure sale has not yet obtained legal title at the time of a subsequent fire, due to lack of final confirmation of the sale, it conceivably had equitable title, which could be the basis for a liability claim against it for failure to prevent a fire that damaged adjacent property. ***O'Connell v. ABN Ambro Mortgage Group, Inc., No. 2006-CA-000327-MR, 2007 WL 867632 (Ky. Ct. App. March 23, 2007) (not yet certified for publication)***, discussed under the heading: "Mortgages; Foreclosure; Premises Liability."

LANDLORD/TENANT; COMMERCIAL; CONTINUOUS OPERATION; IMPLIED OPERATING COVENANTS: No implied operating covenant can be based upon use clause stating "restaurant use and no other use." Language suggests only restriction on use, not duty to operate. ***Giessow Restaurants, Inc. v. Richmond Restaurants, Inc., 232 S.W.3d 576 (Mo. App. 2007).***

This case involves an extra-long term lease, which makes it somewhat more interesting. It is for a former HoJo's location, operated by Howard Johnson's as a sublessee under a long-term ground lease for 25 years. When that use ended, landlord entered into a revised sublease with a new subtenant for an initial 15 year term, but Subtenant had rights to extend the lease in successive ten year increments for an additional 49 years. Tenant, at its own expense, made extensive renovations.

The lease provided for a relatively low fixed rent – $25,000, plus 7% of the gross over a floor (the same floor set by the original parties to the HoJo's lease fifteen years earlier, despite inflation.) If the gross doubled the floor amount, then the percentage rent continued to apply, but to a cap of $20,000. All told, as far as the editor can make things out, the maximum percentage rent was about $45,000. Since the lease was to last for 80 years, one assumes that the maximum likely would be reached assuming regular operation of the establishment and inflation.

The tenant operated for 20 years, then started losing money and closed the restaurant, but continued to pay the base rent (apparently payable monthly). The landlord attempted to terminate the lease, presumably because it wanted to recapture and relet. Tenant resisted and this case ensued.

The sublease expressly states that Tenant could use the property "for no other purpose or business than that of a restaurant, ice cream parlor, bar, tavern and cocktail lounge for the sale and dispensing of food and liquor, and for all activities related and incidental thereto[.]"

The court noted that neither this language, nor any other language in the lease, expressly placed a duty on Tenant to ensure the existence of such a business.

"Lessor is correct that it is a restrictive clause, because it restricts the purposes for which Lessee may use the property. However, the restrictive clause does not thereby also require that Lessee must, at all times, put the property to use. Rather, it articulates the purposes for which Lessee may use the property, should it choose to use the property. Lessor disregards the fact that the Amended Agreement is intentionally silent beyond this restrictive clause. Indeed, a provision which restricts use of the premises is not identical to a provision which enjoins nonuse of the premises."

This principle of interpretation is well-established in other jurisdictions (at least in the retail lease context) that had been applied in Missouri. See, *e.g. Crestwood Plaza, Inc. v. Kroger Co.*, 520 S.W.2d 93 (Mo. Ct. App. 1974).

But a 1988 Eighth Circuit case (*Emro Marketing Company v. Plemmons,* 855 F.2d 528 (8th Cir. 1988) (2-1 decision)) applying Missouri law to the circumstance of a "gallonage lease," a relatively rare agreement in modern times, had found used such a use clause as the basis for implication of operating covenant. In *Enro*, a ground lease for a Nickerson Farms store provided for $100 per month base rent and a percentage based upon gallonage of gasoline pumped at the location. The tenant continued to operate a convenience store but closed the pumps and paid $100 per month (plus taxes) as its whole rent. Historically, gallonage leases have occupied a special place in the vast firmament of implied operating covenant cases (and it is vast) and generally an implied covenant was found.

The trial court, noting that the percentage rent payable under this agreement likely was almost double the fixed rent if the gross revenue figures were reached (we're not told what sort of revenues the tenant had experienced), concluded that the essence of the lease arrangement was a percentage return, and thus chose to follow the *Enro* lead and interpret the use clause as an operating covenant. The appeals court here slammed the door on that interpretation, presumably for the future. If there is another gallonage case, it will have to rest its analysis on something other than a use clause, if it is to succeed at all.

Comment 1: The editor has reported on probably a dozen other implied use covenant cases over the years of DD's, and most of them have come down for the tenant. But many involve larger, out-if- town tenants, such as Wal-Mart, and local good ole' boy developer landlords, and (dare we say it) some of the trial courts tend to "home town" the tenants, leading to a proliferation of appeals, usually successful, overturning the operating covenant finding. There are just enough cases holding for the landlord, however, such as in *Enro* to make things interesting and to give the trial courts a "hook" to make a deal for the landlord that it had been unable to make with its tenant.

Comment 2: Because of the huge amount of authority, there is an extensive discussion of this issue in Friedman on Leases (Randolph Edition) in Section 6.9. The author has left Mr. Friedman's extensive case analysis intact, and has simply appended his own analysis of cases arising in the 20 years or so since Mr. Friedman wrote his materials. The author's discussion commences at page 5- 56 in the Treatise.

Comment 3: An example of a landlord favorable case that implied a continuous operation covenant because of an "inadequate base rent" is *BVT Lebanon v. Wal-Mart Stores, Inc.,* 48 S.W. 3d 132 (Tenn. 2001). The landlord there had agreed to a significant investment in an expanded store facility when it negotiated the lease, and the court concluded that it had a legitimate expectation that percentage rents would amortize that investment.

Although the basis for finding the implied operation covenant in *BVT* was a claim that the landlord was entitled to a flow of percentage rents, but court then turned around and awarded damages to the landlord based upon diminution in the value of the center resulting from Wal-Mart's going dark, including the loss of other tenants with cotenancy clauses. The editor disagrees with the *BVT* decision, and wrote it up as the DD for 4/3/01 under the header "Biggest, Worstest Implied Continuous Operation Clause Yet."

LANDLORD/TENANT; COMMERCIAL; IMPLIED WARRANTY OF FITNESS; WAIVER: Texas continues the dismantling of *Davidow* – court will enforce waivers of implied warranty of fitness in commercial leases and "as is" clause precludes a causation argument as to other claims based upon defective premises. ***Gym-N-I Playgrounds, Inc. v. Snider, 220 S.W. 3d 905 (Tex 2007).***

This important case affirms the lower court decision reported as the DIRT DD for 2/1/05. It resolves a dramatic split in the lower appeals courts as to the meaning of *Davidow* and as to the application of the *Prudential* doctrine on "as is" clauses. [*Prudential Ins. Co. of Am. v. Jefferson Assocs., Ltd.*, 896 S.W. 2d 156 (Tex 1995) had upheld the application of an "as is" clause in a sale agreement of commercial property – holding that it demonstrated that the cause of any injury to the buyer as a consequence of defects in the premises arose due to the buyer's failure to identify the problems, rather than the seller's failure to disclose or remedy them.]

The case construes the well-known, but not particularly influential, holding in *Davidow v. Inwood North Professional Group-Phase I,* 747 S.W. 2d 373 (Tex. 1988). This case, based upon some particularly good plaintiff's facts, concluded that commercial landlords in Texas implicitly warrant the suitability of their premises for a tenant's commercial purposes. The case involved a multi-tenant office building and a claim by a doctor occupying a relatively small portion of the building who suffered from significant structural and systems problems originating inside and outside of his leased area. The case contained ringing language about the superior ability of a landlord to identify and remedy building problems and has been the darling of the law reviews. But no court really has followed *Davidow*, and, as the court notes here, at least four jurisdictions have rejected it expressly – Kansas, Nebraska, New Hampshire, and North Dakota. [The editor believes that there may also be a Utah case rejecting the doctrine, following a case in that state that approved elements of it.] The Texas court, and same commentators, claim that the "sixties" case of *Reste Realty v. Cooper,* 251 A. 2d 268 (N.J. 1969) adopted the concept, but the editor has always believed *Reste* to be a nuisance case involving flooding based upon the common area, despite its broader language suggesting an implied warranty ought to exist.]

The *Davidow* warranty was never as broad as the grandest of the implied warranties of habitability recognized almost universally in residential leases. The court indicated that in determining whether there was a breach of the warranty, a court needed to consider: "the nature of the defect; its effect on tenant's use of the premises; the length of time the defect persisted; the age of the structure; the amount of the rent; the area in which the premises are located; whether the tenant waived the defects; and whether the defect resulted from any unusual or abnormal use by the tenant." Many of these factors would not be relevant to cases evaluating residential warranties. Further, again almost universally, the residential implied warranty of habitability cannot be waived.

At another point in the opinion, the court indicated that the commercial warrant of suitability it was imposing on commercial landlords might be waived by a provision transferring express repair duties to the tenant. This is consistent with statutory residential implied warranty provisions in many states, following the Uniform Residential Landlord Tenant Act. But the Act carefully narrows those circumstances in which such waiver can occur.

Perhaps because of the broad expanse of the parallel implied warranty in residential cases, Texas courts following *Davidow* have been quite confused about how its recognition of the possibility of contractual warranty ought to be construed. Some courts held that a broad contractual waiver ought to be upheld, while others confined the waiver to the narrow circumstance of a delegation to the tenant of specified repair duties. When the Texas Supreme Court, however, decided in *Prudential* that broad "as is" clauses would be recognized on freedom of contract grounds in commercial real estate sales, the stage was set for a broader reading of the lease waiver language as well, and now we have it.

Unlike in *Davidow*, the facts of the instant case were tailor made for a decision upholding the validity of an express waiver. Some years before, the tenants had purchased from the landlord the business they were operating in the leased premises, and in connection with that purchase leased the building. The tenants were long time employees of the buildings and, in the words of the landlord, themselves "knew more about the building than anyone else." The City Code required that buildings containing combustible materials of certain kinds contain sprinkler systems, but the city inspector had not required sprinklers here, though he recommended them. Tenants were fully aware of this.

The tenants, leasing under a "hold over" clause following the end of an initial five year term, suffered a fire that destroyed the premises. The insurer paid them for their business losses and then brought a subrogation claim against the landlord based upon various grounds, including implied warranty, and all predicated on the absence of a sprinkler system and claimed defective wiring.

But the insurers ran head on into the language of the lease dealing with waivers of warranties:

"Tenant accepts the Premises 'as is.' Landlord has not made and does not make any representations as to the commercial suitability, physical condition, layout, footage, expenses, operation or any other matter affecting or relating to the premises and this agreement, except as herein specifically set forth or referred to and tenant hereby expressly acknowledges that no such representations have been made. Landlord makes no other warranties, express or implied, of merchantability, marketability, fitness or suitability for a particular purpose or otherwise, except as set forth herein, and implied warranties are expressly disclaimed and excluded."

Although no masterpiece of English grammar, the clause undoubtedly expresses the meaning that there is no implied warranty given under the lease, and does not do so in the context of transferring any repair responsibilities to the tenant. The court found the waiver enforceable, and found no implied warranty in the lease, thus resolving once and for all the enforceability of such waivers in Texas. It makes virtually nothing of the various factors (listed above) suggested by the *Davidow* court in determining whether a warranty breach as arisen, and does not make the validity of the waiver expressly dependent upon the special facts of the case (single use building leases to former key employees in connection with a sale of the business.) Instead, the court relies upon reasoning in *Prudential* and other cases emphasizing the need for business to exist in an environment that upholds, to the greatest extent reasonable, the concept of freedom of contract.

Predictably, after *Prudential* the court goes on to use the "as is" language in the waiver above to conclude that the insurer's other claims against the landlord for negligence *per se*, gross negligence, violations of the Texas Deceptive Trade Practices-Consumer Protection Act, and fraud. Any violations on these counts were not the cause of the tenant's injury.

Because the tenant had no right to recover, the subrogated insurer was barred as well.

Comment 1: In case the reader wonders, there was a waiver of subrogation clause in the lease as well. The court really wanted to chew on the waiver issue, and thus elected not to decide the case based upon waiver of subrogation.

Comment 2: Clearly the "as is" language and the waiver of implied warranties language are both going to be critically important to Texas landlords going forward. Don't bargain for one without the other.

Comment 3: Is anything left of the *Davidow* language suggesting that courts ought to apply waivers only in narrow circumstances? Certainly not while the current Texas Supreme Court membership is running the show. And in light of the dismal history of *Davidow* in other courts, the editor suspects we won't see much of it anywhere else either.

LANDLORD/TENANT; LANDLORD/LIABILITY; INJURY TO TENANT VISITORS; CRIMINAL ATTACKS: Landlord had duty to take "minimally burdensome measures" to protect visitor to apartment complex from known threat of violence by gun-brandishing tenant. ***Barber v. Chang, 151 CA4th 1456, 60 CR3d 760 (2007).***

Barber, a former tenant in a small apartment complex owned by Chang, was shot by another tenant of the complex. Three weeks earlier, Chang had been advised by certified letter from another tenant of an incident in which the shooter brandished a gun and threatened a visitor and another tenant. Barber sued Chang for negligence for failure to adopt measures to reduce the risk of harm posed by a potentially violent tenant. The trial court granted Chang summary judgment on the ground he owed Barber no duty of care.

The court of appeal reversed. A landlord's general duty of maintenance includes the duty to take reasonable steps to secure common areas against foreseeable criminal acts. When the third-party crime is committed by a tenant, foreseeability turns on whether the landlord had notice of the tenant's propensity for violence. Chang failed to meet his initial burden of demonstrating he owed no duty, based on lack of notice, to take measures to reduce the risk of harm the shooter posed to others.

Evidence the shooter discharged the weapon in an earlier incident was not required. Prior similar criminal incidents or other indications of a reasonably foreseeable risk of violent criminal assaults in that location suffice to establish heightened foreseeability. The prior incident here, which demonstrated that the shooter committed the misdemeanor offense of brandishing a gun in an angry and threatening manner (Pen C §417(a)) and, if the gun was loaded, the felony offense of assault with a firearm (Pen C §245(a)(1)), would alert a reasonably prudent landlord that the shooter posed a risk of serious injury to other tenants and invitees.

Barber, who visited the apartment complex periodically, was a foreseeable plaintiff. Because Chang knew Barber had a common law stepson and mother-in-law living in the complex, Barber's presence was reasonably foreseeable. Moreover, like any other visitor to the property, Barber was entitled to reasonable protection from harm on the premises.

Chang's summary judgment motion asserted Barber could not show the heightened foreseeability required to impose a duty to hire security guards. However, Barber based his theory of recovery on the general duty of the landowner to protect tenants and invitees from the risk of harm posed by a potentially violent tenant, an allegation broader than a specific duty to hire security guards. The general duty covers minimally burdensome measures reasonable under the circumstances, which may include investigating the incident to determine whether to evict the potentially violent tenant, threatening to evict the tenant, or calling police. The prior brandishing incident rendered the danger the shooter posed foreseeable enough that undertaking one or more minimally burdensome measures was not, as a matter of law, beyond the scope of a landlord's duty of maintenance.

Reporter's Comment: The lesson landlords should probably take from it is to call 911 personally whenever one tenant complains about the dangerous behavior of another. But I fear (as apparently did the authors of the concurring opinion) a slippery slope may lie beyond that call. In this case, the tenant did make such a call and got nowhere. If the landlord receives a similar rebuff (which is likely because the incident is over and he was not a percipient witness), can he then sit back, or must he try harder? And what is "harder"? Should he call twice? Should he attempt to file a police report? Should he also speak to the offending tenant? If the offender denies everything, must the landlord then seek witnesses? If the offender admits it all, will a simple threat to evict if the behavior continues be enough? Even if it is not then carried out? With enough hindsight, the landlord will almost never be deemed to have taken enough minimally burdensome steps as to be exonerated, at least at the summary judgment stage.

There is no indication of any appeal from this decision. Thus, it does not appear that the California Supreme Court will have the opportunity to consider it in light of *Castaneda v. Olsher,* 41 C4th 1205, 63 CR3d 99 (2007) (mobile home park lessor had no duty to protect tenant from gunshot from gang member where, although there had been prior harassment from gang members, there had been no shootings on the premises), which was decided by the California Supreme Court six weeks later. Would *Castaneda* have dictated a different result? That decision requires heightened foreseeability in order to fault a landlord for not evicting a possibly dangerous tenant, but the danger in Barber was pretty foreseeable; the untaken measures of calling the police or threatening to evict seem much less burdensome than an actual eviction would be. On the other hand, *Castaneda* also wanted (on the security guard issue) a causal connection between the hypothetical avoidance measure and the actual harm. Would the *Barber* landlord have had a defense by showing that the suspected gang member, even if he was evicted and no longer resided there, might still come back and present the same threat to the plaintiff?

The reporter for this item was Roger Bernhardt of the Golden Gate Law School, writing in the California CEB Real Property Reporter. Reprinted with permission.

LANDLORD/TENANT; RESIDENTIAL; PUBLIC HOUSING: Public housing authority may evict a public housing tenant because he has committed a violent crime approximately one mile from the leased apartment where the authority concludes that such tenant threatens the other residents' health, safety, or right to peaceful enjoyment. ***Lowell Housing Authority v. Melendez, 865 N.E. 2d 741 (Mass. 2007).***

Provisions in the lease permitted the authority to evict anyone who engaged in criminal activity that constituted a threat to the other residents' health, safety or right to peaceful enjoyment. Tenant used a seven inch kitchen knife in an attempt to rob someone in a convenience store about a mile from the housing complex.

A housing court judge concluded that the authority was entitled to possession on the basis of the lease provision. This appeal resulted:

Tenant argued that an event occurring a mile from the housing complex did not establish any danger to the residents of the complex. The court elected to take this claim seriously and give it a thorough discussion, although it described the authority's case from the outset as "persuasive." It concluded that such discussion might be helpful in guiding authorities in the future.

The court had no trouble agreeing that the tenant's crime reasonable presented a risk to the other tenants. (Indeed, during a brief stay of eviction while the tenant appealed, he committed three other violent crimes). But it did comment that it was not holding that all criminal activity of whatever nature is cause for termination of a public housing tenancy. It cited an example of a tenant convicted of credit card fraud, who obtained a reversal of his eviction.

In a telling analysis of the real purpose of this rule, the court commented:

"Tenants of public housing developments ... represent some of the most needy and vulnerable segments of our population, including low-income families, children, the elderly, and the handicapped. It should not be their fate, to the extent manifestly possible, to live in fear of their neighbors."

Comment 1: The editor finds it interesting that the provision apparently applies only to crimes committed *after* the tenant moves in. Don't tenants with criminal records present equal risks? Perhaps the authority asks for information on this score in the application, and lying on the application may justify eviction if a criminal record is detected later. What if the criminal occupies as a guest, and never filled out an application? *See: Wellston Housing Authority v. Murphy*, 131 S.W.3d 378 (Mo.App. E.D. 2004). (Where a tenant in public housing allows a guest with a prior criminal history (murder) to reside in her unit, the housing authority has no right to terminate tenant's lease if the guest does not engage in criminal activity during the lease term.)

Comment 2: Although the editor basically agrees with the "zero tolerance" issue, a real question is if people who engage in these crimes can't live in housing authorities, where can they live? At a recent NCCUSL meeting, a proposed uniform law was introduced that would prohibit housing authorities and many other employers and service providers from discriminating in opportunities (employment, housing, etc.) on the basis of criminal records. Your editor got on his hind legs on that one, and it's back on the drawing board. But the problem still is there. You don't make it go away by ignoring it. But the editor hasn't a clue, nor a spare room, to contribute to the solution of this problem.

Comment 3: Speaking of "zero tolerance," the editor should note that the "criminal conduct exclusion" permits termination of the lease not only when the tenant commits a crime, but when the tenant, any member of the [tenant's] household, or any guest or other person under the [tenant's] control commits a crime. So any broadening of the definition of what activity supports eviction significantly broadens the number of relatively innocent friends and relatives who have provided a support network to the offender who also get evicted. Hence, fewer and fewer persons in a potential support network are going to provide that support. Is that a good thing? There are no easy answers. One DIRT DD dealt with this, protecting the innocent tenant, in *Memphis Housing v. Thompson*, 38 S.W.3d 504 (Tenn. 2001), (the DIRT DD for 9/3/01). But the editor believes that the majority view does not favor the innocent tenant. See: *e.g. South San Francisco Housing Authority v. Guillory,* 49 Cal. Rptr. 2d 367 (Cal. Super. 1995) (DD for 7/16/95). (In fact the editor believes that the U.S. Supreme Court recently has ruled this way on the issue, but the editor is too lazy to look it up.)

Comment 4: One assumes that a private landlord could certainly include these kinds of protections in the tenant rules and leases. What if it doesn't, and a tenant engages in off-premises criminal behavior? Compare: *Barber v. Chang*, 151 CA4th 1456, 60 CR3d 760 (2007) (DD for 11/1/07) (on premises). (Landlord had duty to take minimally burdensome measures to protect visitor to apartment complex from known threat of violence by gun-brandishing tenant.) *Castaneda v. Olsher*, 41 C4th 1205, 63 CR3d 99 (2007) (DD for 8/4/07) (decided later and arguably modifying *Barber).* (The simple act of leasing a mobile home space to persons who have known affiliations with juvenile gangs is not an act of negligence that will render a landlord liable for subsequent injuries caused by such persons on premises.)

What about simply warning other tenants of known criminal tendencies? See: *Rhaney v. University of Maryland, Eastern Shores,* 388 Md. 585; 880 A.2d 357, (Md. 2005) (DIRT DD for 8/17/05). (The relationship between a college and a dormitory resident is one of landlord tenant, and the tenant does not occupy the status of "business invitee," but in either case the college owes no duty to warn against or prevent an assault by a randomly assigned roommate, even when that roommate has been suspended from the campus for a year due to a prior violent incident.)

LANDLORD/TENANT; RESIDENTIAL; IMPLIED WARRANTY OF HABITABILITY: Landlord of condo unit may be liable under implied warranty for impact of secondhand cigarette smoke emanating from neighboring unit owned by others and from common area controlled by others. ***Poyck v. Bryant, 820 N.Y.S. 2d 774 (N.Y.S2d Misc. 2006).***

Tenants leased a condominium unit in a New York multifamily building from landlord, who owned only that unit in the building. Halfway through their second term, new occupants moved into the neighboring apartment. The new neighbors apparently were heavy smokers, and, as alleged by tenant, both the common area hallway and the air within tenants' apartment were suffused with smoke odors.

One of the tenants was recovering from her second cancer surgery and had a tobacco allergy, and Tenants were concerned about the health impact of the secondhand smoke. Tenants complained to the building superintendent, who spoke to the neighbors, but "the incessant smoke continued unabated."

Tenants wrote to Landlord outlining the problem and pointing out that Tenants had lined the door with weather stripping and a draft barrier and had installed two air filters, but that nothing seemed to work. But "[d]espite these efforts, we can still smell the smoke ... in our apartment."

The court noted that New York statutes precluded either Landlord or Tenant from seeking remedies against the condominium association based upon the implied warranty of habitability. But Tenants, the court indicated, did have the right to press a claim based on the warranty against Landlord.

Landlord responded that it was an inappropriate application of the implied warranty notion to hold him liable for actions of third parties beyond his control. But the court responded that New York law imposes such an absolute liability on a landlord to provide an habitable premises, even when circumstances affecting habitability are beyond landlord's control.

Despite that grim pronouncement, the court went on to analyze whether Landlord ought to have done more in this case to resolve the problem. It suggests that Landlord could have asked the condominium association to ban smoking in the hallway or elevator and to alter the ventilation so as to protect Tenant's apartment from being affected by smoke in the neighboring unit. The court suggested that the association, in response, might have treated the neighbors as a nuisance and even fined them and required a surety against future violations.

In the end, the court concluded that the question of whether secondhand smoke caused a breach of the implied warranty of habitability created a sufficient triable issue to justify denial of a motion for summary judgment.

Comment 1: There is no reported history to the case. Since the only issue had to do with a few months rent, presumably the landlord saw that an appeal would be necessary to get around the smoke conscious trial judge on the case, and decided to settle or walk away.

Comment 2: The court indicated that it could find no precedent discussing whether secondhand smoke could violate habitability. The editor is used to determinations of habitability based upon objective factors. The editor finds it noteworthy that, on a community standards basis, the presence of a smoke smell in an apartment, though certainly irritating, could be viewed as support of a claim that there was a significant enough breach for there to be a habitability violation.

Comment 3: Also noteworthy is the question of whether a landlord should be liable for a habitability violation based upon conditions which the landlord has no way of remedying. The existing cases may place the burden on a landlord to bring a nuisance action against neighbors creating a nuisance. The court here may have viewed the problem in that category. But there is no case law of which the editor is aware holding that smoking in one's own apartment is a nuisance to one's neighbors. The real problem here was the special sensitivity of the Tenants, especially the wife. But why is this the neighbors' problem? For that matter, why is it Landlord's problem? People looking for smoke-free apartments apparently can get help from www.smokefreeapartments.org. Not surprisingly, that site advocates the position that tenants have legal rights to secure their apartments and condo units from secondhand smoke. But I found no citations of law. Federal housing laws may work where sensitivity to smoke amounts to or is caused by a disability.

For a report of a trial court report permitting an association to prohibit smoking in condo units, see http://www.thedenverchannel.com/news/10336501/detail.html. The case number is 06CV1256, Dist. Ct. Jeff. Cty. Colo. (11/7/06). The editor believes that many condo associations probably have this power. But it is another matter to argue that they are compelled to use it. The editor also has seen mention of a similar decision in *Merrill v. Bosser* 12 Fla. L. Weekly Supp. 885 (County Ct. 17th Jud. Cir. 2005) (affects only Broward County).

LANDLORD/TENANT; LANDLORD LIABILITY FOR INJURIES TO GUESTS: Even where landlord retains the right to enter the premises to make improvements and an approval right over tenant repairs, the landlord is not in possession of the premises and not responsible for third party injuries caused by dangerous conditions on the premises absent prior notice of the hazard. ***Gilley v. Kiddel, 865 N.E. 2d 262 (Ill. App. 2007).***

Plaintiff claimed injuries caused by loose carpeting on the stairs. Tenant testified that he had mentioned to landlord a desire for a more permanent installation on the stairs, but apparently did not tell landlord of the fact that tenant and several others had fallen on them. The court found that the landlord's reservation of the right to come onto the premises to effect repairs was not an agreement to repair.

LENDER LIABILITY; SERVICING; REINSTATEMENT: Florida court certifies class of claimants for servicer misconduct to include persons losing their homes to foreclosure as a consequence of inability to pay overcharges demanded for reinstatement. ***Cole v. Echevarria, McCalla, Raymer, Barrett & Frappier, 2007 WESTLAW 2805409 (Fla. App. 9/28/07).***

The plaintiffs are residential property owners who were in default on their mortgages, and the defendants are attorneys representing the mortgage holders. The essence of the complaint is that the defendants engaged in an illegal collection practice and a deceptive trade practice by requiring the plaintiffs to pay inflated costs for title searches and title examinations in order to reinstate their mortgages. Presumably these charges were demanded pursuant to language in the standard FNMA/FHLMC residential mortgage instrument that permits reinstatement, even after acceleration, if the borrower:

" ... pays all expenses incurred in enforcing [the mortgage], including, but not limited to, reasonable attorneys' fees, property inspection and valuation fees, and other fees incurred for the purpose of protecting Lender's interest in the Property and rights under this Security Instrument; and ... takes such action as Lender may reasonably require to assure that Lender's interest in the Property and rights under this Security Instrument, and Borrower's obligation to pay the sums secured by this Security Instrument, shall continue unchanged."

Specifically, plaintiffs alleged that defendants included a charge of $325 for title services when in fact the cost to the defendants of the services was $55. Defendants responded that their contracts with the lenders permitted them to levy the disputed fees for the services performed. It appears that the defendants were claiming that their fees were a permitted "mark up."

Thus far, apparently, the trial court has not reached the substance of the charges made by the borrowers, but, after numerous appeals, has remained bogged down in class certification issues. The trial court originally ruled that it would certify a class consisting only of persons who paid defendant's allegedly improper charged in order to avoid foreclosure. Plaintiffs insisted that the class ought to also include persons who failed to pay the disputed fees and lost their property in foreclosure. They argued that the offense was not the *collection* of the charges, but the *demand* for them. All plaintiffs in the asserted large class had received a reinstatement letter demanding the disputed charges.

In a prior appeal, the defendants had argued (perhaps offhandedly) that the basis for the trial court's ruling, otherwise unexplained, might have been that the litigation privilege immunized the defendants in those cases that proceeded to foreclosure. Florida Court of Appeals had ruled categorically that the litigation privilege was applicable only to common law defamation actions, and was not available in cases involving statutory claims. The Florida Supreme Court reversed that ruling, and remanded. This Court of Appeals case follows that remand and a further inquiry on the part of the Court of Appeals to the trial court.

The Court of Appeals obtained a communication from the trial court that in fact its decision to narrow the class was not based on the litigation privilege, and thus the appeal to the Supreme Court on that issue proved to be an idle exercise. The trial court indicated that it did not think the litigation privilege applied because the reinstatement letters were not sent in the process of an ongoing foreclosure proceeding. The Court of Appeals commented that this ruling was not before it, thus setting up still more grinding away by the defendants to avoid getting to the substantive issue.

But the court of appeals did rule, again, that aside from any claim based upon litigation privilege, the broader class should have been certified:

"We have considered the possibility that the distinction the trial court made might have been based on the fact that those who lost their property in foreclosure would have a different kind of injury from those who did not. That notion is dispelled by the findings in the certification order. The order states that '[i]ndividual issues of reliance and damages do not predominate,' because the remedy in all cases is limited to the damages set by statute. This statement is consistent with the trial court's observation in an earlier part of the order that the case focuses on the actions by the defendants, not on individual differences between the prospective class members."

Comment 1: The editor normally would not be filing a DD involving a procedural ruling in the context of ongoing litigation. But the issue of alleged wrongdoing by the community of residential loan services has reached such a pitch on the editors DIRT internet discussion group that the editor has concluded that some ongoing reporting in this area seems appropriate.

Comment 2: Of course, it is too early to make a final judgment on the substantive issues. But the editor feels constrained to point out that the borrowers are all parties who allegedly had committed a default in a residential mortgage and the ongoing negotiations with the borrower had reached the point that an acceleration had been declared. Unless there has been a dramatic change in servicing practices, the gap between initial default and ultimate acceleration customarily is somewhat extended, with ample opportunities for borrowers who in fact have the resources to continue paying on the loan to avoid acceleration.

Of course, recent dramatic changes in loan charges, including monthly payments increased as a consequence of adjustable rates, have created stress for many borrowers, particularly those with otherwise heavy debt loads. Many would argue that these borrowers should have thought of this before they agreed to a loan with a low initial rate but a likely "bump" later on. Insofar as the legal issues go, however, the foolish have the same legal rights as the wise. But see Comment 4, where I report reactions from foreclosure defender April Charney.

The editor's only point is that borrowers who had suffered accelerations were a class of borrowers as to whom it was highly unlikely that reinstatement would in fact lead to a happy lending relationship, and the lender certainly was justified in asking that there be an evaluation of the title to ascertain whether any additional risks to the security were evident, including any violations of the due on sale clause (which also is triggered by most junior liens.)

Comment 3: The next question is whether the lender's counsel is justified in charging more to the lender for title services than the services cost the counsel. Of course, the courts could tell us otherwise, but the editor's impression is that many lawyers enter into retention agreements with their clients that permit them to charge "mark ups" for a variety of things. Clients pay more attention to the overall cost of representation, rather than to the way in which the costs are derived.

If the lawyer's costs will be paid by the lender regardless of whether the lender recovers the fees from the borrower through foreclosure or otherwise, the editor suspects that, in the end, the lawyers will not be found guilty of inappropriate consumer practices here. If, however, the lender pays the lawyers only what is recovered from the foreclosure, then in a sense the charges in question are not charges to the lender, but to the borrower, and of course the borrower has no employment contract. Let's see where all this goes as the litigation progresses.

Comment 4: I "prescreened" this DD with consumer lawyer April Charney, and she responded that, insofar as the subprime market is concerned, the original sale of these mortgages to borrowers was rife with hard sell deception, and the servicing laden with inappropriate fees, so that it is wrong to conclude that the borrowers were just plain stupid – they were defrauded, in her view. Further, it is wrong to conclude that their situation is hopeless, since, in her view, we should "roll back" the deal and give them the loan that they "deserved," not the one which they got stuck with. Or else we should give them remedies for fraud and mistreatment that would in fact make it possible to avoid the economic circumstances in which they find themselves.

As long term readers of DIRT know, I've been warning about fraud among many mortgage brokers for years, and anticipating that they were pushing into the system borrowers who had no chance of repaying their debt. Consumer activists would have it that the rot is much more widespread in the consumer mortgage lending industry, and goes beyond the brokers to include servicers and even trustees engaged in fraudulent and unlawful practices designed to wring the last ounce of profit from their broken victims. These advocates have provided lots of anecdotal evidence of that, and it will be interesting to see how their claims work out in court.

The editor is stubbornly caught in the model, based upon thirty years of experience, that the last thing a lender typically wants is a foreclosed loan, and the lender will do everything possible to work with borrowers to prevent that from happening. The editor sees no reason that this model wouldn't apply to securitized loans in the present situation. Under that model, the chaos in the servicing industry now is due not to fraud or malevolence, but to incompetence and unanticipated volume, since it operates against the best interests of the lenders as well as the borrowers. And it is likely also affected by the fact that there has been so much layering on of costs on these mortgages that there is now going to be a loss to be distributed somewhere in the system, and everyone is pushing to make sure the losses go somewhere other than in their pockets.

Along these lines, April gives us the cite to ***In re Fagan, 2007 Westlaw 2782773 (9/24/07)***, where a bankruptcy judge imposed $10,000 in sanctions when a creditor falsely claimed that the debtor had defaulted on the mortgage loan postpetition. The court commented that there had been too many of these false default claims in the court in recent months, and it was time to crack down. April would cite this as attempted chicanery. I would say it results from incompetence and disorganization. Why would a creditor deliberately mislead a federal court? An invitation to disaster.

I wish that the mortgage banking industry could sit down with consumer advocates to work out a program to save that part of the situation that can be saved. But, like many negotiations between two camps that are much at odds, constructive compromise may already be out of reach. The lenders point to many situations in which the borrowers clearly were irresponsible "flippers," liars who deserved what they got, or just plain foolish, and refuse to bail them out. The consumerists point to the fraud and deception that infects some of the loans, and demand recompense. Neither side can afford to give up any of their constituency, so they are unable to get together on the middle group.

MARITAL PROPERTY; TENANCY BY ENTIRETIES: A contract for deed between a vendor and purchaser for real property held by the purchaser and his wife in a tenancy by the entirety was enforceable, even though the wife did not consent to the sale before her death and the property did not pass before the vendor's death. *Estate of Sommerer, 211 S.W.3d 123 (Mo. Ct. App. 2007)*, reported under the heading: "Vendor/purchaser; Installment Land Contracts; Tenancy by Entireties."

MECHANIC'S LIENS; ELIGIBLE FILERS; EMPLOYMENT AGENCIES: A temporary employment agency that supplies workers for a construction project "furnishes labor" for purposes of a statutory mechanic's lien claim if it retains responsibility over the workers as their employer. ***Reliance Nat'l Indem. Co., L&T, J.V., and Lamar Constr., Inc. v. Advance'd Temporaries, Inc., 227 S.W.3d 46 (Tex. 2007).***

Lamar, as general contractor of an apartment construction project, subcontracted with Gonzalez to frame, drywall, and roof the project. Gonzalez sought additional workers from Advance'd Temporaries, a temporary employment agency. The contract between Gonzalez and Advance'd identified the workers as Advance'd employees, and contained further obligations of both parties. Ultimately, Advance'd supplied more than 100 workers for Gonzalez, completed paperwork and insurance requirements, and paid the workers and their payroll taxes, before invoicing Gonzalez weekly for those services. When Lamar terminated Gonzalez's work and paid him what was owed for that work, Gonzalez failed to pay Advance'd for supplying the temporary workers. Advance'd paid the temporary workers and then claimed a mechanic's lien under the Texas mechanic's lien statute. When Advance'd failed to collect from Gonzalez's or Lamar's surety bond, it brought an action for the balance owed.

The primary issue in the case involved Advance'd's recovery against Reliance National Indemnity Co., Lamar's surety, under the mechanic's lien statute. Specifically, a person has a lien if the person "labors . . . or furnishes labor or materials for construction or repair . . . of [] a house, building, or improvement" and "the person labors . . . or furnishes labor or materials under or by virtue of a contract with the owner or the owner's agent [which includes contractors and subcontractors among others]."

The trial judge concluded that Advance'd was not entitled to recover against the surety bond because it had not "furnished labor" as required under the statute, but rather had simply extended credit to Gonzalez for its payroll. On appeal, the court of appeals reversed, holding that Advance'd furnished labor under the contract with Gonzalez because the temporary workers were Advance'd's employees. Appealing that decision to the Texas Supreme Court, Reliance argued that Advance'd did not furnish labor for the project because it did not control or supervise the temporary workers and was not responsible for their work. It also submitted that the workers were Gonzalez's employees under the borrowed-employee doctrine, which provides that an employee ceases to be an employee of his general employer if he becomes the "borrowed employee" of another.

The supreme court upheld the court of appeals, noting that the contract between Gonzalez and Advance'd clearly identified the workers as Advance'd employees and made Advance'd the accountable party, as Advance'd required both prior notice and agreement for certain hazardous duties and notification of any injury, and was responsible for recruiting, screening, hiring, firing, paying, and insuring the workers, activities which were not merely administrative services. Even though it did not control the details of the work, it did not cease to be their employer. The borrowed- employee doctrine was inapplicable because as a tort doctrine concerned with vicarious liability and apportionment of responsibility for employees who have more than one master, it has no application in contract cases where responsibilities are provided for in the parties' agreement.

Comment: The editor sees no reason why this decision would not have applicability to many mechanic's liens statutes around the nation. But the outcome caught him by surprise, as one doesn't usually think of employment agencies as "subcontractors." The editor is unsure whether the agency's business model is the same as that used by others – it contracted directly with its workers and paid them as its employees, charging a fee to the customer, rather than having the customer pay the workers and charging a commission to the customer. The latter business model might have changed the outcome, but the editor really isn't sure whether any modern agency can or does operate on such a model.

MORTGAGES; FORECLOSURE; FINALITY: Foreclosing creditor held up in traffic, and $6 million property sells for $2,000 at foreclosure. Court refuses to undo sale. ***Amalgamated Bank v. Superior Court, 149 CA4th 1003, 57 Cal. Rptr. 3d 686 (2007).***

PTF, a judgment creditor on real property owned by Winncrest, requested the county sheriff to issue a writ of sale to execute on the property and sell it to the highest bidder (subject to the debtor's right of redemption). The property was worth approximately $6.5 million. PTF intended to bid at the public auction but did not do so because its designated bidders, delayed in traffic, did not arrive until after the property was sold to Palmbaum for $2,000. Winncrest did not exercise its right of redemption within the one-year redemption period.

PTF sued to set aside the foreclosure sale for irregularities and recorded a notice of *lis pendens*. The trial court granted Palmbaum summary judgment, concluding that PTF was barred from setting aside the sale. It concluded that PTF had no standing to bring an action to rescind the judicial foreclosure sale. Under CCP §701.680(c)(1), which applies to judicial foreclosure sales, including those subject to a right of redemption, only the judgment debtor can set aside the sale for irregularity and only if the purchaser was the judgment creditor. Here, the property was sold to Palmbaum, a third party; he became the fee owner, subject only to the right of redemption. Because Winncrest did not bring an action to set aside the sale or exercise its right of redemption within the statutory time frames, Palmbaum's title to the property was perfected.

Having lost at the trial level, PTF appealed. But while PTF's appeal was pending, Palmbaum successfully moved to expunge the *lis pendens.* PTF petitioned for writ of mandate to stay the expungement order.

The court of appeal granted an alternative writ and stayed the expungement order pending resolution of the petition. But the court of appeal then proceeded to deny the writ. It first concluded that its stay of the expungement order was superfluous because, under California law, a stay upon filing a petition for writ of mandate is automatic; the expungement order is not effective until the writ proceeding is finally adjudicated.

California statute requires a court to order the expungement of a notice of *lis pendens* if it finds "that the claimant has not established by a preponderance of the evidence the probable validity of the real property claim." "Probable validity" is defined as "more likely than not" that the claimant will prevail against the defendant in the action. The language the statute is plainly targeted at motions to expunge before trial, not expungement motions made after judgment has been entered and while an appeal is pending. In *Mix v. Superior Court*, 124 CA4th 987, 21 CR3d 826 (2004), the court held that a trial court presented with an expungement motion after judgment against the claimant must apply the probable validity standard and may deny the motion only if the court believes that its own decision will be reversed on appeal.

In deciding a writ petition under the statute, after judgment and pending appeal, an appellate court must also assess whether the underlying real property claim has probable validity, *i.e.*, whether it is more likely than not the real property claim will prevail at the end of the appellate process. The appellate court will conduct a *prima facie* review of the probable success of the underlying appeal, a mini-review that is not equivalent to a full-scale resolution of the underlying appeal. Summary denial of a writ petition does not constitute law of the case requiring the appellate court to decide the appeal against the real property claimant.

Reporter's Comment 1: From a systems point of view, one should approve this decision as showing that deadlines really are meaningful and apply to creditors as well as lenders. On the other hand, from a common-sense or equity point of view, one should say it is insane to reject an attempt to set aside a foreclosure of collateral that was worth between $6 million and $10 million but was sold for only $2,000 because the lender was held up in a traffic jam and showed up at the sale a minute late, and had its attempt to enter a bid thereupon rejected. (I confess to some bias in this analysis, having been involved in this case at some of its stages.)

Both the trial and the appellate court decisions are based on pure formalism: the trial court's summary judgment against undoing the sale on the ground that judicial foreclosure sales are statutorily invulnerable from attack, regardless of merits; and the appellate court's refusal to issue a writ undoing expungement of the *lis pendens*, despite its disclaimer that the merits of the case had not been decided. Both results have great appeal as policies that should be generally supported, but at the same time they generate considerable doubt as to the wisdom of their application in this particular case.

Reporter's Comment 2: As to the summary judgment, the foreclosure sale was upheld because CCP §701.680 provides that a judicial foreclosure is "absolute and may not be set aside for any reason" except in an attack made by the judgment debtor (not the creditor, as here). But despite this statute saying that foreclosure sales are absolute, CCP §726 provides at the same time that they are subject to rights of postsale redemption whenever a deficiency judgment can be rendered. Since "absolute" is supposed to mean "not subject to redemption" (*Yancey v. Fink*, 226 CA3d 1334, 1350, 227 CR 415 (1991)), there clearly has to be a carve-out for sales, such as this one, when a deficiency judgment was sought if both §726 and §701.680 are to be respected.

When §701.680(a) then also says that the sale "may not be set aside for any reason," is that subject to the same carve-out, or are the two clauses in the section to be treated differently? Since the policy behind this section is to give sales more finality, in order to encourage bidding at them, is any additional finality gained by making a sale immune to attack when it is already subject to redemption? Would a prospective bidder offer more in one case than in the other? When a sale is truly "absolute" (not subject to redemption), then "finality" (invulnerability to attack) is a meaningful companion, but what good does invulnerability do when there can be a redemption anyway? It does not seem very likely to me that the legislature truly wanted to bar judicial attacks on sales that were already subject to statutory redemption.

I can understand having what seems like a logically absurd principle if it did a party some good, but that does not seem to be the case. Denying the creditor an opportunity to vacate the sale so that it can enter a higher bid certainly does not help the debtor, who only loses the prospect of the deficiency judgment being reduced by virtue of a higher bid (if it exceeded fair value). Nor does it help junior creditors, who, like the debtor, lose the opportunity to receive any surplus from a higher bid. It clearly hurts the selling creditor, whose deficiency recovery remains limited by fair value regardless of how little was bid. Only the third party bidder comes out a winner. (Unless the trustor then redeems, and it is certainly puzzling why there was no redemption here, when it would have taken only $2,000 to reacquire property worth $6 million to $10 million.)

I have written previously about my misgivings as to making the fall of the hammer the crucial last moment of the sale, as opposed to the delivery or the recordation of the trustee's or sheriff's deed. See Midcourse Correction, Setting Aside Foreclosure Sales, 24 CEB RPLR 80 (Mar. 2001), and my Editor's Take (26 CEB RPLR 161 (July 2003)) on *Residential Capital, LLC v. Cal-W. Reconveyance Corp.*, 108 CA4th 807, 134 CR2d 162 (2003). I think either party – debtor or creditor – whose objection is publicly made before the selling official has accepted the bidder's money and delivered the deed to the bidder should have standing to make that protest in court even though the hammer had already fallen, but that does not appear to be the rule.

Reporter's Comment 3: With regard to expunging the *lis pendens*, the court of appeal applied similar policy notions: Notices of pendency have to be readily expungeable in order to keep them from being frivolously or abusively filed. As with foreclosure sale finality, I think that is an admirable policy, but only when and if it serves some appropriate purpose.

By permitting this *lis pendens* to be expunged when the merits have yet to be decided, this lender – even if it prevails – will recover nothing. Even if the debtor is not a single-asset judgment-proof entity, the lender's deficiency judgment will be calculated according to the $6 million to $10 million fair value, rather than the $2,000 bid, allowing all of the rest in between those numbers to escape. Even if the lender's arguments on the merits are upheld, the sale cannot be undone if title was transferable to a BFP because of the expungement, and such a transfer did occur. The bidder will have sold for $6 million what it purchased for $2,000, and it will take some pretty imaginative theorizing for the lender to find a way to reach into its pocket and retrieve that profit. Once the *lis pendens* is expunged, the foreclosure purchaser can capture the kind of resale profit that was sought and lost in Residential Capital, supra, regardless of whatever happens on the merits.

The probable validity test that the court of appeal applies seems generally an appropriate standard. But nowhere in it is any consideration given to the potential harm that can result if expungement is permitted at the preliminary stage and then regretted at the final stage. Again, efficiency beats equity.

Editor's Comment: A truly amazing part of the case was that the party scheduled to be bidding could think of nothing to do to delay the foreclosure sale other than to fight the traffic doggedly (and unsuccessfully) on the way to the courthouse. Didn't the Lord invent cell phones exactly for situations like this? Note that this was a sheriff's sale, not a trustee's sale, so it may be that the wheels of justice were grinding along and no one at the sheriff's office was inclined to cut any slack or answer a phone. A private trustee likely would have had an obligation to adjourn the sale if informed in a credible way that someone willing to bid millions more than the bid on the table was stuck in traffic but on the way to the sale.

The Reporter for this item was Roger Bernhardt of Golden Gate Law School. His work first appeared in the California CEB Real Property Reporter. Reprinted with permission.

MORTGAGES; FORECLOSURE; PREMISES LIABILITY: Although the winning bidder of real property at a judicial foreclosure sale has not yet obtained legal title at the time of a subsequent fire, due to lack of final confirmation of the sale, it conceivably had equitable title, which could be the basis for a liability claim against it for failure to prevent a fire that damaged adjacent property. ***O'Connell v. ABN Ambro Mortgage Group, Inc., No. 2006-CA-000327-MR, 2007 WL 867632 (Ky. Ct. App. March 23, 2007) (not yet certified for publication).***

On April 6, 2004, ABN Ambro Mortgage Group, Inc. ("ABN") purchased real property at a foreclosure sale. Four days later, a fire started on the foreclosed property. The fire damaged adjoining property owned by O'Connell. At the time of the fire, ABN did not yet have legal title to the property. It did not obtain such title until months later, in September, when its purchase of the foreclosed property was confirmed, and it received a commissioner's deed.

O'Connell filed suit against ABN, claiming that ABN's negligence had caused the fire and the damage to her property. The trial court dismissed her claim on the basis that at the time of the fire ABN did not hold title to the land. The Kentucky Court of Appeals reversed and remanded, finding that while legal title to the property had not yet passed to ABN, it possibly possessed equitable title at the time of the fire.

ABN relied on section 426.575 of the Kentucky Revised Statutes, which provided that "[a] conveyance by a commissioner shall not pass any right until it has been examined and approved by the court; which approval shall be endorsed on the conveyance and recorded with it." Because a court had not yet approved the foreclosure sale, ABN reasoned, no right had passed to it, and thus it had no legal obligation to make the property safe. The circuit court agreed with ABN's argument, finding that while ABN could have obtained equitable title if it had taken "steps to comply with the terms of the bid," it had not paid any deposit at the time of the fire or done anything else to comply with the bid.

On appeal, the court of appeals affirmed the general premise that a successful bid at a foreclosure sale, by itself, does not vest the bidder with any title. But it noted that "equitable title of property passes to the purchaser through a valid judicial sale upon the execution of the statutory bond required by Kentucky Revised Statutes (KRS) 426.705." It then concluded that it was unclear whether ABN had executed such a bond and remanded for clarification. The court also stipulated that O'Connell be allowed reasonable time to conduct discovery upon remand.

Comment 1: Wow!!! One assumes that, although judicial confirmation of a foreclosure sale certainly is routine in most cases, it is more than a rubber stamp. The foreclosure purchaser in fact did not have title to the property. Is there anything in Kentucky law providing that a foreclosure purchaser in these circumstances even has a right to possess the property? Would it be entitled to bring a summary possession or ejectment action against the prior owner? Note that, under the doctrine of equitable conversion as generally recognized, equitable title passes while a contract is still executory, but the right to possess the property typically does not.

The court seems to conflate the two concepts, talking about whether a purchaser has an "insurable interest." Under the doctrine of equitable conversion, certainly a buyer has an insurable interest, but this would seem to be irrelevant to whether the buyer has a right of possession in the property. The court cites a Kentucky statute that states that a foreclosure purchaser shall have no rights in the property until the sale is confirmed. This would seem to preclude a finding of a possessory right.

Comment 2: The editor concludes that the question of whether the foreclosure purchaser had equitable title ought not to be dispositive of the liability claim. If the foreclosure purchaser had no clear right to possess the property and was not in fact in possession, then pinning such purchaser with premises liability certainly seems a stretch. The court, on remand, did authorize the plaintiff to conduct discovery to ascertain whether ABN AMRO had in fact taken possession of the property. Presumably it might have done so as a mortgagee in possession or by consent with the borrower prior to confirmation.

Comment 3: In any event, it appears that Kentucky law has created a kind of "suspended animation" period for foreclosure properties – between auction and confirmation – and ought to provide greater clarity as to the rights and responsibilities of the parties during this period. This was a court's opportunity to do just that, but the editor believes the court blew it.

MORTGAGES; INSURANCE; ESCROWS: Mortgagee acquiring insurance with monies escrowed from mortgagor may be fiduciary. ***Smith v. GMAC Mortgage Corp., 2007 WESTLAW 2593148 (W.D. No. Car. 9/5/07).***

Smith had a home mortgage on which she paid escrows for taxes and insurance. She acquired insurance from Nationwide Insurance Company. About eight months into the loan relationship, she received a notice from the original mortgagee loan was being transferred to GMAC, and that GMAC would collect payments and "manage your escrow account for insurance ... "

GMAC sent Smith a letter confirming this and that a notice was being sent to the insurer to send future insurance information to GMAC.

For over two years, GMAC made regular payments out of the escrow account to pay insurance premiums on Smith's property. Nationwide periodically sent notice to Smith that the premiums were being billed to GMAC.

Then, although Smith had continued to pay into escrow, Nationwide sent a series of notices to GMAC that the insurance premiums had not been paid and that the policy would be cancelled if the nonpayment was not resolved. Ultimately, a Nationwide agent sent a notice to GMAC that the insurance had indeed been cancelled and that Ms. Smith had lost the advantage of earlier eligibility rules, so that if she renewed her insurance, the premium would be recomputed under new guidelines.

Later, GMAC denied that it had failed to pay the insurance premiums to Nationwide, and blamed the problem on Nationwide. But GMAC apparently never denied that it did not respond to the numerous warnings it received from Nationwide that the policy was about to lapse for nonpayment. And Smith apparently got no word of the problem from either Nationwide or GMAC until after the policy had lapsed.

Shortly after the policy was cancelled, Smith received notice from GMAC that it would force place an insurance policy through Balboa Insurance Group. The policy cost three times the amount of the Nationwide policy. Interestingly, GMAC had just selected Balboa as the manager of its mortgagor escrow functions. So if the mortgagee's side did fail to make a payment to Nationwide, it likely was Balboa that erred. And Balboa is also the beneficiary. Smith alleged that GMAC had a profit interest in Balboa, anyway.

Ms. Smith alleged that the increased burden of this policy caused her to default in her mortgage payments, which led GMAC to schedule a foreclosure. Even when confronted with the evidence of Nationwide's assertion that GMAC had defaulted in the insurance payments, leading to increased insurance payments and therefore mortgage payments, GMAC refused to postpone the foreclosure. A judge dismissed it.

In addition to these problems Smith's credit rating deteriorated, causing other credit problems. Smith further alleged that GMAC failed to pay the property taxes on her home as well, although it had the escrowed monies to do so. She reobtained a Nationwide insurance policy, but due to the rerating, her premiums were around 70% higher than before.

In her lawsuit, Smith chose to predicate her claim on the notion that GMAC had a fiduciary responsibility to her as manager of her insurance escrow account. GMAC sought summary judgment on the grounds that a lender could not be regarded as a fiduciary of a borrower as a matter of law.

The federal court here ruled that, under North Carolina law, whether a fiduciary relationship exists depends on all the facts and circumstances. A party can be a fiduciary for another party as to some elements of the relationship between the two, but not others. Here, the court ruled, plaintiff Smith certainly had made a sufficient showing to support denial of summary judgment.

The court noted that even as to situations where North Carolina had determined that no fiduciary relationship typically was involved, such a relationship could be found where "special circumstances" existed resulting in one party having "superiority and influence" over the other. Apparently as an additional consideration, the court discussed relationships in which a subordinate party entrusted the handling of its business affairs to the dominant party and placed trust and confidence in it. In fact, the court suggested, North Carolina already has concluded that a mortgagee had a fiduciary relationship toward a mortgagor where transactions affecting the mortgaged property are concerned.

Although the court acknowledged that a typical debtor creditor relationship normally would not give rise to a fiduciary relationship being found, this likely will not be so when in a residential transaction a debtor entrusts to the mortgagee the responsibility for paying taxes and insurance with monies provided by the debtor. The court concluded, however, that the ultimate determination of whether there was a fiduciary duty would be a jury determination. But certainly there were enough facts alleged, the court held, to permit the jury to consider the question here.

Comment 1: This case has potentially broad consequences. If, indeed a mortgagee is a fiduciary of the borrower in managing the escrow account, it might also have that same duty in connection with the "force placing" of insurance. If that is the case, then the fiduciary would have a duty, first, to avoid profiting itself from the placement of such insurance and, second to make forced placement decisions that were in the best interests of the borrower. Certainly there is cheaper insurance available than that which typically is force placed by lenders. And certainly the lenders generally profit in such forced placements at the present time. All this would have to change.

Further, the fiduciary relationship might help the mortgagor in situations in which, due to the mortgagee's negligence, the insurance is not paid, but the mortgagor gets wind of the problem. Once the mortgagor knows of the problem, the mortgagor perhaps would have an immediate duty to mitigate. But if the mortgagor can rely on the mortgagee as a fiduciary, the mortgagor's failure to solve the problem immediately may not deprive the mortgagor of remedies against the mortgagee.

Note that here apparently there was not prior communication about the premium default between mortgagee and mortgagor, but the facts are vague about when the mortgagor discovered that she had a problem and what she did to correct it.

Comment 2: The editor believes he may be the only scholar who has ever considered insurance escrow questions in a law review article. He did so in "The Mortgagee's Interest in Casualty Loss Proceeds; Evolving Rules and Risks," 32 ABA Real Property, Probate & Trust Law Journal, 1 (1997). Specifically as to the escrow issue, the editor concluded that there ought to be a cognizable duty on the part of the mortgagee that collects escrows to use them to buy appropriate insurance. But, remarkably, the editor found several cases suggesting otherwise, and discusses them at some length in the article. (Most of the article deals with other mortgagee insurance issues.)

MORTGAGES; LATE PAYMENT FEES; BALLOON PAYMENTS: Lender could not recover percentage late fee on promissory note's final balloon payment when fee provision applied only to interim installment payments. ***Poseidon Dev., Inc. v. Woodland Lane Estates, LLC, 152 CA4th 1106, 62 CR3d 59 (2007).***

Woodland executed a promissory note (Note) and deed of trust in favor of Poseidon which provided for monthly interest-only payments and a final payment of principal and unpaid interest. If any installment was not paid on time, the Note provided for a late charge of 10 percent of the overdue amount, described as processing and accounting charges.

Woodland failed to make the final payment of principal and interest on the due date. Poseidon recorded a notice of default and then began collection proceedings, incurring attorney fees and costs. Although Woodland eventually made the final payment of principal and interest, it refused to pay a late charge or the expenses of collection.

Poseidon sued Woodland for breach of contract, seeking to recover a late charge of 10 percent of the final balloon payment, its collection expenses and damages for lost business opportunities, costs and attorney fees. The trial court sustained Woodland's demurrer without leave to amend, concluding that the Note's late charge provision applied only to the interest payments, not the final balloon payment, that Poseidon was not entitled to costs of collection because it was not authorized to initiate foreclosure proceedings, and that Poseidon could not recover damages for lost business opportunities. The trial court granted Woodland's motion for costs and attorney fees.

The court of appeal reversed. Although the trial court correctly determined Poseidon was not entitled to the relief sought in the complaint, it erred in sustaining Woodland's demurrer without leave to amend because Poseidon was entitled to recover actual damages suffered by reason of the late payment.

Poseidon was not entitled to a late charge on the balloon payment as an element of damages. Although a final, balloon payment may be considered an installment within the common meaning of that term, the parties did not so intend here, as indicated by the plain language of the Note read as a whole, in accordance with CC §1638, §1641, §1643, and §1644. Moreover, the trial court's interpretation saved the late charge provision from being an unlawful penalty under CC §1671(b). The Note provided that the purpose of the late charge provision was to compensate Poseidon for administrative expenses, which would not vary appreciably depending on the amount of the overdue payment. If the late charge provision was intended to apply to both interim installments and the final payment, it would be an unenforceable penalty provision because it could not possibly be considered a reasonable estimate of the damages contemplated by a breach. The only interpretation of the late charge provision that would make it lawful, operative, definite, reasonable, and capable of being carried out, as required by CC §1643, is one that would make it inapplicable to the final payment.

The trial court properly took judicial notice of a recorded assignment of the Note and deed of trust whose clear legal effect was that Poseidon no longer held the beneficial interest under the deed of trust. Because Poseidon gave up its right to replace the trustee and initiate foreclosure when it assigned the Note and deed of trust, it had no power to initiate foreclosure proceedings and was not entitled to recover the cost of doing so from Woodland.

The demurrer should not have been sustained without leave to amend. It was undisputed that Poseidon was entitled to interest from the date final payment was due until it was paid and might also be entitled to other damages in the nature of administrative expenses. Although Poseidon had been given one opportunity to amend the complaint to state a claim for unpaid interest and failed to do so, it was appropriate to give Poseidon one more chance.

Reporter's Comment: When I read this decision, my immediate reaction was to wonder how real estate attorneys would respond to it and how they might advise clients to rewrite their documents (or redo their deals). It also occurred to me that non-Californians might react differently, so I decided to survey the country. To do so, I turned to leading real estate lawyers in Los Angeles, Chicago and New York. They noted as well that a party drafting a promissory note could easily craft language that would expressly provide for a late charge to be paid with reference to monthly installments of interest and a payment of the principal balance at maturity.

But then, of course, the question arises whether such a charge would be a penalty. The court held as a matter of law that the 10-percent late charge was unenforceable as a penalty when applied to the principal balance. In particular, the court focused on the gross disparity in the relative amount of the late charge when applied to an installment of interest or to the principal balance of the note.

The California commentator found this analysis "troubling." He noted that the court relied on the fact that the amount of the late charge was vastly different if applied to an interest installment, as distinguished from the entire principal balance due at maturity. But he saw this reasoning as flawed because varying late charges would commonly occur as to payments other than balloon payments, for instance, if a note provided for monthly payments of interest and quarterly payments of principal, differing late charges would result. He noted, further, that although the Third District focused on "processing and accounting expenses," it is clear the language of the late charge provision was not intended to make these the exclusive components of damages that the parties were apparently seeking to liquidate.

The California commentator also properly noted that the court of appeal's analysis of the validity of the late charge as a matter of law did not address the seminal decision by the California Supreme Court in *Garrett v. Coast & S. Fed. Sav. & Loan Ass'n* 9 C3d 731, 108 CR 845 (1973), which had invalidated a contractual charge in a residential mortgage and triggered the legislative adoption of CC §1671 to govern the validity of liquidated damage provisions.

It is possible that the court's entire analysis of the validity of late charges in general could be viewed as *dictum*, since the court found that the contractual language of the note did not support late charges on the balloon payment.

The Chicago commentator, Jack Murray of the Chicago office of First American Title, also noted that the case has two parts – analysis of the contractual language in particular and analysis of the validity of late charges in general.

As to the second issue, he concluded that it is virtually impossible to justify a 10-percent late fee on the entire principal balance, especially when the loan is interest-only with no principal amortization. Even if the documents clearly so provided, he believed that virtually any court (especially in bankruptcy) would find it inequitable and a penalty instead of reasonable compensation for, or estimation of, damages. Thus, he agreed with the court's holding in the Poseidon case. The lender in that case was entitled to an increased default interest rate (from 10 percent to 18 percent) on the unpaid balance if it accelerated the debt, and this should be enough to protect it.

Jack discusses this issue some in his article: Murray, Default Interest Rates, Late Charges and Exit Fees: Are They Enforceable? *http://www.firstam.com/listReference.cfm?id=5574*

He opined that a late-charge provision that compensates the lender for administrative expenses by charging $614.67 for one late payment and $77,614.67 for a late final payment is not a reasonable attempt to estimate actual administrative costs incurred. He indicates that he had not found another case with similar facts that would permit such a charge. In fact, several cases have held that a 10- percent late charge, even on regular installments, is excessive and a penalty (in one case, a 5-percent late charge on regular installments was held to be a penalty.)

Jack asks whether, if the court struck down the 10% penalty, it would still permit the lender to collect its "actual" damages? He believes the *Poseidon* court made contradictory statements in this regard.

The New York lawyer, DIRTer Joshua Stein, first discussed the contract interpretation issues. He noted that the court mentioned that the note sometimes referred to "payments" as opposed to "installments." Different words must have different meanings, the court reasoned, and "payment" would without doubt include the payment due on maturity; "installment" could well mean something else. He said:

"The court's reasoning demonstrates why legal drafters should use the same word consistently when they intend to refer to the same concept. If the drafter sometimes says 'payment' and sometimes says 'installment,' the inconsistency invites a court to infer some difference in meaning. In commenting on whether the 10-percent late charge on the final principal balance would constitute an unenforceable penalty, also speculated that the whole discussion in the case could be viewed as *dicta* – unnecessary to the result."

Joshua didn't entirely agree with the court's narrow reading of the word "installment." He speculated that "payment" and "installment" are probably synonymous in the context of this transaction. Either can readily apply to any payment due on a note that requires multiple payments. There is no particular reason to treat the payment due on maturity as anything different from another "installment." Common usage, Joshua said, would call that payment the "final installment," which would imply it's just another installment, though it happens to be the final one. Installments that are not the "final installment" might be called "monthly installments" or "periodic installments."

But he also acknowledged that the interpretational issue could go either way. If the lender really wanted to collect a late charge on the outstanding principal balance on maturity, the lender should have clearly said so. A late charge on maturity represents a rather draconian and "off market" result. Therefore, the lender should have borne the burden of being "even clearer than necessary" about the parties' intentions to impose a late charge on the outstanding principal balance. It's just the old principle that courts should construe documents against the drafter.

In theory, if the lender had hit the borrower over the head with the "late charge on maturity," the borrower might have negotiated the note to eliminate that particular burden. Well-represented, sophisticated commercial borrowers do routinely add language to negate a late charge for the payment due on maturity. Lenders almost always agree to that concession with little debate. So, the "standard in the market" probably contemplates that lenders cannot collect late charges on the outstanding principal balance on maturity. Correspondingly, if lenders truly do intend to collect such a late charge, they bear the burden of being absolutely clear about it. I have certainly seen it, though only in a small minority of loan documents.

As to the validity of a late charge on a balloon in general, Joshua commented that he was not convinced that the theory of "contract damages" offers the right test to validate or invalidate various payment alternatives available to a borrower under a promissory note.

"A note typically allows the borrower to pay on maturity, in which case the payment is one amount. It also (often) allows the borrower to pay before maturity, in which case the payment may include some formula to make up for some or all of the lender's loss of interest. Finally, the note also recognizes the possibility that the borrower might pay after maturity, in which case the payment becomes some other amount (in this case, 110 percent of what was due-perhaps to compensate the lender for the greater risk of nonpayment at this point).

"It is unclear to me why consenting adults should not be allowed to negotiate a menu of commercial alternatives just like these. The court treats only one of those alternatives as the 'contract,' and then treats the 'payment after maturity' alternative as a breach of that contract. It just doesn't make a great deal of sense to me. Even the usury law (which generally doesn't make much sense to me, either) tolerates higher interest rates, or other consideration for the use of money, if the borrower fails to pay when due."

Joshua asks whether the *Poseidon* court would invalidate an "exit fee" – a payment as additional consideration for making the loan, but due only on maturity.

"At what point would the court invalidate such a fee? But why shouldn't the parties be able to agree to one? If they can, then why can't they also agree that the lender will waive the "exit fee" if the borrower repays the loan strictly when due – thus dramatically reducing the risk profile of the loan for the lender?"

In Joshua's view, the *Poseidon* court's invalidation of a late charge on maturity drags the judicial system into a thicket of discretionary line-drawing, with the result that borrowers and lenders never know what agreements the courts will deign to enforce. The resulting lack of certainty probably imposes burdens that far outweigh the random benefits bestowed on occasional lucky borrowers.

Finally, Joshua found another lesson here. He noted that the Poseidon lender pledged its deed of trust to another lender as security for a loan to the holder of the deed of trust, sometimes called a "hypothecation" or a "mortgage warehouse line." But instead of recording a collateral assignment, it seems the parties recorded an absolute assignment and never undid the mistake. Thus, as a matter of technical legal rights, the party that thought it was the lender actually had no right to foreclose the deed of trust, because that right had been assigned to someone else.

"Silly defects like these offer any borrower wonderful fodder for defenses. If the borrower can somehow establish that the would-be lender doesn't actually hold the loan, then the borrower can conceivably unwind the entire enforcement process. The borrower can do this even though the putative holder of the loan gave the borrower every notice and all the "process" to which the borrower was entitled, even though the borrower was, and is, in default under the loan.

To prevent such defenses, a lender needs to make sure that any post-closing documents say what they were intended to say and do what they were intended to do. As a practical matter, though, many lenders try to consummate post-closing transactions with the least possible involvement by lawyers.

Even if a lender saves legal fees by using chimpanzees to handle its post-closing transactions, once a loan goes into default, the lender might be well advised to have counsel take a close look at the file to try to find problems of the type that arose here. Even that exercise, however, may be more than lenders are willing to undertake. They may regard the resulting risk of surprises as just a cost of doing business – far preferable to paying the level of legal fees that would be necessary to proactively identify and solve problems like the one that occurred here."

The Reporter for this item was Roger Bernhardt of Golden Gate Law School in San Francisco, writing in the California CEB Real Estate Reporter. The editor has edited Roger's piece substantially, especially in summarizing the views of the three other commentators.

MORTGAGES: PARTICIPATION: If a group of parties receive partial assignments or participation shares in a note and mortgage, and if they do not specifically agree among themselves as to their priority, the court is not bound to treat them as *pro-rata* participants, but instead can assign priority among them based on the equities of the case. ***Carbon v. Spokane Closing & Escrow Co., 147 P.3d 605 (Wash. App.2006).***

This case involves the creation of a set of partial assignments (participations) in a $2.5 million note and deed of trust. The facts are complex, and it isn't clear that the court understood them perfectly, but here's what seems to have happened.

Mr. & Mrs. Carbon sold a parcel of land to A&P Properties for $930,000. A&P gave them a note for $330,000, secured by a deed of trust on other property (which was never paid to them), and they also received $30,000 from one of the promoters of the deal. They were supposed to receive the remaining $566,000 by way of a 15-day note from A&P, but that note was never paid to them. Instead, A&P gave a note and deed of trust to Solid Rock for $2.5 million; this deed of trust was a lien on the land the Carbons had sold to A&P. (A&P never received anything of value for the $2.5 million note). Solid Rock then issued five partial assignments of the $2.5 million note to five individuals, one of which was a partial assignment to the Carbons in the amount of $566,000. The deed to A&P, the deed of trust from A&P to Solid Rock, and the partial assignments were all duly recorded.

Thus, the partial assignment received by the Carbons was evidently intended to represent payment of the remaining purchase price owed to them for their land, and they evidently accepted it in lieu of payment of the 15-day, $566,000 note. However, of the $566,000 they were to receive on the partial assignment, they were paid only $150,000; at that point, the $2.5 million note went into default and payments on it ceased.

This transaction was ill-thought-out, to say the least. Why would the Carbons have accepted a one- fifth share of a note for $2.5 million in partial payment for, and secured by, land that they had just sold for less than $1 million? Why did they not insist on receiving immediate payment of the $566,000 note, and sue on it when it was not paid? There are no clear answers to these questions. The trial court concluded that the escrow officer who prepared the document breached a fiduciary duty to the Carbons.

In effect, the Carbons were holders of about a 23% participation share of the $2.5 million note and deed of trust, although there was no participation agreement. When the note went into default, the Carbons brought a suit against all of the other parties, demanding among other remedies that they be given first priority in the payout of the foreclosure proceeds on the deed of trust.

Ordinarily, when there is no contrary agreement, the parties to a participation share pro-rata in the proceeds of a foreclosure if a shortfall occurs. But here, the court granted the Carbons the first priority as they had requested. In doing so, it applied equitable principles. The Carbons were entitled to first priority, in essence, because they had provided the real estate that made the whole deal possible. Their priority would extend, the court held, to let them recover up to the full purchase price they had originally agreed to accept.

The court found that the $2.5 million note and deed of trust were fraudulent conveyances, by which it presumably meant that they were executed without receipt of equivalent value, and that their issuance left A&P, which issued them, insolvent. Nonetheless, the court refused to set the note and deed of trust aside on the basis of the fraudulent conveyance statute, because the Carbons and each of the other holders of the partial interests had contributed value to the deal, and hence all were BFPs.

Not only did the Carbons receive first priority, but the court prioritized at least some of the other parties interests as well. One party who made a cash investment in the property received second priority, and another party, who did not provide any cash but who renegotiated existing security interests in other properties, was given third priority.

Reporter's Comment 1: The fact that the Carbons were given first priority is not surprising when we remember the principle that a purchase-money mortgage to a vendor is presumed to have priority over other security interests that come into effect in connection with the purchase. While the Carbons' interest was not, strictly speaking, a purchase-money mortgage, it was in effect granted to them in lieu of a purchase money mortgage. Hence, the priority they received makes sense.

Reporter's Comment 2: The purchase-money mortgage doctrine, however, doesn't explain the allocation of priorities among the *other* partial assignees. That was done on the basis of pure equity. The lesson is clear: if the parties to a participation want a particular priority, they had better spell it out. They can't assume that the court will treat the participants as all *pro-rata* if their agreement is silent on the point.

Reporter's Comment 3: There was no participation agreement or other contract regarding the priority of the partial assignments here. It's interesting to think about what the court might have done if there had been. It is likely that the court would have enforced the agreement. After all, the purchase-money mortgage doctrine is only a presumption, and can be reverse by specific language of subordination. There is every reason to suppose the court here would have enforced a specific priority agreement as well.

Reporter's Comment 4: In one paragraph, near the end of the opinion, the court goes off on a tangent concerning UCC Article 9. It points out (correctly) that the perfection provisions of Article 9 apply to security interests in a note, even one secured by a mortgage. This is true but irrelevant, since the partial assignments in this case were (so far as one can tell from the opinion) outright assignments rather than security assignments. (Article 9 provides that outright assignments of "instruments" – such as promissory notes – are automatically perfected, without the necessity of either delivery of the instrument itself or of filing a UCC-1; see UCC 9-309(4). And perfection as to the note automatically perfects as the real estate security – the mortgage or deed of trust – as well; see UCC 9-308(g)). The court concludes by saying that since none of the partial assignees perfected, none of them had secured interests in the note. Again, true but completely irrelevant, since their interests were outright shares of fractional ownership, rather than security interests in the $2.5 million note. The paragraph does no ultimate harm, but illustrates how confused judges and lawyers can become when faced with the interaction of Article 9 and real estate interests.

The Reporter for this item is Professor Dale Whitman, emeritus professor of the University of Missouri-Columbia School of Law.

MORTGAGES; PREPAYMENT; PREMIUMS; BANKRUPTCY: When the bankruptcy estate has sufficient cash to pay claims of all creditors, a lender may collect a prepayment premium without regard to whether such premium is "reasonable" within the meaning of Bankruptcy Code Section 506(b). The only relevant question is whether the fee is valid under state law, the test for creditor's claims under Bankruptcy Code Section 502. ***UPS Capital Business Credit v. Gencarelli (In re Gencarelli), 501 F.3d 1, (1st Cir. 8/30/07)***, discussed under the heading: "Bankruptcy; Creditor's Claims; Lender's Fees; "Reasonableness."

MORTGAGES; PREPAYMENT; PREMIUMS; FORECLOSURE: Whether a Federal savings bank can collect a prepayment premium as part of its judgment in a state foreclosure proceeding. ***Eastern Savings Bank, FSB v. Munson, 50 Conn. Supp. 374, 932 A.2d 1079 (Super. Ct. of Conn., May 10, 2007***).

The prepayment provision in the promissory note in this case read as follows:

"Borrower's Right to Prepay: If this note is prepaid in whole or in part, whether the prepayment is voluntary or involuntary, including any prepayment affected by the Note Holder's exercise of the acceleration provision of this note or the Security Instrument, within thirty-six months from the date of this note, then borrower must pay a prepayment premium. The premium will be six months interest, at the note rate, on the prepaid principal."

The issue before the court was whether the mortgagee was entitled to a judgment in a foreclosure proceeding in which the prepayment penalty (calculated without controversy at $10,966.60) was added to the mortgage debt. According to the court:

"The short answer as to whether a prepayment penalty can be included in the mortgage debt in a foreclosure proceeding is that it depends on the language of the prepayment penalty provision in the note and whether the mortgagor defaulted with intent to avoid the penalty."

The court, citing previous Connecticut cases, noted that prepayment premiums in mortgage documents are valid and not against public policy, nor are they in violation of the Connecticut Unfair Trade Practices Act. The court also noted that the plaintiff was a federal savings bank, and that the federal Office of Thrift Supervision, which has jurisdiction over federal savings associations, issued a regulation, 12 C.F.R. § 560.34, which specifically provides that "a federal savings association may impose a fee for any prepayment of a loan." The court acknowledged that there are some limitations on the enforceability of prepayment premiums (e.g., unconscionability, condemnation, and casualty loss such as insurance proceeds from a fire that destroys the property), and that there are limitations that carry over to foreclosure cases where "the lack of voluntary prepayment by reason of the acceleration of the note is a factor."

The court stated the general rule in this situation as follows:

"[W]hen a mortgage note simply provides for a penalty if the note is paid before a specified date, the mortgagor defaults and the mortgagee brings an action to foreclose on the mortgage, a prepayment penalty is not permitted because the note is accelerated at the option of the holder."

But the court noted that, as in this case, "[w]here the promissory note ... expressly provides for imposition of a prepayment premium upon acceleration, that premium is required to be included in the final foreclosure judgment." The court, citing several cases from other jurisdictions, reasoned that the parties contractually bargained for that provision and that it should therefore be enforced.

Reporter's Comment 1: The ruling in this case (which did not involve a yield-maintenance prepayment provision) is not surprising. Although the court stated the "general rule" that a lender cannot collect a prepayment premium in a foreclosure proceeding where the lender has accelerated the debt, it also stated that "there cannot be a per se rule that acceleration precludes a claim for a prepayment provision because a borrower may default intentionally and induce the acceleration and foreclosure in order to avoid prepayment liability." The court considered this implausible in the instant case because of the cost of the foreclosure, which would likely exceed the cost of the prepayment premium. The court noted that where there was clear evidence that the borrower intentionally defaulted to avoid payment of the prepayment premium, "the courts have no difficulty requiring that the prepayment penalty be added to the mortgage debt." And in any event, the court further noted, where (as in this case) the note or mortgage specifically provides for a prepayment premium upon acceleration of the loan, "that premium is required to be included in the final foreclosure judgment."

Reporter's Comment 2: Lenders should be careful to request specifically, in state foreclosure proceedings, that the prepayment premium be included in the foreclosure judgment so that state and bankruptcy courts will permit collection of the premium. In *In re McClung,* 2003 Bankr. LEXIS 2076 (Bankr. D. Kansas, Dec. 11, 2003), the debtor defaulted on a mortgage and note held by Washington Mutual Bank ("WMB"), which then commenced a state foreclosure action. The foreclosure decree entered by the Kansas court, which was submitted and approved by the attorneys for WMB's successor (the loan had been assigned to WMB by the original lender prior to the debtor- mortgagor's bankruptcy filing), granted judgment for the amount of the principal balance of the loan, together with interest at the contract rate, title insurance expenses, and costs, including reasonable attorneys' fees, "together with all advances and expenditures properly chargeable under the terms of the Mortgage." The debtor-mortgagor sought and obtained the bankruptcy court's approval to sell part of the property consisting of ten unimproved acres (of the 25-acre total), and WMB did not object to the sale. The debtor-mortgagor subsequently entered into a contract to sell the remaining 15 acres, which sale was authorized by the court and not objected to by WMB. The net proceeds obtained from these sales (which were sufficient to pay the full amount of WMB's loan) were escrowed with the closing agent pending the bankruptcy court's decision as to whether WMB was entitled to a prepayment premium in the amount of $5,915.69. WMB argued that it was entitled to the prepayment premium because the debtor-mortgagor sold the property during the three-year "lockout" period which, pursuant to the prepayment provision in the loan documents, would trigger the payment of a prepayment premium by the debtor-mortgagor. WMB also asserted that the language in the foreclosure decree did in fact, include payment of the prepayment premium and that in any event the state court did not have the authority to refuse to allow the prepayment premium and that, therefore, the bankruptcy court should alter the state court's foreclosure judgment to allow it.

The debtor-mortgagor argued that WMB was prohibited from collecting a prepayment premium because the language in the foreclosure decree (which was submitted and approved by WMB's attorneys) did not provide for such a remedy. The court summarily rejected WMB's argument that the foreclosure judgment allowed it to collect a prepayment premium, noting that no reasonable person could conclude that the words "advances" or "expenditures" included a prepayment premium, because such terms contemplate an actual expenditure of funds. The court also pointed out that the judgment was drafted by counsel for WMB's predecessor and that WMB stood in the shoes of its predecessor. The court further reasoned that even if there were an ambiguity, it would construe the terms against the drafter under established law. The court also rejected WMB's argument that the bankruptcy court should set aside or "reform" the state-court foreclosure judgment, holding that the judgment had not been appealed by WMB and was final. The court further rejected WMB's argument that federal law, specifically12 C.F.R. § 560.2(b)(5) (affecting federal savings associations regulated by the Office of Thrift Supervision) preempted state law with respect to the charging of prepayment penalties, because WMB failed to raise this argument before the date that the state court entered its foreclosure judgment and that under applicable federal law the bankruptcy court lacked subject matter jurisdiction to determine or review matters that had previously been determined by the state court. The court also reasoned that "matters of preclusion" prevented it from relitigating this matter, i.e., the full faith and credit statute "directs a federal court to refer to the preclusion law of the State in which judgment was rendered."

According to the court, "If WMB wished to assert its right, under the note and mortgage that were the subject of the suit, to a prepayment penalty, it was required to raise the issue in the foreclosure proceeding it commenced in state court, or be forever barred." The court noted that WMB was required to litigate the issue before the entry of the final judgment by the state court, and that "there is no note left to enforce" because the note had merged into the foreclosure judgment issued by the state court.

Reporter's Comment 3: Unfortunately, there may be a malpractice action lurking in the woods based on the facts of the *McClung* case. It is hard to understand why WMB pursued this litigation, given the shaky foundation for its claim; it undoubtedly paid far more than the disputed $5,900 prepayment premium in legal fees to contest the matter. This is a decision that should serve as a cautionary tale for lenders' lawyers: If you screw up in state court and do not specifically include the right to a contractual prepayment premium as part of the amount claimed in the foreclosure decree, do not expect a bankruptcy court (or even the state court) to bail you out. Or, alternatively, if you think the state court should have awarded a prepayment premium but failed or refused to do so (whether based on federal preemption or another argument), make sure to specifically raise the issue at the trial court level and appeal an adverse ruling immediately. Lenders also would be well advised to insert language in the mortgage (or deed of trust) specifically providing for application of the proceeds of a foreclosure sale to the payment of (among other things) the contractual prepayment premium, similar to the following:

"The proceeds of sale shall be applied, to the extent such funds are available, to the following items in such order, proportions, and priority as [Mortgagee] [Beneficiary] in its sole discretion may determine:

" . . . To payment of the Debt and all other obligations secured by this [Mortgage] [Deed of Trust], including, without limitation, interest at the Default Interest Rate and, to the extent permitted by applicable law, any prepayment fee, charge or premium required to be paid under the Note in order to prepay principal."

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

MORTGAGES; PRIORITY; PURCHASE MONEY MORTGAGES: A purchase-money lien used to buy real estate has priority over a prior judgment lien. ***Citifinancial Mortgage Company, Inc. v. American Builders and Contractors Supply Company, Inc.*, *No. 2006-CA-000507-MR, 2007 WL 491532 (Ky. Ct. App. Feb. 16, 2007).***

In January 2001, American Builders and Contractors Supply Company, Inc. (ABC) recorded a judgment lien against Donald R. Gordon that purported to attach to "all of the right, title and interest of the Defendant, Donald R. Gordon, Jr., in and to any real property located in Warren County, Kentucky." At the time, Gordon did not own any property in Warren County, but in April 2001, Citifinancial Mortgage Company, Inc. (Citifinancial) closed a loan to Gordon to finance his purchase of certain real estate in Warren County. Subsequently, a deed was executed to Gordon and a mortgage to Citifinancial, and both were recorded on May 3, 2001. Gordon later defaulted on the loan, and Citifinancial instituted foreclosure proceedings, naming ABC as a defendant to assert the priority of its lien.

The trial court found that ABC had priority because its lien was the first to be recorded.

The Kentucky Court of Appeals reversed, finding that it had recently switched its position in *Kentucky Legal Systems Corp. v. Dunn*, 205 S.W.3d 235 (Ky. Ct. App. 2006), adopting the view that purchase-money mortgages have special priority over prior liens and judgments unless agreement or statute provides otherwise. The court noted that Kentucky is typically a "race-notice" jurisdiction with priority of liens, and that in most circumstances, the first lien holder to record will prevail. In cases involving a purchase-money mortgage, however, the debtor would never have acquired the property if not for the mortgage, and thus other claimants would never have even had the opportunity to make claims against the land if not for the purchase-money mortgagor.

The rule applies whether the mortgagor is the prior owner of the real estate or a third-party lender. It applies even if the mortgagor has actual knowledge of the preexisting lien. The court noted that its adoption of the rule is consistent with the stance taken by numerous other jurisdictions, and it refused to carve out any exception advocated by ABC. In arguing for an exception, ABC relied on case authority that the court found to be inapposite. The court dismissed ABC's reliance on *ATS, Inc. v. Kent*, 27 S.W.3d 923 (Tenn. Ct. App.), on the basis that it involved the priority of the seller's judgment creditor over the buyer's purchase-money lender in a situation where the seller sold land to which a judgment lien had already attached to a buyer who borrowed money to purchase the land. The judgment creditor prevailed in that case but only because his lien had attached to the specific land before any sale took place. Thus, the "exception" did not follow the facts of this case, and the court could not find any other reason to depart from the general rule.

Comment 1: Nothing much new here, other than the fact that Kentucky recently has adopted the "purchase money priority" rule. This is a nice, clean application of the concept, and a good explication of its purposes.

Note, however, that the beneficiary of the purchase money priority is not a "seller take back" purchaser money lender, but rather a third party lender. This is a well-established feature of the rule. Not every student grasps this aspect of the rule.

Comment 2: Note that the application of this rule can lead to vicious circular priority issues. Consider, for instance, J has a judgment lien against B, buyer. B acquires property and gets a third party purchase money mortgage from L, lender. But L fails to record its mortgage, and soon thereafter, S, a second mortgagee, records a mortgage and is a BFP vs. the unrecorded L mortgage.

J primes S, because J's lien, of course, was in the judgment lien records and S takes subject to it. But S primes L, because L failed to record. But, further, L primes J because of the purchase money mortgage rule. Note that J can't take advantage of the fact that L recorded late because J is not a **subsequent taker of an interest.* Voila!!* Circular priority.

MORTGAGES; SERVICING; DEFAULT: Florida court certifies class of claimants for servicer misconduct to include persons losing their homes to foreclosure as a consequence of inability to pay overcharges demanded for reinstatement. ***Cole v. Echevarria, McCalla, Raymer, Barrett & Frappier, 2007 WESTLAW 2805409 (Fla. App. 9/28/07)***, discussed under the heading: "Lender Liability; Servicing; Reinstatement."

MUNICIPAL CORPORATIONS; DEDICATION; PARKS: Deed transferring property to city "for Park purposes only, and none other," was a common law dedication, and City may not terminate use as a park so long as such use is practicable. ***Citizens for the Preservation of Buehler Park v. City of Rolla, 230 S.W.3d 635, (8/7/07)***, discussed under the heading: "Public Trust; Dedication; Parks."

NUISANCE; STANDING: A neighboring landowner has standing to assert that a dominant tenant/pipeline company is causing a nuisance by cutting down trees over a pipeline easement in a public road even after that tenant has obtained the consent of the servient owner/township. ***Township of Piscataway v. Duke Energy, 488 F.3d 203 (3rd Cir. 2007).***

A group of homeowners initiated litigation to prevent a utility company from removing fifty shade trees planted along a public street in a municipality.

Predecessors in title to the homeowners in the lawsuit had in 1944 granted a utility company and its successors an easement to lay, operate, and maintain natural gas pipelines. The area of the easement was apparently not limited – the pipes could be laid anywhere across the servient tract. The pipeline easement grants (there were several) indicated that the company would bury the pipelines at a sufficient depth "not to interfere with cultivation of soil" and that it would pay for any damages to "growing crops, timber ... resulting from maintenance and operation" of the lines.

Later, subsequent owners of the servient tract desired to develop it into homesites. In 1963, they granted a third easement to the pipeline company for another line, but also narrowed the easements to a sixty foot wide right of way. Apparently this sixty foot strip then was conveyed to the local township for the creation of a public street above the pipelines. Thus the pipeline easement area became a long public street.

Along the edge of the street were a large number of shade trees, some as high as seventy-five feet. Homeowners of the residences built thereafter on the balance of the original tract came to view the trees as extensions of their front yards. But it should be emphasized that, according to the court, the land on which the trees were located "belonged to the municipality."

The pipeline company originally had sought the removal of eighty trees along the street. It argued that it was difficult to monitor the pipeline for leaks because the trees impeded the company from aerially surveying the area to look for evidence of gas leaks, usually disclosed by discolored or dying plant life. Further, the company argued that the coating that it had used on the pipes originally was susceptible to injury from the tree roots.

A lawsuit ensued, in which both the township and neighbors joined to prevent the removal of the trees. They obtained a preliminary injunction preventing the removal of the trees. The case was removed to federal court, which refused to remove the preliminary injunction pending a trial of the facts.

Before trial, however, the township and the company settled the case and agreed to the removal of fifty-five trees and the future removal of any trees that exceeded eight inches in diameter.

The neighboring landowners, however, viewed the trees as adding important aesthetic value to their properties, and continued the lawsuit. The company challenged their standing to continue in the lawsuit without the township. The trial court found that the neighbors had no right to raise the claim of trespass (note the trees were not on the neighbors' land), but held that the neighbors had standing to raise claims of breach of easement and nuisance.

The federal trial court ultimately found that the company had not mustered sufficient evidence to support its claim that the removal of the trees was "reasonably necessary" for the maintenance of the pipeline and further that such removal was barred by the doctrine of laches. The company appealed to the Third Circuit Court of Appeals.

The court of appeals panel affirmed the trial court's conclusion that the neighbors had standing to bring the action. The appeals court noted that, for standing to exist, the proponent must show that it has or will suffer an actual injury to a legally protected interest and that the conduct challenged in the lawsuit has or will cause such injury. It noted further, under the "prudential" notions of standing, that courts ought not to be used to redress the claims of others. "The plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.

The court began its analysis be reiterating that the presence of the trees added value to the neighbors' property. It further noted that the trees are "effectively irreplaceable." But the court still had to conclude that injury to the trees was an injury to the legally protected rights of the neighbors. So the court went on to analyze whether the neighboring homeowners had a "cause of action" cognizable under New Jersey law protecting them from the removal of the trees.

The court concluded that the restriction in the easement grant – that the pipeline owners were to bury the pipeline at a depth so as not to interfere with the cultivation of the soil – was intended to benefit the owners of the residences on the land adjacent to the easement. Note that many of these owners in fact owned land that was part of the original tract to which the easement appertained, but that the easement was narrowed before they obtained their interests.

"In this case, the restrictions set forth in the Easement grant were clearly intended by the original grantor, the homeowners' predecessors-in-title, to benefit the land by ensuring that the pipelines would not unduly interfere with the cultivation and development of the property. The homeowners took title to their homes with notice of the easement grant, and the rights and restrictions set forth in the grant. It is reasonable to infer from the drawing attached to the 1963 agreement [between the developers and the pipeline company] that when the [pipeline company] executed the agreement, it was aware that the owners of the property- three real estate development companies – planned to build a residential neighborhood through which the pipelines would run. Based on these facts, the individual homeowners have a cause of action under New Jersey Law."

Comment 1: The editor finds the decision – well – stunning. The owner of the property on which the trees were growing – the township – has decided that it will permit the trees to be removed. But the neighboring owners claim that they have a legal right to restrict such removal. The basis of the right is a 1963 agreement – admittedly drafted in the context of a proposed residential development adjacent to the pipeline easement – that says *nothing* about restrictions on pipeline activity for the purposes of protecting residential development – or if it does, the court neglects to tell us. All we are told is that the 1963 agreement contained was an extension of the rights and restrictions granted in the original easement, a 1940's instrument entered into when the servient land was all agricultural in nature. There is not one whit of evidence adduced here to suggest that there was any intent on the part of either party to the 1963 agreement to confer a right on neighboring landowners.

Consider, for instance, if the city elected to remove the trees itself. Could the neighbors object? Of course they could politically. But would they have standing to restrict the cutting of trees on neighboring property because the loss of shade or other aesthetic benefits would constitute a nuisance? If so, then the law of nuisance has been hugely expanded. But that is a possible conclusion to be drawn from this case.

Presumably the court would answer that the question is not whether the city – owner of the servient estate – can cut the trees, but rather whether the pipeline owner can. And here, the court concludes – the 1963 easement agreement imposed a duty on the pipeline company to protect the neighbors. But, as indicated, it is a huge stretch – the editor believes an irresponsible one – to conclude that any rights ran to the neighbors when in that same agreement the parties reduced the size of the servient estate to a sixty foot strip and said not one word about the property outside of that strip.

Comment 2: Another possible conclusion here is that somehow the public right of way, and the trees planted thereon, passed to the township as a public trust, similar to the creation of a park, and the neighbors – beneficiaries of the public use on the public property – had the right to require continuation of beneficial activities that occurred on the public property. There is a little precedent for this in the (previously unprecedented) decision of *Citizens for the Preservation of Buehler Park v. City of Rolla*, 230 S.W.3d 635, Mo. App. W.D. (2007), the DIRT DD for 9/28/07. But to find a public trust in the trees on facts such as those in the instant case goes far beyond the scope of *Buehler Park.* There, the city had received the property in a dedication "for public park purposes only." Here, the city received property subject to the pipeline easement and got it for the construction and maintenance of a roadway – not an arboreal paradise for those living adjacent to the road.

Note: The substantive issue of whether the pipeline owner really was justified in cutting down the trees is discussed under the heading: "Easements; Scope; Pipeline Maintenance."

NUISANCE; TREES: Virginia high court reviews, revises view on bothersome trees on neighboring property. ***Fancher v. Fagella, 650 S.E.2d 519, (Va. 9/14/07).***

Plaintiff and defendant owned townhouse properties in Fairfax County with abutting rear yards. Defendant's property was at a higher grade than Plaintiff's, and a masonry retaining wall ran between the properties, permitting Plaintiff to have a sunken rear patio.

On Defendant's property there was located a large sweet gum tree. Sweet gum trees are native to the area, and the facts of the case do not indicate whether Defendant or anyone else planted the tree. Plaintiff alleged that the tree was a "noxious nuisance" because its roots had invaded and would continue to damage and displace the retaining wall protecting Plaintiff's patio, as well as the pavers that formed its base. Plaintiff also complained that the tree roots blocked his sewer lines and were affecting his foundation. Plaintiff also complained that overhanging branches from the tree grew onto his roof, depositing leaves and other debris there and in the rain gutters. Plaintiff brought suit for an injunction compelling removal of the tree.

An expert for Plaintiff testified that the tree, in fact, was just getting started, that it would grow to twice its present girth and height, and that cutting the roots away would do no good as the root systems would quickly return. He described the droppings from the tree as including "spiky gumballs" and stated that "no amount of concrete" would keep the tree's invasive root system at bay.

Following Plaintiff's testimony, which also included engineering evidence that the tree was the source of damage to the wall, Defendant moved to strike Plaintiff's plea for injunctive relief. The trial court granted the motion to strike on the authority of a 1930's Virginia decision, *Smith v. Holt,* 5 S.E. 2d 492 (Va. 1939), which adopted what is known as the "Virginia rule" on invading trees. This rule states that the intrusion of roots and branches from a neighbor's plantings which were not "noxious in their nature" were not actionable at law, and the plaintiff is limited to his right of self- help. When there is a "sensible injury," a party suffering from the protrusion of roots from a "noxious" planting has a right, after notice, to an action in trespass.

The court noted that in fact four distinct common law rules had developed over time in this area: Under the Massachusetts rule, protruding branches or roots of planted or natural trees on adjoining land are "*damnum absque injuria,*" although the injured part retains a right of self help. The "Virginia rule" is close to this, but apparently would not apply to rule to "noxious" trees and other vegetation. There is the Restatement Rule, based upon the Restatement (Second) of Torts, sections 389, 840 (1979) which imposes an obligation on a landowner to control vegetation that encroaches on adjoining land if the vegetation is "artificial" (planted or maintained by a person but not if the vegetation is natural.) This appears also to be the rule in California and Washington. The third variant, the "Hawaii Rule," holds that living trees and plants ordinarily are not nuisances, but can become so when they cause actual harm or pose an imminent danger of actual harm to adjoining property. Under this rule, the harm may be from overhanging branches or protruding roots, where the danger or actual injury involved harm to property other than plant life, in ways other than by casting shade or dropping leaves, flowers or fruit.

The court noted that the Massachusetts Rule seems ill-suited to modern conditions where neighbors live in close proximity to one another, and the Virginia variant, with the exception for "noxious" trees and vegetation, depends upon a very vague and ultimately "unworkable" concept – noxious is in the eye of the beholder. The Restatement Rule struck the court as impracticable, as it often is difficult to ascertain whether a given plant arrived at its location artificially or naturally, and because it tends to penalize those who care for their property and reward those who let vegetation run wild.

The court concluded that it would overrule the Virginia precedent establishing the "Virginia Rule" and adopted the Hawaii rule as to responsibility for invading roots. This rule preserves a right of self help in the landowner affected by the intrusion, but also holds that such landowner may seek equitable relief to compel the neighbor on whose land the tree originates to cut back or otherwise relieve the condition causing damage.

As to the granting of the injunctive relief sought, the court commented that the decision to grant an injunction "always rests in the sound discretion of the chancellor, and depends on the relative benefit an injunction would confer upon the plaintiff in contrast to the injury it would impose on the defendant. Any burden imposed on the public should also be weighed." The court suggested that it might be unreasonable to impose a removal burden on the owner of "historically forested or agricultural land" but more reasonable to impose such a requirement where the parties reside in adjoining residential lots. Further, in some cases it might be sufficient to leave a plaintiff to his right of self help in cutting back roots and branches, coupled with an action for damages for the expenses.

Note: The court specifically withheld ruling on the situation in which a large undeveloped and forested lot abuts a lot that has been subdivided into a residential subdivision.

Comment 1: Of course, the court could not consider all the ramifications of its decision in this one case. For instance, although the court resoundingly affirms that there is a self-help remedy, its opinion probably should not be read to approve such remedy without advance notice to the defendant or other actions that would reasonably provide the defendant with the continued right to a healthy tree. The proper remedy, it would appear, would vary with each case.

Comment 2: Since an intruding tree now can be a trespass, can it also establish a prescriptive easement? See *Koresko v. Farley,* 844 A.2d 607, (Pa.Cmwlth. 2004), the DIRT DD for 05/06/05. In a case of first impression, the Commonwealth Court of Pennsylvania decided that a prescriptive easement did not arise from encroaching tree roots and overhanging branches. The Editor agreed with the result, but criticized the reasoning that the intruding tree limbs were not "open and notorious." He would have preferred a conclusion that, until an objection was made, such intrusions are "implicitly permissive." Of course, intruding roots typically are invisible until damage begins to occur, and the court's analysis works there.

Compare: Ballard v. Harman, 737 N.E.2d 411 (Ind.App. 2000), the DIRT DD for 07/05/01. (Actual; hostile possession is established where adverse claimant planted 50 trees on a five foot strip of land on neighbor's property and watered and maintained the trees for 18 years.)

OPTIONS; REFUSAL RIGHTS; PERPETUITIES: Although an option to purchase real estate at a fixed price is subject to the Rule Against Perpetuities, a right of first refusal is not, because the right of first refusal does not ripen into an option to purchase until the property owner has decided to accept a third-party offer and has so informed the right holders. ***Bortolotti v. Hayden, 866 N.E. 2d 882 (Mass. 2007).***

Massachusetts now has adopted the Uniform Laws version of the Rule Against Perpetuities, which contains a specific exclusion for rights of refusal. But the statutory enactment applies only to transactions originating after June of 1990, and the interest in question arose under a deed transferred in 1981. The right created in the deed had no expiration.

The court then turned to an interpretation of the common law Rule, and noted that the 1944 Restatement of Property states that refusal rights *are* subject to the Rule. For this reason, the trial court had found the unlimited refusal right in question invalid.

The court here, however, decided to interpret the common law rule as not applicable to rights of refusal, even though Massachusetts precedent had applied the rule to other forms of commercial options. The court's language speaks for itself:

"Because the holder of a right of first refusal may only choose to purchase property on the same terms as a bona fide offer, if and when the owner decides to sell, there is no power either to compel an owner to sell the property at an unfavorable price or to encumber an owner's ability to sell the property for a lengthy period of time. There is no casting of a cloud of uncertainty on the title to the property, and no potential to forestall a sale. Hence, the rule against perpetuities logically should not apply. In our view, this position is better suited for business transactions, such as the one here, in which the right of first refusal was created."

The Restatement of Servitudes, which is considered a Third Restatement of Property on that subject, has decided that the Rule ought not to apply to rights of refusal. Further, the influential Barton Leach had also advocated freeing commercial transactions general from the harshest applications of the rule, and the 1952 American Law of Property, at Section 26.67 had also argued that the Rule ought not to be applied to preemptive rights.

The court distinguished or dismissed cases in Maryland, North Carolina, Florida and Connecticut that had not only applied the Rule to these interests, but had maintained that to do so was consistent with the clear common law majority rule.

The court noted, however, that there are other common law rules, such as the rule against unreasonable restraints on alienation, that might be considered by a common law court to address especially difficult problems involving broad and unlimited preemptive rights. The right in this case, however, was relatively standard for commercial transactions, had a reasonable basis for existing, and was not an unreasonable restraint. Thus, the court found that it was not an unreasonable restraint on alienation.

Comment: Also see *Murphy Exploration & Production Company v. Sun Operating Limited Partnership,* 747 So.2d 260 (Miss. 1999), the DIRT DD for 10/6/07 (RAP should not apply to commercial arrangements such as rights of refusal in oil and gas leases) and *Pathmark Stores, Inc. v. 3821 Associates, L.P.*, 663 A.2d 1189 (Del. Chancery 1995). (Suggesting that a commercial option to acquire property within 30 years does not offend the Rule Against Perpetuities because the commercial parties have bargained for a time period that they deem reasonable.)

OPTIONS; REFUSAL RIGHTS; PERPETUITIES: Where two Delaware companies contract with respect to a settlement, and choose Delaware law as the controlling law, Delaware law will apply to invalidate a right of first refusal that is part of the settlement, even though the property is located in Georgia. ***CS-Lakeview at Gwinnet, Inc. v. Simon Property Corp, 642 S.E. 2d 393 (Ga. App. 2007),*** discussed under the heading: "Rule Against Perpetuities; Choice of Law."

PERSONAL PROPERTY; UCC ARTICLE 9; PRIORITY OF SECURITY INTERESTS; CROPS AS PROCEEDS: Crops are not proceeds of crop seed under the UCC; therefore, a lender who perfects a security interest in crops by filing first has priority over a second lender who has a purchase money security interest in the crop seed. ***Searcy Farm Supply, LLC v. Merchants & Planters Bank*****, 369 Ark. 487; 2007 WL 1290246 (Ark. May 3, 2007).**

In July 2001, Lee Vaughn Clark borrowed $120,000 from Merchants & Planters Bank for his farming operations, securing the promissory note with a real estate mortgage and a security interest in crops, government payments, and equipment. Merchants perfected its security interest by filing financing statements with the county and Secretary of State. Later in 2001, Clark borrowed $9,700 from Merchants, giving the same collateral as in the previous note. Merchants again filed a proper financing statement to perfect its security interest. Clark defaulted on both notes, and both remained in default. The specific collateral given by Clark included a security interest in crops to be grown on 931 acres of crop land. Clark had a poor year in 2001, and thus he carried over the Merchants debt into 2002. Merchants continued to hold a perfected security interest in the crops to be grown on the 931 acres. In 2002, a large portion of the farming operation was a corn crop, and Clark purchased seed, chemicals, fertilizer, and other materials for this corn crop from Searcy and Tripp. Searcy took a security interest "in all crops and other plant products grown and to be grown on [Clark's] property as well as all proceeds and products from said crops." Searcy filed all required financing statements to perfect its security interest.

After another poor year for Clark's farming operations, Clark also owed Searcy $112,000 for the 2002 crop transactions. Merchants filed a complaint against Clark and Searcy, seeking judgment against Clark for the principal and interest on its promissory notes. Meanwhile, Searcy had sold the corn crops and had retained the proceeds from the sale, and it asserted priority over Merchants based on having a purchase money security interest (PMSI). The circuit court found that Merchants had a prior lien in Clark's crops. On appeal, Searcy argued that its PMSI followed the crop, including proceeds from the sale of the crop, and thus the PMSI took priority over Merchants' lien. Merchants responded by arguing that because of its first-in-time, first-in-right status, its lien had priority.

The primary issue in this case was whether the superpriority provision of UCC section 9-324 applied to give Searcy, who held a perfected PMSI, priority over Merchants, who had a conflicting security interest but was the first to file. UCC section 9-322(a)(1) (in Arkansas § 4-9-322) provides the general rule that conflicting perfected security interests rank according to priority in time of filing or perfection. However, § 9-324 provides that a perfected PMSI in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and a perfected security interest in its identifiable proceeds also has priority, if the PMSI is perfected when the debtor receives possession of the collateral or within 20 days thereafter.

In interpreting these two statutes, the court noted that the collateral for Searcy's PMSI was seed, chemicals, and fertilizer, rather than the corn crop itself. Further, Clark's crops were not "identifiable proceeds" of the collateral under the § 9-102(a)(64) definition of proceeds, and as a result, the Merchants security interest had priority over Searcy's PMSI. Therefore, despite the harsh result for agricultural suppliers, in Arkansas, crops are not proceeds of crop seed, and a PMSI holder's security interest in seed will not have a superpriority under UCC § 9-324 if another lender's security interest is prior in time.

PUBLIC TRUST; DEDICATION; PARKS: Deed transferring property to city "for Park purposes only, and none other," was a common law dedication, and City may not terminate use as a park so long as such use is practicable. ***Citizens for the Preservation of Buehler Park v. City of Rolla, 230 S.W.3d 635, Mo. App. W.D. (2007).***

This contentious matter went to the Missouri Court of Appeals three times. It still may take a trip to the Missouri Supreme Court, although the opinion strikes the editor as correct and even indisputable.

The Chamber of Commerce of the City of Rolla had created a public park which it maintained in the memory of a popular Chief of Police. Ultimately, it resolved to transfer the park to the city as part of its parks system, and delivered a deed of the property to the city that stated that the property was transferred "for Park purposes only, and none other." The *habendum* clause simply said that the property was transferred to the City, "its heirs and assigns forever," and contained no condition. Further the deed stated on its face that the chamber "releases any right of entry and any reversionary right it may have in and to [the Park] and releases any right it may have to enforce as a covenant the provision in said deed that said land be used for a park."

The City in fact maintained the property as a park for four decades, long enough to create a reliance interest in its citizens, and ultimately determined to abandon the park use and sell the property to Cracker Barrel. (Cracker Barrel is a common highwayside retailer in this part of the world.)

A group of citizens challenged the abandonment of the park use and sued to enforce the restriction. They obtained a temporary injunction. The trial court initially concluded that the citizens lacked standing to raise the issue as citizens of the City, as users of the Park, or as taxpayers. The trial court also concluded that the transfer amounted to a transfer of a defeasible fee. As the interest over had been waived, as well as any other right in the grantor to contest the change in use, one assumes that this meant that the city could do with the property as it wished. But the plaintiffs appealed.

The first court of appeals, as indicated, affirmed the lack of standing. Then apparently the injunction was dissolved, but Cracker Barrel had disappeared. A substantial bond claim was made by the City, and perhaps paid.

Four years later, another developer appeared, and the City again attempted a transfer of the park property, and a citizens group again brought suit. This time they were backed by a public interest law firm from St. Louis, which argued (as had the dissent in the first case) that the action by the Chamber of Commerce was a public dedication, creating a public trust, and that members of the public by definition had standing to enforce the restriction. The trial court, predictably, denied standing again. But on appeal, the plaintiffs found a new panel on the Court of Appeals, which was influenced by the thinking of the original dissenter and reversed.

The Court of Appeals here concluded that the language of the deed necessarily evinced an intent of the Chamber of Commerce to offer a dedication to the City. The fact that this intent was evidenced by a deed that did not contain the words "dedicate" or "dedication" was not significant when the apparent purpose of the deed was to donate property to the City for an identified public use.

In response to the argument that a defeasible deed was intended, the court noted that in Missouri an express interest over is necessary to create a fee on condition subsequent and that words expressing duration are necessary to create a determinable fee. Such language did not appear here, and the fact that the *habendum* clause, which customarily ought to contain any words limiting the nature of the grant, instead expressed a grant "to heirs and assigns forever" suggested that there was no defeasance intended. (Of course, note that the Chamber, in any event, had waived the right to enforce any reversionary interest. This might not have been necessary, however, if the interest had been a fee simple determinable – the property might have passed directly to the Chamber anyway. But we know nothing of the trial court's analysis on this point.)

The dedication to public trust language is important, as it may have an impact on interpretation of similar grants in other cases.

"The landowner's acts establishing a dedication must be unequivocal, and indicate expressly or implicitly, an intent to establish the public's right to use the land ... Absent an actual intention by the landowner to dedicate the property, their conduct may nonetheless manifest such an intention. In that case, the owner can be prevented from resuming rights over the property if the public has relied upon his manifestations.

Dedication is based upon the theory of a mutually binding contract between the landowner and the public. A common law dedication is a continuous, irrevocable offer to dedicate, which the dedicator cannot retract ... This 'contract' is based in the principle of estoppel, rather than an affirmative grant. Though a dedication generally cannot be revoked, the property can revert to the landowner or to his successors if it is no longer possible to fulfill the purpose of the dedication or if the dedicated use of the property is legally abandoned ... Impossibility of a dedicated use and abandonment frequently have synonymous meanings. In this case, the property's dedicated use has not been abandoned, nor is there any evidence indicating that it is impossible to continue to use the land as a park. Furthermore, we cannot say that continued use of the property for park purposes would be damaging to the public good ... property dedicated for a particular purpose may not be diverted to a different purposes."

As indicated, the court went on to hold that *a fortiori* the appropriate party to enforce a dedication to the public good is the public itself. So the neighbors had standing as members of the benefited public.

The City, of course, argued that there was a deed to the City, not a dedication to public use. The grantors obviously did not make an express dedication to the general public. The court found this argument "hyper technical and hollow." The court noted that the City's maintenance of the property as a park for 40 years with the Chamber's knowledge and acquiescence in indicate of an intent to dedicate, or perhaps operates to preclude denial of such intention."

Comment 1: There was apparently not much argument on the nuances of estates in land and future interests. The editor spoke to the appellant's counsel – an environmental lawyer who acknowledged that neither he nor, he thought, the opposing counsel, gave much thought to that aspect of the case. They were fixated on the question of whether the transfer *was* a dedication, not on the question of whether it *was not* something else.

Comment 2: Common law dedication cases have appeared at various places around the country, and if the non profit environmental law firms start exploiting the public trust doctrine aspects of this concept, we are likely to see them much more often. It is unclear whether there is a difference between a dedication to the public and a dedication to the public at large. Typically a dedication to a public agency must be accepted, and many jurisdictions have statutes or policies that preclude such dedications if there is not acceptance within an identified period of time. The issue is moot here, since the City promptly began operating the park, but it is noted that the Missouri court describes Missouri dedications as a potentially unlimited and irrevocable offer.

Comment 3: For other dedication cases in DIRT, see *Township of Middletown v. Simon,* 387 N.J. Super. 65, 903 A.2d 418 (App. Div. 2006) (The DIRT DD for 03/06/07) (When lands are sold with reference to a map upon which appears a dedication of certain areas to the public as a park, but there is no immediate acceptance of such dedication, this establishes an offer of dedication that cannot be revoked except by consent of the municipality; therefore, when the affected property is sold, even in a tax sale, it is sold subject to the municipality's right to accept the dedication); *Christiansen v. Gerrish Township,* 608 N.W.2d 83 (Mich. App. 2000) (the DIRT DD for 9/16/00) (Dedication of a roadway to the public on a subdivision plat constitutes a "continuing offer" of dedication for as long as 37 years, and public entities acceptance 37 years later is therefore deemed a "timely" acceptance within meaning of common law requirement); *St. Charles Parish School Board v. P & L Investment Corporation*, 674 So.2d 218 (La. 1996) (The DIRT DD for 11/15/96) (Public may acquire interest in land on which road is built through "tacit dedication," where landowner is aware that public is making permanent improvements in roadway and public uses the roadway for three years.)

But compare: *General Auto Service Station v. Maniatis,* 765 N.E.2d 1176 (Ill.App. 1 Dist. 2002) (DIRT DD for 8/6/02) (An implied dedication of a dead end alley will not be found without substantial evidence of offer and acceptance. The implied offer expires upon the death of the alleged offeror, and acceptance must be manifest by that time.) *Stafford v. Klosterman*, 998 P.2d 1118 (Idaho 2000) (the DIRT DD for 4/11/01) (Roadway easement depicted on a subdivision plat but not accepted by the county highway district through endorsement of the plat are not public roads; consequently, there is no public right of use.)

RULE AGAINST PERPETUITIES; RIGHTS OF REFUSAL: Although an option to purchase real estate at a fixed price is subject to the Rule Against Perpetuities, a right of first refusal is not, because the right of first refusal does not ripen into an option to purchase until the property owner has decided to accept a third-party offer and has so informed the right holders. ***Bortolotti v. Hayden, 866 N.E. 2d 882 (Mass. 2007),*** discussed under the heading: "Options; Refusal Rights; Perpetuities."

RULE AGAINST PERPETUITIES; CHOICE OF LAW: Where two Delaware companies contract with respect to a settlement, and choose Delaware law as the controlling law, Delaware law will apply to invalidate a right of first refusal that is part of the settlement, even though the property is located in Georgia. ***CS-Lakeview at Gwinnet, Inc. v. Simon Property Corp, 642 S.E. 2d 393 (Ga. App. 2007).***

Simon and CS had undertaken a joint venture in commercial property in Georgia, but had fallen out. Litigation ensued, and the parties settled in 1985 by Simon taking title to the property in question and CS having a right of first refusal if Simon should ever receive a bona fide offer to sell the property after 1995 (we don't know why they put this date in the arrangement).

Subsequently, in 2000, Simon conducted discussions with a potential buyer and notified CS that it had received an offer to acquire the property for $5.5 million. CS demanded evidence that a formal offer had been received, but Simon had not yet obtained such an offer. Nevertheless, Simon offered to CS the option to buy the property for $5.5 million. CS evaluated the property but tendered an offer to purchase the property for $3.85 million. Simon refused the offer. A year later, it sold the property to the original buyer for $5.5 million without giving CS a chance to match the offer at that time.

CS filed a breach of contract action, apparently on the notion that Simon had never formally complied with the terms of the right of first refusal. Apparently, also, there was some dispute over the discussions over the option to purchase for $5.5 million and whether Simon had played fair in that exchange.

We never learn the details of all this litigation in part because the court found that, under Delaware law, the right of first refusal was void because it violated the Delaware version of the Rule Against Perpetuities. Under the common law Rule, this would not be an unusual result, although there is some authority *contra* and although many jurisdictions have modified the Rule and don't apply it to commercial transactions. In fact, one of the jurisdictions that has modified the Rule so as to exempt commercial transactions is Georgia. CS made a number of creative arguments to escape consequences of the invalidation of its right.

First, of course, CS argued that, since this was real estate, it is appropriate to apply the law of the *situs.* Although this may be true, the Georgia court here acknowledged that commercial parties are free to designate the law of another jurisdiction, at least one that has "significant contacts" to the agreement. Here, both parties were Delaware corporations and the original litigation between them, from which the settlement arose, was brought in Delaware Chancery court. The selection of Delaware law was appropriate to the transaction. There was no sound public policy basis for refusing to apply that law. Mere dissimilarity of law does not provide such a basis.

CS then argued that the Georgia court should grant reformation of the contract, applying Georgia law, due to the mutual mistake of the parties that Delaware law would permit the right of first refusal to be enforced. But the court uttered that deathless phrase (in effect) "mere ignorance of the law is no excuse." The mutual mistake doctrine applies to mistakes of fact, not of law. There was no question here as to the parties' agreement on the contract language or what it meant.

CS further argued that for Simon to get the rewards of the settlement agreement and unfettered title to the property was unjust enrichment, and that the court ought to strike down the entire settlement agreement if a critical part – the right of first refusal – is found to be invalid. The court first pointed to the severability clause, which preserved the contract even if one or another clause was invalidated, and further noted that unjust enrichment does not apply where the parties have arranged their relationship by contract.

Comment 1: In possibly the only part of the opinion that gives the editor pause, the court further stated that CS ought to have no complaint here because it in fact got what it bargained for when Simon offered it the option to purchase the property for $5.5 million in 2000. The editor doesn't agree. Typically these rights are triggered only by an actual offer – in the words of this agreement – a "bona fide" offer. There wasn't such an offer in 2000. Thus offering CS the right to buy the property at that time was a nice gesture, but didn't satisfy the terms of the right of first refusal. A year later, when Simon in fact got an actual formal offer to purchase from the same purchaser, CS should have had the right to match the price at that time. Perhaps, due to market conditions, the property had a greater value and CS would have had less difficulty finding financing and matching the offer. That's the reason courts typically "read in" the requirement for an express offer even if one isn't there. But here there was language that should have been read to require an express offer. In the overall context of the litigation, this analysis isn't all that important. The right was void for other reasons and the unjust enrichment claim failed for other reasons as well. But it's a sticking point for the editor that the court threw in this comment at the end.

Comment 2: As to the application of the Rule to rights of first refusal, some jurisdictions differentiate between options and ROFR. The following is excerpted from an earlier posting by DIRTer Jack Murray in the Chicago office of First American Title:

"See *Mitchell, Can A Right of First Refusal Be Assigned*? 68 U. Chi. L. Rev. 985, 994 (2001) (In traditional common law jurisdictions, a right of first refusal of indefinite duration violates the common law Rule Against Perpetuities); *Ferrero Constr. Co. v. Dennis Rourke Corp*., 311 Md. 560, 572 (Md. 1988) (rule against perpetuities is implicated by right of first refusal to purchase real estate, as rule was designed not only to facilitate the alienability of property but also to prevent restrictions that render title to land uncertain). The rule against perpetuities is a 'peremptory command of law and not a Rule of Construction.' *Emerson v. Campbell*, Del. Ch., 84 A.2d 148, 155 (1951). But see *Continental Cablevision, Inc. v. United Broad. Co.*, 873 F.2d 717, 722 (4th Cir. 1989) ('Of all options, a right of first refusal is one of the least obnoxious to the policy concerns of the rule.')"

A majority of jurisdictions recognizes that a right of first refusal is subject to the rule against perpetuities (though there is contrary authority). See, *e.g., Stuart Kingston v. Robinson*, 596 A.2d 1378, 1383-1384 (Del. 1991) ("Although the rule is most often applied in the construction of testamentary devices, it applies equally to rights of first refusal, also known as preemptive rights, to acquire interests in land. Despite the view of some courts that preemptive rights are merely contract rights and not direct interests in property, a vast majority of courts and commentators view such rights as equitable claims sufficient to support an action for specific performance if the property owner attempts to sell to someone other than the owner of the right of first refusal. Because the holder of the right of first refusal acquires merely an equitable interest, it remains inchoate until the owner decides to sell thus triggering the right of first refusal.") See also *Lake of the Woods Assoc. v. McHugh,* 380 S.E.2d 872, 874 (Va. 1989) (rejecting a request to treat first-refusal provision as procedural right that could be saved by application of "wait and see" doctrine). But see *Murphy Exploration & Prod. Co. v. Sun Operating Ltd. Pshp.*, 747 So. 2d 260, 265 (Miss. 1999) ("Mississippi, like many jurisdictions, has modified the draconian effect of this rule with the wait and see doctrine.")

Courts adopting the minority view generally reach their conclusion by assuming that the sole policy underlying the rule against perpetuities is the elimination of restraints on alienation. Based on this distinction, the minority view contends that, unlike ordinary options, at least some rights of first refusal do not restrain alienation; consequently, the minority view concludes that such rights of first refusal should not be subject to the rule against perpetuities. See, *e.g., Forderhause v. Cherokee Water Co.*, 623 S.W.2d 435, 438-439 (Tex. App. 1981); *Robroy Land Co. v. Prather*, 95 Wash.2d 66, 71 (1980); *Hartnett v. Jones*, 629 P.2d 1357, 1361 (Wyo.1981); *Weber v. Texas Co.*, 83 F.2d 807,808 (5th Cir. 1936). [The editor also has seen cited for the minority position a New York case, *Metropolitan Transp. Auth. v. Bruken Realty Corp.*, 67 N.Y.2d 156, 153 (1986); also see ***Bortolotti v. Hayden, 866 N.E. 2d 882 (Mass. 2007),*** discussed under the heading: "Options; Refusal Rights; Perpetuities." in this Report.] Thus, in effect, the minority view postulates that an interest should not be subject to the Rule unless the interest constitutes a restraint on alienation. The minority view then distinguishes rights of first refusal from ordinary options. As stated in VI American Law of Property, § 26.64, at 507:

"An option creates in the optionee a power to compel the owner of property to sell it at a stipulated price whether or not he be willing to part with ownership. A pre- emption does not give to the pre-emptioner the power to compel an unwilling owner to sell; it merely requires the owner, when and if he decides to sell, to offer the property first to the person entitled to the pre-emption, at the stipulated price. Upon receiving such an offer, the pre-emptioner may elect whether he will buy. If he decides not to buy, then the owner of the property may sell to anyone."

But this position has been harshly criticized. See *Ferrero Constr. Co. v. Dennis Rourke Corp.*, supra, 311 Md. at 572-73 ("Even assuming the validity of the distinction between rights of first refusal and other options, the minority view errs in assuming that an interest should not be subject to the Rule unless the interest constitutes a restraint on alienation. In making this assumption, courts adopting the minority view confuse the Rule Against Perpetuities with the rule against unreasonable restraints on alienation. Admittedly, both rules belong to 'a family of related rules that regulate the devolution of wealth from generation to generation' (citation omitted). These two rules are nonetheless distinct. The Rule Against Perpetuities prevents property interests from vesting remotely (citations omitted). The rule against restraints on alienation, on grantors from unreasonably depriving grantees of the power to alienate their estates (citations omitted). The policies underlying these two rules are likewise not identical. Obviously, the rule against restraints on alienation serves to facilitate the alienability of property. Similarly, one of the purposes of the Rule Against Perpetuities is to facilitate the alienability of property (citation omitted). Contrary to the minority view, however, the Rule Against Perpetuities is not simply a rule against restraints on alienation (citation omitted). Instead, the Rule Against Perpetuities is concerned with restrictions that render title uncertain (citation omitted). Without the Rule Against Perpetuities, it would be possible at some distant point for a remotely vesting future interest to divest the current owner's estate. Because of this threat of divestment, the owner might be deterred from making the most effective use of the property, even if he never has any desire to alienate his estate. Thus, by voiding certain remotely vesting future interests, the Rule Against Perpetuities eliminates this deterrent both for owners who wish to alienate their estates and for owners who have no intention of ever doing so (citation omitted). Consequently, from the standpoint of the Rule Against Perpetuities, it is irrelevant whether a particular future interest imposes a light burden, a heavy burden, or no burden at all upon the alienability of property" (citations omitted)).

SERVITUDES; RESTRICTIVE COVENANTS; BUILDING RESTRICTIONS; MODULAR HOMES: A restrictive covenant prohibiting the erection of temporary buildings of any kind, including mobile homes, tents, and trailers, does not operate to preclude the construction of a modular home. ***Williams v. Fox, 219 S.W.3d 319 (Tenn. March 15, 2007).***

The subdivision's restrictive covenant, which prohibited "mobile homes" and "trailers." Plaintiffs, owners of lots in the subdivision, sought to enjoin another owner from constructing a modular home on his lot. The trial court enjoined the construction and ordered the demolition of the work already done. The court of appeals affirmed, finding that "the intent of the parties in adopting these restrictive covenants was to prohibit this type of structure from being erected on any lot in the subdivision."

On further appeal, however, the Tennessee Supreme Court reversed, focusing in part on differences in the statutory definitions of "trailer," "mobile home," and "modular home." In particular, the court emphasized that modular homes, unlike trailers and mobile homes, were not designed for ready removal to another site. Also, mobile homes are titled as vehicles, whereas modular homes are not.

The court determined that "[o]nce delivered and erected on the property, [modular homes] become part of the property as a permanent improvement to the real estate similar to a 'site-built' home."

The court also concluded that the creators of the restrictive covenant should have recognized this distinction and addressed it in the covenant if they had wanted to proscribe modular homes in addition to trailers and mobile homes. As of 1995, when the covenant was recorded, the distinction between modular homes and mobile homes was clear both in Tennessee statutes and in comparable restrictive covenants.

In rendering its decision, the court noted that past case law interpreting restrictive covenants of this sort had broadly construed restrictive language in favor of the covenant. In *Apollo Shores Community & Maintenance, Inc. v. Lynn*, No. E-199-00946-COA-R3-CV, 2000 WL 796126 (Tenn. Ct. App. June 21, 2000), for example, on which the trial court relied, the court noted that "the manner of construction between a 'modular home' and a 'mobile home' was a difference without a distinction." In this case, the court distinguished *Apollo* and other cases with similar holdings on the basis that those cases, despite their reference to modular homes, had all, in fact, dealt with structures more aptly defined as mobile homes. Those cases also had considered covenants that predated the Tennessee Modular Building Act of 1985, which explicitly distinguished modular homes from mobile homes and trailers. Thus, in the context of this restrictive covenant, the court refused to interpret the words "mobile home" and "trailer" to also implicitly include "modular homes."

STATE AND LOCAL TAXATION; HISTORIC SITES; TAX EXEMPTION: An application for tax-exempt status for historic property should be evaluated based on the requirements in effect at the time of hearing and cannot be denied because of the possibility that the standards may be changed in the future. ***University Cottage Club of Princeton New Jersey Corp. v. NJDEP, 191 N.J. 38, 921 A.2d 1122 (2007).***

A private university eating club applied to the New Jersey Department of Environmental Protection (NJDEP) for a property tax exemption as an historic site pursuant to statute. Under the law in effect at the time of the application, the applicant's property had to have been listed in the New Jersey Register of Historic Places, be owned by a non-profit corporation, be open to the public on a regular basis, and be operated in a non-discriminatory manner in regard to race, creed, color, or religion.

The Office of Historic Preservation (OHP) of the NJDEP, as administrator of the tax-exempt historic-site certification process, notified the NJDEP Commissioner that certification should be granted because all the requisite conditions had been met, including the requirement of at least twelve days public access each calendar year. A year later, the Commissioner denied the application, finding that the club could not merely satisfy the minimal public access requirements existing at the time of the application, but had to satisfy requirements that the Commissioner intended to promulgate to enable the public to have free access to, and enjoyment of, properties meriting certification.

The Commissioner never promulgated such rules. The New Jersey Legislature, however, enacted statutory certification requirements requiring public access for at least ninety-six days each year and requiring that a certified property's mission be the research, preservation, and interpretation of history and architectural history. Notably, these statutory amendments were prospective. The club appealed the Commissioner's ruling and the Appellate Division upheld the Commissioner's ruling finding the Commissioner had not abused his discretion in refusing to certify the property. An appeal was taken to the New Jersey Supreme Court.

The Supreme Court examined whether the Commissioner's denial of the application was valid. If not valid, the Court found that the club was entitled to have its tax-exempt status evaluated based on its satisfaction of the standards in effect at the time of the administrative adjudication.

It concluded that the Commissioner's actions were arbitrary in that the club's petition had been perfected over a period of five years during which it satisfied all of NJDEP's stated requirements. It also found that the OHP had recommended approval and the Commissioner did not merely suspend the processing of the petition in anticipation of the publication of a new rule.

Rather, he upended the prior public access requirement of twelve calendar days, and imposed his own standard even though not formally adopted. This gave him the (improper) basis to deny the petition outright without benefit of an adjudication based on the regulations and standards actually in effect. As such, the Court found that the club was not subject to the later statutory amendments and remanded the matter to the Commissioner to take action consistent with the opinion.

Reporter's Comment: I don't know why this case had to go all the way to the Supreme Court. (The editor agrees.)

See also: ***Harding Acad. v. The Metro. Gov't of Nashville & Davidson County, 222 S.W.3d 359 (Tenn. 2007),*** discussed under the heading: "Zoning and Land Use; Building Permits; "Pending Legislation Doctrine" (The "pending legislation doctrine," which authorizes a city to withhold action on a legally permitted building permit where pending land use legislation may restrict such issuance, applies only where an amendment to a zoning ordinance that would prohibit the use of land for which the permit is sought is sufficiently pending at the time of the permit application. Consideration by a city advisory committee is not sufficient to qualify the proposed change as "pending.")

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

STATE AND LOCAL TAXATION; PROPERTY TAX; EXEMPTIONS; HOSPITALS: To determine whether a particular facility of a hospital is entitled to exemption from real estate taxes, a court may examine relevant factors such as the degree to which there is integration between a facility and the hospital, the extent of the hospital's control or supervision of the facility, and whether the facility primarily serves the hospital's patients or the general public. ***Hunterdon Medical Center v. Township of Readington, 391 N.J. Super. 434, 918 A.2d 675 (App. Div. 2007); March 28, 2007.***

TITLE INSURANCE; FORECLOSURE; INADEQUATE CONSIDERATION: Arizona appellate court holds that when foreclosure sale is set aside because purchase price is "grossly inadequate" and "shock[s] the court's conscience," an exclusion in the purchasers' Owner's Title Policy against losses for failure to pay value bars the purchasers from recovering the fair market value of the home from the title insurer. ***First American Title Insurance Company v. Action Acquisitions, LLC, 169 P.3d 127 (Ariz. App. Div. 1), Oct. 30, 2007.***

[Note that the Reporter is employed by the defendant in this case. See the editor's pithy rejoinder at the end.]

I imagine this is the kind of bizarre lawsuit we may start seeing more of as title insurance companies (and lenders, appraisers and other parties to residential transactions) become a target for "quick- buck" artists out there hoping to cash in on the housing downturn. In this case, the home was worth between $300,000 and $400,000 and was encumbered by a $162,000 deed of trust. The purchasers, professional foreclosure entities named (perhaps aptly), "Action Acquisitions, LLC" and "Free for Now, LLC," (together, "Purchasers"), respectively, paid only $3,500 (the amount of unpaid homeowners' association assessments plus costs) for between $138,000 and $238,000 of equity; their successful bid was between 1.5 percent and 2.5 percent of the equity they acquired.

According to the court, "Purchasers' practice is to bid only the minimum required to cover the homeowners' association liens that have been foreclosed upon." In this case, after the statutory redemption period expired, the Purchasers bought a $400,000 Owner's Title Policy for the home from Capital Title Agency, which policy was underwritten by First American Title Insurance Company ("First American"). The home's previous owner subsequently filed a motion to set aside the sale because "the price Purchasers paid was so inadequate that it shocked the conscience." Purchasers notified First American, seeking a defense to the action. First American retained counsel to defend the Purchasers. The Arizona superior court that heard the foreclosure action then granted the motion to set aside the sale, and Purchasers filed a claim against First American under the Owner's Policy, asserting a loss of $400,000. (Query: Why did the superior court approve the sale to the Purchasers in the first place, as it knew – or certainly should have known – of the vast discrepancy between the value of the home and the price paid by the Purchasers? If the previous owner had not finally woken up and filed a suit to overturn the foreclosure sale, Purchasers' normal method of operation would have worked perfectly.)

First American refused to pay the claim and filed a claim for declaratory judgment, arguing that coverage was barred under 1) Exclusion 4(a) of the Policy (providing that Purchasers were not insured against loss resulting from "risks ... that are created, allowed, or agreed to by [Purchasers]," and 2) Exclusion 5 of the Policy, which excluded loss "resulting from ... failure to pay value for [the] Title." Purchasers filed a counterclaim against First American and a third-party complaint against Capital Title, alleging bad faith and breach of the covenant of good faith and fair dealing, fraud and fraudulent misrepresentation, negligence and negligent misrepresentation, breach of fiduciary duty and constructive fraud and consumer fraud.

The Superior Court found for First American under Exclusion 4(a) of the Policy, stating that the Purchasers "knowingly incurred the risk that the sale could be set aside." The Superior Court did not deem it necessary to address First American's argument that Exclusion 5 also barred coverage. The appellate court, on the other hand, affirmed the Superior Court's ruling but relied entirely on Exclusion 5, holding that Exclusion 5 "bars coverage of the loss Purchasers incurred when the purchase was set aside"; the appellate court therefore deemed it not necessary to consider Exclusion 4(a). The appellate court agreed with First American's argument that the word "value" in Exclusion 5 means "substantial value" or "fair and adequate value" as compared to the actual cash value of the property acquired at the foreclosure sale. The appellate court cited several cases, from both Arizona and other jurisdictions, holding that purchasers who acquire property for a grossly inadequate price are not bona fide purchasers for value. According to the appellate court, "by arguing that 'value' effectively means 'any consideration,' Purchasers would render the exclusion all but meaningless." The appellate court also cited the general rule stated in sec. 8.3 cmt. B of the Restatement (Third) of Property: Mortgages, i.e., that a foreclosure sale may be invalidated if the price paid is less than 20 percent of the fair market value.

The appellate court rejected the Purchasers' assertion that because Capital Title was aware of the price for which Purchasers acquired the home, the entire $400,000 claim should be paid. The appellate court noted that "the nature of title insurance is that it covers risks to title other than those that are specified in the policy. In this case ... an insurer that is aware of the possibility that a sale will be set aside for failure to pay value will expressly exclude coverage for that risk." The court further noted that Purchasers' practice was to bid in the bare minimum required to cover the homeowners' assessment liens foreclosed upon, and that by doing business in this manner, "they take a calculated risk that a purchase will be set aside for failure to pay sufficient value." The court further reasoned that because most foreclosure sales are not challenged by the homeowner, Purchasers "may enjoy a windfall," because in many cases the Purchasers would be able to sell the home at or near its fair value for an (often) exorbitant profit. According to the court, title insurers should not, on public policy grounds, be in the business of guaranteeing Purchasers' a sizable profit on their speculative bid at a foreclosure sheriff's sale. The appellate court also rejected Purchasers' argument that if Exclusion 5 of the policy were held to prevent coverage by the Purchasers, the coverage under the policy would be illusory and a nullity, noting that "the Policy provided Purchasers a wide variety of valuable coverages," including unknown easements, title defects and access impediments.

Reporter's Comment 1: The facts in this case virtually cried out for the decision (by both the superior court and the appellate court) that the foreclosure sale should be overturned and the title insurer not required to pay the $400,000 liability amount under the Owner's Policy. This is probably as clear a case for equitable intervention by a court that could be imagined. Unfortunately, as the appellate court points out, very few distressed homeowners facing foreclosure have the inclination, time or money to bring an action to set aside a foreclosure sale, and they rarely even put in an appearance or an answer. And it would certainly be unfair to permit speculative foreclosure sale purchasers (who are solely in this type of business to make a profit; the court noted that Purchasers "acquired most of the homes for bids of only $3,000 to $6,200") to "insure" or "guarantee" their anticipated profits even if the sale were later set aside, by purchasing an Owner's Title Policy for an amount far in excess of the amount they voluntarily bid at the foreclosure sale and then be able to recover the grossly higher amount from the title insurer. As noted earlier, with the current severe downturn in the housing market, we can expect to see more of these types of actions against various parties involved in residential real estate transactions; hopefully homeowners will not capitulate with respect to grossly inadequate bids for their property at foreclosure sales and will realize that they have legal rights also.

Reporter's Comment 2: On the other hand, it always makes sense to pay your homeowners' association assessments (at least when it appears you are able to), which normally are quite low in relation to the value of the property. In this case, the facts are somewhat unusual because the homeowners were foreclosed upon because they didn't make assessment payments of $3,000 on a home worth as much as $400,000. It at least seems that the homeowners (obviously not the victims of poverty) could have come up with the $3,000 somewhere and avoided the time, hassle, and expense of challenging the price paid at the foreclosure sale, or else contested the foreclosure sale while it was pending — since they were able to pay attorneys to contest it after the redemption period expired. (Although this certainly does not excuse the actions of Purchasers that were rejected by the appellate court.)

Reporter's Comment 3: It is somewhat worrisome that, as the appellate court notes in a footnote, "Capital Title did not dispute Purchasers' assertion that it was aware of both the estimated fair market value of the home and the amount Purchasers paid for it." At what point (if any) could the discrepancy be low enough that the court (or some other court) would still set aside the sale but perhaps permit a purchaser to make a successful claim against the title company to pay the higher liability amount under the Owner's Policy? Note that the Purchasers did not purchase the title policy until after the expiration of the statutory redemption period, so that Capital Title knew exactly the amount of the bid and the approximate value of the property; thus there was no fraud, misrepresentation, or withholding of information from Capital Title on the part of Purchasers. Fortunately for the title agent and underwriter, the term "value" in Exclusion 5 has been decided under existing case law in a manner favorable to title companies and agents, i.e., it does not mean "any" consideration but instead means valuable and adequate consideration. As noted by the appellate court, "the purpose of [Exclusion 5] would be served by interpreting it consistently with the authorities that set out the requirements for a bona fide purchaser or that, in this context, establish when a foreclosure sale may be set aside for failure to pay adequate value."

Editor's Comment: The editor supposes there is something in the policy that might support the title company's escaping liability here, but he doesn't agree that the "value" requirement ought to be the basis for such relief.

There can be little doubt that the purpose of the policy's language that there is no coverage if "value" is not paid is to avoid liability where the insured is not a "bona fide purchaser for value" and therefore does not take free of unrecorded interests. But the definition of what constitutes sufficient value to constitute a "bona fide purchaser for value" varies from one jurisdiction to the next and RARELY is it read to mean the same as "adequate consideration" as the court (and Jack) would appear to have it mean here.

Given the court's analysis, which stresses an interpretation of the language of the policy only, and does not tie its analysis to the meaning of the term "value" as it appears in the recording acts literature, an insured in a state that does recognize any significant payment as "value" for recording act purposes might find itself uninsured because the court reads that term differently in the policy. This result could obtain whether or not the insured was a foreclosure purchaser. Not a good thing.

The fact is that foreclosure sale purchasers frequently do not pay "adequate consideration" as that term is variously defined. They pay the amount necessary to win at foreclosure. No less an authority than the U.S. Supreme Court has recognized that we shouldn't expect more from foreclosure sales than an open and fully noticed auction. Remember the *Durrett* controversy – resolved (mostly) in *In re BFP?*

The bottom line is that it's neither a sin nor a crime for a third party to buy at foreclosure sale for a low price. And those who buy at such foreclosure sales are certainly entitled to strike a bargain with a title insurer to insure their foreclosure title. If, as should always be the case, the title insurer is aware that it's insuring a title derived from a foreclosure sale, shouldn't we expect it to state more specifically that it's not insuring against the risk of a court's undoing the sale? The editor certainly thinks so. Back to the drafting room, Jack. Don't rely on this case.

The Reporter for this item was Jack Murray of First American Title Insurance Company's Chicago office.

TITLE INSURANCE; TORTIOUS INTERFERENCE: When title insurer agrees to "insure over" a third party option right in order to permit a closing of property, it will not be liable to such third party for tortious interference with the option when the seller, prior to seeking the title insurance, has already resolved to sell the property notwithstanding the third party's right. ***CS-Lakeview at Gwinnet, Inc. v. Simon Property Corp, 642 S.E. 2d 393 (Ga. App. 2007)***, discussed under the heading: "Rule Against Perpetuities; Choice of Law."

VENDOR/PURCHASER; INSTALLMENT LAND CONTRACTS; TENANCY BY ENTIRETIES: A contract for deed between a vendor and purchaser for real property held by the purchaser and his wife in a tenancy by the entirety was enforceable, even though the wife did not consent to the sale before her death and the property did not pass before the vendor's death. ***Estate of Sommerer*, *211 S.W.3d 123 (Mo. Ct. App. 2007).***

In this case, Paul and Frances Sommerer owned a parcel of land jointly in a tenancy by the entirety. In April 2000, Paul Sommerer agreed in writing to sell the land to his son, Leroy Sommerer, who had been renting it. Frances Sommerer was not a party to the agreement and did not sign the writing. She died three months later in July 2000.

Paul Sommerer died four and a half years later in January 2005 without having transferred title to the land to his son, despite his son having already paid the agreed-upon price.

Leroy Sommerer subsequently brought suit, seeking specific performance of the contract. His brother opposed the contract and argued it was void from the absence of his mother's signature. The circuit court found the contract to be valid and ordered specific performance.

The Missouri Court of Appeals affirmed. The court found that the agreement between Paul Sommerer and his son was a contract for deed, as opposed to a mortgage, and as such, the agreement did not purport to immediately convey legal title to the land to Leroy Sommerer. Instead, it was merely a promise to convey title once the contract price was paid in full. Until that point, Leroy Sommerer's interest in the land was purely equitable. In finding for Leroy Sommerer, the court relied on the rule that "a seller can lawfully agree to sell something that he does not own but expects to acquire." Thus, even though Paul Sommerer could not have conveyed the property without the consent of his wife at the time the parties made the agreement, his agreement to convey the property at a later point in time was valid.

The court distinguished the cases that Leroy Sommerer's brother relied on as involving agreements that actually purported to convey title, unlike the agreement at issue, which merely promised to convey it once the buyer had made all payments. After his wife died, Paul Sommerer had sole ownership of the land in question, and as Leroy Sommerer had completed his end of the contract, the court reasoned he was entitled to specific performance.

WATERS AND WATER RIGHTS; PRIVATE LAKES; USE RIGHTS: Owners of portions of lake bed of a private lake have the right to exclude others from that portion of the lake above their property, and even to fence or drain their portion of the lake. ***Orr v. Mortvedt, 735 N.W. 2d 610 (Iowa 2007).***

One family owned a large rock quarry that had ceased operations. Over time, through the operations of underground springs and groundwater, the quarry became a thirty acre lake. An outlet ran from the lake to a nearby natural creek and carried overflow water, but otherwise the lake was totally land locked.

The family sold off portions of their property over time. Each transfer included some of the land adjacent to the lake together with a portion of the lake bed.

A dispute arose among the neighboring owners as to their respective rights in the lake, and this declaratory relief action ensued.

The Iowa Supreme Court, noting that the question was one of first impression in Iowa, elected to commit Iowa to what it described as the majority common law view that the owners of a lake bed own the property above the bed, including the lake surface, and are free to fence off their area of the lake, or even to drain it, as they have as complete a dominion and control over the lake and its surface as they would have over dry land within their described boundaries. The court noted, of course, that the rule was entirely different with respect to navigable waters, as the owner of all navigable waters is the State.

A dissenting judge argued that the minority rule, characterized as the Civil Law rule, ought to apply. This gives a collective right of use of all the surface waters of the lake to all the owners of the lake bed.

In rejecting this rule, which is followed in Illinois, Michigan, Florida and Washington, and adopting the common law approach, which is followed in a much larger group of states, the Iowa court stated that this approach "recognized the legal significance of property boundaries and protects the interests of owners when neighbors are unwilling or unable to coexist cooperatively. The court pointed out that this is simply the "default" rule, and neighbors on lake beds can certainly reallocate their respective rights as they saw fit.

A strong dissent by Justice Cady concluded that the adoption of the common law rule in the modern environment is unreasonable. First, it is difficult to measure and enforce the rights of parties derived from property boundaries sunk far beneath the lakes surface. Second, it frustrates the proper recreational use of lakes as resources. Third, the free access rule fits best the modern expectations of citizens and does not disrupt prevailing norms of property ownership.

Justice Cade noted that a scholar recently concluded that the "civil law" rule in fact had its origin in Scotland while the "common law rule" is derived from Roman law. He argued that most courts that have adopted the common law approach because they regarded it as consistent with the English common law, which it probably is not.

Comment: Many of these cases are resolved differently because the lake in question is shown on a subdivision map and the various landowners adjacent to the lake (and often everyone in the subdivision) receives, expressly or implicitly, an easement of use for the lake. Although there was a map drawn here, it was drawn only at the time of the third conveyance out from the original landowners. They had already conveyed away two hunks of lakebed.

WORDS AND PHRASES; "BLIGHTED:" In order to meet the statutory definition of a blighted area as a basis for a condemnation action, the condemning party must present sufficient evidence that the subject area has become a "social liability," the definition of which includes concerns about the area with respect to the health, safety, and welfare of the public. ***Centene Plaza Redevelopment Corp. v. Mint Properties, 225 S.W.3d 431 (Mo. 2007) (en banc),*** discussed under the heading: "Eminent Domain; Redevelopment Condemnation; 'Blighted' Areas."

WORDS AND PHRASES; "TEMPORARY BUILDINGS: A restrictive covenant prohibiting the erection of temporary buildings of any kind, including mobile homes, tents, and trailers, does not operate to preclude the construction of a modular home. ***Williams v. Fox, 219 S.W.3d 319 (Tenn. March 15, 2007),*** discussed under the heading: "Servitudes; Restrictive Covenants; Building Restrictions; Modular Homes."

ZONING AND LAND USE; LICENSES: Restaurant's obtaining of an entertainment license does not amount to an amendment of the zoning classification of the property from restaurant to nightclub use. Such zoning changes are subject to the full set of land use procedures applicable to the municipality, and cannot be short circuited by the permit process. ***Nouhan v. Board of Adjustment of the City of Clifton, 392 N.J. Super. 283, 920 A.2d 700 (App. Div, 2007); April 19, 2007.***

A group of residents sued a zoning board over its interpretation and enforcement of a zoning ordinance and its grant of a special exception to allow a restaurant to operate as a nightclub in the evening.

The restaurant was authorized to operate as a restaurant as under to operate with a parking area that was too small for its capacity. The permit required that the applicant maintain a license for additional parking at a neighboring business's property. Some years after obtaining this permit, the restaurant began operating a discotheque-nightclub at night, after its normal restaurant operating hours. It purported to be operating under the authority of an entertainment license granted to it by the municipality. The nightclub business attracted a substantially greater numbers of patrons than the restaurant business drew, and the number of existing parking spaces was inadequate for the nighttime business.

The neighboring residents perceived this to be a zoning violation and asked a zoning officer to enforce the violation. The officer refused to do so, having concluded that the nightclub use was consistent with the conditional use permit for a restaurant. The residents brought suit challenging the agency's affirmation of the restaurant's operation as a nightclub based on its entertainment license.

The lower court noted that a municipality has the statutory authority to issue entertainment licenses to restaurants, and that such a license can be read as part of an overall zoning ordinance that allows for restaurant operation. The court commented, as had the zoning official in testimony that the neighbor's fight was with the City over the entertainment license as it was this license, and not the restaurant zoning, that caused their problem.

On appeal, the Appellate Division held that the nightclub operation was not a restaurant and had not been blessed as a restaurant under the zoning ordinance simply because it had received an entertainment permit. A municipality may adopt a zoning ordinance regulating land use only after the land use and housing elements of its master plan have been approved by the planning board. The board has to approve all zoning proposals and notices of amendments to any prior ordinances. Ordinance interpretation is also the exclusive exercise of land use boards. Thus, the business license process by which the restaurant had obtained an entertainment permit was not part of the land use process and did not amend the zoning classification of the property, or the limits that it imposed.

The regulation of land and of businesses, the Court remarked, should be two separate spheres of municipal regulation. Therefore, the restaurant's discotheque operation was not a permitted use of the restaurant unless it was permitted under the zoning ordinance or by way of a variance.

Here, the municipality's zoning ordinance specifically did not make discotheques a permitted use in every zoning district. The special exception originally granted to the restaurant was only to authorize expanded seating for the restaurant; it did not authorize a discotheque or related activities for the space.

Comment: This outcome seems so logical that it is difficult to understand why both the zoning officer and the lower court had different views. Most states, and especially New Jersey, have elaborate land use planning legislation, both state and local, and land use decisions are based upon a multi-layered analysis that is unrelated to whether a business license ought to issue.

It does seem to the editor, however, that a municipality ought not to issue a business license where the intended use is inconsistent with zoning. But even if that rule were to apply (as it might have here), the full zoning process of the municipality ought not to be estopped by the judgment of the business license issuer, even if the issuer is the mayor and city counsel.

ZONING AND LAND USE; BUILDING PERMITS; "PENDING LEGISLATION DOCTRINE": The "pending legislation doctrine," which authorizes a city to withhold action on a legally permitted building permit where pending land use legislation may restrict such issuance, applies only where an amendment to a zoning ordinance that would prohibit the use of land for which the permit is sought is sufficiently pending at the time of the permit application. Consideration by a city advisory committee is not sufficient to qualify the proposed change as "pending." ***Harding Acad. v. The Metro. Gov't of Nashville & Davidson County*, *222 S.W.3d 359 (Tenn. 2007).***

Harding Academy, a private elementary and middle school, acquired 11 residential lots near its campus in an attempt to expand. In 2003, Harding asked the Metropolitan Government of Nashville & Davidson County Board of Zoning Appeals to grant recreation center status to its properties. A neighborhood group challenged the interpretation of a Metro official that use of the properties qualified as a "recreation center" under local zoning codes. At the request of a city councilwoman, Harding withdrew its application in March 2003 in order to attempt to reach an amicable resolution of the dispute. When no resolution was reached, the councilwoman filed an application on behalf of the neighborhood in April 2003 to have the area surrounding Harding declared a neighborhood conservation overlay district.

In May 2003, Harding applied to the Metro Department of Codes Administration for permits authorizing the demolition of nine structures on the residential lots. The Codes Director issued the requested permits on May 6, 2003. Two days later, the Codes Director notified Harding that he was revoking the permits pursuant to the "pending legislation doctrine," which provides that a building permit need not be issued if an amendment to a zoning ordinance that would prohibit the use of land for which the permit is sought is pending at the time of the application for the permit. Harding timely appealed the revocation of the permits. On May 14, 2003, the Historic Zoning Commission approved the proposed zoning change, and the Metro passed the neighborhood conservation overly ordinance, which became effective July 19, 2003. Upon hearing Harding's appeal on June 10, 2003, the Metro Board of Fire and Building Code Appeals voted to uphold the revocation of the demolition permits based on the Codes Director's argument that because there was legislation pending to place a historic conservation overlay on the properties, the Harding permits were issued in error.

On July 29, 2004, the trial court reversed Metro's decision, finding that the "pending legislation doctrine" was arbitrary and capricious, and ordering the Harding demolition permits to be reissued. The Court of Appeals affirmed, agreeing that Metro's revocation of the demolition permits was exercised in an arbitrary and capricious manner, but held that the trial court erred in holding Metro could not rely on the "pending legislation doctrine." A footnote in the Court of Appeals' opinion stated that its holding "should not be construed to mean that Harding Academy is now permitted to carry out its planned demolition of the structures on the property at issue."

Because of the confusion caused by this statement as to whether Harding could demolish the structures, the Supreme Court granted a further appeal to determine the propriety of Metro's decision to revoke the demolition permits that were issued to Harding. In discussing the "pending legislation doctrine," the court noted that the purpose for the doctrine is to permit a city to amend its zoning ordinances without the threat of landowners racing to beat the clock by filing an application and obtaining vested rights under existing zoning regulations. The court held that the doctrine is applicable in the contexts of both comprehensive zoning ordinances as well as specific ordinances such as the historic zoning ordinance at issue in this case.

The issue here, however, involved the point in time at which a zoning ordinance became "pending" for purposes of the doctrine. While some jurisdictions require that the proposed change must be formally proposed and open to public inspection, others require only that the appropriate department of the city be actively pursuing an ordinance. In this case, the City Council person did submit an "application" for an historic overlay district and the matter was referred to the Historic Zoning Commission, which scheduled hearings, all before the school managed to reapply for the demolition permits.

The appeals court held that the Historic Zoning Commission's activities were not sufficient to establish a pending zoning ordinance, as the zoning change had merely reached the application stage (proposing that the area be declared a historic overlay district), and had not yet been considered by the Commission or the City Council. At a minimum, the Commission needed to recommend the historic conservation overlay designation to the Metro City Council before the demolition permits were issued in order to justify revoking the permits pursuant to the "pending legislation doctrine."

Arguably, nonetheless the school's rights had not "vested" because Tennessee requires some reliance on a building permit in order to establish vested rights. But the court held that the city had prevented any reliance by the school when it quickly withdrew the demolition permits after issuing them, and therefore could not now claim that the school had not shown reliance. Had the permits not been withdrawn, the school would have relied.

Comment: This is an old, old story that any experienced land use lawyer has lived through. Some councilperson says "let's talk," and then uses the delay to slip through a legal blockage so that when the talking's done, the developer is stymied. Note that the permit apparently permitted the demolition of the buildings, but didn't necessarily give the school the zoning classification it needed to develop its campus as it wanted. Sad standoff.

Also see: ***University Cottage Club of Princeton New Jersey Corp. v. NJDEP, 191 N.J. 38, 921 A.2d 1122 (2007),*** discussed under the heading: "State and Local Taxation; Historic Sites; Tax Exemption." (An application for tax-exempt status for historic property should be evaluated based on the requirements in effect at the time of hearing and cannot be denied because of the possibility that the standards may be changed in the future.)

ZONING AND LAND USE; PROCEDURE; NOTICE: Where notice of a proposed change to a zoning ordinance must be sent to affected property owners if the amendment proposes to change the "classification" or boundaries of a zoning district, the term "classification," unless otherwise defined, includes changes that could fundamentally alter the character of a zoning district, including the creation of subzones with differing bulk and density requirements. ***Robert James Pacilli Homes, L.L.C. v. Township of Woolwich, 394 N.J. Super. 319, 928 A.2d 412 (App. Div. 2007).***

A developer sued a municipality for failing to give it proper personal statutory notice when it amended an ordinance to alter the density and bulk standards for residential zones.

The amendment listed development preferences for new subdivisions in designated residential zones, but did not alter the uses in those zones. The municipality did not send out notices by certified mail, as would be the statutory process if notice was required, prior to the first reading of the amendment. A public hearing was held for the second reading. The amendment was then referred to the planning board, and then passed by the municipality.

The developer had two subdivision applications pending at the time of the amendment's adoption. In response to the developer's claim that the municipality failed to give proper notice of the amendment, the municipality answered that notice was not required because the amendment did not change the permissible uses under the ordinance.

The lower court carefully analyzed the amendment to determine if it changed the classification of the ordinance. It found that the amendment created subzones within the residential districts. Each of these subzones had differing bulk and density requirements. The lower court found that the scope of the changes was significant, and therefore the notice actually given was inconsistent with due process requirements. As a result, it ruled the ordinance invalid.

On appeal, the municipality argued that its notice complied with all statutory requirements. The statute required notice to be given for any amendment proposing to change the "classification" or boundaries of a zoning district. The Appellate Division noted that the term: "classification" was not defined within the statute and thus required construction. It found that "classification" was usually synonymous with the broad general uses permitted in an area, as well as with sub-categories. The Court held that a change in a broad category, as well as in any sub-category, could fundamentally alter the character of a zoning district. It cited prior cases where notice had been needed after a similar amendment to bulk and density requirements within a zone because those could result in a substantive change to future development in the zoning area. This necessitated notice to those who could be affected.

The municipality argued that a notice requirement dependent on the substantiality of the change introduces an element of uncertainty into the municipal planning and zoning process. The Court disagreed, noting that the test was not based on the number of changes, but was based on the substance of the changes. Because, in this case, the Court found that the municipality was required to provide notice under the statute and did not, it invalidated the ordinance.

Comment: Obviously this could be a very useful case to buy time, which often is an extremely useful commodity in a land use process. Put it somewhere where you'll find it when you need it.