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ABA REAL ESTATE QUARTERLY REPORT

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Quarterly Report on Current Developments in Real Estate Law

January 1 through March 31, 2009

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

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ADVERSE POSSESSION; REQUIREMENT OF HOSTILITY; MISTAKEN BELIEF ON BOTH SIDES: An adverse possession claim is not defeated by the fact that the landowner-claimant and the neighboring owner operated under a mistaken belief as to the location of the relevant property line. ***Mastroianni v. Wercinski*, *965 A.2d 1139 (N.H. 2009).***

The adverse possession claimant (and his predecessors) mistakenly believed that a preexisting stone wall marked the end of the claimant's property and the beginning of the neighbor's property. In reality, the boundary was east of the stone wall, and the claimant was using part of the neighbor's property. The claimant mowed grass, planted flowers, and otherwise treated the property as his own. Upon discovering the actual boundary, the neighbor relocated the stone wall in an effort to reclaim the land. The claimant petitioned to quiet title on the basis of adverse possession.

The trial court found for the neighbor, holding that no adversity can exist when the parties were mistaken as to the property line. On appeal, the claimant argued that the trial court erred by treating as dispositive the parties' beliefs about the location of the property line.

The Supreme Court of New Hampshire found for the claimant, holding that the parties' mistaken assumption about the property line was immaterial. It stated that "it matters not, that the possessor was mistaken, and had he been better informed, would not have entered on the land." The trial court applied the minority view, not adopted in New Hampshire, which regards mistaken beliefs about the property boundary as preventing an adverse possession claim. Under the majority view, a use of land can be adverse even when the parties were wrong about the property boundary at issue. The court, accordingly, reversed the judgment and remanded for a correct application of the law.

Comment: The "mistaken possession" exception, sometimes known as the "Maine Doctrine," has been receding steadily around the country in common law courts. Will the brouhaha about *deliberate* adverse possessors (opposite of this case) that has sprung up in New York and Colorado and other places eventually lead to modification of the hostility rule in this case as well? Hard to say.

The fact that the "true owner" was not aware of the adverse possession ought not to matter if, as appears to be the case here, the possession met the "open and notorious" test.

BROKERS; COMMISSIONS: To incur liability to pay leasing commissions following its purchase of leased property, a buyer must have affirmatively assumed its seller's obligation to pay the commissions. Whether such assumption has occurred depends upon whether: (1) there is a clear separate promise or (2) the entire record, taken as a whole, signals that the buyer agreed to assume the obligation despite the absence of a separate promise to do so. ***Pagano Company v. 48 South Franklin Turnpike, LLC, —- A.2d ——, 2009 WL 578563 (N.J. 2009).***

The New Jersey Supreme Court stated the issue succinctly: Is "a purchaser of commercial property] liable for the real estate broker commissions due under the leases it acquire[s] [by way of] a general assignment from the seller"? In a 1994 opinion from that same court, *VRG Corp. v. GKN Realty Corp.*, 135 N.J. 539 (1994), it was held that to incur such liability, a purchaser must have "affirmatively assume[d]" its seller's obligation to pay the commissions. That could be satisfied by a separate promise or by discerning such from the entire record. "If, taken as a whole, the record signals that the assignee agreed to assume the obligation, he or she will be held to it despite the absence of a separate promise to do so."

Here, the seller had executed an exclusive leasing agreement with a broker. Under it, the broker was entitled to a commission on account of a new lease and for its renewals, extensions, and options as well. The brokerage agreement recited that it would be binding on the owner's heirs, successors, and assigns.

The broker procured at least three leases and received its commission in connection with their signing. Then, the owner contracted to sell the property. The contract provided for a due diligence inspection of the property and of property-related documents such as the leases and lease correspondence. The buyer had a specific right to request copies of documents it felt were needed to adequately complete its due diligence requirements. The buyer reviewed the leases and made no further requests for documents.

Each lease was made applicable to the landlord's assigns, and expressly set forth that an assignee would be bound by the terms of the lease and would be assumed to have agreed to carry out all of the landlord's obligations under the lease. No one argued the effectiveness of that provision. Each lease also had a provision dealing with the broker and its commission. After identifying the broker and excluding others who might claim a commission, it said, "by separate commission agreement and letter of understanding said broker shall be paid a commission by Lessor. . . . Lessor agrees to fully satisfy its obligations to said broker for commissions and covenants and agrees to save Lessee harmless with respect to claims of said broker for said commissions."

There was no evidence that the buyer ever saw or actually knew about the contents of the brokerage commission agreement. There was no expressed assumption of the brokerage agreement by the buyer. What there was, however, was a provision in the assignment of leases, not about the brokerage agreement, but saying: "Assignee assumes and agrees to perform all of Assignor's obligations under the Leases."

The broker persuaded the lower court that, taken as a whole, the record demonstrated the buyer had affirmatively assumed the obligation to pay renewal commissions (which later became due). The buyer persuaded the intermediate appellate court that the landlord's brokerage obligation under the lease only ran to the tenant and not to the broker. The intermediate appellate court couldn't find anything in the record where the buyer promised either its seller or the broker that it would pay the commission. It read the lease as imposing only an obligation to indemnify the tenant for the commission, but because the tenant was never called upon to pay the commission, there was no claim for indemnification. The broker appealed.

The court undertook analysis of an important precedent case, *VRG Corp.* That case nvolved a set of facts where neither the leases nor the assignment of leases referred to or included the commission obligation between the seller and the broker. Second, the assignor and assignee there purposely and explicitly amended their agreement to see that the assignor retained the obligation. Thus, the assignment and the leases were silent and the parties manifested an intention contrary to that of having the buyer be responsible for paying the broker. The Court, relying on the principal that the obligation to pay a brokerage commission is "personal," could not find an "affirmative assumption" of that obligation by the buyer in VRG Corp. The Supreme Court looked at its holding in VRG Corp. and never waivered from the underlying principal. But here, it saw the factual situation differently.

Here, the Court said that an "express promise" is not the only way to find an "affirmative assumption." The Court acknowledged "it would be '[] grossly onerous and unfair' to hold that in all contracts 'a buyer impliedly agrees with the broker that he will pay the commission if the broker cannot legally collect it from the seller.'" In this case, however, the leases detailed the broker's role in procuring the tenancies. They disclosed the seller's liability, as landlord, to pay the broker, even if the details of that obligation (such as extending to lease renewals) was not spelled out.

Even though the intermediate appellate court had looked at the very same lease provision, it was the Supreme Court's conclusion that the intermediate court focused only on the indemnification feature and not on the clause's overall implication. Basically, it concluded that the buyer, knowing from the assignment of leases that it was assuming the obligations of the landlord under those leases, had an obligation to inquire into the commission agreement referred to in the lease's brokerage provision, but never did so. Under the contract of sale, it had the right to request the brokerage agreement, notice of which was revealed by the leases themselves. It could not reasonably believe that what it didn't know couldn't harm it. In essence, the Supreme Court found that when the buyer took an assignment of leases making it responsible for the landlord's obligations under those leases, it wouldaa be liable for all of those obligations it could have reasonably discovered by reading the leases and asking about documents or obligations referred to in those leases.

Reporter's Comment 1: The principle survives, but the "empty head, pure heart" defense will not protect an assignee from being obligated to pay a brokerage commission under an agreement that could easily been discovered. The Court's decision made note that this was a sophisticated buyer who must have known to ask for any brokerage agreements. That might mean that the Court saw an intentionally empty head in this case and was questioning the purity of the buyer's heart.

Reporter's Comment 2: The wasn't as open and shut as it might seem. There was a written dissent in which the Chief Justice joined. It made a strong point that the obligation to pay a brokerage fee or commission is personal and neither attaches to the land nor runs to a subsequent property owner. The dissenting justices were upset because they saw *VRG* Corp. as having provided a "bright line" that "skilled commercial real estate professionals" had relied upon for more than a decade. The dissent argued for a strict approach and a high barrier when finding an affirmative assumption of a personal obligation. They thought these facts "did not pass muster."

Reporter's Comment 3: The result would be the same, but there probably have been no case in a jurisdiction (if any) where a commission obligation is a lien or otherwise runs with the land.

Reporter's Comment 4: There was a footnote to the effect that the broker held a 13% ownership interest in the landlord-property owner. One wonders why it didn't act to protect itself in the sale and why its "partner(s)" didn't make the buyer affirmatively assume the brokerage fee obligation. Was that argued? Was there a deliberate reason for that?

Editor's Comment: In the editor's view, this is a perfect example of a covenant that clearly does not "touch and concern" the land and should *not* run with the land unless assumed, as the court held here. Because the court found an assumption, and because there was express assumption language, the editor doesn't think this case disrupts the common law as the dissent seems to feel. The obligation to pay leasing commissions could be viewed as a third party beneficiary obligation assumed by the buyers.

BROKERS; MORTGAGE BROKERS; STATUTE OF FRAUDS: Where parties begin with a brokerage agreement for a refinancing of a commercial loan, but ultimately the deal emerging looks more like a "sale" than a loan, the agreement will be subject to the statutory requirement that agreements for the "sale" of real property must be in writing, and as a consequence, broker may be denied the right to collect fees under the agreement, *quantum meruit*, or reliance damages. ***CB Richard Ellis Real Estate Services, Inc. v. Spitz, 950 A. 2d 704 (D.C. App. 2008).***

Three developers formed an LLC for the purpose of acquiring and renovating an office building on Pennsylvania Avenue in Washington D.C. In general, the project proved successful, but expensive. The developers found themselves with $70 million in debt and a good building that attracted (as the opinion points out) at least an element of the Washington office of the Wilmer Cutler and Pickering law firm.

Developers were interested in refinancing the building and escaping the high debt costs, but retaining the benefits of ownership and operation. They approached an office of CB Richard Ellis, described in the opinion as "Insignia," which had a specialty in this area, to assist them in finding such a solution. There was no limitation placed on the type of deal that the Developers would like to consider, but also there was no talk about the Developers selling out their interest entirely. In fact, Insignia, at least testified that Developers were concerned about avoiding capital gains tax that might arise from an outright sale. Insignia in fact worked diligently to identify and analyze the relevant data and to prepare various offering and information documents, as well as to identify potential investor partners. In the middle of the process, the potential lease with Wilmer, Cutler & Pickering came along, which required virtually a complete rewriting of all that had been done before.

In light of the exigency of the deal, Insignia started work immediately without an executed commission agreement, but also began negotiations on the form of such an agreement. It wasn't until January, 2003, just as the rewriting described about was beginning, that the parties finally came to the table to negotiate the final elements of the agreement. The final proposed written agreement contained a fee schedule compensating Insignia in various ways for various services, gave Insignia an exclusive right to "identify, structure and negotiate the recapitalization of the above-referenced Property." Insignia would "promptly commence and diligently prosecute obtaining required financing . . . ." Of course it was already hard at work doing this. The agreement provided carve outs for several potential sources of refinancing identified by Developers (and for whom Insignia got no commission) and also stated that if Developers elected not to undertake any refinancing, no fees were payable.

Rector, one of the Developers, represented the Developers in these negotiations and executed the agreement draft, but indicated that in a cover memo accompanying the executed agreement: "[m]y execution and delivery to you is contingent upon your receipt of this engagement letter signed by [Spitz]." Spitz was another of the Developers.

Although Insignia never executed the agreement, there is not much dispute that they assented to it.

Spitz, meanwhile, was pursuing another lead, Westwind. Although the agreement did not carve out Westwind, Insignia had been aware that a separate negotiation between Developers and Westwind was going on. Spitz sent to Insignia's representative an email with an attachment that appeared to contain the executed agreement discussed above.

In a conflict of human negotiation and modern technology, a misunderstanding developed. In fact, the attachment from Spitz contained a new "carve out" for Westwind and an agreement to compensate Insignia, something for its services, but less than it anticipated, if Westwind did a deal. Insignia's representative took the message on his Blackberry, assumed that it transmitted the executed original agreement (the parties were separately negotiating about a reduction in fees for Westwind) but couldn't open the attachment, so was unaware that the agreement had been modified in a material way.

In any event, the parties continued to negotiate over what fees would be payable regarding a Westwind deal, with apparently no reference to the language in the transmitted agreement (to which Insignia never expressly assented.)

It was at this time, and apparently for the first time, that it became apparent to the parties that the Westwind deal might finally be structured as a form of purchase of the building rather than as a financing.

The evidence also showed that the materials developed by Insignia had been considered by Westwind in evaluating the deal, although Insignia was not invited to join the negotiations.

Of course, what seemed predictable at this point happened. Westwind did the deal and the Developers "stiffed" the brokers – Insignia.

Here is how the court described the Westwind deal:

"[The deal with WestWind . . . included deeding the debt-encumbered Property to a previously-formed limited partnership called Kan Am 1899 Pennsylvania Avenue LP ("Kan Am 1899"). As part of the transaction, 1899 LLC was admitted to the partnership, which now consisted of one general partner, WestWind 1899 Pennsylvania Avenue Management, LP, holding a 0.01% equity share, and two limited partners, Kan Am Grund and 1899 LLC, holding equity shares of 94.99% and 5.00%, respectively. In accordance with a Contribution Agreement, Kan Am 1899 paid off the existing debt on the Property (approximately $70 million) with proceeds of a new loan and money contributed to the partnership by Kan Am Grund and the General Partner.

Article 10 of the Contribution Agreement, entitled "Brokerage Commissions" provided as follows:

"[Insignia] has represented Current Owner [1899 LLC] in connection with the transactions contemplated by this Agreement. Upon the Closing, and only if the Closing occurs, the Partnership shall pay a brokerage fee of Two Hundred Thousand and No/100 Dollars ($200,000.00) to Broker; provided, however, Current Owner shall be responsible for any additional commission or fee, if any, due Broker."

Insignia was not a party to this agreement, and the $200,000 was never paid.

Not surprisingly, Insignia brought suit. They were met at the gate with a summary judgment motion from Developers invoking the protections of a D.C. statute requiring that brokerage agreements for the "sale" of real estate be in writing. The trial court bought the argument that this transaction was a sale, that there was no written agreement (despite the evidence shown above) and that the statute precluded compensation for *quantum meruit* or money or effort expended in reliance. Consequently, the trial court entered summary judgment for Developers and *bupkus* for Insignia.

On appeal to the Court of Appeals, the appeals court concurred with the trial court on the fundamental issue – the deal with Westwind was a "sale" and that the statute specifically provided the payment of a commission for a "sale" of real property without a written agreement. The court rejected (based upon precedent) and argument that this statute was intended only for residential transactions. As to the definition of sale, the court embraced a simple statement based upon Black's Law Dictionary.

"[a] contract whereby property is transferred from one person to another for a consideration of value, implying the passing of the general and absolute title, as distinguished from a special interest falling short of complete ownership."

[It's more complicated than this – the parties argued extensively and the court responded, but things pretty much boil down to this definition. Although, coming out the other end, the Developers retained a net 5% interest in the new owner's partnership and had all their debts cancelled, the court chose to ignore all this and focus simply on the fact that the entire title to the property had transferred from the Developers to the new partnership.

We recognize, and the Developers acknowledge, that 1899 LLC's receipt of "a five percent limited partnership interest" in Kan Am 1899 conceptually places it on both sides of the transaction. However, this does not serve to exclude the transaction from our definition of "sale." As a limited partner, 1899 LLC has an equity interest in Kan Am 1899; it has no ownership interest in the property owned by that entity. . . Furthermore, 1899 LLC has no management control over the Property. The transaction therefore occurred between two separate and distinct entities, and 1899 LLC transferred complete ownership from itself to Kan Am 1899.

The court saw as irrelevant the fact that the partnership retained a Spitz-controlled entity to manage the property.

Shocking? Well, it would have been to the editor except for the life ring the court tossed to Insignia, one that the lower court had not identified. The court noted that the parties all along had not negotiated on the basis of an intended sale, but that all negotiations had been for a refinancing of the deal. Contracts for consulting and brokerage services regarding refinancing are not covered by the statute. Westwind had never been carved out. Although they were not entitled under the agreement for a commission based upon the "sale," Insignia was not precluded from proving an unwritten agreement for services pursuant to a proposed refinancing, and, of course, ultimately refinancing of the property did occur as part of a deal in which Insignia played a role.

Comment 1: Of course we'd all like to know the rest of the story. Did the trial court in fact find that Insignia was entitled to compensation, that Rector had authority to bind the Developers, that there was in fact a "refinancing" contemplated by the fee agreement? The editor surmises that our thirst for a conclusion will be frustrated. There's probably not enough left in this case for the parties to fight about. Litigation lust has abated, and a settlement will be reached.

Comment 2: There are, of course, several lessons here. The case first came to the Editor on the premise that it was all about the fact that no *quantum meruit* or other compensation was available to a broker that lacked a written agreement. The decision here was based on precedent, and it is not an unusual one. A number of states interpret their statutes in this way, although the Editor concedes that more often the statutes deal with residential deals only. The Editor suggests that the commercial brokerage community, if it has any clout, might want to draw this distinction in the D.C. statute as well.

Comment 3: But the aspect of the case that the Editor found most intriguing was the interpretation of what constitutes a "sale" of the property on facts as complex as these. Is a simple approach really best, or should the court take a more transaction oriented approach? If it did, however, would it really reach a different conclusion.

Comment 4: Of course, regardless of "coulda/shoulda," there are practice lessons here. Don't let those listing agreements lag behind the deal. Be aware that a different economic arrangement may emerge than that first contemplated, and provide for that eventuality. And make sure you know what you mean when you use the term "sale" (or don't).

CONDOMINIUMS; VENDOR/PURCHASER; DISCLOSURE: Seller must disclose prior construction defect litigation resulting from flooding of units in the condominium project, including the subject property. ***Calemine v. Samuelson, 171 Cal. App. 4th 153 (Ca. Ct. App. 2009)***, discussed under the heading: "Vendor Purchaser; Condominiums; Disclosure; Construction Defect Litigation."

CONTRACTS; PAROL EVIDENCE: When a contract term is specifically defined, all contract provisions related to the term will be interpreted according to the stated definition, and where the contract language is unambiguous, parol evidence will not be allowed and the contract will be interpreted as a matter of law. ***Café Rio, Inc. v. Larkin-Gifford-Overton, LLC., 207 P.3d 1235(UT 2009).***

Defendant, a landowner in a development in Southern Utah, began constructing a building on its parcel (Parcel 5). In response, an adjoining landowner and its tenant brought action, claiming that Defendant's building construction violated terms of a cross-easement agreement ("Agreement") that had previously been entered into by all six development parcel owners.

The Agreement entered into by the parties, defined the term "Common Areas," and expressly excluded from such definition, all present and future buildings on Parcels 5 and 6. Conversely, the Agreement specifically prohibited any "building or other structure [from being] erected or placed up on any of the Common Areas of Parcels 1 through 4." The Agreement also provided that "none of such Common Areas shall be changed in any material respect . . . without the prior written consent of all Owners of the Parcels." Additionally, the Agreement included a provision entitled "Prohibition of Barriers," which prohibited any parcel owner from constructing or erecting within any of the Parcels, any "fence, wall, barricade, or obstruction, whether temporary or permanent in nature, which materially limits or impairs the free and unimpeded flow of vehicular or pedestrian traffic between and among the Parcels or the ability to have an unobstructed view of any of the Parcels."

Based upon the Agreement language regarding the need for prior consent of all owners prior to changes in the Common Areas and the prohibition of erecting obstructions, the trial court granted summary judgment in favor of the adjoining landowner and tenant.

On appeal, the trial court's decision was reversed and the case was remanded. The Supreme Court of Utah held that the Agreement definition of "Common Areas" was "clear and unambiguous" since it precisely stated that future buildings on Parcels 5 and 6 were not part of the common areas. As such, the parties placed no limitation on the location of future buildings on those Parcels and implicitly agreed that buildings on Parcels 5 and 6 would not be subject to the restrictions placed on the defined common areas, including the requirement for prior written consent before making material changes.

The court also found that the term "obstruction" did not include buildings. First, the Court reasoned that when provisions of the Agreement were read together, it was clear that the parties contemplated the construction of buildings on Parcels 5 and 6, and made specific provisions in the Agreement in accordance with such intentions. As such, the Court stated that it was plain that the parties did not intend the term "obstruction" to include buildings. Second, the Court reasoned that interpreting "obstruction" to include buildings would eliminate Defendant's ability to construct a building on Parcel 5, which the Court believed was a right explicitly bargained and provided for in the Agreement. Thus, consistent with prior case law, the Court would not interpret the term "obstruction" in a manner that rendered an explicit right meaningless.

Last, using the principle of *ejusdem generis*, the Court construed "obstruction" according to the specific Agreement enumerations of "fence, wall, [and] barricade," that preceded "obstruction." Consequently, the Court found that a building is not similar in character or purpose to the other listed obstructions.

CONTRACTS; PAROL EVIDENCE: Where a contract is facially unambiguous, parol evidence will not be allowed, even where the contract fails to reflect the true intentions of the parties. ***Flores v. Earnshaw, 209 P.3d 428 (UT App. 2009).***

In 2005, Defendant and Plaintiff entered into an option agreement, followed by a Real Estate Purchase Contract ("REPC"), for a residential condominium unit in a prospective building site. Both agreements listed a purchase price of $144,950. The form of REPC used, intended for use in the purchase and sale of existing real estate, contained a provision regarding "Included Items." The provision specified that items such as plumbing, heating, air conditioning equipment, appliances, and light fixtures, were included in the sale "if presently owned and attached to the Property."

Approximately one month after the binding REPC was executed, Defendant contacted Plaintiff and conveyed that the purchase price of $144,950 had been an error. Defendant subsequently sent an addendum to the REPC to Plaintiff, with an increased purchase price. Plaintiff then filed action for specific performance and breach of contract.

During a bench trial, the trial court found that the REPC was clear and unambiguous as to the price of $144,950, but that the REPC was ambiguous as to whether the parties intended to convey a fully built-out unit or just a shell of a unit. As such, the court allowed the presentation of parol evidence to determine the parties' intent regarding this issue. Both Plaintiff and Defendant testified that their intent was to contract for a fully built-out unit. However, the Defendant testified that he intended to do so for a price of $184,950, but that either he or his secretary had mistakenly written a price of $144,950. Based upon such testimony, the trial court ordered Defendant to sell a fully built-out unit to Plaintiff for the purchase price of $144,950. Defendant appealed.

The Utah Court of Appeals reversed the trial court's holding. The court found that the trial court erred when it allowed parol evidence to determine the intent of the parties. The court explained that admission of parol evidence to determine intent is allowed only if there is a finding of facial ambiguity. Otherwise, "the parties' intentions must be determined solely from the language of the contract." Furthermore, the court stated that this rule applies even where poor drafting exists and that "contractual confusion" does not necessarily equate to a finding of ambiguity.

Based upon the language of the REPC, the court found that the "Included Items" clause of the REPC was not ambiguous. The court noted that neither party offered different versions of the language used in the clause and that there did not appear to be a dispute over the fact that the term "presently" referred to the date of execution of the REPC. As such, because the unit had not yet been constructed on the date of execution of the REPC, there was no ambiguity that the listed "Included Items" were not then "owned and attached to the Property." Thus, based upon the plain language of the REPC, the court concluded that the parties intended for the sale of only a "shell" of a unit for the purchase price of $144,950.

Comment: In this case, both parties agreed that it was their intention at the time of executing the REPC, to convey a fully built-out condominium unit. However, the standard REPC form that the parties used included language that was not appropriate for a transaction involving yet-to-be-built property. Since the REPC language was unambiguous, even though it may not have been appropriate to the transaction, the court was forced to rely on the sole language of the REPC.

EASEMENTS; CREATION; IMPLIED EASEMENT; INTENT OF GRANTOR: Landowners do not, as a matter of law, have an implied quasi-easement over land granted for railroad purposes when the intent of the original grantor who conveyed the strip is in dispute. ***Connolly v. Maine Central Railroad Co., 969 A.2d 919 (Me. 2009).***

The original grantor deeded a strip of land on which a railroad track was later constructed to the defendant's predecessor. Although the conveyance created a complete bisection of the grantor's property, the deed did not reserve any rights of the grantor to cross the railroad track. Subsequent owners of the original grantor's property regularly crossed the railroad track to access the southerly portion of the property.

The current owners of the original grantor's property filed a complaint seeking a declaratory judgment that they possess a perpetual right-of-way over the strip. The trial court entered summary judgment in favor of the current owners, holding that they possessed an implied quasi-easement as a matter of law. This appeal followed.

The Supreme Judicial Court first stated that a quasi-easement is created when a common grantor severs real estate, conveying part of it and retaining the balance, and the circumstances at the time denote the grantor's intent to subject the conveyed land to an easement benefitting the retained land. Because the intent of the common grantor was in dispute, the court held that summary judgment should not have been granted. While a fact-finder would be entitled to infer the requisite intent from the circumstances of the conveyance, such intent could not be inferred as a matter of law.

Reporter's Comment: As this case illustrates, it is difficult for quasi-easement cases to be resolved at the summary judgment stage. Especially where the grant occurred long ago, the intent of the original grantor often cannot be established as a matter of law.

Editor's Comment: What is critical, of course, is not only the intent of the grantor, but the reasonable understanding of both parties with respect to the existence of an implied easement. Typically this is supplied by evidence of a "quasi easement" – an established pathway crossing the granted or retained parcel that is of reasonable necessity and suggests that the parties assumed that this access would continue. Both sides would view this as a probably fact unless the existence of an implied easement was denied in the instruments.

But, of course, an easement for railroads is of a distinct class. It might very well be that the railroads expected that there would be no crossing of the tracks except at designated locations and the editor agrees that, in the special case of railroads, perhaps further inquiry is warranted.

This case should not be read to suggest the plaintiff must come up with proof intent in every case, even though there is no evidence of intent other than physical evidence of continued use that is reasonably necessary. So in some cases summary judgment will be appropriate.

The Reporter for this case was Mort Fisher of the Ballard Spahr Baltimore office.

EASEMENTS; CREATION; NECESSITY: Easement of necessity may be implied even when alleged dominant tenant has permissive access over other property unless original grantor responsible for creating land-locked parcel intended there to be no legal access. ***Jernigan v. McLamb, 665 S.E.2d 589 (N.C. App. 2008).***

Although the facts are presented in a confusing manner, the essence is that a large rural tract was divided in 1925 into six lots, each conveyed to a child of the grantor. Through mesne conveyances Lot 1 now belongs to defendant, and Lot 4 to plaintiff. Lot 4, which does not abut a public highway, has been accessed by two routes, one over Lot 1 and another over lands of strangers to the original conveyance. In approximately 1980, defendant redirected part of a farm path over Lot 1 used to access Lot 4 along a new driveway. In 1999, defendant blocked the driveway with his truck (leading plaintiff to damage the truck). Plaintiff sued in 2003, claiming an implied easement by necessity, or in the alternative, an easement implied from prior use, by estoppel, or by prescription. The trial court denied plaintiff an easement, finding it was not necessary for plaintiff to use defendant's property to access Lot 4. On appeal, the Court of Appeals reversed, holding that plaintiff was entitled to an easement by necessity.

The Court stated the standard elements for an easement by necessity: (1) the dominant tract and the servient tract were once held in common ownership that was severed by conveyance, and (2) the necessity for the easement arose out of the conveyance. Concerning the necessity, the Court ruled that permissive access without legally enforceable access does not provide full beneficial use of property. The Court then stated that "the relevant issue" is whether the original owner intended Lot 4 to have a legal right of access when the property was subdivided. Finding no evidence that he intended to deny access, the Court held that the plaintiff is entitled to an easement by necessity.

Reporter's Comment. The reference to intention muddies things up considerably and, probably unintentionally, taps into a long-running debate about whether a subdivider can intentionally create a parcel without access to the public highway. Is the implication of an easement by necessity based upon inferred intention? Or is it based upon a policy of promoting a public interest in efficient utilization of natural resources? The Restatement 3d: Servitudes § 2.15 takes the position that an easement by necessity will be implied "unless the language or circumstances of the conveyance clearly indicate that the parties intended to deprive the property of those rights." In the present case no very extensive fact-finding was involved, nor at this late date would much likely have been found, so the presumption of no intention to deprive the lot of access prevailed.

The Reporter for this item was John Orth of the University of North Carolina Law School.

EASEMENTS; SCOPE; RIGHTS IN "THE PUBLIC:" Owner of 800 acre parcel abutting subdivision had right to invite public to access its parcel by using subdivision's ways where owner had previously created an easement in such ways "subject to the rights of . . . the public.". ***Cannata v. Berkshire Natural Resources Council, Inc.*****, 901 N.E.2d 1250 (Mass.App.Ct. 2009).**

Berkshire Mountain Corporation ("Mountain") owned a large tract of undeveloped land in Aldford, Massachusetts. It established a thirty-six unit residential subdivision on part of the land, with three ways. Mountain sold eight subdivision lots to Plaintiffs. The grant included access rights to the subdivision's ways, "subject to the rights of Mountain, and all others to whom such rights have been or may be given and of the public." Thereafter, Mountain sold 800 acres of land adjoining the subdivision to Berkshire Natural Resources Council ("Berkshire"), a charitable corporation dedicated to the preservation of outdoor space. The deed granted Berkshire, "its successors and assigns, and its agents, employees and invitees, including the public a non-exclusive, perpetual right of way for all the usual purposes of a right of way" over the ways of the subdivision. Upon learning that Berkshire intended to open its land to the public, Plaintiffs sued for a declaration that Berkshire had no right to invite the public to access its property through the subdivision's ways. The trial court granted summary judgment for Berkshire, declaring that it had a right to invite the public to use the subdivision's ways. Plaintiffs appealed, claiming that references in the terms of the easement to "the public" were intended only to create rights for the public only as visitors, and that extending easement rights to the public would overburden the Plaintiffs' easement rights.

The Appeals Court of Massachusetts rejected the claim that references in the deed to "the public" were limited to situations where the members of the public were visiting the subdivision. An expressly granted right of way may be used for "such purposes as are reasonably necessary to the full enjoyment of the premises to which the right of way is appurtenant." The scope of a particular easement is determined by the intent of the parties at the time of conveyance, based upon the terms of the grant, in conjunction with the facts and circumstances as they existed at that time. The grant to Plaintiffs specifically created easement rights subject to easement rights given to the public. The terms of the easement did not limit the use of the word "public" to persons visiting residents of the subdivision. Moreover, even if the terms of the easement to Plaintiffs were so limited, the Plaintiffs' easement rights were subject to the rights of others that were given easement rights. The owner of the subdivision could subsequently grant broader rights to Berkshire, so long as it did not interfere with Plaintiffs' easement rights. Thus, the terms of the grant and surrounding circumstances were insufficient to limit easement rights to only those members of the public that were visiting the subdivision.

The Court also rejected Berkshire's claim that use of the easement effected an overburdening of the easement. Overburdening typically applies where an easement holder expands the use of the easement to the detriment of the servient landowner. In this case, Plaintiffs are merely common easement holders with Berkshire. Their easement rights are not overburdened unless Berkshire's use unreasonably interfered with Plaintiffs' use of the ways. Here, Plaintiffs' claims of increased parking in the neighborhood and increased costs of maintenance were insufficient to overcome a grant of summary judgment for Berkshire. The Plaintiffs' failed to show a substantial interference with their ability to use the easement, and therefore, their easement rights were not overburdened.

EASEMENTS; TERMINATION; ABANDONMENT: Evidence established neighbor's abandonment of paper road even where neighbor had done nothing to block use of the road in a permanent fashion ***Carlson v. Fontanella, 904 N.E.2d 792 (Mass.App.Ct.).***

Plaintiff Carlson, brought the action seeking to eliminate rights in a paper street which crosses through the middle of his property in the town of Wellesley. The street, shown on a 1940 subdivision plan as Tyler Road, has never been constructed, accepted as a public way, or used as a private way, in Wellesley. Plaintiff wished to place the residence on his property with a new one but could not do so because of Tyler Road, at least on paper, covered most of his lot. Defendants' property, where their residence is located, has alternate frontage and a driveway on Manor Avenue in Wellesley

The Land Court ordered dismissal of the complaint on the grounds that the Defendants had acquired registered rights to use Tyler Road when they purchased their property and the evidence of abandonment was insufficient.. The judges ruling rested on his view that the evidence that nonuse, by itself, will not operate to extinguish an easement.

On review, the Appeals Court asserted that an abandonment of an easement is a question of intention to be ascertained from the surrounding circumstances and the conduct of the parties. *Sindler v. William M. Bailey Co.*, 348 Mass. 589, 592 (1965). The Court observed that Tyler Road was originally created in 1940 to provide access from the Wellesley side of the subdivision to the Weston side but that, at least since 1954, Manor Avenue has been laid out as a continuous public way providing frontage to the lots in Weston and thus rendering Tyler Road obsolete.

The Court indicated that the Defendants had neither taken any steps to remove the stone wall or stockade fence blocking access to the easement from Weston nor objected to Carlson's or his predecessor's use of the area as a lawn and driveway.

The Court also indicated that failure to protest acts which are inconsistent with the existence of an easement, particularly where one has knowledge of the right to use the easement, permits an inference of abandonment. *Lund v. Cox,* 281 Mass. 484, 492-493 (1933).

The court also noted that Defendants used a portion of Tyler Road as if it were an extension of their lawn.

Although the court acknowledged that nonuse alone does not constitute abandonment, it can be a factor in aggregate with others, and here the activities of the Defendants, their acceptance of Plaintiff's acts, and the overall situation of the properties, justified the reversal of the Land Court's previous ruling.

Reporter's Comment: The conclusion they reached is this case is consistent with the trend toward allowing the elimination of useless easements generally.

Editor's Comment: What makes this case somewhat unusual is that the factors constituting abandonment included the failure to object to blockages put up by the neighbors. Typically, in these cases, the court would find that such blockage is not prescriptive or adverse where the blockage can be readily removed and does not interfere with the easement holder's current usage. Needless to say, planting grass in an easement area also is not a permanent and irrevocable demonstration of abandonment. In the editor's view, the fact that the properties had developed in ways inconsistent with the original plan, and that Defendants had by their action and inaction demonstrated no desire to depart from that plan were an appropriate basis, and need not be viewed as a significant departure from the common law rule that nonuse alone does not constitute abandonment.

The Reporter for this item is the law firm of Goodwin Proctor, Boston.

EASEMENTS; SERVIENT'S RIGHT'S; "EXCLUSIVE" ACCESS: Owner of landlocked dominant Lot described in easement in residential subdivision may enjoin neighbor from using easement for purposes of horse trails and manure hauling. ***Gray v. McCormick, 167 Cal. App. 4th 1019 (Cal. Ct. App. 2009).***

Very upscale Hatfields and McCoys battled here over the right of the servient tract owner to use as area specifically identified as an exclusive easement, which use was detrimental to the owner of the dominant tract.

The McCormicks owned Lot 3 and the Grays owned Lot 6 in Coto de Caza, in Orange County, California. As this reporter can attest (having driven by the front gate but never having been invited in), Coto de Caza is a pricey and very exclusive subdivision. As is the case with all such property in Orange County, Coto de Caza is subject to a set of Covenants, Conditions and Restrictions, and these are duly recorded and applicable to the Lots in the subdivision.

In a Supplemental Declaration of Covenants, Conditions and Restrictions and Reservation of Easements, the developer subjected property in the subdivision to both exclusive and non exclusive easements. The streets are private, and therefore the tract map referenced in the CC&Rs gave non exclusive appurtenant access easements over private streets and sidewalks. One such easement right is associated with Olympic Way, a street serving the McCormick's Lot. Unfortunately, Olympic Way did not directly serve Lot 6, owned by Grays, and neither did any other street. The Grays' Lot was effectively landlocked.

To solve this problem, the CC&Rs granted "an exclusive easement of access, ingress and egress ("Easement") over that portion of Lot 3 . . . more fully described as Exhibit G on the Final Subdivision Tract Map . . . ("Easement Area.") The Easement is created for the benefit of the Owner of Lot 6 for the purposes of (a) access, ingress and egress to and from Lot 6 to the private street [Olympic Way] ...; and (b) construction, installation, maintenance and repair of access drive improvements on the Easement Area . . . ."

The McCormicks were apparently first to use and occupy their Lot (Lot 3), and rode and kept horses on their property. This involved riding the horses and hauling manure along the Easement Area.

According to the case opinion, the Grays paid $2,995,000 for their unimproved Lot (Lot 6), and planned to "spend *several times that amount* on the construction of the residence and improvements." (Emphasis added.) In the course of building their home, the Grays planned to build their driveway on the Easement area to obtain access to Olympic Way. They further intended to surround the driveway with "perimeter walls and landscaping." The McCormicks' horses did not fit into the Grays' plans, and one can imagine that even without perimeter walls, the Grays did not wish to dodge either horses or horse manure when driving to and from their stately home.

The trial court entered judgment for the McCormicks, stating the McCormicks "have the right to use the Easement Area in any way that does not interfere with the [Grays'] uses. The court of appeals reversed holding that "any use of the surface of the easement area by owners of Lot 3 is inconsistent with the exclusive use granted to the owners of Lot 6."

The court of appeals primarily focused on the meaning of the word "exclusive" in the context of this kind of easement right, and whether exclusive easements are legal, valid and constitutional. As to the first issue, the court suggested that the word "exclusive" means what it says. As to the latter, the court holds that exclusive easements are valid in California.

That easement rights may be exclusive is well settled. The question is whether the use of this word excludes only other *non owners* of the servient tract, or the fee owners of the servient tract as well. The McCormicks argued that the grant of an exclusive easement gave the Grays the right to exclude other non fee parties but not the fee owner of the servient tract.

Absent the use of language specifically giving the dominant tract owner exclusive rights, the owner of the servient tract retains the right to use the easement land. California courts have hewed to this rule consistently. This is in keeping with the general idea that the grant of an easement is a grant of something less than fee; the right to exclude the owner of the servient tract is a very valuable right and a more significant limitation on the rights of the servient tract owner. It is incumbent on the drafter of the easement to make it clear that the easement includes this right.

The court rightly points out that however, that cases setting out this general rule do not interpret easements that give exclusive rights to the owner of the dominant tract.

The easement in *Gray* also gave the owners of Lot 6 the right to improve the Easement Area, and build a driveway. The easement did not limit this right, and the construction of an elaborate drive with perimeter walls would seem to be in keeping with the exclusive nature of the subdivision. According to the court "it is inconceivable that the owners of a multi-million dollar property who build out 90 feet of access drive improvements would be expected to share that drive with a neighbor whose property abuts the street and to bear the costs of cleaning up the horse droppings and hay scatterings associated with that neighbor's use of the easement area." The easement not only granted the owner of Lot 6 rights; it also subjected the owner (the Grays) to liability. The owners of the dominant tract are required to indemnify and hold harmless from liability or loss the owners of Lot 3 (the McCormicks) for any damage resulting from use of the easement.

Together, these facts and expectations suggest that the Grays could use the Easement Area and exclude the McCormicks and their horses.

The McCormicks attempted to deflect the Grays attack on their use of the Easement Area primarily by looking at the use of the word "exclusive" in other California cases. They argued that the Grays' exclusive easement gave the McCormicks "the right to all uses of the easement area *that are not inconsistent* with the Grays' access rights." (Emphasis added.) The McCormicks cited City of Los Angeles v. Igna, 208 Cal. App. 2d 338 (1962). In that case, the city and its water department held power transmission rights pursuant to two "exclusive" deeds/easements. The owner of the servient tract operated a trailer park and used some of the easement area. The trial court required the trailer park owner to remove all structures and to refrain from conducting business in the easement property. But the appellate court modified the order to exclude only those uses inconsistent with the easement.

The court of appeals in *Gray* distinguished Ig*n*a by noting that, unlike the power transmission easement, the language of the Coto de Caza eaement "also specifically states that the use of the easement by the owners of Lot 6 "shall be exclusive."" The *Igna* easement was not qualified in this manner. In other words, the court of appeals was satisfied that the drafter intended to confer a more exclusive right on the owner of the easement in *Gray*.

The court also held that exclusive easements are valid in California, and that they do not "in effect grant fee ownership over the easement area." This is not fee simple in disguise. The court points out that the owner of the servient estate does not have unfettered right to use the Easement Area – the owner may only use it for access and to construct a driveway.

Reporter's Comment 1: Assume initially that the McCormicks were correct on their basic legal proposition – that they have the right to uses that are not inconsistent with Grays' use of the easement area. Just on the facts, the author thinks that the McCormicks' use of the sole private driveway that connects a multi million dollar estate to the road for a horse trail would seem to be patently inconsistent with the purpose of the easement. If the lawyer for the McCormicks could demonstrate that *the Grays planned to ride horses on the driveway* to reach the road, then the use would be consistent, but short of this, it seems to be a stretch.

Reporter's Comment 2: Our colleague Roger Bernhardt discusses *Gray* in California Real Property Law Reporter in January 2009. He makes many fine points and sees case as being fairly close. Among other things, Roger states:

From the dominant owners (Grays') point of view, since the word "exclusive means no one else, it should naturally exclude the servient owners as well. But from the servient perspective, a fee interest normally entitles those owners to make any use of the property that they want as long as it does not unreasonably interfere with the dominant tenants' activity. This would equally naturally lead the McCormicks to believe that they could also use the driveway whenever their activity did not get in the way of the Grays – including "exclusive" as a modifier in the document only meant that they, the McCormicks, could not grant any third parties similar privileges on the driveway. (After all, if a dominant tenant is only protected against unreasonable interference with his easement, why should nonharmful use by the servient tenants matter? The trouble with this logic, however, is that while protecting a dominant tenant against nonharmful uses sounds like a silly outcome, it is no sillier than allowing a fee owner to prohibit trespasses even when they do not hurt her – which is what property law is all about, and which is why the McCormicks lost.)

Reporter's Comment 3: Roger also asks "So, why did counsel for the subdivider fail to make clearer just what was intended?" He suggests that it is unfair to blame the lawyers, even though "there is often a temptation" to do so. "The world keeps on changing, and no amount of worrying or extensiveness of drafting is going to anticipate everything." As Roger points out, the Restatement of Servitudes does not help here. It states that "exclusive" easements grant "the right to exclude others." As Roger points out, this phrasing minimizes the daylight between the meaning of the words "exclude" and "exclusive." Asking the attorney for the subdivider to state that the dominant tenant had the "right to exclude" (which arguably would be clearer) is perhaps redundant when the Restatement defines exclusive as providing this right.

Editor's Comment: The editor has long maintained that easements and options are the most underdrafted instruments in real estate practice. Frequently they fail to anticipate what happens when situations change in the future.

That being said, the editor not only agrees with Professor Bogart's reasoning in Comment 1 but disagrees with Roger Bernhardt's argument that this is a close case on the interpretation of the easement rights. If one made a study of a broader range of easement cases, one could discover a myriad of applications for the term "exclusive." In some cases, it confers upon the dominant tenant the right to license additional uses. In others, it gives the dominant tenant the right to exclude all others. In many other cases, due to the facts and circumstances, an "exclusive" right may confer one or both of the above rights but will not permit exclusion of non-invasive activities of the servient tenant.

Frankly, in light of the circumstances, the editor believes it would be a close case as to whether the servient could conduct the activities it was conducting even if the declaration did not state the dominant right to be "exclusive." Horse manure can raise hell on the undercarriage of a Rolls Royce.

The court is incorrect in assuming that permitting the servient some use would require that the dominant keep the driveway clean. This would clearly be the servient's duty in any event. But this is meaningless *dicta* here, since the court properly found that "exclusive" is what the dominant tenants bought and what they get.

EASEMENTS; TERMINATION; ABANDONMENT: "Useless" public easement terminated by abandonment where the easement represented a long un-constructed road that crossed the lawn of the servient lot. ***Carlson v. Fontanella, 904 N.E. 2d 792 (Ct. App. Mass. 2009).***

As so often seems to be the case in reported easement opinions, Carlson involves a dispute between two residential neighbors. Carlson purchased Lot 35, with a street address of 107 Manor Avenue in Wellesley, Mass. in 2002. There was a single family home sitting on the lot at the time, but Carlson was unhappy with the structure and wanted to tear it down to build something new. The author suspects, although the case does not actually say, that the newer home would be larger. In any event, Carlson was stymied, because of an imaginary road (and very real easement for that road) that ran directly through the front lawn of the Lot. Tyler Road is a real road in the neighboring town of Weston and serves as frontage road for many homes. But for whatever reason, although shown in local government offices and in Land Court files, the road was not actually built in Wellesley.

Apparently the imaginary section of Tyler Road sits precisely where Carlson wished to construct his new home. (The opinion states that the easement "crosses through the middle of his property.")

As it happened, the government officials in Wellesley did not oppose Carlson's intended new home, and it location and "stipulated that it had no objection to the discontinuance of Tyler Road." Such reasonable behavior hardly makes for an interesting case. However, Carlson's neighbor Fontanella, owner of adjacent Lot 45, objected to discontinuance.

The Land Court ordered an examination of title to property affected by Carlson's request for a discontinuance of Tyler Road, and during the course of this process, Fonatellas objected to Carlson's request. The Land Court denied Carlson's motion for summary judgment on Carlson's action to eliminate rights of beneficiaries of the Tyler Road easement. The Land Court held that Fontanellas "had acquired registered rights to use Tyler Road when they purchased their property and the evidence of abandonment was insufficient." The Court of Appeals reversed the Land Court and found an abandonment of the easement by the Fontanellas.

Carlson's lot was created in 1954; the Fontanellas' was created in 1974 upon an additional subdivision of properties. The Fontanellas' Certificate of Title was subjected to an overarching set of easements in a separately recorded document . In this separately referenced instrument, the developer provided grantees in the subdivision (including the owner of the Fontanella lot) "a right to use the streets and ways shown . . . . The intent of this instrument is to create a right of way as appurtenant to all lots shown on said plans or which may be shown on any future subdivis8ion thereof over the streets and ways on said plan."

It is not surprising that Wellesley did not object to the termination of the paper road: it would have been pretty much impossible to build the real thing. According to the opinion, "Tyler Road has never been used as a road, improved as a public or private way, or accepted by the town of Wellesley. At the point on Carlson's northern boundary line where Tyler Road theoretically crosses into Weston it is blocked by a stone wall that has existed since 1940. In addition, private parties have constructed a stockade fence that makes passage between the two towns at that juncture impossible."

But it is not just the passage of time and the barriers to construction of an actual road that makes the Fontanellas' decision to contest the termination of the paper road interesting. According to the court, "The entire area at issue . . . has been fully incorporated into the lawns of both parties." In other words, the Fonatellas had also been using land described in the easement for Tyler Road as their own private property.

The court asks one basic question: when is an easement abandoned, so as to give the owner of the servient tract freedom to put the property to a desired conflicting use? The trial judge rested his decision on the correct if sometimes overly simplistic statement of the law that mere non use of an easement does not constitute abandonment. The Fontanellas did not use the easement as described in the easement instrument, but this mere non use does not terminate their rights.

The appellate court agrees with this premise as a starting point, but it examines the facts more closely. Mere non use may not constitute abandonment, but the goal of the court should be to establish the intent of the party holding the easement right. Did Fontanellas intend to relinquish their legal rights to enforce the easement over Carlson's property? Behavior that is flatly inconsistent with an easement reaches beyond "mere nonuse."

As the court explains, the record of the case "reveals a history of acquiescence indicative of the Fontanellas' intention to never make use of Tyler Road." 1) The Fontanellas never attempted to remove the stone wall or stockade fence blocking access to the easement from Weston. 2) The Fontanellas never protested the Carlson's' use of easement property as a lawn and driveway. 3) The Fontanellas used a portion of the easement property that crossed their lawn as a driveway.

The appellate court therefore held that Fontanellas' failure to protect their rights, coupled with the affirmative act of using the a portion of the easement property in a manner inconsistent with the easement, constituted an abandonment.

On top of it all, it appears that even if Tyler Road could be constructed, it would be largely obsolete. Another road, Manor Avenue, serves and fronts both Carlson's and Fontanellas' lots, as it does many lots in the subdivision.

The appellate court adopts a general tone in its opinion that the common law should not serve to perpetuate "useless" easements. As support for this approach, the court cites comment a to Restatement (Third) of Property §7.10 (1) (2000), providing that a change making it impossible as a practical matter "to accomplish the purpose for which the servitude was created" enables a court to modify the servitude, or if modification is not practicable, "terminate the servitude."

Reporter's Comment 1: The court is correct that, with a huge push from the Restatement, the common law has been moving towards giving greater rights to the owner of the servient tract where full enforcement of the servitude or easement would seem to produce significantly inefficient land use. This is seen in other parts of the Restatement. For instance, § 4.8 grants the servient tract owner the right to relocate the easement, even against the wishes of the dominant tract owner, so long as the relocation does not unreasonably burden the rights of the dominant tract owner or frustrate the purpose of the easement. The rule in § 4.8 is a significant departure from prior common law and has been much debated, but it has also been adopted with surprising speed in a number of jurisdictions. On this latter change, the interested reader might look at Susan F. French, Relocating Easements: RESTATEMENT (THIRD), SERVITUDES § 4.8(3), 38 REAL PROP. PROB. & TRUST J. 1 (2003).

Reporter's Comment 2: The opinion does not adequately explain Fontanellas' reason for resisting Carlson's desire to secure use of the easement property. There may have been very legitimate reasons for Fontanellas to dispute the termination of the easement that are just not described in the facts. Or perhaps Fontanellas did not like the idea of a large new home next door, or simply did not like their neighbor, Carlson. However, situations in which one person may obstruct another's expenditure of significant sums of money improving real property almost invite opportunistic behavior. Speaking only very generally, an individual in the shoes of Fontanellas in this kind of scenario may see an opportunity to demand payment for release of easement rights, and it is also possible that the party subjected to the demand for payment may have refused.

Editor's Comment: The outcome in this Massachusetts case is not suprising, because this state's courts earlier had embraced much of the Restatement's thinking in this area. The editor has seen few other states so broadly accepting of Restatment's devaluation of easements. Although the case does rely in part on the Restatement, it also includes significant and detailed analysis of the facts supporting abandonment here. Although no one fact might be said to lead to a conclusion of abandonment alone, taken together they might have satisfied the common law test.

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

EASEMENTS; UNILATERAL RELOCATION: North Carolina rejects Restatement proposal on relocation of easements. Burdened landowner may not relocate easements. ***A. Perrin Development Co., LLC v. Ty-Par Realty, Inc., 667 S.E.2d 324 (N.C. App. 2008).***

The facts in this case seeking the termination or relocation of an easement are simple and undisputed. Defendant Realty Company owned an express, recorded easement over land owned by plaintiff Development Company. The Development Company sought a court order under the North Carolina Declaratory Judgment Act to "purge" the easement from the registry of deeds – that is, to declare void the conveyance by which it was created – or, in the alternative, to allow the plaintiff Company to relocate the easement. The trial court dismissed the complaint, and the Court of Appeals, following clear North Carolina Supreme Court precedent, affirmed the trial court's dismissal of the complaint under the Declaratory Judgment Act. Although the Act authorizes the court to declare the rights and liabilities of parties concerning property, it does not confer jurisdiction on a court to declare a conveyance void.

More significant is the Court of Appeals' rejection of the requested relocation of the easement. Prompted by the Restatement 3d: Servitudes, a few courts have allowed a burdened landowner to relocate an easement without the easement owner's permission. *See, e.g., M.P.M. Builders, LLC v. Dwyer, 809 N.E.2d 1053* (Mass. 2004) (burdened landowner may relocate the easement after a judicial determination of appropriateness despite objection by the easement owner). In the present case, the Court of Appeals reiterated that North Carolina common law does not permit unilateral relocation and affirmed that "this Court does not have authority to rely on cases from other jurisdictions and reject the common law of this State which has been set forth by the North Carolina Supreme Court." (327)

Reporter's Comment: Breaking with earlier Restatements of Property, the latest Restatement 3d: Servitudes § 4.8 (3) allows unilateral relocation:

Unless expressly denied by the terms of an easement . . ., the owner of the servient estate is entitled to make reasonable changes in the location or dimensions of an easement, at the servient owner's expense, to permit normal use or development of the servient estate, but only if the changes do not (a) significantly lessen the utility of the easement, (b) increase the burdens on the owner of the easement in its use and enjoyment, or (c) frustrate the purpose for which the easement was created.

In the interest of full disclosure: I should state that I have criticized the Restatement's position in print. Orth, "Relocating Easements: A Response to Professor French," 38 Real Property, Probate and Trust Journal 243-54 (2004).

The Reporter for this item was John Orth of the University of North Carolina Law School.

EMINENT DOMAIN; CONDEMNATION OF LEASEHOLD: Tenant is not entitled to portion of condemnation award representing fixtures where lease provides for termination upon condemnation notwithstanding separate allocation of condemnation damages provision in lease agreement. ***Metropolitan Airports Commission v. Noble, 763 N.W. 2d 639 (Minn. 2009).***

Noble was the assignee of the landlord's rights under a lease with SuperAmerica, the tenant. SuperAmerica operated a convenience store, gas station and car wash on the property. The lease contained an initial ten year term, and provided SuperAmerica with two five year extension periods.

The lease provided as follows:

18. Eminent Domain

(a) Entire Premises. If substantially all of the leased premises shall be taken by virtue by any public authority under the power of eminent domain then the term of this Lease shall cease as of the day possession shall be taken by such public authority and the rent shall be paid up to that day with a proportionate refund by [lessor] or such rent as may have been paid in advance.

. . .

(c) Damages. In any event all damages awarded for such taking under the power of eminent domain whether for the whole or a part of the leased premises shall belong to and be part of the property of [lessor] whether such damages shall be awarded as compensation for diminution in value to the leasehold or to the fee of the premises; provided, however, that [lessor] shall not be entitled to any award made to [lessee] for the fair value of, and cost of removal of stock and fixtures, provided a separate award is permitted by the taking authority directly to [lessee].

The leased property apparently sat adjacent to the airport. In September of 2004, the Metropolitan Airports Commission brought a petition to the district court to condemn the entirety of the leased property. The property was needed to permit an expansion of the airport. The court granted the petition, and proceeded to appoint commissioners to fix valuation of the property. After some back- and-forth, the commissioners ultimately fixed the total value of property condemned at $2.7 million. This included a specific valuation for immovable fixtures of $360,000.

The dispute concerns solely who between the landlord or tenant is entitled to the $360,000 designated as the award for fixtures. Because of language in the lease contract speaking to this issue, and the conflict between the landlord and tenant, the commissioners "referred the matter back to the district court to conduct a hearing to determine [which party has] the legal right to those damages." The district court dismissed Noble's summary judgment motion and required disbursement to SuperAmerica of the $360,000. The court of appeals reversed, holding for Noble, although in a divided and unpublished opinion.

The trial court thought the language of the lease unambiguous. Notwithstanding the fact that the lease had terminated, Section 18 (c) reserved to tenant the cost of removing fixtures, "provided a separate award is permitted by the taking authority directly to [lessee.]" The court of appeals, in its (unpublished) opinion, thought otherwise, and held that 1) SuperAmerica's interest vanished upon condemnation because of Section 18(a) of the lease, and 2) there was no "separate" award entitling SuperAmerica to damages under Section 18(c).

The supreme court of Minnesota affirmed the appellate court, giving the landlord a solid win.

The starting point for this (or any case on a tenant's right to a portion of a condemnation award) is the constitutional principle that any person whose property interest is taken in entitled to just compensation. This arises from both the Minnesota and federal constitutions. A tenant has a recognizable property interest. Quoting Naegele Outdoor Adver. Co. v. Village of Minnetonka, 281 N.W. 2d 206 (1968), the court states that the tenant's compensation should equal the "fair rental value of the premises less the amount of the rent for the remainder of the term." However, the court also acknowledges that the tenant may contract away its constitutional right for compensation – leaving this amount to the landlord – in the lease agreement.

SuperAmerica's lease did just this; Section 18 terminated the lease automatically on condemnation. If the lease comes to an end at the moment of condemnation, then theoretically, the tenant has received its value for all its rental payments and should not be entitled to any portion of the condemnation proceeds.

Rejecting SuperAmerica's reading of prior Minnesota case law, the supreme court of Minnesota held that parties to a lease may not "reallocate the right to just compensation when a condemnation clause is present."

Instead, parties must remove or alter the condemnation clause. In *Noble*, Section 18(a) comprises the primary operative language terminating the lease, and it was neither altered nor removed from the lease. As a result, the court existentially decides that language just a few lines later in Section 18(c) granting SuperAmerica a right to damages resulting from the condemnation "no longer exists."

The court then proceeds to address the question "if a lessee no longer has a property interest in the condemned property and no right to just compensation, does that preclude a lessee from contracting for a division of a condemnation award in the lease?" In other words, even if the lease removes the constitutional basis for awarding a portion of the proceeds to the tenant – by saying that the lease terminates and the tenant no longer has property that can be taken – can the landlord and tenant nevertheless agree that tenant will receive a portion of the proceeds? The court, agreeing with case law in other jurisdictions, recognized the contractual ability of parties to do just this. Citing *Musser v. Bank of America*, 964 P.2d 51 (Nev. 1998), the court states that contract law principles require the court to read provisions to give them meaning. In *Musser*, the lease provided that lessees would receive "the portion of such award that the unexpired term of the lease bears to the entire term of the lease and the Lessor [would receive] the balance."

In *Noble*, the court examined the "plain language" of the lease and specifically Section 18(c), and focused on the requirement that the condemning authority to make a "separate" award to the "directly" to the tenant. In *Noble*, the commissioner "made a single award of damages for the value of the land and improvements." The court was also put off by the language of the lease itself, which requires that SuperAmerica will be entitled to its award if "permitted by the taking authority directly to [lessee.] The court pointed out, somewhat rigidly, that "in a condemnation, the court-appointed commissioner, the lessee and lessor, or the court determine the allocation of the condemnation award" and thus the language of the leases does not correctly describe the award process.

Reporter's comment 1: The tenant really does not care if it loses a battle if it wins the war. The court held that as a result of the operation of Section 18(a) of the lease, the lease terminated and that the tenant did not have a true compensable property interest. But who cares if later language in Section 18 would give the tenant the damage amount it wanted? The question thus comes down to contract law, not constitutional law. The trial court found the language unambiguous, but the Minnesota supreme court disagreed. The reporter thinks that the supreme court missed the basic point of contract law – to effectuate the intent of the parties. Here, the parties may have inelegantly memorialized their agreement, but they make their desire plain. The tenant is supposed to receive a damage amount in connection with the lost fixtures. The court parses the language of the Section 18(c) to avoid giving the parties what they agreed to. Perhaps the lawyer for SuperAmerica could have asked for and received a separate award for damages. However, that attorney really had no standing to do so – his client had in the lease already given up his property interest in the lease and any constitutional right to the award. And there was certainly no incentive for the attorney for the landlord to ask for "separate" awards for compensation for land and for fixtures, since that would deprive landlord of the $360,000.

Reporter's comment 2: Professor James Smith, at University of Georgia, has shared his thoughts on *Noble* and those of his on editorial colleagues that will appear in the upcoming edition of Probate & Property magazine. He agrees that the court's result would seem to digress from the intent of the parties, and states:

The editors question whether this decision effectuates the parties' probable intent. The case highlights the need for careful drafting in commercial leases. From the lessee's perspective, the lease document should have delayed termination until the completion of all condemnation proceedings and should have provided for the lessee to receive any condemnation funds specifically attributable to stock and fixtures, regardless of the form of the award.

EMINENT DOMAIN; VALUATION; "PROPERTY OWNER RULE": The "Property Owner Rule," which holds that individual property owners familiar with the market value of their real property may testify as to their opinions regarding such value (even though they do not qualify as expert witnesses), applies equally to representatives of corporate property owners. But there is a widespread split in this rule. ***Speedy Stop Food Stores, Ltd. v. Reid Road Municipal Utility District No. 2, ___ S.W.3d ___ (Tex. Ct. App. 2009).***

Speedy Stop Food Stores, Ltd. ("Speedy") owned a 2.0661 acre tract of land in Harris County, Texas. Reid

Road Municipal Utility District No. 2 (the "District") initiated a condemnation action to acquire a 0.0592 acre water line easement burdening a portion of the property. A report which was offered to the court by three special court-appointed commissioners to assess condemnation damages was prepared by a state-certified appraiser and valued Speedy's damages related to the condemnation at $9,342, an amount which was deposited into the registry of the court. Speedy disputed this amount at trial, arguing that there was a $62,000 difference in the fair market value of the property immediately before and immediately after the condemnation of the easement.

In making such argument, Speedy offered an affidavit of Carlton LaBeff, who was the vice president of Speedy's general partner. Speedy did not designate LaBeff as an expert witness. While LaBeff had responsibility for all real estate transactions (including dealing with easement issues), he is not a licensed real estate broker or real estate appraiser. At trial, the District sought to exclude the affidavit, arguing that LaBeff was not qualified to testify as an expert since he was not a licensed appraiser, and his methodology in determining Speedy's damages did not satisfy the reliability requirement for expert testimony. The trial court granted the District's summary judgment motion to exclude the affidavit, resulting in no evidence before the court as to how much compensation the District owed Speedy. As a result, the trial court awarded Speedy one dollar, with the remaining funds to be returned to the District.

On appeal, the court considered whether the trial court erred in granting the District's "no evidence" summary judgment motion. More specifically, the issue was whether the "Property Owner Rule" (as described by the Texas Supreme Court) applies to corporate entities in the same manner as it applies to individual property owners.

The Texas Supreme Court has held that "property owners who are familiar with the market value of their property, including real property, may testify as to their opinions regarding this value, even though they do not qualify as expert witnesses and even though they would not be allowed to testify regarding the market value of property they do not own." Sister courts of appeal in Texas interpreted the applicability of this rule to corporate entities differently. The Waco and Corpus Christi courts have concluded that the rule applies equally to corporate property owners, while the Fort Worth court has held that it does not.

Because of this split among the Texas appellate courts (and because no Texas Supreme Court case has addressed the issue), the court in this case analyzed the effect of the "Property Owner Rule" in other jurisdictions. Courts in Arizona, Colorado, Kansas, Tennessee, and Washington have applied the rule to corporate owners. Courts in Hawaii and Nebraska have refused to do so. A third group of states, including Florida, Maryland, Massachusetts, Minnesota, and Oregon, have allowed representatives of a corporate property owner who demonstrate familiarity or knowledge of the property in question to fall within the rule. The court then noted the premise for the general rule which is that "property owners ordinarily know the market value of their property and therefore have a sound basis for testifying as to its value."

Agreeing with the majority of Texas courts of appeal and most other states, the court concluded that "there is no reason to conclude that corporate officers who are familiar with the market value of corporate property are less reliable than natural persons who are familiar with the market value of their property." Accordingly, it held that "the Property Owner Rule applies to corporate entities owning property and that a representative of the corporate owner who is familiar with the market value of the property in question may testify under this rule as to the market value of the property, without being designated as an expert witness."

Comment: The Fort Worth case, which this case cites as *contra*, observed that the majority rule, at least as of 1972, required that corporate agents qualify as experts. That case cited cases that the opinion in this case appears to view as stating a "middle position" that the submitting witness have direct familiarity with the property in order to qualify under the "owner's exception." Even the Fort Worth case involved facts in which the corporate agent was not testifying as to the specific market involving the property in question. So it appears that the real "majority" is that corporate experts cannot testify unless they have specific knowledge of the subject property. Apparently this is assumed in the case of an individual owner, and is the basis for the exception.

GUARANTIES; ASSIGNMENTS OF DEBT: When a debt obligation is assigned to a third party, a general guaranty that guarantees such debt is automatically transferred by operation of law, even if such guaranty is not attached to or referenced in the assignment document transferring such debt obligation. ***American First***

Federal, Inc. v. Battlefield Center, L.P., ___ S.W.3d ___ (Mo. Ct. App. 2009), discussed under the heading: "Mortgages; Assignments; Guaranties."

INSURANCE; CASUALTY INSURANCE; INSURABLE INTEREST: Record owner of real property, who is serving as the nominee of another person, has an insurable interest in the realty sufficient to recover proceeds of a vandalism insurance policy on which he is listed as a named insured. ***Balentine v. New Jersey Ins. Underwriting Assoc., 966 A.2d 1098 (N.J. Super. Ct. App. Div. 2009).***

The plaintiffs William Balentine and Luke Gianetta jointly purchased a commercial warehouse building. Balentine subsequently went into bankruptcy, and the plaintiffs jointly transferred the property to Gianetta for one dollar. Balentine was still allowed to use the property after the transfer, and Gianetta later issued a power of attorney to Balentine, allowing Balentine to take care of all incidents of ownership on behalf of Gianetta. Balentine kept the rents and paid the expenses. After the events described here arose and were in litigation and on appeal, Balentine sold the property and kept the proceeds.

Balentine obtained a liability and fire insurance policy and listed the named insured as "Luke Gianetta c/o William Balentine." The insurance writer dealt with Balentine as Gianetta's agent. Subsequent to the issuance of the policy, an unlawful entry on the premises occurred, and the intrusion caused vandalism and other damage to the structure.

A claim on behalf of Gianetta was filed with the insurance carrier, which responded that Gianetta had no insurable interest in the property because he was merely Balentine's nominee. As a result, plaintiffs filed a complaint seeking damages for the property damage.

The trial court concluded that Gianetta had an insurable interest in the premises, and the insurance carrier appealed.

On appeal, the insurance carrier argued that Gianetta did not have an insurable interest and, furthermore, that Balentine could not recover because he was not a named insured. The appellate court held that Gianetta did have an insurable interest. In so holding, the court noted that Gianetta could realize significant loss if the premises were left uninsured. Such loss could come, the court noted, in the form of a tort claim by an injured visitor. Accordingly, Gianetta's relationship with the property was not as distant as the insurance carrier depicted. In any event, well-settled principles dictate that an insurance policy is to be governed by its own clear terms and without recourse to other documents. The relationship between Gianetta and Ballentine was therefore irrelevant to the court's analysis.

Reporter's Comment: The insurance carrier's position that neither Gianetta nor Balentine could receive insurance proceeds was strange. For what purpose then was the carrier receiving insurance premiums? [The court noted this argument.]

Editor's Comment 1: The insurer argued that all effective ownership was in Balentine, and so any money that Gianetta would receive for injury to the building would be a windfall to him. The court responded that the insurer had agreed to name Gianetta as the insured with full knowledge that he was merely a "nominee" for Balentine, and hence it had accepted Gianelli as its insured. It commented that the purpose of the relationship of Gianetta and Balentine (to shield Balentine's interest from bankruptcy creditors) was of no consequence to the insurer's liability.

The court also commented that Gianetta, although he had no "upside" benefit, did have some "downside" exposure as he might be liable personally for surplus unpaid taxes and might be liable in tort (query what this has to do with insurability under a casualty policy.)

Editor's Comment 2: Does this court tell us anything about "nominee" relationships that might be useful in puzzling out the cases involving MERS? Here, again, no one was hiding MERS nominee relationship from borrowers or anyone else. Should it therefore be viewed as holding a "real interest" as against third parties?

Editor's Comment 3: Near the end of the opinion, the court comments that the insurer's knowledge of the relationship between Gianetti and Ballentine was not critical to the outcome of the case, which was based upon the insurer's listing of Gianetti as insured? But can this really be true? What happens to the "insurable interest" requirement when complete strangers might be listed? Perhaps the court is limiting its remarks to the broader relationship between the two characters, and not to those aspects that were evident to the insurer when the policy was written.

The reporter for this item was Mort Fisher of the Ballard Spahr Baltimore office.

LANDLORD/TENANT; EXTENSIONS AND RENEWALS; OPTIONS: In the absence of an express lease provision prescribing the specific time and method for exercising an extension option, if a tenant holds over and continues to pay the agreed-upon rent and the landlord accepts such rent, this creates a presumption that the lessee has effectively exercised an option to extend the lease. ***Ellis v. Pauline S. Sprouse Residuary Trust, 280 S.W.3d 806 (Ten. 2009).***

Ellis, a farmer, leased a 103.3 acre tract from Bagwell. After the lease terms were agreed on by Ellis and Bagwell over the telephone, Ellis reduced the agreement to writing. The written agreement provided that the lease "will be for a period of five years with Mike Ellis having the option of five additional years."

Ellis farmed 60 acres of Bagwell's property for several years, and intended to exercise the extension option. In a conversation with Bagwell in late 2001 or early 2002, Ellis notified her of such intention, but Bagwell denied that the parties ever discussed an option. Nevertheless, after the original term expired, Bagwell continued to accept Ellis's timely $3,000 rent payments, and Ellis continued to farm the property.

In 2004, Sprouse, a Knoxville real estate developer, became interested in the property. According to Ellis, in one of Sprouse's visits to the property, he informed Sprouse that he had leased the property. Sprouse denied that Ellis mentioned this, and in May 2004, Sprouse signed a contract to purchase the property for $440,000. The contract contained a handwritten statement providing that the "[c]urrent lease not . . . be disturbed." A day after signing the contract to sell the property to Sprouse, Bagwell faxed a copy of the Ellis lease to the real estate agent handling the transaction. Bagwell and her family members also executed affidavits stating they were in possession of the property and there were no tenants on the property. While Sprouse did not see a copy of the lease and professed to rely on the affidavits, he admitted knowledge that Ellis had "some interest" in the property.

Sprouse received a warranty deed on May 25, 2004, and in mid-June, entered the property without Ellis's permission, driving across Ellis's corn crop on his way to the river. Sprouse also threatened to plow under the entire crop after Ellis complained about the damage to his crops. In September 2004, Sprouse sent a demand letter to Ellis, demanding that he vacate the property by the end of December 2004. Ellis did so but was unable to find comparable farmland to lease. Subsequently, Ellis filed suit against Sprouse, seeking to recover compensatory damages for damage to his corn crop, lost profits for the remaining two years under his lease, and punitive damages. A jury found in favor of Ellis, and Sprouse appealed.

On appeal, the primary issue was whether Ellis had effectively exercised his extension option in the absence of an express provision in the lease prescribing the specific time and method for exercising such option. Sprouse argued the trial court erred by instructing the jury that (1) Ellis had a reasonable time after the expiration of the lease to exercise his extension option, and (2) by continuing to occupy the land and pay rent, there was a presumption that Ellis had effectively exercised his option. The Tennessee Court of Appeals found that the jury's conclusion that Ellis had effectively exercised his extension option was factually and legally unsupportable, concluding that (1) Ellis's testimony regarding precisely when his conversation (in late 2001 or early 2002) with Bagwell expressing his intention to extend the lease was too uncertain, and (2) Ellis's holding over by continuing to farm the property and paying rent in 2002, 2003, and 2004 could not, as a matter of law, amount to an exercise of the extension option under *Norton v. McCaskill*. Ellis appealed the holding from the court of appeals. The Tennessee Supreme Court granted the appeal "in order to address how *Norton v. McCaskill*, 12 SW. 3d 789 (Tenn. 2000) applies to leases that do not contain a specific provision prescribing the time and method for exercising an option to extend a lease."

The Tennessee Supreme Court began its analysis with a discussion of *Carhart v. White Mantel & Tile Co.*, a 1909 case holding that a tenant that holds over and continues to pay the agreed-upon rent (and a landlord who accepts such rent) "creates a presumption that the lessee has effectively exercised an option to extend a lease that does not require the lessee to give notice of its decision to extend the lease." The court then addressed *Norton*, a 2000 case involving a ten-year lease of property on which a commercial billboard had been constructed. The lease contained an extension option (reserving in the tenant "an option to renew [the] lease at the end of 10 years"), but the lessee did not attempt to exercise the option until it received a notice from the property owner after the expiration of the initial term that the lease was no longer in force. The owner leased the property to another billboard company and refused to accept the tenant's rent check. At trial, the Tennessee Supreme Court held that lessees must exercise the option within the original term of the lease. However, the court explicitly limited its holding specifically to "leases that require renewal 'at the end of' or 'at the termination of' the lease or that contain similar language conveying the same requirement."

Because the lease in the subject case did not contain similar language, the court concluded *Norton* did not apply. Moreover, the court held that even after *Norton*, the principles of *Carhart* remain viable and applied to this case, creating a presumption that Ellis extended his lease since he made timely lease payments and Bagwell accepted the same, despite the existence of a factual dispute regarding whether Ellis gave notice of his intention to extend the lease.

Comment 1: To the editor, *Norton* appears to have been incorrectly decided, and this case exposes the reason. A court is unwilling to disturb a continuing relationship such as the parties created here simply because there was no formality in the exercise of an option. If a presumption of renewal occurred simply by the holdover, as the court suggests, then it will be difficult to apply the *Norton* rule in the future except in circumstances in which one of the parties expressly indicates prior to the holdover that there has been no extension or renewal.

EMINENT DOMAIN; VALUATION; TRADE FIXTURES; "INTEGRATED SYSTEM:" Placement of fixtures to maximize efficiency did not define an integrated operation in eminent domain proceeding. ***In re City of New York, 899 N.E.2d 933, (N.Y. 2008)***.

The City of New York acquired title by eminent domain to property owned and occupied by Kaiser Woodwork Corporation and used as a woodworking shop. In addition to seeking compensation for the underlying real estate, Manfred Kaiser, the founder and president of the corporation, claimed that 147 items were compensable trade fixtures. The items claimed as trade fixtures included about 38 standard industrial woodworking tools, for which Kaiser's appraiser calculated a final "sound value" – the cost of reproduction less depreciation – of about $577,000.

The city's appraiser, meanwhile, disputed that many of these claimed items were trade fixtures, and determined that the claimant was entitled to a sound value of $128,936. The trial court determined that these claimed items were compensable trade fixtures and awarded $525,000 to Kaiser.

On appeal, the City challenged the court's conclusion, urging that some of the items were noncompensable personalty and that others were part of the underlying realty. The Appellate Division modified the trial court's order, excluding a few items from the list of trade fixtures, and otherwise affirmed.

The Court of Appeals here reversed, noting that machinery normally is personal property and is not deemed a fixture except where (1) it is installed in such manner that its removal will result in material injury to it or the realty, or (2) the building in which it is placed was specially designed to house it, or (3) there is other evidence that its installation was of a permanent nature, or (4) those improvements which are used for business purposes would lose substantial value if removed. *Matter of City of New York*, 278 N.Y. 276, N.Y. 1938). *Rose v. State of New York*, 24 N.Y. 2d 80, (N.Y. 1969). Here, as there was no claim of special design, the court's analysis focused on the question of substantial loss in value. The court noted that substantial loss in value would occur, for example, where machinery was specially constructed for the building, or the building was so designed that the subject items were functionally dependent on other items or on the building. *Matter of New York City Tr. Auth., 160 A.D.2d 705, (N.Y. 1990)*. Another example would be equipment that functions as part of a truly integrated operation, such that the removal of one item diminishes the utility of remaining items. The fact that the equipment here was placed in a certain order to maximize efficiency did not define an integrated operation for purposes of determining a loss of substantial value.

The court also rejected claimant's argument that many of the listed items would lose substantial value because they are worth less as secondhand goods than they are in a shop. Under such analysis, the court found, virtually every machine used in a business would be a compensable fixture, obliterating the distinction between fixtures and personalty. Therefore, the court held that the equipment in question did not qualify as compensable trade fixtures, reversed the order of the Appellate Division, and remitted the case for further proceedings.

Comment 1: This little saga took ten years for New York's condemnation authority to win, so certainly the points made were important to it. Clearly, the condemnee felt strongly that there was an economic impact resulting from the condemnation and the loss of his ability to use these machines productively. The court's basic view here – tough. We don't pay for personalty. You keep it and sell it.

Comment 2: Note that the use of the concept"trade fixtures" here has a quite different purpose, although apparently the same meaning, as in regular landlord tenant law. If it were a ordinary fixture, the item would be compensated by the taking of the land. New York apparently recognizes a special value in trade fixtures, which, although in one sense are real estate, but have particular value to the business that the owner will lose when the taking occurs.

LANDLORD/TENANT; EMINENT DOMAIN; ALLOCATION OF PROCEEDS: Tenant is not entitled to portion of condemnation award representing fixtures where lease provides for termination upon condemnation notwithstanding separate allocation of condmenation damages provision in lease agreement. ***Metropolitan Airports Commission v. Noble, 763 N.W. 2d 639 (Minn. 2009)***, discussed under the heading: "Eminent Domain; Condemnation of Leasehold."

LANDLORD/TENANT; LANDLORD LIABILITY; MOLD: Owners and managers, to be liable for injuries from mold, must have sufficient notice of potential for mold growth that allegedly caused tenant's injuries. ***Litwack v. Plaza Realty Investors, Inc., 898 N.E.2d 571 (N.Y.).***

In April 1999, the tenant complained about a "brown wet, dark brownish" spot in the middle of her dining room wall. The building handyman removed part of the wall and there revealed a potential tiny crack in a steam pipe. In October, the steam was turned on and revealed the exact location of the crack within the pipe. A plumber replaced the damaged section of the pipe and the wall was repaired by the building handyman.

In July of 2001, doctors advised the tenant to have her apartment environmentally tested. The tests confirmed the presence of toxic mold and the tenant vacated the apartment that month. Tenant then brought suit for negligence amongst other things and the landlord moved for summary judgment. The Supreme Court granted summary judgment concluding the tenant did not give the landlord sufficient notice of the toxic mold condition.

The Appellate Division affirmed on the ground that the evidence was insufficient to put the landlord on notice of a hazardous mold condition. The tenant bears the burden of proving that the landlord had notice of the dangerous condition and a reasonable opportunity to repair it (*Juarez v. Wavecrest Mgt. Team*, 88 N.Y.2d 628, 642 (1996)). A landlord may be liable for failing to repair a dangerous condition, if it has notice, on leased premises if the landlord assumes a duty to make repairs and reserves the right to enter in order to inspect or to make such repairs. (*Chapman v. Silber,* 97 N.Y.2d 9, 19 (2001)). In this case, the tenant never complained about the air quality or dampness of her carpet. In fact, the tenant vacated the apartment three months before notifying the landlord of the mold condition. The Court of Appeals affirmed the decision of the Appellate Division.

LANDLORD AND TENANT; LANDLORD LIABILITY; LEAD PAINT: Whether landlords had constructive knowledge of lead-based paint could not be decided on summary judgment. ***Richardson v. Boes, 902 N.E.2d 77 (Ohio App. 6 Dist.).***

Landlords and tenant agreed to lease the premises in a house that was built in the 1920s or 1930s. In a deposition testimony the tenant stated that the interior of the house needed repairs and that she noticed paint chipping in the kitchen, living room and dining room. She stated that the landlord agreed to address these issues.

Tenant stated that she lived in the apartment for about one year before moving due to her child experiencing health problems related to lead poisoning in June 1995. Landlord said that he noticed the woodwork that he had repainted was chipped, but attributed it to the children "beating on it." According to *R.C. 5321.04(A)* a landlord is to make all repairs and do what is reasonably necessary to put and keep the premises in a fit and habitable condition. The landlord's violation of such duties constitutes negligence *per se*, and a landlord will not be excused from liability under either section if he either knew or should have known of the factual circumstances that caused the violation.

The landlord in this case belonged to the Real Estate Investors Association and had knowledge of lead paint issues within residential real estate. Constructive notice will suffice for a case brought under *R.C. 5321.01(A)(2)*. Although observing that paint is chipping does not amount to notification of lead based paint being present, the landlord's knowledge of the industry and that lead based paint probably exists combined with the chipping of paint gives rise to there being a genuine issue of material fact as to whether this is lead paint in the home. Consequently, for the purposes of summary judgment, the tenants established sufficient evidence that the landlords had constructive knowledge of the existence of lead-based paint in the dwelling. Thus, the Court of Appeals reversal of the Lucas County Court of Common Pleas judgment and remand for proceedings consistent with the Court of Appeals decision.

LANDLORD/TENANT; COMMERCIAL; CONTINUOUS OPERATION; LIQUIDATED DAMAGES: Tenant that goes dark must pay liquidated damages to landlord in an amount representing lost good will and traffic at the mall even where tenant's lease had not generated any percentage rent for approximately 5 years. ***El Centro Mall, LLC v. Payless Shoesource, Inc., 174 Cal. App. 4th 58 (Cal. Ct. App. 2009).***

Payless entered into a ten year lease with its landlord, a predecessor of El Centro Mall ("ECM") commencing January 1, 1990 and ending December 31, 2000. The lease covered 3300 square feet of space. Prior to expiration of the lease, in 2000, Payless and the landlord entered into an amendment extending the term by five years, thus taking the term out to December 31, 2005. ECM purchased the position of landlord during this five year extension period.

The lease contained the usual base and percentage rent requirements, 6% percentage rents on gross sales, and additional rent for CAM charges.

The lease also contained three especially pertinent provisions: First, the lease included a continuous operation provision, in which "Tenant covenants and agrees that, continuously and uninterruptedly . . . it will operate and conduct within the premises its business . . . ." The lease described operating hours for Payless. Second, Section 23.5 of the lease stated explicitly that in the event Payless terminated the lease early, Payless would pay damages for Percentage Rent according to a formula based on an average of payments over the preceding five year period. Third, in a separate section, the lease provided liquidated damages in the event Payless violated the continuous operation provision. The lease stated that landlord "shall be entitled to collect [in addition to the minimum base and Cam charges] an additional charge at the daily rate of Ten Cents ($0.10) per square foot of the Floor Area of the premises or One Hundred Dollars ($100.00), whichever is greater, for each and every day or partial day the Tenant fails to commence to do or to carry on business as herein provided. . . ."

Apparently, this was not a great location for a Payless shoe store; the store suffered from "lagging sales." According to the opinion, "Payless had not paid any percentage rental since 1999, and ECM did not assert that Payless owed any percentage rental for the period during which Payless discontinued business operations." It is not surprising that Payless wanted to take this money loser dark.

Payless ceased operations in March of 2005, nine months short of the end of the lease term. ECM responded by sending a letter noticing Payless of its default and Payless's contractual obligation to operate continuously. Payless continued to make its minimum base rent payments along with additional rent for CAM charges. It did not make any other payments, although this was not a change, at least monetarily, from prior behavior, since Payless had not made enough sales in prior years to justify percentage rent.

The parties stipulated to a number of facts, and waived jury trial, preferring to have a judge hear the case. The trial court ruled for the landlord and enforced the liquidated damages provision.

Section 1671(b) of the California Civil Code provides that a "provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." According to the trial court, Payless failed to overcome this statutory presumption. As a result, the trial court held that Payless owed ECM $90,226.80 "($330 per day times 279 days), less a $7,783.20 credit owed to Payless."

The California Appeals court affirmed and enforced the liquidated damages provision to the full amount requested by ECM.

Payless won a battle only to lose the war. The appellate court initially sided with Payless and determined that the liquidated damages provision was actually an unenforceable penalty, at least to the extent the provision was intended to substitute for percentage rentals. According to the court, Section 23.5 of the lease provided "a readily ascertainable basis for calculating damages for loss of percentage rental, rendering the additional liquidated damages provision unnecessary, except to penalize Payless." Payless had not paid percentage rent in the five year period preceding its decision to go dark, and the average rentals were zero. According to the formula in Section 23.5 of the lease, Payless did not owe damages for failure to pay Percentage Rent.

But Payless lost the war because the court then determined that the liquidated damages provision covered damages resulting from a loss of goodwill and traffic in the shopping center. An expert witness testified to the effect of losing a 3300 square foot tenant on the shopping center. The court decided that it would have been difficult for the landlord and tenant to determine at the time of contracting the extent of damage to something as amorphous as good will and traffic. Liquidated damages are therefore appropriate.

The idea behind liquidated damages is that each party takes a risk – the breaching party assumes the risk that the formula in the contract will overstate the loss, and the non breaching party risks use of a formula that understates the loss. The parties agree to use the formula because the actual amount of damages are hard to foresee at time of contracting, and at least one party wishes to avoid a trial determination of some portion of damages at the time of breach.

In California, the courts use a "reasonable endeavor" test. The appellate court quotes the California Supreme Court case of *Rigley v. Topa Thrift & Loan Assn.*, 17 Cal. 4th 970 (1998): "The amount set as liquidated damages 'must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that my be sustained.'" The court then states that it must look first to "the purposes stated in the provision itself." The liquidated damages provision in the Payless lease entitled ECM to "the minimum damages the Landlord is deemed to have suffered, including damages as a result of Landlord's failure to receive Percentage Rental." As noted, the court held that liquidated damages for percentage rental were, in its opinion, inappropriate because the lease elsewhere specified a formula for damages representing Percentage Rent. But the general language referring to "minimum damages the Landlord is deemed to have suffered" is broad. Indeed, the court held that this language is broad enough to encompass damage from loss of traffic and good will at the shopping center.

Payless made one last ditch effort to undermine ECM. Payless argued that forcing it to pay liquidated damages would amount to a penalty because ECM had arbitrarily enforced liquidated damages provisions with respect to other breaching tenants. ECM allowed Sears, an anchor tenant "to escape from its lease obligations for a 65,000 square foot space without the payment of any damages for loss of synergy, goodwill, or patronage." Payless pointed out other examples of tenants treated differently by ECM. The court agreed that these examples of ECM's differing treatment of other tenants "may give rise to an inference the provision is arbitrary." But the court concluded that "it does not conclusively prove the point." Bluntly, Payless did not overcome the presumption that the liquidated damages provision is reasonable. The court suggests a number of reasons that ECM might have released Sears.

Reporter's Comment 1: One can understand Payless's upset in this case. It could not make a profit or pay any percentage rents from the space and it continued to pay the same amounts to the landlord that it would have paid in rent if Payless had not gone dark. However, Payless agreed to a continuous operation provision in the lease, and this has its consequences. Payless was saddled with over $90,000 in damages. Payless presumably made its decision to close up shop from a cold calculation of costs and benefits that would result from its action, but it clearly miscalculated. One wonders if Payless could have scaled back operations at the location for the remaining 8 months of its term to have avoided costly litigation and the damages award.

Reporter's Comment 2: Friedman on Leases recognizes in § 6:12 that damages resulting from a tenant's breach of the obligation to continuously operate are difficult to ascertain. Experts clash on the extent of damages such a breach can cause in any specific instance to a landlord, to a shopping center, or to other tenants. "[T]he wronged landlord has no adequate remedy at law. The cases indicate that his prospects in equity, via specific performance, are not very good." The treatise therefore says that "this, then, would appear to be an appropriate situation for a lease to fix liquidated damages for breach – where actual damages are uncertain and difficult to establish, and the liquidated damages fixed by agreement represent a *bona fide* effort to approximate the actual damage." This seems consistent with the decisions of California courts and statute. Note, however, that California applies the "reasonable endeavor" test. There is no mention in the Payless opinion of the negotiation process – if any – between Payless and the original landlord with respect to the liquidated damages formula. Was there any "endeavor" at all? Presumptions are beautiful things.

Reporter's Comment 3: One of the primary reasons a landlord extracts a continuous operation provision is to cover the loss of percentage rentals. One imagines an anchor tenant departing an old mall to move to a newer location. Very often, the anchor may be making money and paying percentage rents in the old location, but it is lured by the prospect of a greater return in the newer location. In Payless, percentage rents were not part of the equation. What is interesting is that the court stated that when looking at liquidated damages provision, it is important to examine at the purposes of the provision. The Payless lease speaks only very generally – and nowhere mentions loss of traffic or good will. The landlord's provision was ultimately vindicated, but in the future it might be better to state specifically in the provision that "this liquidated damages provision represents all damages and loss attributable to Tenant's failure to continuously operate, including but not limited to damage resulting from loss of traffic in the shopping center, a tenant mix inappropriate to the shopping center, a loss of other tenants who fail to exercise renewals or otherwise terminate in light of the loss of the Tenant, the increased difficulty of recruiting national tenants, the loss in value of the shopping center," and so on.

Editor's Comment 1: The Editor agrees that liquidated damages clauses should state clearly the premises for the damages claim, including some self serving statement that the parties agree that the amounts fixed for such damages are "reasonable." But the Editor believes that the landlord is entitled to compensation for two distinct losses, and should not be shy about contracting for protection from each of them separately. For instance, here, had Payless made money and paid percentage rent in the past, it would have been liable for damages under the formula looking to past payments. But, by going dark, it still injured the Landlord by cutting back on traffic into the mall, reducing the profitability of other space in the mall and perhaps even triggering"cotenancy clauses" in other tenant's leases. Consequently, the parties should have been free, at the outset of the lease, to provide separately for this form of damages and to collect it separately.

Consequently, the editor would not necessarily advise using only one form of liquidated damages provision stated to include "all damages" caused by Tenant's going dark. Otherwise, the editor views the Reporter's suggested language above as well conceived.

LANDLORD/TENANT; EVICTION; PROCEDURE; *RES JUDICATA*: Dismissal of prior eviction complaint without prejudice was not judgment on merits, and, thus, new claim was not barred by *res judicata*. ***Zaremba v. Nevarez 898 N.E.2d 459 (Ind.App. 2009).***

Zaremba appeals the trial court's dismissal with prejudice of her claim against Defendants, Jessica Nevarez and John Nevarez, for rent and damages. Court consolidated and restated Zaremba's issue as whether the trial court abused its discretion by denying Zaremba's motion to correct error concerning the trial court's dismissal with prejudice of Zaremba's complaint.

On February 1, 2008, Zaremba filed a small claims eviction complaint against the Nevarezes. On February 22, 2008, the trial court held a hearing on ejectment. Zaremba advised the trial court that the Nevarezes had vacated the premises. The trial court set a hearing on damages for March 14, 2008. On March 14, 2008, the trial court entered an order indicating that the parties appeared for an initial hearing and set a bench trial for May 30, 2008.

On May 30, 2008, Zaremba counsel, in her absence, appeared and requested dismissal without prejudice. The trial court dismissed the matter with-out prejudice. On July 7, 2008, Zaremba filed a claim against the Nevarezes for $2,063.39 in connection with the rental property. On August 14, 2008, the trial court dismissed Zaremba's claim with prejudice.

The trial court's order states in pertinent part: "On May 30, 2008 the matter of Zaremba v. Jessica and John Nevarez . . . was dismissed because [Zaremba] failed to appear for bench trial. The trial was set after [the Nevarezes] appeared at Damages Hearing and contested the amount that [Zaremba] had sought in post-possession damages. [Zaremba]'s Attorney set forth no reason for [Zaremba]'s failure to appear and filed no motion under Trial Rule 60 to set aside the dismissal.The finding of dismissal served as *res judicata* on this subsequent filing, which appears to be an attempt by [Zaremba] to circumvent the dismissal for [Zaremba]'s failure to appear.

Zaremba filed a motion to correct the error and argued that the trial court erred by relying on the dismissal without prejudice as a basis for *res judicata*.

On Appeal: *Held: Reversed*. The trial court denied Zaremba's motion to correct error. Zaremba argues that the trial court abused its discretion when it (a) determined that a previous dismissal without prejudice could serve as *res judicata* for a subsequent refiling of the same claim; and (b) stated that a plaintiff who fails to appear one time for trial in a small claims case was required to seek relief pursuant to Indiana Trial Rule 60. The Appellate court agreed with Plaintiff stating that "under the doctrine of *res judicata*, 'a judgment rendered on the merits is an absolute bar to a subsequent action between the same parties or those in privity with them on the same claim or demand.' " For these principles to apply the court further concluded that "there must have been a final judgment on the merits and that judgment must have been entered by a court of competent jurisdiction" and since Plaintiff's cause was dismissed without prejudice, it was not a judgment on the merits.

In regards to Plaintiff's second argument the Appeals court cited *Multivest Properties v. Hughes*, 671 N.E.2d 199 (Ind.Ct.App.1996). In this case the court cited Small Claims Rule 10(A) which states that "[i]f the plaintiff fails to appear at the time and place specified for the trial, or for any continuance thereof, the court may dismiss the action without prejudice .... If the claim is refiled and the plaintiff again fails to appear such claim may be dismissed with prejudice." The Appelate court in *Zaremba* held that the rule is "specific and '[d]ismissal with prejudice is contemplated only when the plaintiff again fails to appear after the claim has been refiled.'" In this case, the record does not reveal that Zaremba failed to appear after the claim was refilled and therefore the trial court abused its discretion by dismissing Zaremba's claim with prejudice. The Court of Appeals reverses and remands the trial court's decision.

LANDLORD/TENANT; MISREPRESENTATION; "AS IS" CLAUSE: Landlord's deliberate misrepresentation of size of premises not shielded by exculpatory provision in lease. Landlord did not violate obligation to deal in good faith with tenant in negotiation of lease. ***McClain v. Octagon Plaza, LLC, 71 Cal. Rptr. 3d 885 (2008)***

McClain operated "A+ Teaching Supplies" and leased spaced for a five year and two month term in a shopping center located in Valencia, California, from Octagon. The two principals of Octagon were Ted and Wanda Charanian. The lease provided McClain with an option to extend the term by two successive five year periods. According to the case opinion, the lease agreement was styled as a "Standard Industrial/Commercial Multi-Tenant Lease-Net" and was a form created by the American Industrial Real Estate Association. The parties entered into the lease on February 28, 2003.

The primary dispute concerned the size of the space and the share of operating expenses that should have been allocated to it. Paragraph 1.2(a) of the lease described the space as containing "approximately 2,624 square feet." This number was used to determine both the tenant's base rent as well as its share of the operating expenses for the shopping center.

Paragraphs 2.1 and 2.4 seemingly tied the McClain's hands to object to this calculation. Paragraph 2.1 stated that "unless otherwise provided herein, any statement of size set forth in this Lease, or that may have been used in calculating Rent, is an approximation which the Parties agree is reasonable and any payments based thereof are not subject to revision whether or not the actual sizes is more or less." Paragraph 2.4 is the Octagon's exculpatory provision. It provides that "Lessee acknowledges that (a) it has been advised by Lessor . . . to satisfy itself with respect to the condition of the Premises . . ., and their suitability for Lessee's intended use, [and] (b) Lessee has made such investigation as it deems necessary with reference to such matters and assumes responsibility therefore as the same relate to its occupancy of the Premises . . . ."

The lease contained standard language permitting Octagon to pass through operating expenses and to estimate operating expenses prior to each calendar year. As is common, the lease required Octagon to provide a statement to McClain of actual operating expenses within 60 days following the end of each calendar year. McClain was required to pay Octagon the amount of any under payment and Octagon would credit McClain with the amount of any overpayment. In any event, McClain's payments depended on the correct statement of the size of its space, and the portion of the shopping center that McClain occupied relative to the total rentable square footage of the shopping center.

Facts reflected in the opinion suggest that Octagon may have misrepresented the size of the space (and perhaps quite knowingly.) In June of 2005, McClain obtained a copy of the landlord's earthquake insurance policy. It reflected different numbers for the size of the shopping center and for the premises than those given to the McClain by Octagon. According to the policy, the shopping center contained 12, 800 square feet, and not 11,835 square feet used by Octagon in calculating operating expenses requirements for McClain. In addition, the policy reflected the premises at 2,438 square feet rather than the 2,624 square feet shown in the lease. As a result, the base rent was overstated by nearly $270 per month and McClain's share of operating expenses for the shopping center was set at 23% instead of 19%. The total loss to the tenant was nearly $90,000 over the term of the lease.

What made this so upsetting to tenant – apart from the fact that she was simply paying too much money – was the behavior of Octagon leading up to execution of the lease. According to the opinion, McClain attempted to independently confirm the size of the premises prior to execution of the lease, and asked the landlord for an opportunity to check the numbers. The Charanians, according to the court, "purported to be offended by her inquiries," and "responded that measuring the area would be unreasonably costly due to the unit's unusual angles." The Charanians further "insisted that they [the landlord] had intimate knowledge of every detail of the shopping center, and that McClain could rely on their representations regarding the sizes of the unit and the shopping center." Rather than simply walk away from the lease, McClain signed.

Having discovered the discrepancy, McClain brought suit against Octagon. For our purposes, two claims are especially pertinent. McClain claimed that that Octagon misrepresented the size of the space and its portion of the shopping center, and that Octagon breached its implied obligation to deal with the McClain in good faith and honestly. The trial court sustained Octagon's demurrer on all grounds and entered a judgment for the Octagon. The California Court of Appeals agreed with the trial court on a number of issues. It affirmed the trial court's holding that the landlord did not violate its obligation to act in good faith.

However, the Court of Appeals reversed the trial court on a key claim of McClain. The court held that the Octagon may have acted fraudulently and the exculpatory language in the lease did not shield the Octagon from its misrepresentations.

The court remanded for determinations on the issue of fraud and misrepresentation.

(McClain's other claims included a demand of a right to an accounting of documents other than the detailed statement of tenant's share of operating expenses. McClain argued on appeal that the Octagon violated the Consumer Credit Reporting Agencies Act. The tenant failed on both counts on appeal, but the author will leave it to the reader to examine these issues more fully.)

The court draws upon a reservoir of California law and secondary sources to determine both that the behavior of Octagon and its principals could constitute fraud, and that the exculpatory provision in the lease is no shield to this behavior.

Witkin, a primary treatise of California law, explains that one party will have an action even when she knows what she is signing "but consent is induced by fraud." The primary elements of the cause of action are misrepresentation, knowledge of falsity, intent, justifiable reliance and resulting damages. Negligent misrepresentation is similar, except that the action does not require knowledge of falsity or intent to deceive and induce reliance.

Thus, in this case, (according to the facts presented in the opinion) the Charanians knew or had reason to know of the falsity of their statements. It is reasonable to suppose that the principals of Octagon were totally familiar with their own insurance policy reflecting the different space calculations. Yet they rebuffed attempts of McClain to investigate the size of the space, were (or feigned) offense at the request, and insisted that they could be relied upon.

There is a two step process to examining the fraud and misrepresentation claims. First, the court determined whether the exculpatory language controlled. Second, even if the language was unavailing to landlord, the court determined whether the elements of the underlying action were met.

If the lease contract's exculpatory language controlled, there would be really no reason to argue about fraud or misrepresentation. It is very broad language. In it, McClain acknowledged his right to verify the size of the space and gave up pretty much any claim he might have against the landlord. The court summarily rejected the notion that an exculpatory provision of this kind can shield either affirmative or negligent misrepresentation. Section 1668 of the California Civil Code states "contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, . . . whether willful or negligent, are against the policy of the law." This section has been previously interpreted as applying to negligent misrepresentation in addition to active fraud.

Indeed, some of the cases cited by the court, while not directly on point, come from the realm of shopping center litigation. For example, the court cited *Hinesley v. Oakshade Town Center*, 135 Cal. App. 4th 289 (2005), in which the landlord's agent made representations to the tenant that the other stores in the center would be occupied and attract "heavy foot traffic." The lease in that case contained a representation that the tenant had not relied on such representations. Nevertheless, the court held that the provision did not shield the landlord from liability.

The second issue relating to the fraud and misrepresentation is that of the tenant's justifiable reliance. Reasonable reliance is necessary to McClain's fraud and misrepresentation claim. Octagon argued that McClain's reliance on the statements of the landlord were not reasonably justified on two grounds. The lease stated that the square footage of the premises were an "approximation." The court was unimpressed, citing an earlier case *Furla v. Jon Douglas Co.*, 65 Cal App. 4th 1069 (1998) (residential seller and brokers not shielded by language in contract to seller regarding square footage of lot; contract provisions repeated that buyer had opportunity to independently obtain survey and that calculation in contract was approximation). Relying on *Furla*, the court equated "approximate" as "near to," "about," or "a little more or less." In the case at issue, Octagon's exaggeration of the size of the premises and McClain's share of operating expenses, while not huge, was nevertheless significant. These calculations were not "near to" the actual numbers.

Also, according to Octagon, the discrepancy between what Octagon told McClain and what the lease actually said should have clued McClain in to the possibility that the numbers were off. As the court explained, "Octagon's counsel also suggested that because the [First Amended Complaint] alleged that McClain had been assured the square footage figures used in the lease were "exact," the contract's "approximation" language necessarily put her on notice of a discrepancy she should have pursued." The court admitted that this might affect the ultimate determination of whether McClain's reliance was reasonable, but alone "it does not bar her claim as a matter of law."

It is the overall weight of all the facts – the "approximation" language of the lease differing from exact square footage language used to induce McClain, the actual misstatements of the landlord, the degree to which the landlord worked to induce McClain's reliance – that allowed the court to determine that the reliance might be justified.

Octagon's attorneys carefully parsed the language of the contract in an attempt to preclude the court from finding that McClain reasonably relied on the statements of landlord – to no avail. Octagon's lawyers noted that Section 2.1 of the lease "not only uses the term "approximation," but states (1) that the parties agreed the approximations were "reasonable" and (2) that McClain's rent was not subject to revision regardless of the actual sizes." As to the first assertion, the court simply stated that any attempt to lock parties into language permitting one party to act fraudulently is inoperative. The court reads the second assertion essentially like an "as-is" clause – that McClain would take the property no matter how great the disparity between the actual square footage and that reflected in the lease. But the court stated "California courts have routinely rejected such clauses as ineffective in insulating a contracting party from fraud claims regarding non obvious defects in goods." As to this latter assertion, the court cited a case in which a home purchaser was not barred from bringing an action against his seller for concealing termite damage, when the contract contained an ”as is” clause.

McClain did not fare so well on her argument that Octagon breached its implied obligation to deal fairly and in good faith. The problem is not that Octagon behaved well. Rather, the court held that the implied covenant of good faith and fair dealing applies to *performance* of a contract and not its *negotiation*. In this case, Octagon's misstatements regarding the shopping center and the premises, and the unwillingness of the Charanians to allow a separate determination by McClain, occurred prior to execution of the agreement.

Reporter's Comment 1: The court's treatment of the implied obligation of good faith and fair dealing is not surprising. Section 205 of the Restatement of Contracts (2d) details the implied covenant, and it only addresses "performance" of an agreement, and not pre contract negotiations. The comments leave open the possibility that a court might imply the covenant into contract negotiations, but this is not a position expressly taken by the language of the section. Some courts do imply a covenant of good faith into contract negotiations where there is finding of express fraud, or where the parties reach a precise understanding and one party relies to its detriment on the agreement. However, most courts shy away from finding an implied good faith obligation at the stage of contract negotiation.

Reporter's Comment 2: California statutory law governs (perhaps intrudes on) many aspects of the common law, and lease law is no exception. The state adopted statutory language invalidating broad exculpatory provisions in contracts and the court applied that law. However, even in jurisdictions that do not have such statutory language on the books, many courts have taken the position that parties cannot exculpate themselves from their own fraudulent behavior. Whether negligent behavior (negligent misrepresentation) would be similarly prohibited in such jurisdictions is an area of conflict.

Reporter's Comment 3: "As-is" clauses typically can protect sellers and landlords from negligent misrepresentation, but not from affirmative fraud. This may not be the case in California, according to the court in *McClain*. That said, *McClain* was not really a negligent misrepresentation case – at least as described in the appellate opinion.

Reporter's Comment 4: The real question here is the justifiable reliance of McClain. In order to demonstrate fraud, the tenant must show that she reasonably relied on the statements of Charanians. At what point is a prospective tenant negotiating a lease for commercial space supposed to see red flags that the landlord is not telling the truth, or at least, to become suspicious of the landlord's statements? Here the principals of the landlord refused a reasonable demand of McClain to measure the space to determine the actual size of the premises. The landlord's principals acted offended that such a request might even be made (presumably because this would be an assault on their honesty.) Should the law protect the tenant here, even in face of an affirmative misrepresentation? This is an issue of reasonable reliance, and the court does not answer it, leaving this determination instead to the lower court on remand. The author sympathizes with the tenant and does not wish to see bad behavior rewarded. In this case, though, the red flags were pronounced. A reasonable business person might not have simply signed the lease agreement.

Editor's Comment: Compare: the recent Texas decision in *Prudential Ins. Co. of America v. Italian Cowboy Partners, Ltd.*, 2008 WL 2841848 (Tex.App.7/24/08), the DIRT DD for 10/24/08 (similar exculpatory clause upheld against Landlord's alleged fraud when tenant sophisticated, negotiations extended, and tenant given broad latitude to inspect. Case involved undisclosed intermittent sewer gas – not size.)

The Reporter for this case was Professor Daniel Bogart of the Chapman Law School.

LANDLORD/TENANT; OPTIONS TO PURCHASE; SUBORDINATION: Lessee's right of first refusal survived lessee's subordination of his option to purchase property to company. ***Four Howards, Ltd. v. J&F Wenz Rd. Invest., LLC, 902 N.E.2d 63 (Ohio App. 6 Dist. 2009).***

On October 18, 2000, Swade leased a premises known as Sav-On, a combined gasoline station and carryout business. The lease gave Swade an option to purchase the land and buildings for $200,000 during the first three years of the lease, and thereafter, a right of first refusal for purchase of the land and building, so long as Swade was current on his rental payments and in compliance with the conditions of the lease. The lease was not recorded.

In January 2003, Swade entered into an agreement with Four Howards and American Petroleum (“Four Howards”) for the purchase of gasoline. The agreement included renovations by Four Howards in return for a option to purchase the property. Apparently the landlords were agreeable to this, and Swade expressly subordinated his right to exercise his option to purchase to that of Four Howards in its executed “Option to Purchase.”

In January 2004, Swade terminated Sav-On’s business relationship with Four Howards. On February 17, 2004, Four Howards sent a letter stating that it was “ready and willing to exercise the option to purchase the property.” In response, on March 1, 2004, Swade sent a letter to Four Howards, stating that it was formally exercising its first right of refusal. Four Howards filed a complaint, asking the trial court to declare its option to purchase superior to Swade’s right of first refusal. After a bench trial, the trial court issued judgment for Four Howards, granting specific performance and ordering the sale of the property to Four Howards in accordance with the terms of the option to purchase. Swade appealed, claiming that the trial court erred in finding that Four Howards’ option to purchase extinguished Swade’s right of first refusal. The Court of Appeals of Ohio reversed.

First, the Court found that the terms of the contracts established that Swade’s right of first refusal was superior. An option to purchase is a distinct and separate agreement from a right of first refusal. While the first creates a unilateral contract on the owner of the property if the holder of the option decides to exercise it, the second creates only a preemptive right for the holder of the right of first refusal if the owner decides to sell. Because Swade’s option to purchase and right of first refusal were two separate contracts, his subordination of the first did not necessarily waive the second. The “Option to Purchase” was drafted by Four Howards, and any ambiguities are therefore construed against Four Howards. Because the contract specifically subordinated only the option to purchase, it did not serve to subordinate Swade’s right of first refusal. Therefore, Swade’s right of first refusal remained superior to Four Howard’s option to purchase.

Second, the Court found that Swade’s right of first refusal was not extinguished by Four Howard’s status as a bona fide purchaser without knowledge of the existence of a prior conveyance. Although the lease was not recorded, the Ohio courts have held that a grantee may be bound by the terms of an unrecorded lease if he knows of its existence. Here, Four Howards clearly knew of the lease. Herbie Howard, a principal of Four Howards, testified at trial that he knew of the lease, but did not ask to see it. Thus, the trial court’s finding that Four Howards did not have “either actual or constructive notice of any facts which would impair the priority of its right to purchase” was contrary to the undisputed evidence, and the trial court abused its discretion in holding that Four Howards’ option to purchase was superior to Swade’s right of first refusal.

Comment 1: SURPRISE!!! Certainly Four Howards should have desired, and perhaps expected, that both the option and right of first refusal would be subordinated to their option. Without knowing more about the facts, it appears that someone made a big mistake here. This is the kind of thing that keeps transactions attorneys awake into the wee small hours. In this case, the drafting might have been done by a land agent for Howards and not a lawyer at all. Still a big mistake.

Comment 2: Yes, from a business perspective, a prospective optionee would want to have all prior inconsistent rights subordinated But it is not so crystal clear that all parties would agree to this. Not so clear that one could demand reformation. One could argue that a prior right of refusal is not nearly as scary as a prior fixed option, and that Four Howards might have been willing to accept the existence of the prior right of refusal if the other terms of the deal were sweet enough.

LANDLORD/TENANT; RESIDENTIAL; PUBLIC HOUSING: Public housing authority had notice of tenant’s mental disability, for purposes of requirement for consideration whether reasonable accommodation could be made where, prior to attempting to evict tenant, authority had sent tenant for counseling to address potential difficulties cause by tenant’s mental illness.. ***Boston Housing Authority v. Bridgewaters, 898 N.E.2d 848 (Mass.)***

The Housing Court Department, Suffolk County, Boston Division evicted the tenant and the tenant appealed. The Appeals court affirmed the decision of the Housing Court. The Supreme Court reversed, holding that: 1) housing authority had notice that tenant had mental disability; 2) tenant made reasonable accommodation request; and 3) housing authority was required to consider whether causal link existed between tenant's disability and assault.

Tenant was evicted from his apartment by the Boston Housing Authority (the "BHA") on the grounds that he threatened the health and safety of another resident. The tenant has a mental disability which makes the case more complex than a simple eviction. Before a public housing authority may conclude that a disabled tenant poses a "significant risk to the health or safety of others that cannot be eliminated by a modification of policies, practices, or procedures, or by the provision of auxiliary aids or services," 24 C.F.R. Sec. 9.121(b)(2008) the authority "must make an individualized assessment, based on reasonable judgment that relies on current medical knowledge or on the best available objective evidence to ascertain: the nature, duration, and severity of the risk; the probability that the potential injury will actually occur; and whether reasonable modifications of policies, practices, or procedures will mitigate the risk." 24 C.F.R. Sec. 9.131(c)(2008).

The Supreme Court concluded that the BHA was on notice prior to trial that the tenant was disabled (tenant suffers from manic depression or bipolar disorder) and that the tenant raised both his disability and a request for a reasonable accommodation. After such, a public housing must conduct an individualized, objective inquiry whether accommodations can mitigate the risk to other tenants based on guidance from Housing and Urban Development procedures.

The Supreme Court rejected the BHA's assertion that it did not know that the tenant was a disabled person because several weeks before trial the Housing Court referred the tenant to the Boston Tenancy Preservation Project ("TPP"), which is a "cooperative effort" between the Housing Court and private nonprofit agencies, that assists tenants whose mental illness may be jeopardizing their tenancies. The BHA did not notify the tenant of his rights as a disabled tenant when it commenced the eviction proceedings against him. By opposing his eviction, asking to remain in his apartment, and stating that he was being successfully treated for his disabilities, the tenant fulfilled the second requirement of a reasonable accommodation request. To make sure a request no specific words are required. A reasonable accommodation is required when there is a causal link between requested accommodation and the misconduct that set the eviction in motion. Since the individual assessment did not take place the judgment was vacated by the Supreme Court and remanded the case to the Housing Court.

LANDOWNER LIABILITY; BUSINESS INVITEES; WARNING SIGNS: Merchants that invite persons to enter their premises owe a duty to keep the premises in a reasonably safe condition; and this extends to the merchant's selection and use of devices intended to warn patrons of a hazard where the warning has the inherent potential to expose them to a different one. ***American Multi-Cinema v. Brown, 285 Ga. 442, 2009 Ga. Lexis 284 (Ga. 2009).***

Theater employees marked spill near exit doors of theater with "Wet Floor" sign. Exiting moviegoers knocked sign over and moviegoer tripped on sign and fell resulting in significant injury. The Court of Appeals had, held that certain cases argued by the theater owner did not hold as a matter of law that "Wet Floor" signs set up over spills can never be the basis for a premises liability claim, regardless of where they are placed, and reversed the trial court's grant of summary judgment in favor of the owner.

In affirming the Court of Appeals' ruling, the Supreme Court disagreed with the owner's argument that there could be no premises liability because there was no evidence that any theater employee had actual or constructive knowledge that the "Wet Floor" sign had fallen down. Because the theatre employees knew the crowded theater audience would be spilling into the hallway at any minute, the employees could be considered to have actual knowledge of the hazard as soon as the employees placed the sign, regardless of whether it was placed in the correct manner. The Court of Appeals' reversal of the trial court's grant of summary judgment was affirmed by the Supreme Court.

MORTGAGES; ASSIGNMENTS; GUARANTIES: When a debt obligation is assigned to a third party, a general guaranty that guarantees such debt is automatically transferred by operation of law, even if such guaranty is not attached to or referenced in the assignment document transferring such debt obligation. ***American First Federal, Inc. v. Battlefield Center, L.P., ___ S.W.3d ___ (Mo. Ct. App. 2009).***

In February 2003, Battlefield Center, L.P. ("Battlefield") executed three promissory notes in favor of Allegiant Bank ("Allegiant") in an amount of approximately $2,175,000, secured by three leasehold deeds of trust on property in Springfield, Missouri. Christopher Kersten ("Guarantor") executed a Guaranty guaranteeing payment and performance of the notes to Allegiant.

After Battlefield fell behind on payments, the parties agreed to extend the maturity date of the notes until July 31, 2005. Allegiant sold its interest in the notes to American First Federal, Inc. ("American") in December 2004. In connection with the sale of such notes, Allegiant assigned the three leasehold deeds of trust and executed three allonges specifically making the notes payable to American. American sent Battlefield a notice of default on February 15, 2005 after Battlefield failed to make scheduled payments, and informed Battlefield it would accelerate the balance due on the notes if payment was not made by March 2, 2005. Battlefield failed to cure its default, and the property was sold at a foreclosure sale to Eureka Properties, LLC for $1.5 million. After applying the proceeds of the foreclosure sale to the balance due on the notes, American brought an action against Battlefield and Guarantor on the deficiency. The trial court entered judgment against Battlefield and Guarantor and awarded American $1,163,847.28. Battlefield and Guarantor appealed.

In its appeal, Guarantor argued that American did not have standing to sue Guarantor on his Guaranty because American did not take title to or have the right to enforce the Guaranty. Specifically, the issue was whether Guarantor unconditionally delivered the Guaranty to American. In making that argument, Guarantor focused on the documents effecting the transfer of the notes from Allegiant to American, arguing that: (1) the allonges did not specifically refer to the Guaranty; (2) the asset sale agreement conveying the notes was not designed to convey title to the notes or Guaranty, and the actual title conveyance document (the "Bill of Sale") was not produced; and (3) despite language in the Guaranty stating it is transferable, that language alone did not result in a transfer of the Guaranty.

The court began its analysis by concluding that because the Bill of Sale (which would have expressly included the Guaranty in the list of items transferred from Allegiant to American) was missing, Allegiant did not expressly transfer the Guaranty, despite a clear intent in the asset sale agreement to effect a transfer of the Guaranty.

Despite the missing Bill of Sale, the court concluded that American took title to the Guaranty by operation of law. In reaching this holding, the court first distinguished a general guaranty (assignable and addressed to persons generally) from a special guaranty (addressed to a particular person who alone can take advantage of it). The Guaranty in the subject case was general and assignable. Next, the court noted that even though the specific question presented in this case ("whether a guaranty was transferred by operation of law even though not attached to nor referred to in the document assigning the principal obligation") had not been raised in prior decisions, the general rule that "a transfer of the principal obligation is held to operate as an assignment of the guaranty" and that "[t]his is so even though there is no specific reference to the guaranty in the assignment" applied to the subject case, and therefore American had standing to enforce the Guaranty.

MORTGAGES; EXECUTION; NOTARIZATION: Mortgagee failed to rebut presumption that her notarized signature on mortgages was actually hers. ***Bonilla v. Commercial Services of Perry, Inc., 900 N.E.2d 22 (Ind.App. 2009).***

Ceasario and Alicia Bonilla held title to real estate located at 4310 Parrish Avenue, East Chicago, Indiana. On March 16, 1984, Ceasario secured a mortgage on the property for $60,500. The mortgage documents include signatures for both Ceasario and Alicia, as co-mortgagors. On April 20, 1985, Ceasario secured a second mortgage on the property for $82,000. Once again, the mortgage documents included the signatures of both Ceasario and Alicia, as co-mortgagors.

Ceasario died on November 26, 1991. Commercial Services of Perry, Inc. ("Perry"), as successor in interest to the original lender of both loans, filed a complaint for foreclosure and money damages, claiming that no payments had been made in excess of sixty days. Alicia Bonilla defended on the grounds that she did not sign either of the two mortgages in question. She submitted handwriting exemplars as proof that she did not sign the documents. The trial court entered judgment for Perry, holding that Alicia failed to provide sufficient corroborating evidence to overcome the presumption of authenticity of the notarized documents, and alternatively, that Alicia knew of the mortgages, benefitted from them, did not attempt to set them aside for a period of twenty years, and therefore ratified the documents. The trial court awarded damages of the full principal amount of both loans, plus interest. On appeal, the Court of Appeals of Indiana affirmed.

Under Indiana law, the official certificate of a notary public, attested by a notary seal, is presumptive evidence of the authenticity of a signature. Because both mortgages were notarized, a presumption arose that Alicia signed the documents. This presumption shifted the burden of proof to Alicia to prove that she did not sign the mortgages. According to Indiana Supreme Court law, this presumption continues even where rebutting evidence is offered. Rebutting evidence effectively transforms the presumption into an inference. This inference may be weighed by the factfinder with all other evidence in determining the outcome of the case. Here, Alicia offered her testimony and the handwriting exemplar as evidence to rebut the presumption that she signed the mortgages. The trial court weighed that evidence, along with the inference that she signed the mortgages, and concluded that Alicia's evidence was "inadequate to rebut the presumption." The Court will not reweigh evidence on appeal unless clearly erroneous. In this case, the trial court's finding that Alicia failed to rebut the presumption that she signed the mortgages was not clearly erroneous, and thus, the Court of Appeals affirmed. Because the Court held that Alicia signed the mortgages, it did not address the argument that Alicia ratified the mortgages by receiving their benefit and failing to attempt a set aside for a period of twenty years.

The Court upheld the trial court's finding of damages in the full amount of both loans, plus interest. The Indiana Code provides that, so long as all essential terms of the debt have been proven, a person may enforce a promissory note even where he is not able to produce the note in certain situations. Here, although he was unable to produce the notes, Perry was able to prove the terms, dates, amounts of, and interest rates on the two mortgages by producing the mortgages. Alicia conceded that no payments were made through her testimony at trial. The only appropriate inference following twenty years of nonpayment is that the borrowers were in default. Thus, the trial court properly calculated the damages in this case.

MORTGAGES; FORECLOSURE; JUDICIAL FORECLOSURE; NECESSARY PARTIES: Despite being designated as a beneficiary and holder of legal title in a deed of trust, MERS, as a "mere agent" to the originating lender, is only a necessary party to a foreclosure action if the agent is (1) the borrower, trustee, or true beneficiary (receiving payments, making decisions on late payments, and holding foreclosure rights), or (2) specifically authorized by the lender to act on such lender's behalf in the foreclosure proceedings. Thus, even when a junior lender forecloses judicially and without notice to MERS, the interest represented by MERS can be extinguished without notice, at least where the original lender is notified. ***Mortgage Electronic Registration System, Inc. v. Southwest Homes of Arkansas, ___ S.W.3d ___, 2009 Westlaw 723182 (Ark. 2009).***

In 2003, Jason and Julie Lindsey borrowed money from Pulaski Mortgage ("Pulaski") and executed a deed of trust to secure the promissory note. Mortgage Electronic Registration System ("MERS"), which was developed by the real estate finance industry to facilitate the sale and resale of instruments in the secondary mortgage market and to track registered security instruments for lenders, was listed in the deed of trust as "Beneficiary" acting "solely as nominee for Lender" and "Lender's successors and assigns." The deed of trust (which was recorded) also stated that "the Borrower understands and agrees that MERS holds only legal title to the interests granted by the Borrower and further that MERS as nominee of the Lender has the right to exercise all rights of the Lender including foreclosure."

In 2006, the Lindseys granted a mortgage on the same property to Southwest Homes of Arkansas ("Southwest") to secure a second promissory note. The mortgage was also recorded. In February 2007, Southwest foreclosed on the mortgage, listing the Lindseys and "Mortgage Electronic Registration Systems, Inc. (Pulaski Mortgage Company)" in the foreclosure action. MERS was never served and Pulaski (the lender of record) did not file an answer. The decree of foreclosure was entered in April 2007 and the property was sold to Southwest. In February 2008, MERS learned of the foreclosure and moved for relief, arguing it held legal title to the property and therefore was a necessary party to the foreclosure action. The circuit court denied MERS' motion and MERS appealed.

The deed of trust indicated MERS held legal title and was the beneficiary, but it also provided that Pulaski shall receive the payments, make decisions on late payments, and hold foreclosure rights. MERS did not receive any payments, service the loan or oversee payments, delinquency of payments, or administration of the loan. MERS' involvement was limited to providing electronic tracking of ownership interests in residential real property security interests. Nonetheless, MERS asserted that it held bare legal title due to a principal-agent relationship between it and Pulaski under the express terms of the deed of trust (specifically, the provision that MERS held legal title and was the lender's "nominee"), and therefore it had authority to exercise Pulaski's rights under the deed of trust.

The court first described the nature of the relationship between parties entering into a deed of trust, noting that parties necessary in an action to recover the debt and foreclose the mortgage include the borrower, trustee, and beneficiary.

The court clarified that despite being designated as the beneficiary and holder of legal title in the deed of trust, Pulaski (it appeared to the court) was the true beneficiary because it received payments on the debt. Second, the court discussed MERS' agency argument, concluding that MERS (as Pulaski's agent) was authorized to do only what Pulaski (as the principal of MERS) desired it to do, and the record did not show MERS had authority to act on Pulaski's behalf in connection with the foreclosure. Finally, the court noted that Pulaski was a named party in the foreclosure action, and MERS was not acting as Pulaski's agent at the time it moved to set aside the decree of foreclosure. For the foregoing reasons, the court held that MERS was not a necessary party to the foreclosure action.

Comment 1: Despite what might be argued to be difficult language for MERS in the opinion, the holding is based upon a relatively unusual set of facts. The court appears to have made the assumption that Pulaski, the originating lender, continued as servicer of this loan, and was the party to whom the borrower remitted payments. When the junior lienholder foreclosed, it did name Pulaski as a party defendant, but did not name its agent, MERS. Either Pulaski was the owner of the loan or a designated agent of the owner. Because of these facts, one might distinguish the situation in which it would be necessary to name MERS as a party because that is the only way to notify MERS' principal – a securitized trust or other transferee of the loan. But the court plays rather fast with the facts here, and appears to ignore the fact that Pulaski had the power to transfer the note to others. MERS was there specifically to address that possibililty.

The court relies on the land records as showing Pulaski was the owner of the loan when in fact it had right there in front of it a mortgage stating that MERS was acting as "nominee for Lender [Pulaski] and Lender's successors and assigns."

Comment 2: In the editor's view, MERS counsel did not help the situation by arguing that MERS was the holder of title to the property through the deed of trust. As the court properly analyzed, the title to the property for deed of trust purposes was held by the trustee. But then, amazingly, the court simply ignores the fact that the trustee *wasn't served either.* Maybe one has to be an Arkansas lawyer to understand all of this.

Comment 3: Notwithstanding Comment 1, the editor feels that the case is wrong, and possibly should be attacked as a violation of Due Process in the federal courts. Even if the court obtained personal jurisdiction over Pulaski, it lacked jurisdiction to terminate a senior interest in the property in a junior foreclosure. Typically, when a senior is named, the sole purpose is to ascertain or verify the amount of the senior lien, so that the foreclosure sale purchasers are aware of that claim. Unless the pleadings provided to Pulaski made crystal clear that Southwest was challenging Pulaski's priority, this decision is wrong and Pulaski (or its principles) did not receive a fair shake.

Further, it does not appear that the *Mullane* standard was used to notify the holders of the note when MERS was right there in the record as a means to accomplish such notice.

Note: The editor's affiliated law firm represents MERS in some recent actions, but in fact the editor has no knowledge of and has not participated in discussions of this case. So the editor's views should be seen as those of the editor alone.

MORTGAGES; FORECLOSURE; JUDICIAL FORECLOSURE; NOTICE: Foreclosure action was an *in rem* rather than a *quasi in rem* proceeding; therefore trial court had jurisdiction despite mortgagor's death. ***ABN AMRO Mortg. Group, Inc. v. McGahan, 906 N.E.2d 21 (Ill.App. 1 Dist. 2009).***

ABN provided a loan to Nona McGahan, who executed a note, secured by a mortgage on her property, promising to repay the principal of the loan, with interest. One year later, McGahan defaulted on the mortgage by failing to make payments as required under the note. ABN filed a complaint for foreclosure, however, McGahan, who was the only named defendant, died prior to the filing.

On its own motion, the trial court dismissed the complaint for lack of subject matter jurisdiction because of the death of McGahan. The trial court found that the foreclosure action was a *quasi in rem* proceeding, which required a representative for the defendant to proceed.

ABN appealed, claiming that the foreclosure complaint was an *in rem* action, the mortgagor was not a necessary party to the action such that a personal representative was required to be appointed on behalf of McGahan, and therefore the dismissal for lack of subject matter jurisdiction was improper.

The Appellate Court of Illinois, First District, Fifth Division reversed, and sided with the mortgagee, holding that a foreclosure is an *in rem* proceeding. While a *quasi in rem* proceeding determines the rights to a parcel of property against a particular person, an *in rem* proceeding determines the rights to a parcel of property against the whole world. A foreclosure proceeding falls in the latter category because a foreclosing bank seeks to declare its rights not only against the mortgagor, but also against any other entities or individuals with security interests in the property. Although Illinois law requires a personal representative to be appointed on behalf of a deceased individual in a *quasi in rem* proceeding to maintain subject matter jurisdiction, that is not the case for *in rem* proceedings. Thus, the trial court improperly dismissed the complaint for lack of subject matter jurisdiction.

Comment: Presumably the foreclosure could not result in a personal liability claim against anyone for a deficiency. Still, the editor, who snoozed through a good deal of the civil procedure class, finds it disturbing that there should be a loss of property by public action when no notice is provided to the successor owner, who should not be hard to find. Note that the action had not yet been filed, so presumably no service of process had been made even to the deceased owner. There is an Illinois statute that says that if the action had already been filed, the personal representative would have to be joined. The editor suspects that the Supreme court might use this case as an oppotrunity to clear up some bad old precedent.

MORTGAGES; PRIORITY; PURCHASE MONEY MORTGAGES: A state statute extending a judgment lien to after-acquired real estate does not apply to property that was acquired after the rendering of the judgment when a purchase money mortgage or deed of trust is granted in order to fund the purchase of such property. ***Sutton Funding, LLC v. Mueller, 278 S.W.3d 702 (Mo. Ct. App. 2009).***

Taylor-Mueller Homes, LLC (“Taylor-Mueller”) acquired fee simple title to Lot 93 of Dardenne Landing in St. Charles County, Missouri in January 2002. In February 2002, it encumbered the property with a deed of trust in favor of Allegiant Bank. In April 2004, the successor trustee foreclosed on the deed of trust, and Kratky Road, Inc. (“Kratky”) successfully bid on the property at the foreclosure sale.

On June 10, 2004, the circuit court rendered a $865,500.00 judgment in favor of SJSM, LC against Taylor-Mueller; Forrest Mueller, individually; and others.

On August 18, 2004, Kratky conveyed the property to KTC, Inc. by special warranty deed, which KTC encumbered with a deed of trust in favor of Bank Star. Both the deed and deed of trust were recorded on December 10, 2004.

KTC conveyed the property to Mueller by a general warranty deed on May 31, 2005. Mueller obtained financing from ResMae Mortgage Company, granting a deed of trust in the amount of $216,750. The ResMae deed of trust was subsequently assigned to Sutton Funding, LLC. Both Mueller’s deed and the Sutton deed of trust were recorded on June 6, 2005. The Bank Star deed of trust was paid off with loan proceeds secured by the Sutton deed of trust.

Mueller also gave a second deed of trust for the property to Mid-Am Bank (“Mid-Am”). On June 23, 2005, Mueller conveyed the property to Chesterfield West, LLC by a quit claim deed signed by all parties to the deed and recorded the same date.

In June 2006, SJSM assigned the 2004 judgment to Mid-Am, and Mid-Am initiated proceedings to enforce the judgment lien. On August 9, 2006, the Sheriff of St. Charles County recorded a Notice of Levy on Real Estate on the property, and on November 2, 2006, the circuit court approved a Sheriff's Deed that conveyed the property to Mid-Am. In March 2008, the Sutton deed of trust (which was held by ResMae) was assigned to DLJ Mortgage Capital, Inc., and DLJ assigned the Sutton deed of trust to Sutton on April 4, 2008. Sutton filed a petition to quiet title, alleging that Mid-Am held fee simple title subject to the Sutton deed of trust's first priority interest. The trial court determined that Mid-Am held fee simple title, subject only to the lien of the Missouri Division of Employment Security ("MDES") for a judgment against Mueller, and Sutton appealed.

While the facts are complicated by the number of assignments made subsequent to the initial deed of trust, the primary issue on appeal concerned the priority between the Mid-Am lien (as assignee of the SJSM judgment against Mueller), and the lien secured by the Sutton deed of trust. Sutton argued that because the Sutton deed of trust was a purchase money deed of trust, the lien created thereby should take priority over a lien based on a pre-existing judgment against Mueller. Mid-Am contended it was entitled to priority over the Sutton deed of trust based on the Missouri statute providing that "[t]he lien of a judgment or decree shall extend . . . to the real estate acquired after the rendering thereof, as to that which was owned when the judgment or decree was rendered. Such liens shall commence on the day of the rendition of the judgment . . ."

The Missouri Court of Appeals began by stating that "[A] mortgage or deed of trust given to secure the purchase price of land, and executed simultaneously with the deed to the purchaser, takes precedence and priority over liens created by the grantee prior to his acquisition of title." Because the Sutton deed of trust was used to secure money loaned by ResMae to Mueller, who used it to purchase the property and pay off the Bank Star deed of trust, the Sutton deed of trust was a purchase money mortgage. The court then noted that notwithstanding Mid-Am's interpretation of the Missouri statute, the assignments did not alter the priority of the Sutton deed of trust, and that the assignments vested the rights and interests of the assignors in the assignees. Specifically, it held that the statute "does not give a prior judgment lien priority over a purchase money mortgage given to a third party lender. It does not address the issue of a conflict of priorities between a judgment lien holder and a subsequent purchase money mortgage given to a lender, whether it be the vendor or a third party lender. Rather, it merely states that a judgment lien applies to after-acquired real estate, which prevents a judgment debtor from circumventing justice by using assets to buy real property after a judgment."

Accordingly, the court held that the existence of a statute extending a judgment lien to after-acquired real estate does not apply to property which was acquired after the rendering of the judgment when a purchase money mortgage or deed of trust is granted in order to fund the purchase of such property, and that any pre-existing lien against the property will be subject to the liens of such mortgage or deed of trust.

Comment: The rule about purchase money priority is pretty clear. It gives purchase money lenders priority over preexisting judgment liens on the notion that the portion of the purchase price secured by the lien was never really "property" of the debtor and was not available to the judgment lienholder prior to the transfer.

MORTGAGES; SUBROGATION; FRAUD: Junior security deed holder entitled to equitable subrogation to the rights of prior security deed holder where it advanced funds to pay off prior encumbrances with the express understanding that it would be secured by a senior lien on the property, even when there is no actionable fraud by the party against whom subrogation operated. ***Byers v. McGuire Properties, Inc., 2009 Ga. Lexis 243 (Ga. 2009)***.

Manager of homebuilder assisted homebuilder in obtaining construction loan from bank ("Construction Lender") for development of subdivision secured by a security deed on the propeerty. Manager of homebuilder later took note for payment of management fees secured by security deed on same property.

Lot purchaser then entered into contract with homebuilder to purchase lot and financed purchase with loan from second bank ("Purchaser Money Lender") who put security deed on property. At the time of closing on lot purchase, neither the closing law firm nor independent title examiner discovered the security deed of the manager, and neither the purchasers nor the Purchaser Money Lender had any knowledge of its existence. After homebuilder filed for bankruptcy, manager tried to foreclose on the lot pursuant to its security deed. The purchasers and the Purchase Money Lender sued the manager and others for cancellation of the manager's security deed based on alleged fraud, a decree to quiet title, and equitable subrogation. On cross-motions for summary judgment, the trial court entered an order granting summary judgment to the manager regarding the complaint and in favor of the manager on its quiet title counterclaim. The purchasers appealed that decision to the Court of Appeals which transferred to the Georgia Supreme Court.

The purchasers and the Purchaser Money Lender argued that the manager intentionally waited until shortly before the lot sale closing to file its security deed, knowing the delay in indexing would make it impossible for the security deed to be discovered in a title examination, which "silence" was fraudulent. The Court, however, noted that, under Georgia law, one is not bound on all occasions to give warnings to incautious people. No duty to speak arises from the mere fact that a man is aware that another may take a prejudicial action against him if the real facts are not disclosed. Furthermore, to sustain a claim for fraud, the plaintiff must show he relied on the words or conduct of the defendant to his detriment. The Court found no evidence of fraud or constructive fraud on the part of the manager that would have required denial of its motion for summary judgment.

The Purchaser Money Lender also argued that it should be equitably subordinated to the position of the Construction Lender and have priority over the manager's security deed. At the closing on the lot, the homebuilder and the Purchase Money Lender had an understanding that the funds advanced were to be secured by a senior encumbrance on the property.

The fact that the advance didn't fully satisfy the construction loan secured by a first security deed didn't violate the rule that when less than the total amount of the debt is tendered, subrogation isn't permitted. The rationale behind that rule is that equitable subrogation shouldn't prejudice the senior lienholder's attempt to collect the entire indebtedness secured by the senior lien. In this case, the Construction Lender's rights weren't prejudiced by the Purchase Money Lender's subrogation because the Construction Lender agreed to release its entire lien on the lot in exchange for partial payment of the debt. As a junior lienholder, the manager had no standing to complain that the Purchase Money Lender hadn't paid the entire indebtedness. Furthermore, the Court found that since the manager was a junior lienholder anyway (second to the Construction Lender), the Purchase Money Lender's right of subrogation wouldn't prejudice the manager's rights because its security deed would remain in second priority position. Based on that analysis, the Supreme Court reversed the trial court's award of summary judgment in favor of the manager and ruled that the Purchase Money Lender was entitled to summary judgment on its claim for equitable subrogation.

Comment 1: This is an interesting case not only because subrogation was permitted for less than the senior debt. Although the purchase money lender was innocent, so was, apparently, the construction manager. The Restatement and some courts have ruled that there is no need to "balance the equities." The only "equity" necessary is that the party seeking subrogation paid off a senior debt and the party fighting subrogation cannot prove reliance on an record apparently clean of the senior debt. The Georgia court didn't have to reach that question here. The purchase money lender had an "equity."

Comment 2: Compare: Casstevens v. Smith, 2008 WESTLAW 4660152 (Tex. App. 10/23/08) The DIRT DD for 11/11/08) Victim of fraud who advances money to pay senior mortgage may not acquire subrogation as against subsequent purchaser of property at foreclosure of junior mortgage. [Here – the foreclosure purchaser could argue reliance.] Also compare: *Lawson v. Brian Homes, Inc.*, 6 So..3d 7, (Ala, Jul. 18, 2008) (purchase money mortgagee cannot be subrogated to construction lender so as to obtain priority over mechanic's liens attaching as of commencement of construction, even though construction lien did have priority, having been recorded prior to construction.

NOTARIES; PRESUMPTION OF EXECUTION: Mortgagee failed to rebut presumption that her notarized signature on mortgages was actually hers. ***Bonilla v. Commercial Services of Perry, Inc., 900 N.E.2d 22 (Ind.App. 2009),*** discussed under the heading: "Mortgages; Execution; Notarization."

OPTIONS TO PURCHASE; RIGHTS OF REFUSAL; SUBORDINATION: Lessee's right of first refusal survived lessee's subordination of his option to purchase property to company. ***Four Howards, Ltd. v. J&F Wenz Rd. Invest., LLC, 902 N.E.2d 63 (Ohio App. 6 Dist.***

2009), discussed under the heading: "Landlord/Tenant; Options to Purchase; Subordination."

RAILROADS; GRANTOR'S RETAINED RIGHTS: Landowners do not, as a matter of law, have an implied quasi-easement over land granted for railroad purposes when the intent of the original grantor who conveyed the strip is in dispute. ***Connolly v. Maine Central Railroad Co., 969 A.2d 919 (Me. 2009)***, described under the heading: "Easements; Creation; Implied Easement; Intent."

RECORDING ACTS; DUTY OF INQUIRY; CORRECTIVE DEEDS: Knowledge of a corrective deed may impose a duty of inquiry on a property buyer to investigate whether any title defects have arisen between the date of an otherwise valid deed and the date the corrective deed was recorded, and failure to do so may upset a buyer's claim that it was a *bona fide* purchaser who had taken good title to a property despite an intervening fraudulent transfer. ***Hahn v. Love, 273 S.W.3d 712 (Tex. App. 1st Dist. 2008)***.

There are five actors in this case – a property owner with a judgment against it (the Judgment Debtor); the company that was owed the money (the Judgment Creditor); a couple of people purportedly having a familial relationship to the owners of the Judgment Debtor (the Intermediate Owners); a broker; and a buyer of the property (the Ultimate Buyer).

In 1988, a judgment in favor of the Judgment Creditor was entered against the Judgment Debtor. On April 16, 1992, the Judgment Creditor filed an abstract of judgment against the property. It expired ten years later on the same day. In 2001 or 2002, the property was conveyed to the Intermediate Owners. That deed was recorded in 2002. Despite already having sold the property to the Intermediate Owner, the Judgment Debtor, more than a year later, contracted to sell the property to an unrelated third party. When the title company saw the expired abstract of judgment, it required that the judgment be satisfied. As a result, that deal fell through.

About a week later, the Judgment Creditor filed a motion to revive the judgment and sent notice to the Judgment Debtor. The same broker who had "represented" the buyer in the first contract now represented "represented" the Judgment Debtor as seller. Less than a month later, the Judgment Debtor and the buyer who had cancelled the earlier contract signed another one. Two weeks after that, on January 21, the 2002 deed from the Judgment Debtor to the Intermediate Owner was recorded. It lacked a metes and bounds description. About a week later, on January 23, 2004, just two days after the 2002 deed to the Intermediate Owner was actually recorded, the Judgment Creditor got its order reviving the Judgment. At the hearing, the Judgment Debtor's attorney unsuccessfully asked for more time to respond and never disclosed that the deed to the Intermediate Owner had been filed in the interim. On March 1, the second (now revived) abstract of judgment was recorded and two days later a corrective deed, now incorporating a metes and bounds description, was recorded.

The same broker who has been involved in the two earlier attempts to sell the property to the same buyer was then contacted by, or himself contacted, another interested purchaser. He told this interested purchaser that the contract buyer was unable to close. A closing between the Intermediate Owner and the interested purchaser then took place, however, and this purchaser became the Ultimate Buyer. A deed from the Intermediate Owner to the Ultimate Buyer was promptly recorded on April 16, 2004.

What followed was an attempted execution sale, a request for a temporary and then a permanent restraining order, and the Ultimate Buyer's intervention in the suit. Allegations of a fraudulent conveyance were raised. The validity of the originally recorded deed lacking a metes and bound description was challenged. And , most significantly for this case, the Judgment Creditor charged that property was subject to a constructive trust because the Ultimate Buyer was not a bona fide purchaser for value, in good faith. The Ultimate Buyer contended that the 2002 deed from the Judgment Debtor to the Intermediate Owner was recorded at a time when no active abstract of judgment was in force, and that the property was therefore not encumbered by the judgment lien. It successfully obtained summary judgment in its favor.

In the appeal that followed, the Texas Court of Appeals reversed and sent the matter back for further findings. In doing so, it looked at the Fraudulent Transfer Act. That Act accepts, as evidence of an actual intent to defraud, that a transfer has been made to a related party while there was a threat of suit or a creditor's claim if, at the time, the transfer had been made for less than reasonably equivalent value. Those questions were never seriously treated by the lower court. There is a limitation in the Act to protect *bona fide* purchasers. It protect those who take in good faith and for reasonably equivalent value. A putative *bona fide* purchaser has the burden of proof on those issues. Critical here is that, "[a] transferee who takes property with knowledge of such facts as would excite the suspicions of a person of ordinary prudence and put him on inquiry of the fraudulent nature of an alleged transfer does not take the property in good faith and is not a bona fide purchaser." That is a question of fact, and generally cannot be resolved on summary judgment.

The Judgment Creditor challenged the legal sufficiency of the 2002 deed to the Intermediate Owner which, if fully valid, would have placed the subsequent recorded (revived) abstract of judgment out of the chain of title. The Ultimate Buyer claimed that the original deed, though lacking a metes and bounds description, was still valid and that it had paid reasonably equivalent value (and that seems to be the case). The Ultimate Buyer, by affidavit, claimed no knowledge of the judgment's history, claiming he had first heard of the property in a telephone call from the broker, with whom he had done many prior deals.

The Judgment Creditor countered as follows: The corrective deed to the Intermediate Owner was filed two days AFTER the revived judgment was recorded. The first (failed) contract with the earlier buyer failed because the title company for that transaction raised the judgment as an objection and the broker knew about the judgment (even though the judgment had become dormant). A motion to revive the judgment had been filed. The same broker negotiated the second contract with the earlier (failed) buyer. And, the same broker, who enjoyed a long time relationship with the Ultimate Buyer, served as the broker for the Ultimate Buyer.

After sorting through this set of circumstances, the Appellate Court drilled down to the broker's relationship to the transaction. To the Court, the relationship of the broker to the Ultimate Buyer raised fact questions as to whether the Ultimate Buyer had either actual or constructive knowledge that the Intermediate Owner (as seller) had clear title to the property free of the judgment lien. "A broker is a fiduciary required to exercise fidelity in good faith toward his principal in all matters within the scope of his employment... ." In Texas, and in many other jurisdictions, this "imposes upon [the broker] the positive duty of communicating all information he may possess or acquire which is, or may be, material to his employer's advantage." That was enough to topple the lower court's summary judgment granted in favor of the Ultimate Buyer.

Another problem for the Ultimate Buyer was that the original deed to the Intermediate Owner lacked a proper metes and bounds description. The Court never revealed if it had any property description at all, but clearly found that the first deed was a "conveyance that several title searches indicated was of questionable validity." It would appear that even if the first deed had a sufficient property description, the existence of the corrected deed, filed two days AFTER the revived judgment was recorded, should have triggered an inquiry by the Ultimate Buyer as to what happened between the filing of the first deed and the filing of the corrected deed. According to the Court, "reference to another document puts the purchaser upon inquiry, and he is bound to follow up on this inquiry, step by step, from one discovery to another and from one instrument to another, until the whole series of title deeds is exhausted and a complete knowledge of all the matters referred to and affecting the estate is obtained."

The result: back to square one – the lower court now has to figure out whether the Ultimate Buyer was, in fact, a bona fide purchaser.

Comment 1: Excuse us if we overlooked Texas procedural law regarding such things about the expiration dates for recorded judgments. And, by way of curious note, this case has 29 headnotes and 13 footnotes. After chucking those out, the opinion isn't as long as it looks.

Comment 2: Oh, how much easier life would have been for this judgment creditor and its pocketbook had it revived the judgment before it expired. How many attorneys keep track of the expiration date of expiring judgments (or financing statements)? How many expressly disclaim responsibility to do so? And, what would be the remaining issues if the original deed had included a metes and bounds description and re-recording it as a corrective deed had not been called for?

Comment 3: What are the limits of the duty of inquiry? Presumably, the Ultimate Buyer's title search showed the corrective deed. Assuming that the originally recorded deed was valid notice of the change in ownership, why should the Ultimate Buyer have been required to see if the grantor under that deed had any subsequent judgments? What if an internet search had turned up an article about the Judgment Debtor having lost a law suit ten years earlier? Should the Ultimate Buyer have done more investigation to find out whether a judgment lien was ever filed against the debtor or the property? Wasn't the notice-filing scheme supposed to protect parties who look at the record if they are without actual knowledge of the status of a property's title? Assuming it just never occurred to the Ultimate Buyer that there was something going on here, shouldn't it have been able to rely on the record?

Comment 4: If a buyer knows that its seller obtained title from a party related to its seller, does the buyer need to inquire as to whether that transaction was a fraudulent transfer? After all, the Court is saying that investigation ends when the buyer has "complete knowledge of all the matters referred to and affecting the estate is obtained." The Reporter hopes not. The facts here sure put out a giant smell, and summary judgment certainly seems inappropriate. But, to this editor, the Appellate Court is setting a trap much larger than what would seem to be required to catch this varmint.

Comment 5: A request for a rehearing has been overruled (Dec 12, 2008), and a petition for review has been filed (Jan 26, 2009).

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

OPTIONS; RIGHT OF REFUSAL; SUBORDINATION: Lessee's right of first refusal survived lessee's subordination of his option to purchase property. ***Four Howards, Ltd. v. J&F Wenz Rd. Invest., LLC, 902 N.E.2d 63 (Ohio App. 6 Dist. 2009***, discussed under the heading: "Landlord/Tenant; Options to Purchase; Subordination."

TITLE INSURANCE; INSURER'S DUTY TO DEFEND: Massachusetts federal court rules that title insurer may not avoid the duty to defend by tendering to insured the value of the portion of insured's property that has been put into dispute, where this amount falls short of the total amount of the policy. ***First American Title Insurance Co. v. Grafton Partners, LLC., 2009 Westlaw 79263 (3/20/09).***

Grafton had a title policy insuring his property for a total amount of $16,000,000. A dispute arose with a neighbor concerning the neighbor's alleged adverse possession of a portion of Grafton's land, and Grafton tendered defense of the suit to the Insurer. At first, the insurer agreed to the defense.

Two years later, with the lawsuits still stewing (one for trespass and a counterclaim for adverse possession) Insurer obtained an appraisal of the property in dispute and the appraisal revealed a value of $26,300. Insurer tendered this amount to Grafton, alleging that this satisfied its obligation to defend. Grafton returned the check, indicated that the loss in value to the total property he owned if the adverse possession succeeded would exceed $5,000,000, and took the position that the Insurer could avoid the duty to defend only by tendering the total amount of the policy.

Grafton engaged in a number of other lawsuits relating to these matters, but none involved an insurable claim.

The critical language concerning whether tender of the value of the disputed property satisfied the Insurer's duty was contained in Section 6 of the policy:

"In case of a claim under this policy, the Company shall have the following additional options:

(a) To Pay or Tender Payment of the Amount of Insurance.

To pay or tender payment of the amount of insurance under this policy together with any costs, attorneys' fees and expenses incurred by the insured claimant, which were authorized by the Company, up to the time of payment or tender of payment and which the Company is obligated to pay.

Upon the exercise by the Company of this option, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

The court tipped its hand when it discussed the dispute:

"The disagreement presented by this motion is over the meaning of "the amount of insurance under this policy" in Section 6(a). [Insurer] assumes, *without meaningful discussion*, that “the amount of insurance” is equivalent to the amount of “loss” that Grafton would suffer from the adverse claim-which the [Insurer] then asserts is determined by the appraised value it obtained for the disputed portion of the Property. Grafton’s position is that “the amount of insurance” signifies the “policy limits”-the insurer’s “total liability under the policy prior to the resolution of the underlying claim.”” (Emphasis added)

The court concluded that the language of the policy was unambiguous and permitted Insurer to avoid its defense obligation only by tendering the total face amount of the policy.

Comment: In fact, the Editor had always read the language in question consistently with the view of the court, and believes that title officers for the Insurer who had lectured his class had taken that position. So the position taken by this major title insurer in this case is newsworthy, even though it got creamed by the federal judge. Title insurance expert Joyce Palomar transferred this case to the editor and affirms that it correctly states the law in her view as well.

REDEVELOPMENT; DEVELOPER MISREPRESENTATION; RIGHTS OF NEIGHBORING HOMEOWNERS: Homeowners did not rely to their detriment on Developer’s alleged misrepresentation of financial facts and identity of anchor tenant in Developer’s successful application to redevelop nearby property as a shopping center. ***Stein v. Novus Equities Co., 2009 WL 214342 (Missouri Ct. App. 2009).***

Stein owned a home in an area of Sunset Hills, Missouri (as suburb of St. Louis) known locally as “the Manor.” Officials of Sunset Hills decided that the Manor could do with a bit of redevelopment, and approved Novus as the exclusive developer of the project. Novus proposed to develop a shopping center, and identified Bass Pro Shops as its anchor tenant. Novus also submitted financial information demonstrating the viability of their proposal. As part of Novus’ plan, Novus agreed to pay 15 million dollars to Bass Pro for construction costs. A consulting firm hired by the City evaluated the developer’s proposal and submitted its analysis to the City for approval.

The plan hinged on the successful condemnation of homes and a number of small businesses in the Manor. In July of 2005, the City delegated the right to condemn property in the Manor to Novus. Novus made clear its intention to use this power at a meeting held on August 8, 2005. Presumably, this was a meeting open to the owners of homes in the Manor, because, according to the opinion, immediately after the meeting “many of the other property owners began stripping and salvaging materials from their homes.” What this meant, basically, is that the homeowners resisting the condemnations and the redevelopment were now surrounded by a bunch of gutted homes.

Not long afterwards, at a second meeting, Novus announced that it would *not* be exercising its options to purchase homes and develop the property because it had lost its financing. The opinion also disclosed that Novus in fact agreed to pay Bass Pro 30 million dollars for construction of the facility as opposed to 15 million dollars. Further, in February of 2005, Novus lost Bass Pro as an anchor tenant, and instead solicited May department stores to act as tenant in the anchor space. The problem is that May’s lease would cover less space. In short, the financial projections of the original decision of the City were based on facts that changed considerably. In the end, Novus was unable to develop the property.

Legal mayhem ensued.

Among other things, the plaintiffs, (homeowners who did not agree to option their properties) brought suit alleging loss of property value as a result of the now ragged nature of the neighborhood. The plaintiffs alleged that the developer committed fraudulent misrepresentation, negligent misrepresentation, injurious falsehoods and negligence. The trial court granted the developer’s petition to toss out all counts for failure to state a claim for which relief could be granted and the Missouri Court of Appeals here affirmed.

The case presented the court an opportunity to review basic law of fraud and negligent misrepresentation. According to the court, to prove negligent misrepresentation, the plaintiffs must show the following:

“(1) the speaker supplied information in the course of his business; (2) because of the speaker’s failure to exercise reasonable care, the information was false; (3) the information was intentionally provided by the speaker for the guidance of limited persons in a particular business transaction; (4) the hearer justifiably relied on the information; and (5) due to the hearer's reliance on the information, the hearer suffered a pecuniary loss." Novus, 2009 WL at 3.

It is clear that the homeowners in this case suffered a loss, possibly a really costly loss. It is not clear from the facts, but it is entirely possible that the neighborhood will never look the same again. Many of the homes were deliberately gutted as the owners departed, making resale difficult. The shopping center was not built. Property values likely dropped. But to prove negligent (or fraudulent) misrepresentation, the homeowners who did not sign options were required to show that they relied to their detriment on statements of the developer. In this case, according to the court, the homeowners who did not option their properties did not engage in any different course of conduct because of statements made by Novus. In fact, these homeowners resisted sale of their properties notwithstanding statements of Novus.

The individuals in a position to plausibly say they relied on statements of the developer are the homeowners who optioned their homes, and then gutted them believing that they were going to actually close the sales. Some of these people actually purchased replacement homes. However, these property owners are not plaintiffs in this suit. (And in any event, the reader might doubt whether this reliance is reasonable. Who buys a new home before the owner of the option exercises that right?)

The claim of injurious falsehood essentially is a tort relating to false published statements – in this case, the pro forma statements. Under this tort theory, "one who publishes a false statement harmful to the interests of another is subject to liability for pecuniary loss resulting to the other if (a) he intends for publication of the statement to result in harm to interests of the other having a pecuniary value. . . or should know that it is likely to do so, and (b) he knows that the statement is false or acts in reckless disregard of its truth or falsity." Novus Equities, 2009 WL 214342 at 5. According to the court, this tort addresses a false statement made about the plaintiff. In this case, the false statement concerned the feasibility of developer's plan for redevelopment.

As to the basic negligence claim, the court says simply that Novus did not owe any duty to the plaintiff homeowners. According to homeowners, the developer had a duty to provide truthful information to them because "defendants had superior knowledge not within the fair and reasonable reach of Plaintiffs." Id. at 6. The court rejects this contention. The court states that superior knowledge creates a duty in the context of fraudulent misrepresentation and not pure negligence. As to the former, the court had already dismissed the action because of the failure of the homeowners to rely on the statements of the developer.

The case does not address *Kelo* or the issue of whether there was a sufficient public purpose to support the redevelopment of the Manor. But see comment 1 below; the *Kelo* decision may well have played a role in the decision making of the parties.

Reporter's Comment 1: *Kelo* was handed down on June 23, 2005, and the facts that form the backdrop of *Novus* occurred very soon afterward. To the extent that homeowners in the subdivision may have thought that a taking for redevelopment would be forbidden by the U.S. Constitution, the timing must have seemed horrible. Many of the homeowners agreed to sell, perhaps because the purchase price was simply too good to pass up. But it is reasonable to suppose that there may have been others who were persuaded to take the deal because the law now seemed to turn against them. The case opinion does not give enough detail to determine when all of the option contracts were finalized. Similarly, the handing down of *Kelo* placed the City and the developer in a stronger position and perhaps enabled the developer to insist on a lower sales price. Again, the opinion does not present enough information for this reporter to draw a conclusion, and he has no first hand knowledge of the dispute. Presumably, this was a matter of significant public debate and media attention in St. Louis. Perhaps a reader can fill in some details.

Reporter's Comment 2: In many ways, this is just a case of a developer losing its financing. Anyone agreeing to sell property to a developer via an option must understand the possibility that the developer may not go through with the deal. The inability of developer to obtain a loan is an inherent possibility of all such deals. What distinguishes this case is the hammer of eminent domain. The developer could "encourage" the voluntary acceptance of a sale of units because it had the power to condemn property. Thus, attention shifted to the parties who did not sign options but who were ruined by the developer's inability to make good on its development plans. The court was right that the homeowners who did not option their property did not rely (change their position) on basis of the developer's statements. But the City approved and homeowners sold to some degree because of the false information about the anchor tenant and the financial statement generated by the developer. This chain of events hurt the plaintiffs. To be blunt, this is a wrong in search of a cause of action. As law students sometimes learn, not all wrong behavior is actionable.

Editor's Comment: There is no question that an offer to purchase backed up by a power to condemn is an iron fist in a velvet glove. In obtaining condemnation power, the developers enormously increased the credibility of their project and the ability to negotiate for property acquisition in the area. This led directly (but predictably?) to the situation that now bedevils the plaintiffs.

Of course, the City is the party with the power to sanction the developer for its misrepresentation, and if it was misled by the developer, creating a situation in which City property values significantly declined, shouldn't it have a legal claim as well as a political one?

The Reporter for this case was Professor Daniel Bogart of the Chapman Law School.

RELIGIOUS PROPERTY; SCHISM: Episcopal Church Canons established trust in favor of diocese for real property of Church removed from diocese. ***Episcopal Diocese of Rochester v. Harnish, 899 N.E. 2d 920 (N.Y. 2009).***

All Saints was originally organized in 1927, as a mission under the ecclesiastical canons of the National Church and the Episcopal Diocese of Western New York. Later that year, All Saints incorporated under Article 3 of the Religious Corporations Law. In 1947, All Saints applied to the Rochester Diocese to be recognized as a parish in spiritual union with the Diocese. All Saints signed a document agreeing "to abide by and conform to the constitution and Canons in force in the Episcopal Diocese of Rochester and to conform to all the canonical and legal enactments thereof." The Bishop of the Diocese approved this union, and All Saints became a parish. In November 2005, due to theological disputes between the Rochester Diocese and the leadership of All Saints, the governing body of the Rochester Diocese approved a resolution declaring the parish ecclesiastically "extinct." It was further resolved that All Saints' real property and tangible and intangible assets were to be transferred to the trustees of the Rochester Diocese.

All Saints argued that it held legal title to the real and personal property and neither the Rochester Diocese nor the National Church had claim to the property, as it held the property free and clear under New York property law. Plaintiffs commenced the a declaratory judgment action seeking, pertinent in part: (a) a judgment that the real and personal property of All Saints was impressed with a trust in favor of the Rochester Diocese and National Church; (b) an injunction barring All Saints from interfering with the Rochester Diocese's ownership and use of the property; and (c) an accounting. Defendants counterclaimed, seeking: (a) quiet title to the property; (b) to declare certain provisions of the Religious Corporations Law null and void under the Establishment Clause of First Amendment of the United States Constitution; and (c) to enjoin the Rochester Diocese from trespassing and interfering in All Saints.

The Supreme Court granted summary judgment to Plaintiffs, finding that All Saints held all the real and personal property of the local parish for the benefit of the Rochester Diocese and National Church, dismissing Defendants' counterclaims.

The Appellate Division affirmed "for reasons stated in the decision at Supreme Court" and also affirmed Supreme Court's dismissal of the Article 78 petition, since the Rochester Diocese's decision to dissolve the parish was a purely ecclesiastical determination and not reviewable by the Court. Plaintiffs argue that there has been both an express and implied trust in favor of the Rochester Diocese and the National Church since All Saints' incorporation pursuant to Article 3 of the Religious Corporations Law. Plaintiffs contend that All Saints expressly agreed to abide by the constitution and canons of the Rochester Diocese and therefore, is subject to the trust doctrine of National Canons I.7.4 and I.7.5 (the Dennis Canons). Under these Canons, a parish holds its property in trust for the Diocese and the National Church. Plaintiffs further contend that Rochester Canon 8 reaffirms this doctrine, and that the Religious Corporations Law further supports their contention that a religious corporation, incorporated pursuant to Article 3 of the Religious Corporations Law, holds its property in trust for the Diocese and the National Church. Plaintiffs argue that All Saints has remained an Episcopal parish for more than 20 years after adoption of the Dennis Canons without challenging their substance or applicability.

Defendants argued that a factual question existed as to whether an express or constructive trust was created or existed in favor of the Rochester Diocese and/or the National Church when they were expelled from the Rochester Diocese. Defendants specifically argue that they cannot be bound by the Dennis Canons because they were adopted in 1979, nearly 30 years after All Saints was accepted as a parish. Further, Defendants question whether the Dennis Canons or Rochester Canon 8 create an express trust, effectively divesting All Saints of its property, without violating the due process provisions of the United States and New York State Constitutions. Defendants further argue that there is nothing in any deed or will or in the All Saints certificate of incorporation that establishes a trust over the All Saints property for the benefit of the Rochester Diocese or the National Church. The Appeals Court found that the enactment of the Dennis Canons was an apparent attempt by the Episcopal Church to "do exactly what this language suggests – to 'ensure ... that the faction loyal to the hierarchical church [would] retain the church property.'"

"Application of the neutral principles doctrine requires the court to focus "on the language of the deeds, the terms of the local church charter, the State statutes governing the holding of church property, and the provisions in the constitution of the general church concerning the ownership and control of church property. The court must determine from them whether there is any basis for a trust or similar restriction in favor of the general church, taking special care to scrutinize the documents in purely secular terms and not to rely on religious precepts in determining whether they indicate that the parties have intended to create a trust or restriction."

The Court of Appeals held that in applying the neutral principles of law approach to this case, there was nothing "in the deeds that establishes an express trust in favor of the Rochester Diocese or National Church." Further, all Saints' certificate of incorporation "does not indicate that the church property is to be held in trust for the benefit of either the Rochester Diocese or the National Church." Nor does any "provision of the Religious Corporations Law conclusively establish a trust in favor of the Rochester Diocese or National Church." However, the Court further held that upon requisite review of "the constitution of the general church concerning the ownership and control of church property," the Dennis Canons clearly establish an express trust in favor of the Rochester Diocese and the National Church and All Saints agreed to abide by this express trust either upon incorporation in 1927 or upon recognition as a parish in spiritual union with the Rochester Diocese in 1947.

STATE AND LOCAL TAXATION; PROPERTY TAX SALE; PUBLIC NOTICE: Posting notice of a tax sale on the front door of a property, which is located fifty yards from a private roadway and is not visible from a public roadway complies with Pennsylvania notice requirements for tax sales. ***In re: Upset Sale Tax Claim Bureau, 965 A.2d 1244 (Pa. Commw. Ct. 2009).***

The original owner of the property at issue was delinquent in payment of taxes. As a result, the property was sold at a tax sale. The original owner filed objections to the sale and the purchaser was granted the right to intervene. In the trial court, the only disputed issue was whether the McKean County Tax Claim Bureau (the "Bureau") properly posted a Notice of Sale on the property in accordance with Pennsylvania law. Apparently mailed notice and publication notice were not in dispute.

The property, a hunting camp, fronted a private road but could not be seen from the nearest public road. Tax assessment employees posted the Notice of Sale on the property's wooden front door, which was located fifty yards from the private road. The Notice was printed on 8 ½ by 11-inch paper and measured 6 ½ by 7 inches.

The trial court set aside the tax sale. It stated that the Notice was "not conspicuous such that it will be seen by the public." Id. at 1246. In addition, the court determined that from the distance between the front door and the private road, one would not be able to read the Notice. The purchaser appealed.

The appellate court noted that the Pennsylvania notice statute is silent as to method of notice. The statute merely states that each property scheduled for sale shall be posted at least ten days prior to sale. However, the Pennsylvania courts have interpreted this statute to require a method of posting that must be reasonable and likely to inform the taxpayer, as well as the public at large, of an intended real property sale. In other words, the "posting must be . . . conspicuous, likely to ensure notice, and placed for all to observe." Id. at 1247.

The court then applied these notice requirements and, reversing the trial court, ultimately determined that the notice was sufficient. [!!!!]It rejected the contention that the Bureau was required to post the Notice so that it is visible from the public road. Emphasizing that the general public could still access the private road, the court stated that the Notice was still open to public observation. In addition, the court held that the Notice did not need to contain large enough print to be read from the private road, because "[a]ll that is required is that the notice be conspicuous, i.e. reasonably likely to inform the taxpayer and the public of the sale." Id. at 1247-1248.

Reporter's Comment: The appellate court seems to have made an independent factual determination that the Notice was sufficiently conspicuous. The better approach would have been to remand to the trial court with instructions that it should not view as dispositive that the Notice could not be read from the private road or that it could not be viewed at all from the public road. It is questionable whether the trial court even viewed these factors as dispositive when it first decided the case.

Editor's Comment: It obviously is impossible to provide notice to the general public through a paper posted on a building's front door, unless the door and the notice are the size of billboards. There were other methods of notice provided, and consequently the posting requirement necessarily must mean only that members of the public choosing to approach the building on the property (in virtually every case by trespassing) would be able to read the notice. Consequently, the editor agrees with the Reporter that the posted notice standard should be read quite broadly and not narrowly applied case by case.

The Reporter for this case was Mort Fisher of the Ballard Spahr Baltimore office.

VENDOR PURCHASER; CONDOMINIUMS; DISCLOSURE; CONSTRUCTION DEFECT LITIGATION: Seller must disclose prior construction defect litigation resulting from flooding of units in the condominium project, including the subject property. ***Calemine v. Samuelson, 171 Cal. App. 4th 153 (Ca. Ct. App. 2009).***

Filling out property disclosure statements mandated in many states presents home sellers with a dilemma: just how much information is a person supposed to divulge? Sellers know that revealing too much information, or information that is too precise and particular, will drive off buyers, or perhaps drive down the price for their property.

Samuelson and his spouse purchased a condominium unit in Woodland Hills (L.A. environs) in 1983. The unit is three stories. The bottom story contains the garage, plus a "bonus" room. The opinion states that the bonus room was windowless; often these rooms are used for storage, for kids' games, or perhaps as a spare bedroom. The bonus room was carpeted. Nearly twenty years later, in 2002, Samuelson sold the condominium unit to Calemine.

The years between Samuelson's purchase of the unit and his sale of the unit in 2002 were eventful. Samuelson personally observed intermittent intrusions of water into the lower level of his unit. He was not alone. Owners of other units in the condominium complex experienced similar problems. Eventually, in 1986, Samuelson's HOA and individual owners, including Samuelson, sued the developer, alleging construction defects. While the litigation was pending, the HOA was moved ahead to remediate the defects. The HOA hired a contractor ("Westar") to correct the many water problems in the condo complex. Westar made substantial modifications to Samuelson's unit. The opinion suggests that after completion of this work in 1992, "the bonus room did not suffer any further water intrusion problems."

However, Samuelson was personally aware that the repair work was not as successful throughout the condominium complex, and that the HOA had filed an *additional* lawsuit against Westar.

Samuelson could hardly have ducked knowledge of the water problems or the litigation. He served as president of the HOA from March 1993 to June 1994, and as treasurer from June 1994 to August 2001.

The water problems at the complex were significant and apparently justified a full bore legal effort. As part of their preparations for litigating against Westar, the HOA hired a consultant to review the cost of effecting permanent repairs. The ultimate report (as supplemented) brought the repair costs to nearly one million dollars. This estimate was provided in a report to the HOA in November 1997.

The HOA's suit settled in 1998, and after paying their attorneys, the HOA received $410,000. The HOA solicited bids from contractors to use the money to make permanent repairs to the condominium complex. The HOA took the lowest bid ($119,800). In fact, the bid was directed to the HOA in Samuelson's care, and he took primary responsibility for making sure that the repairs were made in the appropriate manner.

In its proposal, the winning contractor said that the $119,800 constituted only the first phase of its attempt "to mitigate the water intrusion problem." Indeed, when the contractor completed the "first phase," it informed Samuelson by letter that it was ready to begin phase two. According to the contractor's letter, the second phase "will apparently involve clean up, patching, painting and "band aid" covering up of existing subterranean garage and storage room walls." The contractor finished the second phase of repairs in 1998.

Thus, before selling the his condominium unit, Samuelson 1) saw the problem in his own unit 2) was aware of problems in other units, 3) knew fully about the construction defect litigation against both the original developer and the initial contractor hired to fix the problems, 4) was intimately involved in the running of the HOA and 5) served as "point man" in the final efforts to correct the problems.

You can guess what happened next – Samuelson decided to sell his unit and began negotiations with Calemine. In November of 2001, Samuelson signed a real estate disclosure statement, in which he specifically mentioned the flooding, drainage and grading problems that had afflicted the unit. The statement also included the rather ambiguous phrase "heavy rains below ground walls & slab."

For those readers who do not live in California, homes in that state are often built on concrete slabs rather than over basements with cinder block or other foundations. Concrete slabs allow homes to shift during quakes. Often, water pipes are run directly under and through the cement slabs and slab leaks are perennial problems. If ground water swells after heavy rains, the slab will leak.

The disclosure statement did not mention the law suits against the developer or Westar, the initial contractor, or the work done to remedy the failed remediation performed by Westar. The disclosure statement did encourage buyer to obtain his own physical inspection of the unit.

Calemine hired a general home inspector, as well as a termite inspector. These reports noted a variety of problems, including prior leakage of water or moisture in the bottom floor of the condominium unit, damaged drywall, etc. In fact, the main inspection report instructed the buyer, Calemine, to direct inquiries to the seller, because a visual inspection was inconclusive.

Calemine did as he was directed and asked the seller, Samuelson, about the results of the inspection. According to the opinion, "Samuelson was standing in the lower level of the condominium when he stated: "We've had some water intrusion near the bottom of this wall and up through the slab and the homeowners' association came in. They dug out around the patio areas, waterproofed the wall, put in French drains."" Samuelson made other assertions, and then concluded by saying "Haven't had a problem since."

Calemine purchased the unit; then in January 2005 the garage on the lower level flooded. It was only then that Calemine learned of the lawsuits. The flooding recurred in 2006.

Calemine brought suit against Samuelson in 2005 asserting a whole host of actions, including negligence, breach of contract, nuisance, misrepresentation and concealment. The misrepresentation/concealment actions are the key issues. Both parties moved for summary judgment, but the court held for Samuelson. The trial court determined that Samuelson made sufficient disclosures to eliminate any triable issue of fact. The court of appeals reversed.

The court repeats the common law of California, similar to that in many states that the seller must reveal "facts materially affecting the value . . . of the property . . . and [seller] knows . . . are not known to, or within the reach of diligent attention and observation of the buyer." An undisclosed fact is material if it would have a "significant and measurable" impact on the value of the property.

As the court of appeals points out, the cure to disclosure problems is sunlight. Once the seller discloses a fact, it is no longer material. The buyer can proceed with eyes wide open or back away from the transaction, but it is the buyer's decision.

The court further explains that the failure to disclose a material fact is itself a representation on the state of the property. California Civil Code Sections 2079 and 1102 require the seller to fill out the property disclosure statement, but otherwise do not alter the common law. The Code mandates the specific form for the disclosure statement. The statement requires the seller to disclose if he is "aware of any significant defects/malfunctions" in slabs and walls and any "lawsuits by or against the Seller threatening to or affecting this real property."

According the court of appeals, the trial court was correct that Samuelson sufficiently disclosed the water intrusion problems, although Calemine thought that Samuelson should have explained more about the prior attempts to mitigate. However, according to the court of appeals, it is not necessary for the seller to "elaborate" in detail on the methods used to resolve every problem. It is enough to bring the problem to the attention of the buyer so that the inspector can adequately do his job.

Although Samuelson sufficiently revealed the water intrusion problem, Samuelson failed in his disclosure obligation with respect to the litigation. Samuelson thought that he only had to disclose then pending lawsuits. The court of appeals disagreed, saying that the common law demanded more (and that the statute was not intended to narrow the common law.) The court holds that there was a triable issue of fact as to whether the non disclosed series of lawsuits would have affected the desirability or value of the condominium units.

Reporter's Comment 1: Just how much one has to reveal in a disclosure statement is actually a pretty difficult problem in many cases, and one can understand the seller's desire to say less rather than more. The court acknowledges that Samuelson in good faith said that the water problem was (to his knowledge) corrected and that he had not seen additional flooding. The legal line seems to be one of elaboration. The seller must provide enough good information to allow the buyer to make an informed decision, to independently obtain information – and, with respect to water problems in the unit, the seller met this standard in *Calemine*.

Reporter's Comment 2: Samuelson gave a specific, verbal response to a direct question regarding water intrusion. Had the buyer asked whether the seller had sued the developer, then the seller would have to give a fully, if not perfectly elaborated answer to that question. At a minimum, the seller would have to say that he participated in a lawsuit against the developer. If the buyer expressed concerns about prior lawsuits, this would further indicate that other construction defect suits respecting the water problem at the property were material to the buyer. This means that a failure to mention the suit against Westar would also be actionable.

Reporter's Comment 3: In the face of an express common law and statutory requirement to disclose, "mere silence" is actionable. Silence becomes a form of representation.

Reporter's Comment 4: The goal is to provide buyers with information, but not to coddle them. The disclosure statement should be read broadly enough to prod the seller to give the buyer the kind of information he can not glean on his own that would reasonably matter to buyer. The fact that there were two law suits and a prior failed attempt to correct a problem that plagued the entire complex might well affect the value of the unit.

Reporters' Comment 5: Once again, we take note of our colleague Professor Roger Bernhardt. Roger discusses *Calemine* in California Real Property Law Reporter, in January 2009. Roger states, among other things:

Technically, the appellate court's opinion merely reverses the summary judgment for the seller, with the duty to disclose two previous lawsuits being characterized as a question of fact for the trial court to decide. I would say, however, that the court of appeal has already completely decided the question. If I were the trial court now handling the case on remand, I would believe myself fully instructed to conclude that the facts that two previous lawsuits had been settled, and the disparity between a consultant's estimate of necessary repair costs at over $1 million versus the actual expenditure of only $120,000 for them (with a strong disclaimer of success by the new repair company), all materially affect value, which this seller was obliged to disclose to this buyer. I would feel similarly instructed to conclude that the seller's actual disclosure to the buyers of the underlying water intrusion problem was not sufficient to diminish the significance of facts about the litigation over it to the status of a mere failure to "elaborate."

Editor's Comment 1: There has been a recognized difference between saying nothing and saying not enough. Here, where the buyer's questions provoked a detailed response, it is clear that giving a partial response was inadequate.

As a holding, it appears that this is all that the case says. But, as dicta, it may stand for the principle that disclosure of prior litigation is always mandated.

Editor's Comment 2: Under these circumstances condominium owners ought to expect their association to provide an "official" summary of prior construction defect litigation that can be turned over to buyers. In this particular case, the seller virtually *was* the association for the relevant period. But in many cases the condominium owners will know something of the details of the litigation, but not much. The shouldn't be held liable for failure to research this history.

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

WORDS AND PHRASES: "INTEGRATED SYSTEM:" Placement of fixtures to maximize efficiency did not define an integrated operation in eminent domain proceeding. ***In re City of New York, 899 N.E.2d 933, (N.Y. 2008)***, discussed under the heading: "Eminent Domain; Valuation; Trade Fixtures; "Integrated System."

WORDS AND PHRASES; "SALE:" A "sale" occurs whenever full ownership is transfeerred for consideration, even if the transfer is from a limited partnership is to another limited partnership in which the principles of the original partnership have a limited partnership interest. ***CB Richard Ellis Real Estate Services, Inc. v. Spitz, 950 A. 2d 704 (D.C. App. 2008)***, discussed under the heading: "Brokers; Mortgage Brokers; Statute of Frauds."

ZONING AND LAND USE; CONSTITUTIONAL LAW: Although City may regulate use of property, it may not regulate ownership of property, and "owner/ occupant" requirements are unconstitutional: ***City of Wilmington v. Hill, 657 S.E.2d 670 (N.C. App. 2008).***

Acting pursuant to a valid building permit, defendant constructed a garage apartment on property he owned in Wilmington. The City subsequently determined that his property was in violation of the City's Land Development Code that required the owner of a garage apartment to reside either in the main residence or in the garage apartment. Defendant sought an amendment to the ordinance to eliminate the owner-residency requirement, but this was denied, and defendant was cited for violation of the Code.

Defendant failed to pay the fine that was assessed, and the City filed an action in small claims court to recover it. Defendant moved to dismiss, alleging the ordinance was unconstitutional. The motion was denied and judgment entered for the City. Defendant appealed to the District Court, and the case was set for mandatory arbitration. The City was awarded an arbitration award and judgment.

Defendant requested a trial *de novo*. After trial the District Court granted defendant's motion to dismiss and declared the ordinance unconstitutional.

On appeal by the City, the Court of Appeals affirmed judgment for defendant, and held that the City is only "entitled to regulate the use of defendant's single-family residence with the accessory use of a garage apartment, not the ownership."

The court relied upon relatively clear North Carolina precedent, but in doing so rejected two cases from other jurisdictions that tended to support the City's position: *Anderson v. Provo City Corp.*, 108 P.3d 701, 706 (Utah 2005) ("We reject the proposition that placing an owner occupancy condition on a supplementary accessory dwelling use constitutes an impermissible regulation of 'ownership.' ") *Kasper v. Town of Brookhaven*, 142 A.D.2d 213, 220-21, 535 N.Y.S.2d 621 (1988) ("Inasmuch as the owner-occupancy requirement is an integral component of the town's legislative strategy to achieve" the goal of aiding occupying homeowners in retaining and maintaining their properties while answering the need for affordable housing, the court declined to determine whether the ordinance was the "wisest or most expeditious means" of accomplishing this goal.)

The North Carolina case on which the Defendant relied, *Graham v. City of Raleigh*, 284 S.E. 2d 742 (N.C. 1981), held that the City could not restrict the owner of property already zoned for multi family housing from converting the property to condominiums. The case relied upon language of the North Carolina zoning enabling statute and *Euclid v. Ambler.*

Comment. Whether a modern court, even in North Carolina, would strike down any and all legislation regulating condominium development is somewhat problematic. Certainly many jurisdictions have recognized an important consumer interest that has justified regulating such activities. Such consumer protection interest may be distinct from interests in regulating the use of the land, but there seems to be an overlap.

We have a different issue here. The question is whether a jurisdiction can require an owner to reside on the land. There appears to be a split as to zoning authority. The requirement is quite common in private land use restrictions, but the problem is whether the police power of a public agency can require such a restriction. Frankly, the editor, who does not regularly teach the land use course, cannot remember seeing this issue before. Maybe some readers are in the same boat.

ZONING AND LAND USE; PROCEDURE; APPLICATION OF *RES JUDICATA* TO LEGISLATIVE FUNCTIONS: *Res judicata* (as a judicial doctrine) does not apply to the review of applications for zoning change map amendments, as such review is a legislative function. ***Hume v. Franklin County Fiscal Court, et al., 236 S.W.3d 748 (Ky. 2008).***

Gary, John and Lewis Bizzack, who owned a 10.31 acre tract in Franklin County, Kentucky, requested a zoning change of such tract in 1997. The Frankfort-Franklin County Planning Commission recommended approval of the request, and the Franklin Fiscal Court approved the request. Alice Hume and Pin Oak Stud, neighboring landowners (the "Neighbors"), appealed the approval to the Franklin Circuit Court, which reversed and remanded to the Fiscal Court for reconsideration. The Fiscal Court reconsidered the findings of fact and conclusions of law and reapproved the zoning change without a new hearing. The Neighbors again appealed to the Circuit Court, which again reversed but without remanding. The Bizzacks then appealed to the Kentucky Court of Appeals which reversed on procedural grounds.

In 2001, the Bizzacks applied to the Planning Commission for a zoning map amendment of the tract. After a public hearing, the Planning Commission voted 5-4 to approve the request, and the Fiscal Court approved the zoning change after finding that the zoning map amendments was in agreement with a "Comprehensive Plan." The Neighbors appealed to the Circuit Court, which affirmed the Fiscal Court's approval, and then appealed to the Court of Appeals. On that appeal, the Court of Appeals reversed on non-substantive grounds.

The Kentucky Supreme Court denied discretionary review in June 2004. However, before such denial of review and while the matter was still pending, the Bizzacks applied for a new request for a zone change map amendment in June 2003. The Planning Commission voted 5-5 on such zone map change, which the Fiscal Court granted in February 2004. The Neighbors appealed the Fiscal Court's decision to the Circuit Court, which reversed, holding that based on *res judicata* principles, the zoning request should not have been filed while an earlier request was still pending. Deciding the Bizzacks' subsequent appeal, the Court of Appeals held that *res judicata* could be applied to administrative zoning matters if there are no changes between the two applications. The Kentucky Supreme Court granted discretionary review to discuss, as a matter of first impression, whether the doctrine of *res judicata* applied to applications for zoning change map amendments.

The Supreme Court began by discussing the statutory enabling act that authorizes local governing authorities to consider and adopt land use regulations. Pursuant to the Kentucky statute, in order for a local authority to have such right, it must first adopt a "comprehensive plan," which states goals and objectives of the community and contains a map of the community showing proposed land uses. Once the comprehensive plan is adopted, the community may adopt zoning regulations and maps showing boundaries for each zone in the community. The statute also sets forth the zoning map amendment procedure local governing authorities must use subsequent to the adoption of a comprehensive plan. Because the statute does not include a time limitation on such amendment applications, the Circuit Court and Court of Appeals applied *res judicata* in order to prevent endless applications.

When addressing this issue, the Supreme Court held that "the doctrine of *res judicata* is not appropriate because [it] is a judicial doctrine, while rezoning is a legislative function." Because "the role of judicial review is to determine whether [a]n action [is] arbitrary, meaning whether the action was in excess of granted powers; whether procedural due process was afforded; and whether the action taken was based on substantial evidentiary support," judicial concepts (such as *res judicata*) do not apply to legislative functions. The court noted that the legislative body "passed up its opportunity to limit the numbers by not including the legislative solution – a time provision in the ordinance itself."

The court stated that "[w]hile *res judicata* may apply to subsequent litigation(s) of a zone change application, it does not, nor can it apply to a subsequent zone change map amendment application." Its reasoning was "that life changes, that communities change, and that in short periods of time, the economic, physical, or social nature of community or area can be subject to change, as recognized by the comprehensive or master plan," and "subsequent requests for a zone change must give the applicants an opportunity to show changed circumstances, if any, or merely the opportunity to reexamine their prior decisions." Accordingly, the Kentucky Supreme Court reversed the Court of Appeals decision to the extent it applied res judicata for applications of zoning map amendments.

Comment: It would appear that, although the court suggested that the legislature might have inserted a time limitation for zone map change amendments, in fact it doesn't see such a limitation as necessary or desirable.

Note also that the court emphasizes that the zone changes in question ought to be in accordance with the goals stated in the comprehensive plan. Basically, according to the court, the agency can continue to rethink its zoning decisions on a case by case basis so long as the changes are consistent with that plan. Good idea? The editor thinks it's OK, but maybe more sophisticated thinkers in this area see an opportunity for mischief here.