ASPEN COLLEGE SERIES

Jeffrey A. Helewitz

BASIC REAL ESTATE AND PROPERTY LAW FOR PARALEGALS

FIFTH EDITION

Wolters Kluwer

Basic Real Estate and Property Law for Paralegals

EDITORIAL ADVISORS

ASPEN COLLEGE SERIES

Basic Real Estate and Property Law for Paralegals

Fifth Edition

Jeffrey A. Helewitz, Esq.
Special Referee, New York Supreme Court

Wolters Kluwer

Published by Wolters Kluwer in New York.

Wolters Kluwer serves customers worldwide with CCH, Aspen Publishers, and Kluwer Law International products. (www.wolterskluwerlb.com)

To contact Customer Service, e-mail customer.service@wolterskluwer.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

Wolters Kluwer
Attn: Order Department
PO Box 990
Frederick, MD 21705

Library of Congress Cataloging-in-Publication Data

Helewitz, Jeffrey A., author.
Basic real estate and property law for paralegals / Jeffrey A. Helewitz, Esq.— Fifth edition.
pages cm
Includes index.
eISBN 978-1-4548-6130-0—ISBN 1-4548-5122-8
1. Real property—United States—Outlines, syllabi, etc. 2. Conveyancing—United States—Outlines, syllabi, etc. 3. Vendors and purchasers—United States—Outlines, syllabi, etc. 4. Legal assistants—United States—Handbooks, manuals, etc. I. Title.

KF570.H45 2015
346.7304′3—dc23

2014037911

About Wolters Kluwer Law & Business

Wolters Kluwer Law & Business is a leading global provider of intelligent information and digital solutions for legal and business professionals in key specialty areas, and respected educational resources for professors and law students. Wolters Kluwer Law & Business connects legal and business professionals as well as those in the education market with timely, specialized authoritative content and information-enabled solutions to support success through productivity, accuracy and mobility.

Serving customers worldwide, Wolters Kluwer Law & Business products include those under the Aspen Publishers, CCH, Kluwer Law International, Loislaw, ftwilliam.com and MediRegs family of products.

CCH products have been a trusted resource since 1913, and are highly regarded resources for legal, securities, antitrust and trade regulation, government contracting, banking, pension, payroll, employment and labor, and healthcare reimbursement and compliance professionals.

Aspen Publishers products provide essential information to attorneys, business professionals and law students. Written by preeminent authorities, the product line offers analytical and practical information in a range of specialty practice areas from securities law and intellectual property to mergers and acquisitions and pension/benefits. Aspen's trusted legal education resources provide professors and students with high-quality, up-to-date and effective resources for successful instruction and study in all areas of the law.

Kluwer Law International products provide the global business community with reliable international legal information in English. Legal practitioners, corporate counsel and business executives around the world rely on Kluwer Law journals, looseleafs, books, and electronic products for comprehensive information in many areas of international legal practice.

Loislaw is a comprehensive online legal research product providing legal content to law firm practitioners of various specializations. Loislaw provides attorneys with the ability to quickly and efficiently find the necessary legal information they need, when and where they need it, by facilitating access to primary law as well as state-specific law, records, forms and treatises.

ftwilliam.com offers employee benefits professionals the highest quality plan documents (retirement, welfare and non-qualified) and government forms (5500/PBGC, 1099 and IRS) software at highly competitive prices.

MediRegs products provide integrated health care compliance content and software solutions for professionals in healthcare, higher education and life sciences, including professionals in accounting, law and consulting.

Wolters Kluwer Law & Business, a division of Wolters Kluwer, is headquartered in New York. Wolters Kluwer is a market-leading global information services company focused on professionals.

Summary of Contents

Contents

CHAPTER 3: LAND USE

CHAPTER 4: CONVEYANCING

Preface

This text is designed to assist legal professionals in understanding and effectuating real estate and personal property transactions. The term "legal professional" includes legal assistants, attorneys, law clerks, legal secretaries, and all other persons whose day-to-day activities involve real estate and law. The principles, forms, and tasks discussed in the text are applicable to anyone in the legal profession who deals with these matters. In any given transaction, the totality of the work may be accomplished by a lawyer or a paralegal or legal secretary working under the lawyer's supervision. However, in almost no other area of law is the non-lawyer legal professional called upon to perform such independent work.

Basic Real Estate and Property Law for Paralegals provides an analysis of the basic legal principles involved in real and personal property law, as well as practical guidance in creating, organizing, and completing real estate transactions. This text provides a complete and comprehensive guide to all aspects of property law—real estate, landlord-tenant, land use, and personal property. These topics form the mainstay of almost every general practice law office in the country, and understanding them is a fundamental skill required of all legal professionals.

Jeffrey A. Helewitz

August 2014

Acknowledgment

The fifth edition of this text would not have been possible without the brilliant and detailed assistance of Lara Sawczuk, Esq.

Basic Real Estate and Property Law for Paralegals

1 Estates in Land and Future Interests

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Distinguish between real and personal property
- Differentiate between freeholds and leaseholds
- Discuss the vesting and divesting of fee estates
- List the five types of concurrent fee ownership
- Understand how to create a tenancy in common
- Indicate the requirements to create a joint tenancy
- Discuss how to establish a tenancy by the entirety
- Know the effect of holding community property
- Define a tenancy in partnership
- Explain the concept of a life estate
- Identify future interests in estates
- Define and apply the Rule Against Perpetuities
- Apply the salvage doctrines to the Rule Against Perpetuities
- Apply some practical tips in a real property practice

CHAPTER OUTLINE

CHAPTER OVERVIEW

The law of property has often been referred to as a "bundle of rights." This designation underscores the fact that property law encompasses more than just one simple legal concept. Rather, the law of property concerns a person's ability to possess, transfer, and access both real and personal property.

Real property is defined as land, vegetation growing on the land, structures permanently affixed to the land, and mineral resources that are located beneath the soil. **Personal property** is all property that is not classified as real property, such as clothing, furniture, electronic equipment, and so forth. An individual's ability to use, possess, and transfer real and personal property is dependent upon the legal title to that property that is vested in that individual. **Title** is the legal term indicating rights to property, and **vesting** refers to a person's ability to enforce such rights in the courts. To understand the law of property, one must first understand the different categories of title to property that a person may hold.

This chapter explores this basic legal concept with respect to property—title. When referring to the title that a person has in real property, such title is called an **estate**. However, the same title attaches to personal property as well. The rights (and obligations) incident to a specific title to property are identical regardless of whether the property is **realty** (real property) or **personalty** (personal property). For the purposes of this initial explanation, these titles are exemplified by estates in land.

Classifications of Estates

All estates, or titles, in land are divided into two broad categories: freeholds and leaseholds. A **freehold** is an estate in land that a person has for an indefinite period of time. A **leasehold** is a possessory interest in land that a person has for a period of time specified in a contract called a **lease**. The holder of a freehold estate has rights and obligations created by the law, both common and statutory. The holder of a leasehold has rights and obligations dictated by the provisions of the lease.

Freeholds

Fees

Freehold estates are divided into two subcategories: fees and life estates. A **fee**, or **fee simple absolute**, is the largest estate in land recognized by the law. The holder of a fee interest can sell, gift, devise, and encumber

that interest, and holds that interest for an indefinite period of time.

 EXAMPLE:

A woman purchases a house that rests on one-half acre of land. There are no restrictions on her title, so she holds the property as a fee simple absolute. If she wishes to sell off a portion of the land, rent her house, or use her interest in the property as collateral for a loan, she may do so, because her interest is absolute and unrestricted.

Not all fee interests are absolute. The law recognizes two types of fee simple estates that may terminate upon the happening of a particular event. Note that this interest is still indefinite, because the event may or may not occur, and the time of such possible occurrence is unknown. However, this interest does impose a certain limitation on the titleholder.

The two types of fees that may terminate at the happening of a specified event are called a fee simple determinable and a fee simple subject to a condition subsequent. These two types of terminable fees are referred to as **defeasible fees**, meaning that the interest of the titleholder may be cut off, or defeated, if the event occurs.

A **fee simple determinable** is a fee that terminates upon the happening of a specified event, at which time the title to the property is automatically transferred back to the person who created the interest, known as the **grantor**, or transferor, of the interest in the realty.

 EXAMPLE:

Grantor, who holds a fee simple absolute title to a parcel of property called Blackacre, transfers the title to his son "for so long as the property is used for residential purposes." This restriction on the use of the property creates a fee simple determinable. If the son, or anyone to whom the son transfers his interest, decides to use the property for commercial purposes, the title to Blackacre automatically reverts back to the grantor or the grantor's heirs if such use occurs after the grantor's death. This automatic reversion to the grantor of a fee simple determinable is called a **possibility of reverter**, indicating that there is a possibility that title will revert to the grantor.

A **fee simple subject to a condition subsequent** is created when the grantor transfers title to the property but reserves the right to regain the title upon the happening of an event specified in the transfer.

 EXAMPLE:

Grantor, who holds a fee simple absolute title to a parcel of property called Whiteacre, transfers title to his daughter "but if the property is ever used for commercial purposes, then Whiteacre will go back to Grantor." If the property is subsequently used for commercial purposes, the grantor may reclaim the property provided that he has specifically reserved a **right of re-entry** in the transferring document (which he has). This right, unlike the possibility of reverter, is not automatic under the

law, and the grantor or his heirs may decline to exercise this right.

A fee simple determinable and a fee simple subject to a condition subsequent are very similar, and the distinguishing characteristic lies in the words used by the grantor in the transferring document. Phrases such as "for so long as," "during," "while," and so forth indicate a fee simple determinable, whereas the phrase "but if" or "upon the happening of" creates a fee simple subject to a condition subsequent. With the former, the prohibited use must be mentioned; with the latter any use except for the one specified is permitted. The consequence of this linguistic use is crucial. With a fee simple determinable the title may revert back automatically; with a fee simple subject to a condition subsequent the grantor or the grantor's heirs must actually exercise the right of re-entry or such right is lost. Also, the limitations on the use of the property extend to all persons to whom the property is transferred by and through the original transferee.

 EXAMPLE:

A grantor creates a fee simple subject to a condition subsequent. Five years after the transfer the transferee uses the property in a manner that gives rise to the condition. The grantor is aware of the change in use but does not exercise the right of re-entry. This right of re-entry, if not exercised, will be lost, and the transferee now has a fee simple absolute. If the title had been a fee simple determinable, the title would have automatically reverted to the grantor regardless of the grantor's action or inaction.

If, when creating the title, the grantor decides that he or she does not wish to regain the title but, if the specified event occurs, wishes a third person to be entitled to the property, the grantor may so indicate. The title thus created in the transfer is referred to as a **fee simple subject to an executory interest**. This simply is either a fee simple determinable or a fee simple subject to a condition subsequent in which the reversionary interest passes not to the grantor but to a third person so designated by the grantor.

 EXAMPLE:

A grantor transfers title to Greenacre to his son provided that it is used only for recreational purposes, then to his daughter. The son has a fee simple subject to a condition subsequent, and the daughter has an executory interest, in this case a right of re-entry, which she may exercise if the son uses the property for non-recreational purposes.

Historically, a type of limited fee simple existed known as a **fee tail**, meaning that the property could only pass to lineal descendants of the titleholder. Almost every jurisdiction in the country has abolished this type of title.

 EXAMPLE:

A grantor transfers his property to his son and "the male heirs of his body." This creates a fee tail in

the son's male descendants, referred to as a *fee tail male*.

A fee simple estate may be held by just one person, or by two or more persons collectively. If one person holds the title, it is called a **tenancy in severalty.** The word "tenancy" comes from the French word "tenir," meaning "to hold": the person holds the title individually. If the title is held by two or more persons, the title is referred to as **concurrent ownership.** The United States recognizes five types of concurrent title to property:

1. tenancy in common
2. joint tenancy
3. tenancy by the entirety
4. community property
5. tenancy in partnership

1. Tenancy in common. A **tenancy in common** is an estate in property in which two or more **co-tenants** (titleholders) own a concurrent, but not necessarily equal, title to the property. This interest is deemed to be separate but undivided from the other tenants' interests. Each tenant in common, regardless of her percentage of ownership, is entitled to possess the entire property, but has no right to the exclusive possession of any portion of the property. Each tenant in common is free to **alienate** (transfer) her interest in the property, and there is no right of survivorship in the remaining tenants of a deceased tenant's interest. The interest of a deceased tenant in common passes to her heirs.

 EXAMPLE:

A woman inherits a summer home from her great-aunt. She decides that she does not want to use the home all the time, and to raise capital she sells a one-quarter interest to each of two friends. The three friends are now tenants in common, with the first woman owning a 50 percent interest and the two friends owning a 25 percent interest each. Despite the unequal ownership percentages, each friend has the right to possess the entire house—for example, none of them can lay claim to exclusive use of the "best" bedroom (absent an agreement to that effect).

Any co-tenant who is in actual possession of the property has the right to retain any profit derived from his or her own use of the property, and is not required to share those profits with the co-tenants who are not actually in possession. However, if the tenant in possession realizes profit from an agreement with a third person for the use of the property, this profit must be shared with co-tenants in proportion to their ownership interest.

 EXAMPLE:

Two brothers buy a parcel of real estate as tenants in common. One brother lives on the property where he grows vegetables. The second brother lives in a city 100 miles away from the property.

The brother in possession does not have to share the profit he derives from the sale of the vegetables he grows on the property. However, if the brother in possession rented the property to a neighboring farmer, the brother would have to share the rent with the urban brother. The difference involves income derived from a tenant's own efforts versus income derived from leasing the possessory interest.

Each tenant in common has the legal right to **encumber** her interest, meaning that she may mortgage that interest or have that interest subject to mechanic's liens, but no one tenant may encumber the interests of the other co-tenants without their consent. If the creditor of the tenant in common who encumbered her interest forecloses because the tenant failed to meet the credit obligation, the foreclosure, in most states, acts to sever the title into tenancies in severalty, proportionate to the co-tenants' interests.

 EXAMPLE:

A tenant in common wants to raise some cash to buy some corporate shares as an investment. To raise this capital, she mortgages her one-half interest in the subject property. The price of the shares falls and the woman loses her entire investment and cannot repay the loan. The creditor to whom she mortgaged the property forecloses on the realty (see Chapter 4). After foreclosure the creditor now owns a fee simple absolute in one-half of the property, while the former co-tenant now owns a fee simple absolute in the other one-half of the property.

If the co-tenants want to terminate the tenancy in common, they have three options:

(a) they can collectively transfer their title, transferring to each a fee simple absolute in his or her proportionate share;
(b) a tenant in possession may go to court to seek an **ouster**, a court-ordered termination of a co-tenant's rights because of the co-tenant's failure to meet some specified legal obligation or abandonment of the property; or
(c) if the parties cannot agree to a suitable division, they may seek a court-ordered **partition** of the property in which the court will determine the portion each co-tenant will receive.

A tenant in common may seek contribution from the other co-tenants for all repairs, taxes, and mortgage payments made on the property that exceed the percentage interest of the paying tenant in common, but the tenant is not entitled to be reimbursed for improvements made to the property absent an agreement by the other co-tenants or pursuant to a court order.

 EXAMPLE:

Four cousins inherit a home from their grandmother as tenants in common. Two cousins want to rent the property to produce an income. Prior to such rental, one cousin pays for necessary repairs to the roof and the installation of a new boiler, and then decides to have the property artistically

landscaped. This cousin may seek reimbursement for the roof repairs and the boiler but not for the landscaping, which was not a necessary repair.

Whenever two or more **grantees** acquire concurrent title to property and they are not married to each other, the law assumes that they hold title as tenants in common unless a different title is specified in the conveyance.

2. Joint tenancy. A **joint tenancy** is a form of concurrent ownership of property in which each joint tenant has an undivided interest in the whole estate, and there is a **right of survivorship** in the remaining joint tenants upon the death of each of them. To create a joint tenancy, the conveyance must contain what is referred to as the **four unities** of time, title, interest, and possession. In other words, unlike a tenancy in common that may be created by several conveyances and in which each tenant in common may own a different percentage of the whole, to create a joint tenancy all of the joint tenants must acquire the same title by the same instrument at the same time, and the title must be equal with respect to each tenant.

 EXAMPLE:

Three sisters decide to purchase some land together as an investment, and decide to hold the title as joint tenants. To create the joint tenancy, the grantor must convey this interest in the property in one document in which each sister is given a one-third interest in the realty. The document must also specify that a joint tenancy is being created.

Unlike a tenancy in common in which a co-tenant may alienate his or her interest in the property without destroying the title, with a joint tenancy, because each joint tenant owns an undivided interest, any attempt to alienate his or her interest in a joint tenancy during his or her life acts to destroy the joint tenancy. This alienation will create a tenancy in common. If more than two people hold title as joint tenants, the result would be fairly convoluted: the joint tenant who alienated her portion now holds title as a tenant in common with the former joint tenants who are collectively a tenant in common holding that interest as joint tenants.

 EXAMPLE:

Abel, Baker, and Carr acquire some property as joint tenants. Abel decides to sell his interest to Dorrance. Once the sale is consummated, Abel's alienation has severed the joint tenancy. The property is now held as a tenancy in common. Dorrance holds title as a tenant in common for a one-third interest, and Baker and Carr, holding title as joint tenants, are the tenant in common for a two-thirds interest in the property. If Baker dies, the title to the joint property devolves on Carr, and the property is now a tenancy in common with Dorrance being a tenant in common for a one-third interest, and Carr being a tenant in common for a two-thirds interest. Carr received Baker's interest by right of survivorship.

As indicated by the above example, upon the death of a joint tenant his interest passes automatically to

the surviving joint tenants. Any attempt by a joint tenant to transfer his interest by means of a will fails. Note that an inter vivos transfer destroys the joint tenancy and creates a tenancy in common, whereas testamentary transfers are ineffective and title passes by right of survivorship to the surviving joint tenants.

If a joint tenant encumbers his interest, this also may act to sever the joint tenancy in many jurisdictions. Furthermore, some jurisdictions have held that even entering into a contract for the sale of an interest in a joint tenancy, without the actual sale being consummated, is sufficient to destroy the joint tenancy and create a tenancy in common. Many states prohibit a joint tenant from acquiring a title by right of survivorship if the surviving joint tenant was responsible for the death of the deceased joint tenant.

Joint tenancies are not favorable to the tenants because of the restriction on the alienation of interest, and most jurisdictions require that a joint tenancy be specified as the title in the conveyance for it to be created.

3. Tenancy by the entirety. A tenancy by the entirety is a form of joint tenancy recognized by many states for legally married couples. A tenancy by the entirety is created with the four unities of a joint tenancy plus a fifth unity of a valid marriage.

A tenancy by the entirety cannot be encumbered or conveyed by one spouse alone; any transfer without the consent of both spouses is ineffective. As with a regular joint tenancy, there is an automatic right of survivorship in the surviving spouse, and a tenancy by the entirety may only be severed by divorce, mutual agreement, or a foreclosure by a creditor of *both* parties.

 **EXAMPLE:**

> A married couple purchases a house as tenants by the entirety. As a couple they borrow a portion of the purchase price from a bank and give the bank a mortgage on the house to secure the loan. Several years later, the wife, an inveterate gambler, borrows money to pay her gambling debts and gives her creditor a mortgage on the house. When both of the loans are in default, only the bank can foreclose because both spouses signed the mortgage; the wife's creditor is unable to foreclose because he is the creditor of the wife alone.

A tenancy by the entirety affords protection to the married couple because neither spouse alone has the legal ability to destroy the title, and the right of survivorship will remain intact. This provides more benefits to a couple than a regular joint tenancy.

As of the fall of 2014, after the decision by the U.S. Supreme Court in *US v. Windsor* and subsequent rulings of the Court, state legislatures and popular vote, the following states allow same-sex marriage: Alaska, Arizona, California, Colorado, Connecticut, Delaware, District of Colombia, Hawaii, Idaho, Illinois, Indiana, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, West Virginia, Washington, Wisconsin, and Wyoming. In addition, the U.S. Supreme Court declined to hear appeals of decisions that overturned bans on same-sex marriages in the following states: Arkansas, Florida, Kentucky, Michigan, and Texas. As a consequence, same-sex couples who are legally married in those jurisdictions that permit such unions are also permitted to hold title as tenants by the entirety. For the remainder of this text, whenever the term *married couple* is used, it refers to both opposite- and same-sex

married couples.

4. Community property. Nine jurisdictions in the United States currently recognize community property as a title for married couples. **Community property** is a title to property given to property acquired by a married couple during the marriage if no other title is specified on the conveyance, or if that title is specifically selected. With community property, each spouse is deemed to be the outright owner of one-half of the property, meaning that each is able to alienate his or her portion, and there is no automatic right of survivorship.

 EXAMPLE:

A married couple in New Mexico, a community property state, purchases a parcel of undeveloped real estate as an investment. The wife is killed in a car accident, and in her will she leaves all of her real property to her sister. Because the couple did not specify a different title when purchasing the land, the property is considered to be community property, and the wife was free to will her interest to whomever she wished. Consequently, the property is now held by the husband and the sister as tenants in common.

5. Tenancy in partnership. For business partners, the law has described a fifth type of concurrent ownership known as a tenancy in partnership. A **tenancy in partnership** is only available to persons operating a business as a general or a limited partnership. All of the business property, unless otherwise designated, is deemed to be held as a tenancy in partnership. The attributes of such title are:

(a) no one partner may possess the partnership property for other than partnership purposes without the other partners' consent;
(b) no one partner may sell the property, otherwise than in the regular course of business, without the other partners' consent;
(c) the personal creditors of the individual partners may not attach this property to satisfy the personal debts of the individual partners; and
(d) the heirs of a deceased partner are only entitled to receive the value of the deceased partner's interest in the property—the title to the property itself passes to the surviving partners by operation of law.

The purpose behind the creation of a tenancy in partnership is to assure business partners that the property that is acquired by and for the business will remain the property of the collective partners to be used exclusively for business purposes.

 EXAMPLE:

Three friends decide to go into business together to buy and sell gemstones. Each partner contributes a certain amount of capital, and they purchase a quantity of colored gemstones for the business. Later, one of the partners defaults on a loan that he had taken out to go on a vacation.

This partner's creditor cannot attach the gemstones to satisfy the debt because they are held in tenancy in partnership. Conversely, if the three partners collectively borrowed the money to buy gemstones, this creditor could attach the gemstones because it is a debt of the partnership, not the individual partner.

Life Estates

The second subset of freehold is known as a **life estate**, whereby a person holds title for a "lifetime," which is deemed to be an indefinite period. At the termination of the "life," title to the property will automatically pass to someone else whose identity is specified in the conveyance that created the life estate.

 **EXAMPLE:**

In her will a woman leaves a house, which she owned as a tenancy in severalty, to her "beloved husband for life, then to our children." The husband has inherited a life estate, meaning that he has a possessory interest in the property only during his lifetime, and on his death the children will inherit the property as tenants in common (the woman did not specify any type of title for the children so the law will assume a tenancy in common).

The person whose life determines the duration of the estate is referred to as the **measuring life**. In the most common situation, the grantee is the measuring life, as exemplified above. However, under certain circumstances the holder of the life estate may only hold this possessory interest during another person's life. This type of estate is referred to as a **life estate pur autre vie.**

 **EXAMPLE:**

In the previous example, assume that the widower does not wish to live in the house but wants to travel. To raise capital he conveys his interest in the property to a third person. This person now has a life estate pur autre vie, holding title only so long as the widower, the measuring life, lives. At the widower's death, the title passes to the children according to the terms of their mother's will.

The **life tenant**, the person who holds title to the life estate, is entitled to the ordinary use and profits from the property, but is precluded from doing anything that would injure or reduce the interests of the person who will ultimately acquire the fee estate. The person who eventually receives the fee interest in the property after the termination of the life estate is referred to as the **remainderman** (the children from the previous example). To determine whether the use of the land is considered ordinary or detrimental to the remainderman, see Chapter 2.

Leaseholds

The second broad category of estates is the leasehold. As the term would imply, a leasehold is an interest in property that a person holds pursuant to a contract known as a **lease**. A person who has a transferable

interest in property may grant the use of that property to someone. If this transfer is accomplished by means of a lease, the transferor is called the **lessor**, or **landlord**, and the person who acquires the right pursuant to the lease contract is called the **lessee** or **tenant**. A leasehold differs from a freehold interest in that it is a possessory interest only, and it terminates at a set period of time as determined by the lease.

A leasehold is formed by contract, in which the lessor gives the lessee possession of the property for a specified period of time, and the lessee agrees to pay the lessor a fee for such use known as **rent.** Leasehold rights and obligations are determined by the contract between the parties as well as statutory and common law. These legal rights and obligations come under the heading of **landlord-tenant law**, which is fully discussed in Chapter 7.

 EXAMPLE:

The widower from the previous example decides that, rather than conveying his entire interest to a third person, he will just rent the house for one year and use the rent to travel. He contracts with the third party to rent the property, and then leaves on a trip. The third person now has a leasehold rather than a life estate pur autre vie. *Query:* What would happen if the widower died in a plane crash two days after the lease was executed? See Chapter 4.

Future Interests

One of the primary concerns of property law is to ensure that at some point one person (or a collective group) has a sufficient interest in the property to be able to exercise all rights of a fee holder. This legal ability to exercise rights of ownership and possession is called *vesting*. The area of property law known as future interests is concerned with seeing that all property titles are vested within a reasonable period of time. In the example above, the widower has a presently vested life estate and the children have vested remainder interests in fee, which take effect in the future, at the death of their father.

Earlier in the chapter the concept of the possibility of reverter, the right of re-entry, and reversions were all introduced. Each of these estates is a future estate because even though the holder of such right has a property interest, the ability to exercise that right is delayed until some point in the future.

Classifications

The law recognizes four classifications of future estates:

1. **Indefeasibly vested remainder:** This type of estate is created in a person who is both in existence and ascertainable at the time the conveyance creating such interest comes into existence. The interest is indefeasibly vested because it occurs automatically at the natural termination of a previous estate.

 EXAMPLE:

In her will a woman conveys her house to her niece Betty for life, then to Betty's daughter Joan.

Betty has a life estate and her daughter Joan has an indefeasibly vested remainder. When Betty dies, title automatically passes to Joan. Joan's right is currently vested because she can stop Betty from doing anything that would injure or diminish the value of the property.

2. **Vested remainder subject to open:** This estate is created when a vested remainder is given not to a named person but to a class of persons and that class may be added to. "Subject to open" means that the title is shared by persons who may be added to the class.

 EXAMPLE:

In the preceding example, assume that the woman's will leaves the property to "my niece Betty for life, then to Betty's children." At the date of the woman's death, Betty has one child, Joan. However, because Betty may have more children before she dies, Joan's interest is subject to being proportionately diminished by the addition of more siblings to the class. Joan's interest is a vested remainder subject to open.

3. **Vested remainder subject to complete divestment:** This is a **vested remainder that is subject to a condition subsequent** as discussed above. The interest may be totally lost (divested) if the condition occurs.

 EXAMPLE:

A man conveys his house to his wife for life, then to his son provided that the son always uses the property for residential purposes, otherwise to his daughter. The son has a vested remainder in fee subject to a condition subsequent. If he uses the property for non-residential purposes, he will be divested and the title will pass to his sister.

4. **Contingent remainder:** This is a remainder interest that may or may not vest—it is conditioned upon either a condition precedent or is created in a person who is unborn or unascertainable at the time of the conveyance.

A remainder subject to a condition precedent is exemplified by a conveyance that gives a remainder interest provided that some condition is met before the remainder becomes a present estate.

 EXAMPLE:

A man conveys his house to his wife for life, then to his son provided that the son becomes a priest. The son's interest is contingent upon his taking orders, which means that it may never vest in him if the condition is not met.

A contingent remainder created in unborn or unascertained persons occurs when the person who will

hold the eventual title is not in existence at the date of the conveyance creating the interest.

 **EXAMPLE:**

A woman conveys her house to her sister for life, then to the children of her brother. If the brother has no children at the time of the conveyance, the interests of the unborn children are deemed to be contingent (upon their birth). Note that if the brother had at least one child at the time of the conveyance, the child's interest would be a vested remainder subject to open.

Any time a future interest either cuts off an earlier estate or only comes about after a gap following the natural termination of an earlier estate, it is referred to as an **executory interest.** These interests are not considered vested, and therefore are treated under the law in the same fashion as a contingent remainder.

 **EXAMPLE:**

Grantor to *A* for life, then two years after *A*'s death to *C*'s children. *C*'s children's interest is executory because it follows a gap (two years) after the termination of the preceding estate.

The Rule Against Perpetuities

In order to avoid the situation in which vested titles to land are held up indefinitely because of contingent remainders, the law mandates that, for a transfer of property to be valid, all interests created by the transfer must vest (be legally enforceable) within a predetermined period of time from the date of the instrument creating those interests. This legal doctrine is called the **Rule Against Perpetuities**, and its application has worried and confused legal professionals for centuries. Simply stated, the Rule mandates that all interests must vest, if at all, within 21 years after the death of the lives in being at the effective date of the initial conveyance, plus the period of gestation (pregnancy). In order to understand how the Rule affects estates, each component of the Rule must be analyzed.

"All interests" refers to every interest, vested, contingent, or executory, that is created by the document of conveyance.

"Must vest" means the vesting of each of these interests is required to be legally enforceable.

"If at all" means that if any one of these interests, regardless of how remote, fails to vest within the stated period, none of the interests vests because the transfer is considered invalid.

"Within 21 years after the death of the lives in being at the effective date of the conveyance" refers only to those persons who are alive at the date the instrument becomes effective and who, either directly or indirectly by being the progenitor of an interest taker, acquire some interest in the conveyance. These persons also include anyone who is *in utero* at that date. Persons who do not fall into this discrete grouping are not considered to be lives in being. This provision of the Rule sets the maximum time period for the vesting of all interests created by the conveyance.

 **EXAMPLE:**

In his will a man leaves his property to his "wife for life, then their children for life, then to their grandchildren." In this example the effective date of the conveyance is the day of the man's death when the will takes effect. The wife has an immediately vested life estate. The children are all lives in being because all of a person's children must be either alive or *in utero* at the date of the person's death, and all of them have vested life estates. The man's grandchildren, who are uncertain at this date, have contingent remainders, but they will all be ascertained at the date of his children's death and their interests vest immediately upon the death of those children who are all lives in being. Consequently, this transfer does not violate the Rule Against Perpetuities.

 **EXAMPLE:**

A man makes an inter vivos transfer, as an anniversary gift, to his "wife for life, then to our children for life, then to our grandchildren." In this instance the transfer is invalid according to the Rule. The transfer takes effect immediately. The man and his wife can have a new child two years after this conveyance. Assume that the man, his wife, and their children who were alive at the date of the conveyance are all subsequently killed in a car accident, only leaving the afterborn child alive. According to the transfer, this child takes a life estate, and after his death the property would go to his children. The baby is not a life in being, and if he lives more than 21 years before dying and leaving a child, this grandchild's interest will vest more than 21 years after the death of the lives in being—the man, his wife, and the children alive at the date of the conveyance.

As demonstrated above, the date of the conveyance is the crucial aspect of applying the Rule. In its classical application, the provisions of the transfer are determined by looking at all possibilities, regardless of how improbable, to ascertain whether the provisions of the Rule will be violated. If, under any conceivable scenario, an interest would vest beyond the period of the Rule, the entire transfer fails. To determine whether this might occur, follow these steps:

1. determine the effective date of the transfer;
2. determine who are the lives in being at that date;
3. create an afterborn child;
4. assume all lives in being then die; and
5. using the afterborn, follow through with the provisions of the transfer. If it is possible that an interest will vest more than 21 years after all lives in being die, the entire conveyance fails and the property reverts to the grantor or the grantor's heirs.

Several states have enacted **salvage doctrines** to save conveyances from being found invalid for possible violation of the Rule Against Perpetuities. The most common of these doctrines are:

1. Age contingency: If the transfer would be invalid because a person's interest is delayed until after the person's 21st birthday, the transfer is read as though the person would take an interest at age 21.

2. Administrative contingency: If the transfer would violate the Rule because some contingent event is mentioned in the transfer, the doctrine assumes that the contingency will take place within the period of the Rule.
3. Gifts to person by title rather than by name: The traditional example of this was a gift that wills to "my son for life, then to his widow for life, then to her children." It is conceivable that the woman the son is married to at the testator's death will die, and the son will remarry a woman who was not alive at his parent's death. This man's second wife will be the "widow," and she is not a life in being. The last gift will be to her child who takes after her death, and so the Rule may be violated. This salvage doctrine states that the term "widow" is deemed to refer to the person who meets that description at the time the transfer takes effect, not anyone who may subsequently meet that designation.
4. Wait and see: Many jurisdictions have enacted statutes that will only apply the provisions of the Rule if a violation actually occurs. This means that the court will not look prospectively to improbable situations, but will let the transfer take effect until an actual violation of the Rule occurs. If the "improbable" does take place, the transfer is only deemed ineffective from that point forward.
5. Year limitation: Many states have bypassed the Rule entirely by enacting statutes that permit transfers to continue for a specified number of years (usually 90) at which point the last interest must vest.

When drafting or analyzing a conveyance that purports to create successive estates, the legal professional must perform the following steps:

1. examine the provisions to determine whether the transfer may violate the Rule; and
2. determine whether the state in control of the conveyance has provided for any salvage doctrine that will save the transfer from violating the Rule.

Practical Tips

- To determine the title, obtain an **abstract of title** from the county recorder's office that provides a detailed indication of how the property has been transferred over the years.
- Keep a receipt for the abstract, which is an expense.
- If there is a break in the chain of the title, advise the attorney immediately.
- Review the transfer documents to make sure the Rule is not violated.
- Make a summary of all key documents for easy review.
- Create an information sheet for missing information that must be obtained.
- Review the property descriptions to make sure there are no discrepancies in the different transfers.

Chapter Review

The purpose of this chapter is to introduce the various types of titles to property that a person may

possess. Although the discussion generally is focused on titles to realty, it must be remembered that these same titles, rights, obligations, and restrictions apply to personalty as well.

Interests in real property are known as estates, and the law divides estates into two broad categories: freeholds and leaseholds. Freehold estates are those interests in property that the tenant holds for an indefinite and uncertain period of time. Freeholds are subdivided into fee estates and life estates. These titles may be held by one person or by a group of persons collectively.

The second classification of estates, the leasehold, is an interest in property that is created by contract. The rights and obligations of the parties are determined by the provisions of the lease entered into by them. A complete discussion of the law of leaseholds appears in Chapter 7.

Not all estates in property are presently exercisable. Some interests are created to take effect in the future, known as future interests. These future interests can have an important effect on a person's estate, and, to this end, several legal theories have come into existence over the years to clear titles to property.

The Rule Against Perpetuities was enacted to mandate that all transfers of property will create vested (i.e., legally enforceable) rights within a period of time specified in the Rule. Traditionally, if any future interest would vest beyond the period of the Rule, the entire conveyance was deemed invalid. To avoid invalidating conveyances, many jurisdictions have enacted salvage doctrines to bypass the dictates of the Rule. Further, any attempt to restrict the transferability of legal interests in property is deemed invalid in many states if such restriction extends beyond a statutorily determined period of time.

The law of property is one of the bulwarks of the U.S. legal system, and legal professionals must be conversant with the rights, duties, and liabilities imposed on titles to property.

Ethical Concern

All legal professionals who are not attorneys must be careful not to give legal advice. In the case of real property law, because so much of the work is performed by legal assistants, it is very tempting for the paralegal to provide advice to clients. This is an ethical violation for the legal assistant and for the attorney who supervises the legal assistant.

Key Terms

Abstract of title
Alienate
Co-tenant
Community property
Concurrent ownership
Contingent remainder
Defeasible fee
Encumber
Estate
Executory interest
Fee

Fee simple absolute
Fee simple determinable
Fee simple subject to a condition subsequent
Fee simple subject to an executory interest
Fee tail
Four unities
Freehold
Grantee
Grantor
Indefeasibly vested remainder
Joint tenancy
Landlord
Landlord-tenant law
Lease
Leasehold
Lessee
Lessor
Life estate
Life estate pur autre vie
Life tenant
Measuring life
Ouster
Partition
Personal property
Personalty
Possibility of reverter
Real property
Realty
Remainderman
Rent
Right of re-entry
Right of survivorship
Rule Against Perpetuities
Salvage doctrines
Tenancy by the entirety
Tenancy in common
Tenancy in partnership
Tenancy in severalty
Tenant
Title

Vested remainder subject to complete divestment
Vested remainder subject to a condition subsequent
Vested remainder subject to open
Vesting

Exercises

1. Research how your state applies the Rule Against Perpetuities and whether it has any salvage doctrines.
2. Discuss the advantages of holding title to property as a tenant in common, a tenant by the entirety, and community property.
3. Give three examples by which a life estate pur autre vie may be created.
4. Discuss the difference between a contingent and an executory interest.
5. Discuss several problems that may occur if a conveyance is made to a class of persons rather than to named individuals.

Situational Analysis

A couple has lived together for eight years but has not married. They decide to purchase a home together and want to make sure that each one's rights are protected. The woman is providing the bulk of the purchase price. How should the couple be advised to protect their interests? What factors must be considered?

Edited Cases

The first case discusses the ability of a person to change her estate from one title to another. The second case highlights the problems involved in the construction of a grantor's wishes with respect to the nature of the title he wishes to convey.

Jane Long Smith v. Trinity United Methodist Church

2000 Conn. Super. LEXIS 587

This is an action brought by certain family members of Evelyn Page Long claiming that a deed from Evelyn to herself Evelyn for life and then to Trinity United Methodist Church was the product of undue influence, dominion and control and fraudulent inducement while Evelyn was incapacitated. The defendant church denies these allegations. The conveyance is recorded on the land records on March 16, 1995.

The plaintiffs move for summary judgment. The motion, dated February 1, 2000 does not directly address the pleadings but rather contends that the deed is as a matter of law unable to convey the right title and interest in this land.

The plaintiffs argue that a person cannot directly convey to herself a life interest when she is the owner of the fee in property. Hence, since there is no life estate conveyed there can be no remainder to the church. The

plaintiff states "there is no common law, nor statutory law, recognizing a conveyance to oneself of real estate the title to which is held by oneself."

The plaintiff does not cite any Connecticut cases directly supporting that proposition. The defendant does not cite any Connecticut cases directly opposed to the defendant's contention. The plaintiff cites an Illinois case which stands for the proposition that "a person cannot deliver to himself that which he already possesses." That case, however, is dependent upon that court's interpretation of common law seisin, claiming that a person cannot make livery of seisin to himself.

The decision in that cited case misinterprets the common law concept of seisin. Moynihan, A Preliminary Survey of the Law of Real Property, West Publishing Company, 1940 presents a detailed analysis of the English Common Law as pertains to real property.

"A freehold estate is one in fee simple, fee tail or for life. All other estates are non-freehold. A lessee for years has possession but seisin is in the reversioner or the remainder man having a freehold estate." Moynihan, supra, pp. 41, 42. "Seisin is possession, possession of land under a claim of a freehold estate therein." Moynihan, supra, p. 42.

In the case of a life tenant seisin vests in the life tenant and upon his death seisin vests in the remainder holders. "The livery of seisin to B (life) would be effectual to transfer the seisin to or on behalf of all the tenants in remainder. On B's death seisin would vest in C." The concept that a person cannot "make" such as sitting on the land, has lost its ceremonial indica, still seisin is of significant import, as, for example, it forms the basis of our present statutes and case law as concerns adverse possession.

It is obvious in the instant case that Evelyn Page Long, as the freeholder had and then retained seisin as the life tenant, and upon her death the remainder, the unencumbered fee, would pass to the remainderman, the church.

The further question which is raised by this motion is whether in this state there is a prohibition against a person, having the fee in land, conveying to herself a lesser estate with simultaneous granting to another of the reversion. There can be no question but that the holder of the fee could convey to a third party the fee, subject to and reserving for herself a life estate. That is a common method to retain a life estate. (One of the documents submitted is the earlier motion for summary judgment, and as proffered at oral argument, is that the church did not want to have any responsibility for the property during the life of Evelyn Page Long, and hence that manner of transfer was unavailable.)

There are no Connecticut Appeals Courts decisions dealing with the proposition of whether one can convey to herself a lesser interest than she already has. On one occasion the Supreme Court relates that "…the decedent, through a straw man, by quit claim deals, conveyed his interest in his lone property to the plaintiff and himself with right of survivorship." There was no question before that court as to whether this "straw man" procedure was the only way to convey to oneself a lesser interest. This court however, is attentive to the Goldstein court's description of a conveyance to himself through a straw man, this verbiage hence disregarding any fiction or illusion of a bona fide transfer to the straw man. This verbiage bespeaks of agency and not of independent transactions.

Further precedent is noted in the Superior Court case of Curtis v. Smithers, 20 Conn. curtis, Supp. 321, 134 A.2d 576 (1957), wherein Judge Thim held that a person holding a fee could directly convey to herself and her husband as joint tenants, thus of course diminishing her estate in fee simple. This court further notes

that by Public Act 677, in 1959, two years after Judge Thim's decision, the legislature enacted what is now General Statutes 47-14a affirming the right of a grantor to convey to herself a joint tenancy or tenancy in common, which obviously is a lesser estate than the grantor had prior to the conveyance.

For the reasons set forth herein the motion for summary judgment is denied.

Case Questions

1. What is meant by the term "seisin"?
2. How does the court distinguish between a freehold and non-freehold estate?

White v. Hayes

2003 Tenn. App. LEXIS 683 (2003)

This is a will construction case. The testator's will devised his estate to his children, then to his grandchildren, then to his great-grandchildren. When the great-grandchildren became of age, the estate was to be divided "as law directs." The plaintiffs, great-grandchildren of the testator, filed this action seeking interpretation of the will and a statement of each party's interests. The trial court found that the will in question violated the Rule Against Perpetuities and ordered that the estate be divided among the testator's living heirs as tenants in common and per stirpes. The plaintiffs appeal. We vacate the decision of the trial court and remand for consideration of the cause in light of the Tennessee Uniform Statutory Rule Against Perpetuities, *T.C.A. 66-1-201 to -208*.

Dr. Hillery W. Key ("Dr. Key") died testate in 1912. Paragraph six of his holographic will ("Will") devised the following:

> I desire and will that my real estate shall be enjoyed by my children during their lives as tenants in common; then by my grandchildren during their lives and then by my great-grandchildren until they become of age. Then said estate may be divided as the law directs. This bequest is of course subject to the bequests made above.

Dr. Key's children have died and his last living grandchild died in 1992. It appears from the record that he currently has twenty living great-grandchildren and twenty-nine living great-great-grandchildren.

In 1998, seventeen of Dr. Key's great-grandchildren (collectively, "the Plaintiffs"), asked the trial court to interpret Dr. Key's Will and state each party's interest in Dr. Key's estate. A hearing was held on November 4, 1999. Arguments were presented regarding application of the class gift doctrine and the Rule Against Perpetuities. The trial court found that the class gift doctrine did not apply to the Will, but that the Will violated the Rule Against Perpetuities. The trial court stated:

> It is argued by the plaintiffs that, because a great-grandchild was living at the time of Dr. Key's death, paragraph 6 of the will does not violate the Rule Against Perpetuities. However, it is clear that the test as to the Rule Against Perpetuities is not whether the property does vest within the time prescribed, but whether the interest must vest, if at all, not later than 21 years after some life in being at the creation of the interest. (Footnotes omitted.) Obviously, there is the possibility of grandchildren and great-grandchildren being born after the termination of the lives in being at the time of Dr. Key's death, and that there was a possibility that the property would vest in unborn children of unborn children. Thus, the provision is void for remoteness.

Therefore, the trial court found that the Will violated the Rule Against Perpetuities. Based on this holding, the trial court held that the property would vest in Dr. Key's children, and that "all living heirs of Dr. Key own

the property as tenants in common and per stirpes." From this order, the Plaintiffs appeal.

On appeal, the Plaintiffs argue that the Will does not violate the common law or statutory Rule Against Perpetuities and that the property should vest solely in the great-grandchildren of Dr. Key.

In 1994, the Tennessee legislature adopted the Tennessee Uniform Statutory Rule Against Perpetuities. *Tenn. Code Ann. 66-1-201 to -206* (Supp. 2002). *Section 66-1-202 of the Tennessee Code Annotated* states in part:

> (a) A nonvested property interest is invalid unless one (1) of the following conditions is satisfied:
> (1) When the interest is created, it is certain to vest or terminate no later than twenty-one (21) years after the death of an individual then alive; or (2) the interest either vests or terminates within ninety (90) years after its creation.

Tenn. Code Ann. 66-1-202(a) (Supp. 2002).

Thus, the statute incorporates a variation of the traditional common law Rule Against Perpetuities, stating that an interest in nonvested property can be valid if the interest vests or terminates within ninety years after its creation. See generally Amy Morris Hess, *Freeing Property Owners from the RAP Trap: Tennessee Adopts the Uniform Statutory Rule Against Perpetuities*, *62 Tenn. L. Rev. 267 (1995)*. In addition, *section 66-1-204 of the Tennessee Code Annotated* provides that, under certain circumstances, the disposition of property may be reformed.

In the case at bar, the trial court correctly found that Dr. Key's Will violated the common law Rule Against Perpetuities. It appears from the record, however, that the Tennessee Uniform Statutory Rule Against Perpetuities was not argued to the trial court and was not considered by the trial court in its holding. Since the statute appears applicable, we must vacate the trial court's decision and remand the cause for consideration in light of the Tennessee Uniform Statutory Rule Against Perpetuities, including, but not limited to, *sections 66-1-202* and *-204 of the Tennessee Code Annotated*.

The decision of the trial court is vacated and the cause remanded for further proceedings not inconsistent with this Opinion. Costs on appeal are taxed equally to the appellants, Lorenzo C. White and Vernon R. White, and their surety, for which execution may issue, if necessary.

Case Questions

1. Do you agree with the decision of the court?
2. Are there any salvage doctrines that would create a different result?

Additional Case Analysis

1. A group of people (Group A) owns two-thirds of property that has certain oil and mineral rights attached thereto, with a reversionary interest in the other third. Another group (Group B) owns the oil and mineral rights to the other one-third of the property for a term of 15 years, and for so long as oil and minerals are produced on that one-third. Group A wants to partition that portion of Group B's property that does not produce oil or gas; Group B objects. Discuss what rights are involved in this

dispute, and indicate how you would resolve the problem. See *Witt v. Sheffer*, 636 P2d 195 (1981).

2. In their wills, parents left an undivided one-half interest in a parcel of land to each of their two daughters, provided that, should the daughters decide to sell the property, their brother would have the first right to buy. After a dispute between the sisters, they each went to court to have their interests partitioned. The brother sued to exercise his first right to buy. How would you decide each party's rights? See *Channer v. Cumming*, 270 Neb. 231 (2005).

2 Rights Incident to Titles in Realty

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Define "adverse possession"
- Discuss the effect of adverse possession on title to realty
- Understand the legal implications of surface rights
- Explain what water rights are
- Differentiate between a watercourse, ground water, and surface water
- Define "nuisance"
- Indicate the difference between a public and a private nuisance
- Discuss the concept of a fixture
- List the four types of waste that may affect a person's rights to property
- Define "emblements"
- Apply some practical tips with respect to rights incident to real property titles

CHAPTER OUTLINE

CHAPTER OVERVIEW

The preceding chapter introduced the various titles that may be acquired to create an interest in property. As discussed in that chapter, these titles apply to interests in all property, real or personal. This chapter and the five that follow focus on rights that are incident to a person holding a title in real property only.

Chapter 1 began with the adage that the law of property really concerns a "bundle of rights." This chapter underscores that axiom by discussing several different rights that are incident to owning or possessing realty in which the only common denominator is the realty itself. That is, for the most part, these rights and obligations are not conceptually related outside of their relationship to the land. The seven rights that are examined in this chapter are:

(a) adverse possession, the manner in which the owner of realty may lose his or her title to all or part of the land to an interloper;
(b) surface rights, the right of a landowner to have the land supported by the neighboring property;
(c) water rights, the right of a titleholder in realty to use and exploit the natural resources located beneath the land;
(d) nuisance, the right of the titleholder to the quiet enjoyment of the use of the property;
(e) fixtures, the manner in which personal property may become permanently affixed to and considered part of the land;
(f) waste, the right of the titleholder to prevent the reduction in value of the property; and
(g) emblements, the right to use and enjoy the vegetation that grows on the land.

Adverse Possession

Adverse possession is a method whereby a person may acquire title to all or part of another person's real estate by operation of law. Titles acquired by adverse possession arise when a person, not the titleholder, takes physical possession of the property for a statutorily determined period of time without the true owner attempting to oust the trespasser. To acquire title by adverse possession, certain requirements must be met:

(a) The statutory period: Each jurisdiction, by statute, specifies the time period for determining whether a person has acquired title by means of adverse possession. Typically, the period ranges between 10 and 20 years, depending upon the particular state.

 **EXAMPLE:**

Blackacre is located in a state in which a person may acquire title by adverse possession after possessing the property for ten years. The owner of Blackacre, an undeveloped parcel, lives over 800 miles away and has never visited the site; the property was purchased as an investment for future development. An interloper comes onto the land in 1991 and puts up a shack on the property. The interloper uses the property as a residence. In 2001, after ten years have elapsed, the interloper may have the court declare him the owner of Blackacre by adverse possession.

(b) The possession of the property must be open and notorious: This requirement mandates that the interloper's possession be visibly apparent so that the true owner would be deemed to have notice of the fact that someone was in possession of the property.

 **EXAMPLE:**

In the preceding example, the fact that the interloper constructed a shack on the lot and actually resided in the shack for the statutory period would be deemed sufficiently "open and notorious" to meet this requirement. If the owner had visited Blackacre, the shack and the evidence of habitation would have been obvious.

(c) Actual and exclusive possession: This requirement indicates an actual use and possession of the property in question. If the interloper only occupies a small part of the property, he or she may only acquire title by adverse possession to the part actually used. However, if the interloper occupies a reasonable portion of the property, and has some colorable title to the rest of the land, it will be considered as actual possession of the entire lot.

 **EXAMPLE:**

Whiteacre is a ten-acre tract of undeveloped land. An interloper comes onto the property and builds a small house with a flower and vegetable garden on one-half acre of the property. The interloper then constructs a small and simple stone fence around all of Whiteacre. This use of the property would probably be considered possession of all of Whiteacre.

The fact that two or more people may be taking possession does not destroy the requirement of "exclusive" use, provided that one of the persons is not the true owner.

 **EXAMPLE:**

A brother and sister find an abandoned house on an acre of property. They take possession of the house for the statutory period. The siblings may acquire title by adverse possession as tenants in common. Conversely, if the house had been inherited by the sister from their father and the brother resented that fact and continued to reside in the house along with the sister, he would not acquire title by adverse possession because he is residing with the true owner.

(d) Continuous possession: To acquire title by adverse possession, the interloper must possess the property for the entire statutory time limit in one continuous period—unconnected periods of possession cannot be totaled together to meet the statutory period. However, the use of the property by the interloper does not have to be continuous if such use would be inconsistent with the nature of the property in question. Also, an interloper may tack his possessory period to another's period, provided that there is privity between the interlopers.

 **EXAMPLE:**

An interloper obtains possession of a run-down beachfront house that she uses for vacations during the warm weather periods and for holidays during the winter months. This use of the property is consistent with the nature of the property, and therefore this use would be deemed continuous.

 **EXAMPLE:**

An interloper has lived on a parcel of land for seven years when he dies. He wills his interest to the property to his daughter who continues to live on the land for the remainder of the statutory period (ten years). Because there was privity between the parties, the seven years can be tacked on to the three years for the full possessory period of ten years.

(e) Hostile possession: The person who is claiming title by adverse possession must evidence that he or she possessed the property without the permission of the true owner. If the true owner agrees to the possession, explicitly or implicitly, the possession is not considered to be hostile and the statutory period will not run.

 **EXAMPLE:**

In the earlier example in which a house was inherited by a sister but was inhabited by the brother as well as the sister, as long as the sister permits the brother to reside with her, the brother's possession is not considered to be hostile. Whenever the owner remains in possession of the property, all other

persons are legally considered to be in possession with the owner's permission.

If the property in question is held by two or more people as co-tenants (see Chapter 1), the possession by one tenant is never considered to be adverse to the other co-tenant because all co-tenants have equal rights of possession. For a co-tenant to be in possession adverse to the interests of the other co-tenants, the tenant-in-possession must attempt to oust the co-tenant by a court order or by an explicit assertion that he or she is claiming exclusive title.

 EXAMPLE:

> Two brothers inherit a farm as tenants in common. One brother decides to live on the farm and work the land while the other brother returns to the city. Merely leaving the farm and going to the city does not constitute an abandonment of the property by the urban brother, thereby making the farming brother's possession adverse; the urban brother must make an affirmative act of abandonment in order to start the other brother's period of adverse possession.

Once all of the statutory requirements have been met, the claimant interloper may go to court for an order to **quiet title** in which the court will vest title in the claimant by adverse possession (see Chapter 5). The adverse possessor has now become the true owner of the property.

Surface Rights

Surface rights refer to a property owner's right to have the land supported in its natural state by all adjoining land (**lateral support**). This means that if one landowner uses his property in a manner that causes a neighbor's land to subside, the landowner will be held strictly liable for the resulting injuries to the land. Being held **strictly liable** means that the person who causes the injury is held legally responsible for the injury regardless of how careful he was in performing the action that caused the injury.

 EXAMPLE:

> A young couple have just purchased their first house and are remodeling the property. They want to create a small ornamental pond and hire a landscaper to excavate the pond on a corner of their property. Unbeknownst to the parties, there is a fault beneath the surface, and when the landscaper digs down a few feet a portion of the land collapses, including a part of their neighbor's garden. The couple is strictly liable for the injuries resulting from the collapse of the land to the neighbor's garden.

If the property that is injured has buildings constructed on it, and the damage to the surface causes injury to the structures, the landowner who caused the damage will be held liable if the collapse would have occurred to the property in its natural state. Otherwise, the person who caused the damage to the lateral support will only be liable if he or she acted negligently.

 EXAMPLE:

A woman is remodeling her townhouse. The townhouse shares a wall with the house next door. While the digging is taking place the work causes the neighbor's wall to collapse two feet. If the neighbor can prove that the land would have collapsed even if no house were on it, the woman will be held strictly liable for the damage to the house. If the damage to the wall was only occasioned because of the weight of the house built on the land, the woman will only be held liable if the digging was done in a negligent manner.

In addition to lateral support, a property owner is entitled to **subjacent support**, meaning that anyone who is occupying the area beneath the property must support the surface and all buildings on the property that existed when the use commenced. The underground user will be held strictly liable for any resultant injuries to the land and the buildings on it. If a building is erected after the underground use began, the underground user will only be liable for damage to that structure if the user was negligent and that negligence caused the injury.

 EXAMPLE:

A landowner permits an oil company to drill for oil on his property. The property in question has a house located on it. After the drilling has begun, the landowner uses some of the money he received from the oil company to build a garage. Two months later, due to a weakness in the underground rock that could not have been discovered prior to the drilling, the land gives way and damages the house and the garage. The oil company will be held strictly liable for any resulting injury to the house, but will only be liable for injury to the garage if it can be shown that the company was negligent in its work and that negligence caused damage to the garage. The house was on the property when the use began, but the garage was added after the work had started.

Water Rights

The owner of land has certain rights of use, and limitations of use, of the water located on the land. These rights depend upon whether the water is a watercourse, ground water, or surface water:

(a) Watercourse: A **watercourse** is a stream, a river, or a lake, and four separate legal concepts have developed with respect to the rights incident to these types of waters:
   i. **The riparian doctrine.** The **riparian doctrine** holds that a landowner has the unfettered right to use all watercourses that abut or are surrounded by his or her land. The person who holds riparian rights may use the water only for the land that gives rise to this right, but this use may be limited by the particular jurisdiction.
   ii. **Natural flow theory**. Pursuant to the **natural flow theory**, the landowner may only use the water in a manner that does not damage the quality, quantity, or velocity of the water for adjoining landowners.

 EXAMPLE:

A farmer owns a parcel of land through which a small river flows. In order to irrigate the land, the farmer constructs dykes in the river to direct the water. This causes a tremendous diminution in the amount of water that flows onto his neighbor's property. The neighbor can enjoin the farmer from such use because it destroys the natural flow of the river.

iii. Reasonable use. This doctrine, which is the most prevalent, states that riparian owners may make a reasonable use of the water, meaning that all use is permissible provided that it does not substantially interfere with the rights of other riparian owners. To determine whether the use is "reasonable," the courts consider six factors:

- the amount of the alteration in the flow of the water
- the purpose for which the water is being used
- whether the use causes any pollution to the water
- the amount and extent of the use
- the flow of the water
- any other factors that the court deems significant

Under this theory, permissible use is determined on a case-by-case basis.

 EXAMPLE:

A landowner constructs a waterwheel to harness the flow of a river on her property to generate electricity. This use causes a reduction in the flow of the river, and some downstream neighbors complain that this use has caused some pollution and a reduction in the amount of water that flows onto their property. The court will consider all factors to determine whether the landowner's waterwheel is a reasonable use of her riparian rights.

In determining whether the use of the watercourse by the riparian owner is permissible, the courts will always look to see whether such use furthers a natural or artificial purpose. Natural use is always favored over an artificial use.

iv. Prior appropriation doctrine. Under this theory landowners acquire use of the watercourse by historical actual use. Provided such use does not cause a natural decline in the flow of the water, the courts allocate priority by the time of the appropriation of the watercourse. Under this theory, an appropriated right may be lost by the abandonment of the use by the landowner.

 EXAMPLE:

In 1985 a landowner diverted a stream that runs on his property to create an ornamental pond. This diversion caused a minor reduction in the velocity of the water. Later, the adjoining property is purchased by a couple who want to use the stream for irrigation but cannot because of the decrease

in velocity. The court may consider that the first landowner has prior rights to the stream, under the prior appropriation doctrine, or may decide that such use causes a significant reduction in the velocity of the water for the neighbors.

(a) Ground water: **Ground water,** also called **percolating water,** refers to underground water. Four different theories have developed with respect to the rights to this water, depending upon the particular jurisdiction:

i. **Absolute ownership doctrine.** Twenty eastern states adhere to this doctrine, which permits the landowner to all unrestricted use of such water.

ii. **Reasonable use doctrine.** Twenty-five states favor this concept, which permits the owner of the land all use of such water except for export.

iii. **Correlative rights doctrine.** This doctrine is favored in California; it permits all the owners of overlying land reasonable use of the ground water.

iv. **Appropriation rights doctrine.** This doctrine, followed by several states in the west, allows use based on the historical use of such water, in the same manner as the prior appropriation doctrine for watercourses.

(b) Surface water: **Surface water** is defined as water that accumulates on the land, such as rainfall, that does not flow by means of a river or stream. About half of the states consider surface water to be a **common enemy,** meaning that the landowner may do anything he or she wishes to cause drainage and removal of surface water. The other states permit landowners to use only reasonable methods of draining the surface water.

The legal problems associated with surface water only concern drainage rights.

 **EXAMPLE:**

During the fall rains, a small river tends to overflow, causing surface water on the property through which it flows. One landowner has created a system of canals to run off the water, which causes a higher level of surface water on his neighbor's land. Another neighbor has constructed a channel to drain the surface water into a storage tank. The landowner who has constructed the canals may be liable to his neighbors for the increase in the surface water on the neighboring property, depending upon the jurisdiction in which the land is located. The landowner who stores the water would be totally free to make such storage use of surface water.

Nuisance

Nuisance is a theory that is based in tort law that affects a person's property rights. The law distinguishes two types of nuisance: public and private.

Public nuisance. A public nuisance is any act that unreasonably interferes with the health, safety, or property rights of the community at large. This injury can only be asserted by the government on behalf of the community; a private property owner may only assert a claim based on a public nuisance if the property owner can demonstrate some particular individual injury to his or her property. An example of a public nuisance would be using a building for hazardous waste detention that affects the property rights of the surrounding property owners.

Private nuisance. A private nuisance is a substantial and unreasonable interference with another person's use or enjoyment of property that he or she possesses. "Substantial interference" refers to any act that is offensive to the average person. The law does not consider the action to cause a substantial interference if the interference arises because of a person's hypersensitivity or the particular use to which the subject property is put.

EXAMPLE:

A nightclub has just opened on a residential street. The couple who own the house directly opposite the club are constantly awakened by the noise from the nightclub and the increased traffic from the club's patrons. The couple may be able to enjoin the club from operating if they demonstrate that the noise generated by the club creates a substantial interference with the enjoyment of their property.

If the basis of the claim of nuisance is the "unreasonable interference" with the use or enjoyment of the property, the claimant must be able to demonstrate that this interference with use or enjoyment of the property outweighs the utility of the defendant's conduct. In making its decision, the court will always bear in mind that a person is entitled to the reasonable use of his or her property, considering:

- the neighborhood in which the property is located;
- the effect on the land value to the property in question; and
- the ability of the defendant to use a different method of operation.

EXAMPLE:

A revivalist church has just opened in a residential neighborhood. The person who lives next door to the church asserts that the Sunday morning services are so loud that they interfere with the quiet enjoyment of his property. In determining whether the church's activities are a nuisance, the court will look at the actual amount of noise generated and the particular characteristics of the neighborhood.

Note that the right against interference from nuisance attaches not only to the owners of the property, but also to anyone who has the lawful possession of the property, such as a tenant.

Fixtures

A **fixture** is defined as a chattel that has been so affixed to real property that it is deemed to have become a part of the realty. A **chattel** is simply an item of personal property.

The determination as to whether a chattel has retained its identity as personal property or has become incorporated into the realty depends on two factors:

1. whether the intent of the party affixing the chattel was to make it a permanent part of the real estate; and
2. whether the chattel has been affixed in such a manner that its removal would be inconsistent with its use or would damage the structure to which it has been attached.

 **EXAMPLE:**

A landowner decides to construct a house on a vacant lot. The bricks, tiles, cement, and so forth, all of which are chattel, are incorporated into the structure during the construction of the building and they are totally incorporated as real property. Other chattels, such as water pipes, are so integral to the structure that their removal would cause severe damage to the structure; they are thereby deemed fixtures, permanently attached to the land.

 **EXAMPLE:**

A homeowner is decorating her new house. She has wall-to-wall carpeting installed in the dining room, whereas in the living room she decides to use area rugs. The wall-to-wall carpeting has become a fixture because it was installed for a particular use with the house. Conversely, the area rugs are not fixtures because area rugs are intended to be moved around.

In situations in which title to the realty is divided among two or more persons, such as a life estate followed by a remainder interest or a tenant's possessory title in the landlord's property (see Chapter 7), the law assumes, absent an agreement to the contrary, that the person with the possessory interest lacks the intent to have a chattel permanently affixed to the realty because he or she has a terminable interest.

 **EXAMPLE:**

A couple rent an apartment for a two-year period and decide to put linoleum on the kitchen floor. The linoleum is considered to be personal property, not a fixture, unless the lease specifies a different result.

Many problems are encountered when homeowners attempt to sell their property and the prospective buyer assumes certain items, such as chandeliers, switch plates, and so forth, are fixtures, whereas the sellers

consider the items as personal property that they intend to take with them. To avoid conflicts, whenever property is sold the seller should indicate at the outset which items will not be deemed fixtures.

Waste

Waste is the damage caused to real property by a person who does not have a fee simple title to the property that affects the value of the property for the successor fee holder. The doctrines associated with waste apply to life tenants and lessees because their interests terminate in favor of the holder of a fee title.

The law classifies four different types of waste:

1. **Voluntary waste:** This type of waste occurs when the tenant intentionally or negligently damages the property, or extracts its natural resources in a manner inconsistent with the rights of a life tenant or a lessee.

EXAMPLE:

A life tenant decides that he does not want the two-car garage that is on the property. He calls a construction company and has the garage demolished. The tenant's voluntary action has diminished the value of the property and therefore constitutes voluntary waste.

EXAMPLE:

A woman inherits a life estate in a diamond mine. As a life tenant of such property she is entitled to engage in ordinary mining activities. However, the woman decides to hire miners to extract the diamonds 24 hours a day, 7 days a week, to extract all the diamonds in the mine. This use is beyond the ordinary and reasonable use of the mine and may be considered waste to the interests of the remainderman.

2. **Permissive waste**: This type of waste results when the tenant fails to protect the property from damage from the elements. The life tenant is expected to make ordinary repairs on the property to maintain it in the same condition it was in when he or she acquired possession of the estate.

EXAMPLE:

A couple inherit a life estate in a brick house. They only use the house periodically, and when water starts seeping in they simply mop up the floor. Brickwork needs to be pointed every few years, but the couple are unwilling to go to the expense of maintaining the brickwork. When the damage from the water becomes so severe that the bricks start falling out, the couple will be held liable for permissive waste.

3. **Ameliorative waste**: This category of waste is distinguishable from the other forms of waste because

the action of the tenant increases rather than decreases the value of the property. Historically, a remainderman was entitled to receive the property in the same state it was in when the earlier estate took possession, thereby including all changes to the property within the category of waste. The modern trend of the court is to deny the remainderman any action for ameliorative waste, unless the remainderman can demonstrate that the "improvement" in fact lessens the value of the property to him.

 EXAMPLE:

A life tenant of a house decides that he wants to add a two-car garage to the property. The garage increases the value of the property. Historically, this construction would be considered waste to the remainderman. Today, such construction would not be considered waste, unless the remainderman could show that the building was an eyesore that will have to come down or that it was constructed in a manner that violates the zoning laws of the community.

4. Equitable waste: This type of waste concerns land that is used for agricultural purposes and arises when the life tenant fails to exercise good husbandry, thereby causing decreased production value of the land. It is fairly close to voluntary waste, but attaches to this particular type of property.

 EXAMPLE:

A man inherits a life estate in a farm. During his tenancy he only grows corn on the land and fails to rotate crops. This causes depletion in the mineral content of the soil, lessening the value of the land. The remainderman could sue on a claim of equitable waste.

If a tenant has committed waste on the property, the remainderman has a cause of action. The remainderman may either seek damages, a monetary amount to compensate the remainderman for the degree of injury sustained by the waste, or an **injunction,** a court order requiring that the tenant stop the action that constitutes waste to the property.

Emblements

Emblements are the resources incident to the land, such as crops, minerals, timber, and so forth. All persons with a possessory interest in real property are entitled to take and use the profits, or emblements, on the land, provided that such use does not go beyond an ordinary and reasonable use that would adversely affect the interests of the remainderman or the owner.

Emblements fall into two broad categories:

1. fructus naturales—these are items naturally growing or living on the land that can be used by the possessor during the period of lawful possession.

2. fructus industriales—these are items that are specifically planted by the possessor; the fruits growing on the land as the result of the possessor's own efforts. The possessor is entitled to one final taking of such fruit after the termination of the tenancy, provided that the fruit was growing on the land at the time of the termination of the tenancy.

 **EXAMPLE:**

A woman acquires a life estate in a small house situated on a few acres of land. The land has several cherry trees growing on it, as well as wild flowers. The woman decides to create an herb garden for vegetables and herbs. During the tenancy the woman may use all of the cherries, flowers, vegetables, and herbs that grow on the land. On her death, her heirs may enter the land to remove the vegetables and herbs that were planted and growing at the time of her death, but have no right to the cherries or the wildflowers.

Practical Tips

- Determine the appropriate law in the jurisdiction with respect to surface and water rights before making any changes to the land.
- If representing a landowner, make sure that the owner visits the land periodically to prevent squatters from taking adverse possession.
- If representing a squatter, make sure that he or she has stayed on the land in an open and notorious manner.
- If representing an adverse possessor, make sure that the title is affirmed by a court and recorded with the county recorder's office.

Chapter Review

Any person who acquires an interest in realty also acquires certain other specific rights that automatically attach to the title in land. This is true regardless of whether the title was acquired by sale, inheritance, lease, or adverse possession. Conversely, the titleholder may lose his or her title if a third person obtains possession of the property for a statutory period in a manner that is open, notorious, continuous, and adverse to the rights of the true owner.

The rights that are incident to titles in realty fall into two broad categories: those that permit the titleholder to exert dominion over the land itself, and those that provide the titleholder with freedom from interference with his or her enjoyment or use of the property.

The rights that permit the titleholder to exert dominion over the land are water rights (the right to use watercourses that run on the property and surface water), the right to extract minerals, and the right to fixtures, which are chattels that become permanently affixed to the land.

The rights that afford the titleholder protection from interference with the use and enjoyment of the property include the right to be free from nuisance and the right to seek judicial relief from waste to the property caused by a life tenant or lessee.

A title in realty affords the holder not only the ability to use the land, but also a bundle of other rights that permit her to protect that interest and exert control over actions that affect the land itself.

Ethical Concern

Law and interpersonal relationships often conflict. This is especially true with respect to water and surface rights. The owner of real property must be aware of the impact that asserting these rights for his or her land may have on the neighboring land. Even though the right may be legal, it may cause many personal problems between neighbors.

Key Terms

Absolute ownership doctrine
Adverse possession
Ameliorative waste
Appropriation rights doctrine
Chattel
Common enemy
Correlative rights doctrine
Emblements
Equitable waste
Fixture
Fructus industriales
Fructus naturales
Ground water
Lateral support
Natural flow theory
Nuisance
Percolating water
Permissive waste
Prior appropriation doctrine
Private nuisance
Public nuisance
Quiet title
Reasonable use
Reasonable use doctrine
Riparian doctrine
Strict liability

Subjacent support
Surface rights
Surface water
Voluntary waste
Waste
Watercourse

Exercises

1. Research the statutory period for adverse possession in your state.
2. Research which of the water rights doctrines applies in your state.
3. List several factors that you would use to determine whether a particular chattel is a fixture or removable personal property.
4. Differentiate and give your own examples of the different types of waste.
5. Briefly discuss the factors that a court might use to determine whether a given action constitutes nuisance to a property owner.

Situational Analysis

A brother and sister inherit a large farm from their grandfather. The sister is an attorney who works in a large city; the brother is unemployed. The brother takes up residence on the farm to till the soil. Because of the size of the farm, the brother only farms one-half of the property. Ten years later, a couple claim title to the other half of the property by adverse possession, stating that they have lived in a cabin on the land for ten years. What evidence would be needed to support the couple's claim? What impact does this claim have on the sister's rights? What other information do you need?

Edited Cases

The first case, *Kral v. Boesch*, discusses the concepts of reasonable use and prescriptive easement, and the second decision, *Buckner v. Hosch*, analyzes the doctrine of adverse possession.

Kral v. Boesch

557 N.W.2d 597 (1996 Minn. App. LEXIS 1442)

Respondent Alan Kral commenced this declaratory action against appellant Ralph Boesch asserting (1) that he was entitled to a prescriptive easement to drain surface water through drainage tile on the neighboring Boesch property, (2) that Boesch was obliged to restore the tile line, (3) that he was entitled to enjoin Boesch from future interference with the tile system, and (4) that Boesch be held liable for tile line repair and Kral's crop loss. Following a March 1, 1996 trial, the district court ordered judgment on findings of fact and conclusions of law denying Kral's demand for a prescriptive easement, but, by application of the doctrine of reasonable use, granting Kral injunctive relief and damages for crop loss due to flooding caused by the

obstructed tile line.

Boesch moved for amended findings of fact and conclusions of law. On May 15, 1996, the district court denied the motion. Boesch appealed the judgment and Kral noticed review challenging the district court's determination that he was not entitled to a prescriptive easement.

FACTS

Respondent Kral and appellant Boesch own neighboring tracts of Brown County farmland. During the spring of 1993, problems developed with drain tile located on the Kral property and connected to drain tile running across the Boesch property. The problems arose when LaRay Kral, respondent's father, created a channel to drain surface water from the Kral property to a tile intake bordering the parties' properties. The intake was a vertical span of tile standing about two feet above the ground. Kral apparently lowered this intake in order to allow the channel water to flow into it. Each party testified that he believed the intake was on his property; but neither party surveyed the property to determine the actual property line. When Boesch discovered the channel and modification of the intake, he raised the intake to keep water out. He also plugged the intake with cement, thereby completely blocking the flow of air and water through the tile system. Blocking the intake caused surface water to stand in three areas of the Kral property, which resulted in crop damage.

ISSUES

1. Did the district court err in determining that respondent was entitled to relief under the reasonable use doctrine?
2. [Omitted]
3. Did the district court err in deciding that the law governing prescriptive easements is inapplicable to the determination of Kral's right to drain surface water through Boesch's tile system?

ANALYSIS

…

1. Application of Reasonable Use Doctrine; Injunction

Minnesota follows the "rule of reasonable use" with regard to diversion or obstruction [*599] of surface water. *Evers*, 444 N.W.2d at 859.

The rule is that in effecting a reasonable use for a legitimate purpose a landowner, acting in good faith, may drain his land of surface waters and cast them as a burden upon the land of another, although such drainage carries with it some waters which would otherwise have never gone that way…if

(a) there is a reasonable necessity for such drainage;
(b) reasonable care be taken to avoid unnecessary injury to the land receiving the burden;
(c) the utility or benefit accruing to the land drained reasonably outweighs the gravity of the harm resulting to the land receiving the burden;

(d) where practicable, it is accomplished by reasonably improving and aiding the normal and natural system of drainage according to its reasonable carrying capacity, or if, in the absence of a practicable natural drain, a reasonable and feasible artificial drainage system is adopted.

Duevel v. Jennissen, 352 N.W.2d 93, 96 (Minn. App. 1984) (quoting *Enderson*, 226 Minn. at 167-68, 32 N.W.2d at 289). In determining reasonableness, a court should consider the extent of harm caused, its foreseeability, and the landowner's motive for the action taken. *Miles*, 323 N.W.2d at 55. No one factor or circumstance is controlling and what is a reasonable use is a fact question to be resolved depending on the facts of each case. *Pell v. Nelson*, 294 Minn. 363, 366, 201 N.W.2d 136, 138 (1972).

Boesch does not challenge the district court's factual findings concerning reasonable use, but rather, he argues that the reasonable use doctrine should not be applied because the district court did not make provisions for increased use of the tile system or allocate costs for maintaining the system.

The reasonable use doctrine has been applied to allow a landowner to drain his land by ditching or tiling as long as the interference with the surface water is reasonable. *See id.* at 367, 201 N.W.2d at 139 (owner may drain surface water from property by tiling). We have also extended the reasonable use doctrine to drainage systems (such as the one at hand) and held that a property owner has the right to drain his land into an adjoining owner's drainage system. *Evers*, 444 N.W.2d at 860.

In the instant case, the reasonable use doctrine answers each of Boesch's challenges to its application. Boesch's concern about Kral's increased burden on the system is governed by the reasonable use doctrine. It entitles Kral to drain water into the tile system, provided the drainage remains reasonable; Boesch has the burden of proving that Kral's use of the system is unreasonable. *See id.* (rule of reasonable use permits other landowners to subsequently attach to existing drainage systems as long as the use is reasonable; use is reasonable absent evidence of damage to neighboring owner's property). There was no evidence indicating that the additional water drained from the Kral property caused surface water problems on the Boesch property. Furthermore, the legal remedy for a downstream owner who is burdened by unreasonable drainage of surface water is an action for damages. *See Pell*, 294 Minn. at 367 n.2, 201 N.W.2d at 139 n.2 (liability for drainage of surface water is incurred only for unreasonable interference); *Sachs v. Chiat*, 281 Minn. 540, 545, 162 N.W.2d 243, 246 (1968) (quoting *Stanley v. Kinyon & Robert C. McClure*, *Interference With Surface Waters*, 24 Minn L. Rev. 891, 904 (1940)) ("Each possessor [of land] is legally privileged to make a reasonable use of his land, even though the flow of surface waters is altered thereby and causes some harm to others. He incurs liability only when his harmful interference with the flow of surface water is unreasonable"). A downstream owner may not obstruct a neighboring owner's access to a drainage system when the use of that drainage system is permissible under the reasonable use doctrine. *Duevel*, 352 N.W.2d at 97. Hence, the proper remedy for Boesch, were an appropriate claim to arise, would be an action for damages rather than obstructing Kral's use of the system. The district court recognized this by enjoining Boesch from future interference with the tile system.

We conclude that the district court properly applied the reasonable use doctrine to determine Kral's right to drain surface water into Boesch's tile drainage system and the district court's findings are supported by the evidence. We also conclude that the district court did not err by not allocating costs for maintenance of the system. Boesch neither alleged nor proved harm or costs caused by Kral's use of the tile line. In fact, the

evidence indicates that Boesch had never repaired the tile line or had any problems with it until he obstructed it.

…

3. Prescriptive Easement

Kral's primary claim was for a prescriptive easement and other just and equitable relief. The district court determined that Kral was not entitled to a prescriptive easement because the basis for prescriptive easements does not apply to surface water. Kral filed a notice of review alleging that this determination was error. We disagree. The district court correctly found that Kral's use of the drainage system could not be supported by his prescriptive easement claim. *See Duenow v. Lindeman*, 223 Minn. 505, 513-14, 27 N.W.2d 421, 427 (1947) (explaining that the drainage of surface water from one owner's upper land across a neighbor's lower land is a natural right and lacks all elements of a prescriptive easement).

DECISION

The district court properly applied the reasonable use doctrine in permitting Kral's use of Boesch's tile system and in enjoining Boesch and assessing damages against him for tile line obstruction. The district court also correctly rejected Kral's prescriptive easement claim.

Affirmed.

Case Questions

1. Why did the appellate court find that the reasonable use doctrine applied to the facts of this case?
2. Why did the appellate court reject the prescriptive easement claim?

Buckner v. Hosch

987 So. 2d 1149 (Ala. Civ. App. 2007)

The defendant, James Buckner, appeals from a judgment in favor of the plaintiffs, Danny Hosch and Jowana Hosch, in a dispute regarding land. We reverse and remand.

Between 1985 and 1990, the Hosches acquired record title to several tracts of land ("the Hosches' land") located in Section 3 in Marion County. In 2000, Buckner purchased two tracts of land located in Section 3 in Marion County at a tax sale. One of the tracts purchased by Buckner ("Buckner's northern tract") contained approximately 50 acres and was located immediately north of the Buttahatchee River ("the river") and immediately south of the Hosches' land. The other tract purchased by Buckner contained approximately 70 acres and was located immediately south of the river opposite Buckner's northern tract. Although they had never acquired record title to Buckner's northern tract, the Hosches had erected a fence around Buckner's northern tract sometime in 1987 and thereafter had used it as a pasture for cattle. In 2003, Buckner received a deed conveying title to the two tracts he had bought at the tax sale in 2000. Thereafter, a dispute arose between Buckner and the Hosches over who owned Buckner's northern tract.

In 2006, the Hosches sued Buckner, alleging a quiet-title claim against him. Thereafter, the Hosches amended their complaint to allege a claim seeking the establishment of the river as the boundary line between their land and Buckner's land. Buckner answered the Hosches' complaint and amended complaint with general denials. The trial court received evidence ore tenus at a bench trial on February 23, 2007, and thereafter entered a judgment stating, in pertinent part:

"[T]he court finds that the [Hosches] are entitled to the relief prayed for in the Complaint and the Amendment thereto.

"It is, therefore, ORDERED, ADJUDGED AND DECREED as follows:

1. "That the true coterminous boundary between the lands of the [Hosches] and the lands of [Buckner] is the Buttahatchee River Y.
2. "That the lands of the [Hosches] lie adjacent to and immediately North of the aforesaid coterminous boundary, and that the lands of [Buckner] lie adjacent to and immediately South of said coterminous boundary."

Buckner moved the trial court to alter, amend, or vacate the judgment in favor of the Hosches. After the trial court denied Buckner's postjudgment motion, Buckner appealed to the supreme court, and the supreme court transferred the appeal to this court, pursuant to 12-2-7(6), Ala. Code 1975.

On appeal, Buckner argue that the trial court erred in entering a judgment in favor of the Hosches because, Buckner says, (1) this is an adverse-possession case rather than a boundary-line dispute, and, therefore, he asserts, the Hosches had to prove that they had acquired ownership of Buckner's northern tract by virtue of either statutory adverse possession or prescriptive adverse possession in order to win a judgment in their favor; and (2) the Hosches' failed to prove that they had acquired ownership of Buckner's northern tract by virtue of either statutory adverse possession or prescriptive adverse possession. We agree.

Because the trial court's judgment in this case is based on the application of the law to the facts, the following principles govern our review:

"[W]hen a trial court hears ore tenus testimony, its findings on disputed facts are presumed correct and its judgment based on those findings will not be reversed unless the judgment is palpably erroneous or manifestly unjust." "The presumption of correctness, however, is rebuttable and may be overcome where there is insufficient evidence presented to the trial court to sustain its judgment." "Additionally, the ore tenus rule does not extend to cloak with a presumption of correctness a trial judge's conclusions of law or the incorrect application of law to the facts."

In *Kerlin v. Tensaw Land & Timber Co.*, 390 So. 2d 616 (Ala. 1980), the supreme court recited Alabama law regarding adverse possession:

"In Alabama there are basically two types of adverse possession, these two types being statutory adverse possession and adverse possession by prescription. Adverse possession by prescription requires actual, exclusive, open, notorious, and hostile possession under a claim of right for a period of twenty years. Statutory adverse possession requires the same elements, but the statute provides further that if the adverse possessor holds under color of title, has paid taxes for ten years, or derives his title by descent cast or devise from a possessor, he may acquire title in ten years, as opposed to the twenty years required for adverse possession by

prescription. Code 1975, 6-5-200.

"Boundary disputes are subject to a unique set of requirements that is a hybrid of the elements of adverse possession by prescription and statutory adverse possession. In the past there has been some confusion in this area, but the basic requirements are ascertainable from the applicable case law. In a boundary dispute, the coterminous landowners may alter the boundary line between their tracts of land by agreement plus possession for ten years, or by adverse possession for ten years. The rules governing this type of dispute are, in actuality, a form of statutory adverse possession. See Code 1975, 6-5-2008.

Although the Alabama Supreme Court has applied the hybrid form of adverse possession described above in true boundary-line disputes, see, e.g., *Johnson v. Brewington*, 435 So. 2d 64, 65 (Ala. 1983), it has held that, when a coterminous landowner is claiming to have acquired all or a significant portion of another coterminous landowner's land by virtue of adverse possession, (1) the case is an adverse-possession case rather than a boundary-line dispute, (2) the hybrid form of adverse possession does not apply, and (3), therefore, the party claiming adverse possession must prove the elements of either statutory adverse possession or prescriptive adverse possession. See *McCallister v. Jones*, 432 So. 2d 489, 492 (Ala. 1983) (holding that, when one coterminous landowner claimed to have acquired ownership of a three- to five-acre portion of the other coterminous landowner's land, the case was an adverse-possession case to which the hybrid form of adverse possession applicable in boundary-line disputes did not apply); and *Kerlin,* 390 So. 2d at 619 (holding that, when one conterminous landowner claimed to have acquired ownership of the entire lot of the other coterminous landowner, the case was an adverse-possession case to which the hybrid form of adverse possession applicable in boundary-line disputes did not apply).

Buckner argues that the case now before us is an adverse-possession case rather than a boundary-line dispute because the Hosches claim to have acquired ownership of a 50-acre tract of Buckner's land by adverse possession and, therefore, that the hybrid form of adverse possession applicable in boundary-line disputes does not apply. The Hosches, on the other hand, argue that the case now before us is a boundary-line dispute rather than an adverse-possession case and, therefore, that the hybrid form of adverse possession applicable in boundary-line disputes does apply. Based on the holdings in McCallister and Kerlin, we conclude that this is an adverse-possession case rather than a boundary-line dispute because the Hosches claim to have acquired ownership of a 50-acre parcel of Buckner's land by virtue of adverse possession and, therefore, that the hybrid form of adverse possession applicable in boundary-line disputes does not apply in this case. Consequently, the Hosches were required to prove the elements of either statutory adverse possession or prescriptive adverse possession in order to win a judgment in their favor. See *McCallister and Kerlin*.

The evidence before the trial court failed to prove an essential element of statutory adverse possession because it did not indicate that the Hosches had (1) held Buckner's northern tract under color of title, (2) had paid taxes on Buckner's northern tract for ten years, or (3) had derived their title to Buckner's northern tract by descent, cast, or devise from a possessor of Buckner's northern tract. See *Kerlin, supra*.

The evidence also failed to prove an essential element of prescriptive adverse possession because it did not indicate that the Hosches had adversely possessed Buckner's northern tract for the requisite 20-year period.

Because the Hosches failed to meet their burden of proving that they had acquired ownership of Buckner's northern tract by virtue of either statutory adverse possession or prescriptive adverse possession, the trial court erred in entering a judgment in favor of the Hosches. Therefore, we reverse the judgment in favor

of the Hosches and remand the case to the trial court for further proceedings consistent with this opinion.

Case Questions

1. How does the court distinguish between statutory adverse possession and adverse possession by prescription?
2. How does the court define the hybrid form of adverse possession, and why does it conclude that it does not apply to the instant case?

Additional Case Analysis

1. A landowner sues the city for damages, alleging that the city's groundwater reclamation program caused subsistence resulting in structural damage to the landowner's property. The landowner relies on a theory of "inverse condemnation," whereas the city claims that there was a drought and that it needed to use the groundwater, taking it under its emergency powers to protect the public health and safety. How would you decide the case? See *Los Osos Valley Associates v. City of San Luis Obispo,* 30 Cal. App. 4th 1670 (1994).
2. Property owners seek compensation from the government, alleging that the Army Corps of Engineers intentionally diverted waters from the Mississippi River, which caused flooding and property damage. The property owners rely on a theory of "inverse condemnation," whereas the government claims that the injuries caused by the flood did not exceed the benefits conferred by the federal flood control system and that the single flooding event did not constitute a taking. How would you decide? What is your opinion of the "inverse condemnation" theory? See *Quebedeaux v. United States,* 112 Fed, Cl. 317 (2013).

3 Land Use

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Define the concept of land use
- Discuss what is meant by a "covenant"
- List the requirements to create a valid covenant
- Distinguish between horizontal and vertical privity
- Explain how a covenant may be extinguished
- Differentiate between a covenant and an equitable servitude
- Define what is meant by an "easement"
- List the four types of easements recognized by law
- Discuss a license as it relates to land use
- Explain the different standards of care that the possessor of land owes to persons who enter onto the land
- Distinguish between trespassers, licensees, and invitees
- Define an "attractive nuisance"
- Discuss the implications of zoning on land use
- Apply some practical tips to assist you in a land use practice

CHAPTER OUTLINE

CHAPTER OVERVIEW

Land use refers to the right of enjoyment and access to land that may be permitted to persons who are not the legal owners or possessors of the land. In this regard, this right to the use of the land affects both the person with current legal title to the property as well as a person who will eventually acquire that title.

Five major topics are discussed under the heading of land use. The first concerns restrictions that may be placed on the titleholder with respect to the nature of the use to which the property may be put. These restrictions are known as covenants, and they affect all persons who acquire title to the property from the person who originally received the property subject to the covenant.

An easement is the right of passage over or use of another person's realty, which may be acquired in several ways. Once the easement is established, the easement holder has rights to such use that may be enforced against the titleholder.

A **license** refers to the power a person may have to perform a particular act, or series of acts, on another person's property, such as having the right to receive the fruit from a neighbor's cherry tree.

Any person who has lawful possession of realty, by common and statutory law, owes certain duties of care to anyone who is physically present on the property, even if that person is considered to be a trespasser—a person who has no lawful authority to enter onto the land.

Finally, all owners of property may be subject to certain governmental restrictions. The government—federal, state, and local—has the legal authority to limit the nature of the use of geographic sections within their jurisdiction under the concept of zoning regulation.

This chapter continues the exploration of the "bundle of rights" associated with the law of property by examining these limitations imposed on a person's use of his or her own land.

Covenants

A **covenant** is a written promise to do or not to do something on or with the land. Covenants are often referred to as **real covenants** to imply their effect on realty. Most typically are found in the deed that conveys the property (see Chapter 4), and are considered to "run with the land," meaning that these provisions limit not only the person who originally acquired the deed that included the covenant, but to all subsequent titleholders as well.

 EXAMPLE:

A widow decides to generate some capital by selling off a large tract of undeveloped land that she inherited. She wishes to keep the area purely residential, and so in the deeds she executes as she parcels off the property she includes a covenant that the grantee will not construct a multi-family dwelling on the property. This restrictive provision creates a covenant that runs with the land, thereby ensuring that the property will remain residential.

As a general proposition, a person is not legally bound to any provision that he or she did not specifically indorse. However, under real property law, a person will be bound to a covenant that runs with the land regardless of his or her actual assumption of the provision if the following five requirements are met with respect to the creation of the covenant:

1. Intent: In order for the covenant to run with the land it must be evidenced that the grantor who created the covenant specifically meant that it bind the use of the property. This intent will usually depend upon the exact wording of the covenant, but may be inferred as well.

 EXAMPLE:

The widow from the previous example has divided her tract of land into 20 parcels. In 19 of her deeds she specifically includes the covenant with respect to single-family dwellings. This indicates her intent. On the last parcel she inadvertently neglects to insert the covenant. Her intent *may* be determined from the words of all the other deeds that created the subdivision.

2. Notice: This requirement means that, for a subsequent purchaser to be bound by a covenant, he or she must have notice of the existence of the covenant. This notice could either be actual, because it appears in the conveyance the purchaser acquires, or implied, because the covenant appears in the record books where title to real property is officially recorded (see Chapter 4).

 EXAMPLE:

A young couple purchases a parcel of land from the widow in the preceding examples. Twenty-five years later they decide to sell their house. The conveyance to the man who purchases their house does not include the covenant, but the deed with the covenant was filed with the recorder's office when the widow first sold the property. The man is bound by the covenant because the recording of the covenant provides notice to him as a subsequent purchaser of the property.

3. Horizontal privity: **Horizontal privity** means that the original parties to the covenant must share some interest in the property (usually the covenant), such as being the buyer and the seller, the landlord and the tenant, or the mortgagor and the mortgagee. This common interest creates privity.
4. Vertical privity: **Vertical privity** means that the person who acquired the property from the person who

first acquired the property with the covenant has acquired the entire interest of that original party.

 EXAMPLE:

In the previous example, the widow and the young couple have horizontal privity because of the contract for the sale of the land. The man who buys the property from the couple has vertical privity because the couple owned a fee that they sold to the man—he acquired their entire interest.

5. Touch and concern the land: To create a covenant, the subject of the covenant must **touch and concern the land,** meaning that its provisions must restrict a person from doing something on the parcel of land (such as not constructing multi-family dwellings) or require that the person do something on the particular parcel (maintaining the land in its natural state).

If all of the preceding five requirements are established, a real covenant that runs with the land has been created. If this type of covenant exists, the successor in interest to the original party may enforce that covenant in a court of law. The original parties would be the persons who first created the covenant, such as the widow and the young couple from the preceding example. The successor in interest is anyone who acquired title from the person who first obtained the title subject to the covenant, such as the man who bought the house from the young couple in the preceding example. (See Chapter 1 for a discussion of a fee simple subject to a condition subsequent.) To enforce the covenant, the successor in interest must prove the following:

(a) the original parties intended that the covenant could be enforced by a successor in interest;
(b) there is privity with respect to the party seeking enforcement and the original party; and
(c) the covenant touches and concerns the land.

If all of these requirements are satisfied, the party seeking enforcement of the covenant may seek damages—monetary relief—for the injury caused by its breach.

 EXAMPLE:

The man who purchased the property from the young couple in the previous example decides to modify the house to make it a two-family dwelling. This construction would violate the covenant. The man's neighbor, who also purchased his property from the widow, may go to court to seek damages if such construction takes place because the man is subject to the covenant, as is the neighbor whose deed from the widow contained the same provision.

The provisions of a real covenant may terminate if the person who could enforce the covenant executes a **release,** a document that relinquishes legal rights; the property is condemned by the government (see below); or the property is reacquired by the promisee or the promisee's successor in interest (the above-discussed widow). The reacquisition of the property by the original grantor is called a **merger** of the interests.

Closely associated with the concept of real covenants are equitable servitudes. An **equitable servitude** is a

form of a covenant that is distinguished from real covenants by the remedy that is being sought by the party seeking to enforce its provisions. If the injury results from a covenant, the injured party may seek monetary damages; if the injury results from an equitable servitude, the injured party may only seek an injunction or specific performance—equitable rather than legal remedies.

As with covenants, an equitable servitude may be created by a writing, but unlike a covenant an equitable servitude may also arise by implication. Typically, equitable servitudes arise by implication when a common scheme for a subdivision can be discerned, as with the example of the widow's property discussed above. To be bound by an equitable servitude, any person who acquires a tract of land in a subdivision must have notice of the servitude. Such notice may be actual, by means of the deed of purchase; by record, if it appears in the county record books; or by inquiry, by visual inspection of the property.

To be bound, in addition to notice, the equitable servitude must "run with the land" in the same fashion as a covenant. The primary differences between a covenant and an equitable servitude are:

(a) a covenant *must* be created by a writing whereas an equitable servitude may arise by implication;
(b) no privity, horizontal or vertical, is necessary for an equitable servitude;
(c) notice for an equitable servitude may arise by inquiry; and
(d) the remedy for the breach of a covenant is money, whereas the remedy for the breach of an equitable servitude is an injunction.

Equitable servitudes terminate in the same manner as covenants.

Covenants and equitable servitudes may be viewed as limitations on the use of the land that create fees simple determinable or fees simple subject to a condition subsequent, depending on the wording (see Chapter 1).

Easements

An **easement** is the right of access or use of another person's realty and, unless otherwise terminated, is deemed to exist in perpetuity. Easements are divided into two broad categories: easements appurtenant and easements in gross.

Easements appurtenant are rights of access and use of adjoining property. The tract of land that has the right over the adjacent property is called the **dominant tenement**, and the property that is subject to the use of the easement holder is called the **servient tenement**. Easements appurtenant attach to the land and pass along with the transfer of the title to the land.

 EXAMPLE:

Fred and Ricky own adjacent lots. Fred wants to extend his driveway, but the construction will encompass six inches of Ricky's property. By agreement, Ricky permits Fred to use the six-inch strip but retains ownership of the area. Years later, Ricky sells his property to Lucy. Lucy acquires title to the property subject to the use by Fred of the six-inch strip for his driveway.

An **easement in gross** is an easement that is held by an individual for his or her own enjoyment over non-adjacent property. An example of an easement in gross would be the right a homeowner gives to children in the neighborhood to use his property to reach their school even though they do not live on the adjoining property. If the easement in gross is for non-commercial purposes it is not transferable by the easement holder (the children), but if it is for a commercial purpose it may be transferred.

 **EXAMPLE:**

A property owner has been approached by a cellular telephone company that wants to erect a pole on the property. For a fee the property owner agrees. Because the easement is commercial in nature, the telephone company may transfer its easement rights.

Easements may be created in one of four ways:

1. **Express grant**: The express grant is a writing that may appear in the deed conveying the property or by a separate document. The person who grants the easement must be the owner of the servient tenement upon which the right of the easement will attach. The grantor of the easement may only grant the easement for the period of his title, either fee, life estate, or by lease. The grantee is the owner of the dominant tenement that benefits from the easement. An example of an easement created by express grant would be the previous example involving Fred and Ricky in which Ricky agreed to let Fred use part of his land to build a driveway.
2. **By implication**: An **implied easement** arises by the actual use of the adjacent property without consent. This is created by operation of law and so no writing is necessary. The implied easement may arise by the continuous use of the property because such use is necessary for the enjoyment of the dominant tenement. An example would be a vacation home that has access to a lake either by public road that takes two miles or by a private road over a neighboring property that would take only half a mile. If the vacation homeowner uses this private road for a significant period of time, an implied easement will be created.
3. **By necessity**: An **easement by necessity** occurs when a tract of land has no access to a public road except by going over a neighboring property. In this "landlocked" situation, the dominant tenement has the easement right to gain access to the road, but the servient tenement can determine the exact route for this access.

 **EXAMPLE:**

A tract of land is subdivided in a manner by which a property owner's access to the public road can only be gained by going over his neighbor's property. The neighbor must let the property owner have such access, but may limit that access to a particular strip of land. If access to the public road eventually extends directly to the dominant tenement property, the easement will terminate.

4. **By prescription**: An **easement by prescription** is an easement that is created in the same manner as

acquiring full title to property by adverse possession (see Chapter 2). To acquire the right, the easement holder must use the adjoining property in manner that is:

(a) open and notorious;
(b) adverse to the interest of the servient property;
(c) continuous and uninterrupted; and
(d) for the statutory period mandated by the state statute.

An easement by prescription differs from adverse possession in that the person acquiring the easement is only acquiring the right of use and access rather than title to the property itself.

Easements may terminate in one of eight ways:

1. by the condition that was stated in the grant of the easement

 EXAMPLE:

"You may use my property to gain access to the lake until the new public shortcut is constructed."

2. when the same person acquires title to both the dominant and servient tenements, thereby merging the titles
3. if the easement holder executes a release of his rights, which may be gratuitous or for consideration
4. if the easement holder abandons the easement, either for a statutory period or by a physical act such as constructing a fence surrounding the dominant tenement, thereby closing his access to the servient tenement
5. if the dominant tenement orally states his intention of abandoning the easement and the servient tenement relies on this oral expression to her detriment, the dominant tenement will be stopped from reclaiming the easement

 EXAMPLE:

The dominant tenement says that he no longer wishes to use the easement. Based on this statement, the servient tenement constructs a wall around the property. The dominant tenement will be barred from claiming easement rights because the servient tenement constructed the wall based on those statements.

6. the servient tenement can terminate the easement by prescription—using the property in a manner that is inconsistent with the easement holder's rights for the statutory period
7. if the easement was created by necessity, the easement automatically terminates when the necessity no longer exists
8. the easement will terminate if the property is condemned by the government or is unintentionally destroyed

While an easement is in effect, the servient tenement is precluded from engaging in any activity that would interfere with the easement right of the dominant tenement.

 EXAMPLE:

The owner of a servient tenement no longer wants his neighbor to trample over his property, so he constructs a wall around his land. The neighbor who has the easement right may sue the servient tenement to have the wall taken down so as not to interfere with his easement rights.

Easements create significant rights for the dominant tenement and impose significant liabilities on the servient tenement. Whenever a person acquires title to property she should determine whether any easement attaches to that property.

Licenses

A **license** is the right to do an act or a series of acts on another person's land. Unlike an easement that creates a perpetual right of use, a license arises at the pleasure of the property owner and may be rescinded by the property owner at any time. A license merely grants the **licensee**, the license holder, the permission to enter onto the other person's property, whereas an easement creates a property right in the easement holder.

 EXAMPLE:

Blackacre borders a large lake. The owner of Blackacre let his neighbors use a path across Blackacre to get to the lake. The owner also lets his friend from the city use Blackacre to fish in the lake. The neighbors may have an easement over Blackacre, whereas the city friend merely has a license. The owner of Blackacre can stop his friend from using Blackacre, but the neighbors may have acquired certain property rights to the use of Blackacre for access to the lake.

Duty of Care

Any person who is a lawful possessor of real property owes certain duties of care to third persons who come onto that property. The nature and extent of that duty depends on the category into which the third person may fall. Generally persons who enter onto the land fall into one of three categories:

1. **Trespassers** are those persons who enter onto realty without permission. Because these persons have no lawful right to be on the land, the person in possession only owes such people slight care. This means that the possessor must alert such persons only of artificial structures on the property, or natural circumstances that are not readily discernible, that may injure trespassers. An example might be the posting of a sign indicating that there are bear traps located on the property to alert the trespasser to a dangerous situation.
2. **Licensees** are persons who are permitted to enter the property with the possessor's permission for a

purpose that generally benefits the licensees. This category would include all social guests of the property owner/possessor. Licensees are entitled to the ordinary standard of care, meaning that they must be warned about dangerous conditions, such as a loose step or a broken chair, that may or may not be readily apparent.

3. **Invitees** are persons who are asked onto the property to benefit the property owner/possessor's pecuniary interest, such as customers in a retail store. The property owner/possessor owes invitees the highest standard of care, which requires that the invitee be warned of all potential defects that might cause injury.

Despite these differences, the modern trend of the law is to require the ordinary standard of care to all persons who enter onto property, regardless of the nature and reason for that entrance.

There is one important exception to the foregoing, and that exception involves any situation that would cause children to be attracted to the property. In this instance, the property owner/possessor is held to the highest standard of care so as to protect children, and may be held strictly liable under a legal doctrine called **attractive nuisance.** This doctrine relates to situations that would lure children to the property, such as a swimming pool, construction site, natural gorge, and so forth. If the property owner/possessor knows or should know that children will be drawn to the property, she is expected to take all reasonable precautions to protect the children from harm.

 EXAMPLE:

A property owner has just built a swimming pool on his property and the children in the neighborhood continually come onto the property to swim in the pool. It is dangerous for small children to swim unsupervised, and therefore the homeowner is required to construct a fence around the pool to keep the children away from the pool for their own good.

Zoning

The government is empowered to restrict land use for the purpose of protecting the general health and welfare of the public. To effect this mandate, local governments enact **zoning regulations** that restrict land use. Provided that there is some rational basis between the zoning regulation and the general welfare of the community, such government restrictions on land use are deemed to be constitutional, meaning that it is not considered to be a deprivation of property. However, to ensure the constitutionality of the zoning regulation, a proposed regulation is subject to a public hearing so that members of the community may present arguments for and against the proposed regulation. See Exhibit 3.1.

Exhibit 3.1: California Statutes

Zoning Statutes

§65854.2.1. Single-family residence zone; permit for dwelling unit for senior citizen occupancy; application of section

Notwithstanding Section 65906, any city, including a charter city, county, or city and county may issue a zoning variance, special use permit, or conditional use permit for a dwelling unit to be constructed, or which is attached to or detached from, a primary residence on a parcel zoned for a single-family residence, if the dwelling unit is intended for the sole occupancy of one adult or two adult persons who are 62 years of age or over, and the area of floor space of the attached dwelling unit does not exceed 30 percent of the existing living area or the area of the floor space of the detached dwelling unit does not exceed 1,200 square feet.

Basically, zoning consists of designating geographic areas for specific purposes, such as residential, commercial, public (parks, town halls), and mixed use. Furthermore, within these areas the zoning regulation may prescribe the nature of the buildings that may be constructed within the zone, such as single-family dwellings, multi-family dwellings, and so forth. Enforcement of the zoning regulations rests with a governmental body known as a **zoning board**.

Various problems may arise with respect to zoning regulations. First, if a particular use of the property has existed for a long period of time prior to the zoning regulation that would not permit such a use, the property owner may continue such use provided that it can be demonstrated that such use actually pre-dated the regulation.

 EXAMPLE:

At the turn of the twentieth century a farmer built a small shed next to the road to sell his farm produce. Over the years the entire area became residential, and most of the farms were sold off. The farmer's great-grandchild continues to use the shed, slightly enlarged, as a store. The area has just been re-zoned for residential use only, and the neighbors want the store to stop operating. The great-grandchild may be able to continue running the store by documenting a preexisting use.

If a preexisting use has been established, that use may continue, but any change in the specific use would thereafter have to conform to the current zoning regulations.

Second, zoning regulations may also require certain architectural standards to maintain a uniform style in a community. Therefore, when a homeowner intends to make structural changes to his or her house, it may require prior approval of the zoning board.

 EXAMPLE:

A woman has just purchased a colonial house in a city's historical district. She wants to modernize the house for twenty-first century use. Before she may make any changes to the outside of the building, she must obtain approval of the zoning board.

Third, if a person wants to use his property in a manner inconsistent with current zoning regulations, he may be able to obtain a **variance** from the zoning board, giving him permission to use the property in this manner. Before permitting a variance, most boards require a public hearing so that members of the community may express concerns about the effect of the variance on the community.

Exhibit 3.2:California Statutes

Building Code

§65850.2. Use of regulated substances or sources of hazardous emissions; development projects or building permit applications for projects not requiring development permits; information lists and application forms; completion of application or approval; risk management plans; fees

(a) Each city and each county shall include in its information list compiled pursuant to Section 65940 for development projects, or application form for projects which do not require a development permit other than a building permit, both of the following:

(1) The requirement that the owner or authorized agent shall indicate whether the owner or authorized agent will need to comply with the applicable requirements of Section 25505 and Article 2 (commencing with Section 25531) of Chapter 6.95 of Division 20 of the Health and Safety Code and the requirements for a permit for construction or modification from the air pollution control district or air quality management district exercising jurisdiction in the area governed by the city or county.

(2) The requirement that the owner or authorized agent shall certify whether or not the proposed project will have more than a threshold quantity of a regulated substance in a process or will contain a source or modified source of hazardous air emissions.

(b) A city or county shall not find the application complete pursuant to Section 65943 or approve a development project, or a building permit for a project which does not require a development permit other than a building permit, in which a regulated substance will be present in a process in quantities greater than the applicable threshold quantity, unless the owner or authorized agent for the project first obtains from the administering agency with jurisdiction over the facility, a notice of requirement to comply with, or determination of exemption from, the requirement to prepare and submit an RMP. Within five days of submitting the project application to the city or county, the applicant shall submit the information required pursuant to paragraph (2) of subdivision (a) to the administering agency. This notice of requirement to comply with, or determination of exemption from, the requirement for an RMP shall be provided by the administering agency to the applicant, and the applicant shall provide the notice to the city or county, within 25 days of the administering agency receiving adequate information from the applicant to make a determination as to the requirement for an RMP. The requirement to submit an RMP to the administering agency, shall be met prior to the issuance of a certificate of occupancy or its substantial equivalent. The owner or

authorized agent shall submit to the city or county certification from the air pollution control officer that the owner or authorized agent is in compliance with the disclosures required by Section 42303 of the Health and Safety Code.

(c) A city or county shall not issue a final certificate of occupancy or its substantial equivalent unless there is verification from the administering agency, if required by law, that the owner or authorized agent has met, or is meeting, the applicable requirements of Section 25505 and Article 2 (commencing with Section 25531) of Chapter 6.95 of Division 20 of the Health and Safety Code, and the requirements for a permit, if required by law, from the air pollution control district or air quality management district exercising jurisdiction in the area governed by the city or county or has provided proof from the appropriate district that the permit requirements do not apply to the owner or authorized agent.

(d) The city or county, after considering the recommendations of the administering agency or air pollution control district or air quality management district, shall decide whether, and under what conditions, to allow construction of the site.

(e) Nothing in this section limits any existing authority of a district to require compliance with its rules and regulations.

(f) Counties and cities may adopt a schedule of fees for applications for compliance with this section sufficient to recover their reasonable costs of carrying out this section. Those fees shall be used only for the implementation of this section.

(g) As used in this section, the following terms have the following meaning:

(1) "Administering agency," "process," "regulated substance," "RMP," and "threshold quantity" have the same meaning as set forth in Section 25532 of the Health and Safety Code.

(2) "Hazardous air emissions" means emissions into the ambient air of air contaminants which have been identified as a toxic air contaminant by the State Air Resources Board or by the air pollution control officer for the jurisdiction in which the project is located. As determined by the air pollution control officer, hazardous air emissions also means emissions into the ambient air of any substance identified in subdivisions (a) to (f), inclusive, of Section 44321 of the Health and Safety Code.

(h) Any misrepresentation of information required by this section shall be grounds for denial, suspension, or revocation of project approval or permit issuance. The owner or authorized agent required to comply with this section shall notify all future occupants of their potential duty to comply with the requirements of Section 25505 and Article 2 (commencing with Section 25531) of Chapter 6.95 of Division 20 of the Health and Safety Code.

Zoning regulations are typically enforced by the government by seeking an injunction against any person who violates a zoning regulation without having obtained permission by means of a variance from the zoning board.

Closely associated with zoning regulations are **building codes** that mandate minimum requirements for construction, electricity, plumbing, and so forth, of all structures. See Exhibit 3.2. Such laws regulate the

material and methods used in construction of a building, and buildings may not be occupied without obtaining a **permit** and inspection by the locality's governmental agency that oversees these laws. If a structure does not meet the standards of the building codes and is declared to be dangerous for occupancy, the government may be able to **condemn** the building, meaning that it may be destroyed for the welfare and safety of the public.

Probably the most dramatic governmental interference with land use is its ability to take over private property for public purposes, such as the construction of a road, under the doctrine of **eminent domain**. To meet constitutional guarantees, no private property may be taken by the government without adequate compensation. Questions may arise as to the adequacy of the proffered compensation, but the property owner has no choice but to sell the property to the government.

 EXAMPLE:

A man purchased some undeveloped land ten years ago as an investment. At the time he paid $10,000 for the property. Over the years the surrounding area has become populated, and the man believes his investment is now worth $100,000. The local government informs him that they will need to acquire his property to create roads, utilities, and so forth, due to the new population in the area. The government only pays him $45,000 for the property. The man must transfer title to the government, but may challenge the adequacy of the consideration in court.

Practical Tips

- Check the title at the recorder's office to determine whether any easement exists on the land. If representing the easement holder, make sure all easements are recorded; if representing the servient tenement, see if the easement can be removed.
- Make sure all valid easements and liens are recorded.
- Make no change to existing structures until all zoning requirements and restrictions have been determined.
- Prepare any documents that may be necessary to validate the need for a zoning variance.
- Maintain evidence of all licenses that may be granted to avoid any future problems.
- Become familiar with members of the local zoning board.

Chapter Review

The right to own and possess land is not absolute. Certain limitations and restrictions may be imposed on the use of realty that severely limit the titleholder's unfettered enjoyment of the property.

The most prevalent types of restrictions on land use are covenants and equitable servitudes, restrictions on the use of property that arise when the property is transferred. These limitations create rights in persons not the property owner to see that these restrictions are enforced, either by means of seeking monetary

damages for violations of the real covenants or injunctions against violations of equitable servitudes.

Easements create rights of use of and access over one person's property by another, and this use and access can have important effects on what the property owner may or may not do to his or her own land. Unless specifically terminated, easements are deemed to exist forever, and the owner of the property that is subject to the easement cannot do anything that would interfere with the easement holders' rights.

Closely related to easements are licenses—permissions by the property owner/possessor to third persons to enter the land for a particular act or for a series of acts. However, unlike easements, licenses are not rights, and unless established by contract, are totally revocable by the property owner/possessor at will.

All persons in lawful possession of realty are required to maintain the property in a manner that renders it safe for third persons who enter onto the land. Historically, the law distinguished the standard of care owed by the property owner/possessor by the nature of the third person—trespasser, licensee, or invitee—but the modern trend of authority imposes the ordinary standard of care on the property owner/possessor regardless of the status of the third person. There is one exception to this modern trend that exists for attractive nuisances, hazardous situations that could cause children to wish to enter the property. In this instance the property owner/possessor is held to a standard of strict liability.

Finally, a person's ability to use his or her property may be restricted by several governmental regulations, such as zoning regulations, building codes, and the power of eminent domain.

Ethical Concern

Just because a trespasser is injured on the land does not mean that the landowner is in any way responsible. It is unethical to institute a legal claim against a landowner for injuries that a trespasser caused through his or her own fault. Such frivolous actions may result in sanctions imposed by the court.

Key Terms

Attractive nuisance
Building code
Condemn
Covenant
Dominant tenement
Easement
Easement appurtenant
Easement by necessity
Easement by prescription
Easement in gross
Eminent domain
Equitable servitude
Express grant
Horizontal privity
Implied easement

Invitee
Land use
License
Licensee
Merger
Permit
Real covenant
Release
Servient tenement
Touch and concern the land
Trespasser
Variance
Vertical privity
Zoning regulations
Zoning board

Exercises

1. Determine the statutory period for acquiring an easement by prescription in your jurisdiction, as well as the other requirements to create such an easement.
2. Briefly discuss the methods whereby an easement may be terminated.
3. Research the zoning regulations for your neighborhood. Determine the procedures for obtaining a variance from your zoning board.
4. How would you determine "reasonable compensation" for the taking of private property by the government in a case of eminent domain?
5. Research some cases of attractive nuisance decided in your state.

Situational Analysis

By agreement, Alan was given the right to use a portion of Betty's property as a driveway for a period of one year until he could construct a driveway of his own. The year ended four months ago and Alan continues to use Betty's property and has not constructed his own driveway. What are the respective rights of the parties? What information might you need to arrive at your conclusion?

Edited Cases

The following two judicial decisions underscore certain principles introduced in this chapter. Problems with easements are discussed in *Price v. McNeil*, and the differences between licenses and easements are analyzed in *Taylor v. Vanderlip*.

Price v. McNeil

2001 Ala. Civ. App. LEXIS 221

Gary Price and Martha Price (the "servient estate") own real estate subject to an easement that is now owned by Deborah McNeil (the "dominant estate"). They are adjacent landowners. The servient estate sued the dominant estate, alleging that the dominant estate had wrongfully obstructed their use of the easement by erecting a locked gate. The trial court eventually ruled in favor of the dominant estate, concluding that the dominant estate had an "exclusive" easement that barred any use by the servient estate. The servient estate appealed to the supreme court, which transferred the case to this court, pursuant to Ala. Code 1975, Sec. 12-2-7(6). We reversed the trial court's judgment, holding that, as a matter of law, the easement was not "exclusive." See *Price v. McNeil*, 771 So. 2d 1054 (Ala. Civ. App. 2000) (*Price I*). We instructed the trial court on remand "to determine the extent to which the [servient estate is] allowed to use the easement." 771 So. 2d at 1057. On remand, the trial court ordered that the dominant estate can maintain the locked gate, but that the servient estate is to have a key and that they can use the key to open the gate and then lock it back after each use. The servient estate appealed to the supreme court, which again transferred the case to this court pursuant to Ala. Code 1975, Sec. 12-2-7(6).

In *Price I*, we instructed the trial court on remand to follow the principles set forth by our supreme court in *Blalock v. Conzelman*, 751 So. 2d 2 (Ala. 1999), and *Duke v. Pine Crest Homes, Inc.*, 358 So. 2d 148 (Ala. 1978), to determine to what extent the servient estate may use the easement. The *Duke* court stated that a servient estate may use an easement as follows:

> It is well settled in Alabama that the owner of the servient estate may himself use the land upon which an easement has been dedicated so long as [his use] does not conflict with the purpose and character of the easement.…
>
> ….We wish to make it clear that the servient owner must not in any way interfere with or impinge upon the rights secured by the dominant estate under the express grant of the easement.…Nor must use by the servient owner create any such additional burden upon the easement as would interfere with those rights granted by the express terms of the easement.

358 So. 2d at 150, 151 (citation omitted).

The *Blalock* court stated:

> Moreover, pursuant to the general rule, the [dominant estate and servient estate] have concurrent rights to the use of the easement, and neither party can prevent the other from using the easement in a manner consistent with the purposes for which the easement was created. Thus, the existence of the easement creates mutual rights and obligations.
>
> "The landowner may not, without the consent of the easement holder, unreasonably interfere with the latter's rights or change the character of the easement so as to make the use thereof significantly more difficult or burdensome." Conversely, the easement holder "can not change its character, or materially increase the burden upon the servient estate."

751 So. 2d at 6 (citations omitted).

The servient estate argues that the placement of the locked gate across the easement, regardless of the fact that they now have a key to unlock the gate each time they want to cross the easement, is an "undue burden" on the servient estate. The evidence in the record indicates that the dominant estate placed the gate at the point where the easement accesses a public road. The dominant estate testified that she erected the gate in

order to protect "her property" from trespassers. The easement crosses the servient estate for several hundred feet before entering the dominant estate. The servient estate argues that the locked gate should be placed at the point where the easement enters the dominant estate.

The dominant estate's easement is "[a] perpetual easement for ingress and egress." In *Blalock*, the dominant estate had an easement "for ingress and egress to and from said property." The dominant estate used the easement for a driveway. The servient estate altered the driveway and planned to remove trees and shrubbery along the easement. The dominant estate sued the servient estate, seeking to enjoin it from removing the trees and shrubbery. The trial court enjoined the servient estate from removing the trees and shrubbery. The supreme court reversed, stating:

> At its core, the [dominant estate's] action is about vegetation, that is, the [dominant estate] asserts a right to certain trees and vegetation growing in the area of the easement. However, the easement created by the deeds conveying lots 1 and 2 is only "for ingress and egress to and from [lot 1] as shown in [the resurvey]." Nothing in those deeds addresses vegetation. Thus, the [dominant estate] seeks to change the essential character of the easement from that of a right of way, to—in effect—one of shade and air. See *Metcalf v. Houk*, 644 N.E.2d 597, 600 (Ind. Ct. App. 1994) ("Generally an easement for ingress and egress confers only the right to pass over the land and not to control the real estate or install improvements"); see also *Upson v. Stafford*, 205 Ga. App. 615, 616, 422 S.E.2d 882, 884 (1992) (the holder of an access easement had no right to a "buffer of trees" between his easement and adjoining property); *Solow v. Liebman*, 175 A.D.2d 120, 121, 572 N.Y.S.2d 19, 20 (1991) (holder of an access easement "had no right, as a matter of law," to prevent the owner of the servient estate from removing trees from the easement).
>
> Moreover, the presence or absence of vegetation is not material to the [dominant estate's] ability to use the easement. It is, however, highly material to [the servient estate's] ability to use the easement.

751 So. 2d at 6.

The easement in this case is likewise limited to an easement for "ingress and egress." We hold that, just as the control over the vegetation was held not to be material to the use of the easement in *Blalock*, the placement of the gate across the easement for the protection of the dominant estate, regardless of whether the servient estate is provided a key to the gate, is not material, or reasonably necessary, to the use of this easement. See *Clark v. Kuhn*, 171 Ore. App. 29, 15 P.3d 37 (2000) (holding that the dominant estate's placement of a gate across the easement is not reasonably necessary for the purpose of using an easement for ingress and egress); and *Drew v. Sorensen*, 133 Idaho 534, 538, 989 P.2d 276, 280 (1999) (holding that the placement of a gate across the easement, which barricaded a significant area of the servient estate, is an "unreasonable burden" on the servient estate and is not "reasonable and necessary" to maintenance of the easement). See also *Ballington v. Paxton*, 327 S.C. 372, 488 S.E.2d 882 (S.C. Ct. App. 1997) (holding that the servient estate could maintain on the easement a locked fence that did not unreasonably interfere with the dominant estate's use of the easement).

Therefore, we reverse the trial court's judgment providing that the dominant estate may maintain a gate on the easement as long as the servient estate is provided a key to the gate. As stated above, the dominant estate, as a matter of law, cannot maintain a locked gate on the easement, because the gate imposes an unreasonable burden on the servient owners. On remand, the trial court is instructed to enter a judgment consistent with this opinion.

Case Questions

1. How are the rights of the dominant tenement infringed in this case?

2. How does the court conclude that both the dominant and servient tenement have concurrent rights?

Taylor v. Vanderlip

2011 Conn. Super. LEXIS 2607

MEMORANDUM OF DECISIONS

The plaintiff, Christine M. Taylor, a self-represented individual, who owns property at 103 Brooklawn Parkway in Fairfield has instituted suit against her adjoining landowners William and Celeste Vanderlip, who live at 115 Brooklawn Parkway in Fairfield. The plaintiff claims that the defendants' driveway and fence between the properties is partially located on the plaintiff's property, which she purchased in 1997, and she seeks removal of both encroachments. The defendants have filed a counterclaim asserting that they own certain property by virtue of adverse possession.

The defendants purchased their property in August of 1985. At the time of the purchase there was a preexisting fence, constructed by unknown parties, which separated the properties of the defendants and the property now owned by the plaintiff. From the date of their purchase of the property in 1985 until at least 2003 the defendants maintained their driveway on their side of the fence and also used a grassy area for plantings during the summer months. Over the years the defendants removed the existing asphalt driveway and replaced it with a gravel driveway. Defendants subsequently re-paved the gravel driveway with an asphalt driveway. The driveway was always on the defendant's side of the fence and the court finds it was not increased in width or dimensions beyond the original driveway that existed in 1985.

On one occasion, the defendants had a large cement truck go to the rear of their property for construction activities and, on another occasion, a fire truck also had to gain access to the rear of the property because of a grill fire. While the cement truck and fire truck were able to reach the rear of the property, the access was somewhat inhibited by reason of a garden or bow window which protrudes slightly from the defendant's side of the house toward their own driveway. In 2003, the defendants wanted to gain a little more access on the driveway and therefore wanted to move the existing fence that existed since at least 1985.

The original fence went in generally a straight line from the front of the properties to the rear of the properties. A new fence was constructed in 1983 by agreement of the parties and at the defendants' expense which had a different configuration moving toward the plaintiff's property in the front of the house and towards the defendant's property in the rear of the house. In 1983 the plaintiff prepared a document in order to avoid claims of adverse possession arising out of the movement of the fence so as to indicate that the fence was moved with the permission of the plaintiff. The plaintiff claims at the time the document was signed, she specifically stated to the defendants that the permission to move the fence was temporary and the permission could be withdrawn at any time the plaintiff wished.

In 2008, the parties had a dispute with respect to the placement of an air conditioner placed by the defendants in their garage so their children could "camp out" in the garage with their father. Up until the time of the dispute with respect to the air conditioner neither party discussed the existence or location of the

boundary lines between the two properties. In 2008, the plaintiff stated that she was withdrawing her permission to utilize the fence as moved and also demanded that the defendants remove the fence from the plaintiff's property. The plaintiff also claimed that the driveway utilized by the defendants was on her property. Thereafter, sometime in 2011 the plaintiff consulted a surveyor and hired an individual to stake the location of the property line which showed that portions of the fence and portions of the driveway were located on the plaintiff's property.

The defendants claim that the driveway that existed at least since 1985 was always on their side of the old fence and that they therefore have title to that property by virtue of adverse possession. The plaintiff claims that the surveys demonstrate the driveway and the new fence are partially on her property and she wants the encroachments removed. None of the surveys submitted into evidence show the location of either the new fence or the old fence.

The Fence

"In determining whether an interest relating to real property is a lease, easement or license, the intent of the parties is the controlling factor." (Internal quotation marks omitted.) Middletown Commercial Associates Ltd. Partnership v. Middletown, 42 Conn.App. 426, 440, 680 A.2d 1350 (1996), cert. denied, 239 Conn. 939, 684 A.2d 711 (1996). "[A] license in real property is defined as a personal, revocable, and unassignable privilege, conferred either by writing or parol, to do one or more acts on land without possession any interest therein…Generally, a license to enter premises is revocable at any time by the licensor…It is exercisable only within the scope of the consent given." (Internal quotation marks omitted.) State v. Bharrat, 129 Conn.App. 1, 24, 20 A.3d 9 (2011).

"A license, while affording justification for what is done under it while it remains in effect, [is] not effective to convey an interest in the land and [is] revocable at the will of the licensor, even although the licensee has expended money under the license." Bland v. Bregman, 123 Conn. 61, 64, 192 A. 703 (1937); see also Stueck v. The G.C. Murphy Co., 107 Conn. 656, 661, 142 A. 301 (1928) ("mere giving of a…license and its execution by the expenditure of money…[i]n and of itself…would not make a license, otherwise revocable, irrevocable").

Accordingly, the court finds the plaintiff's agreement to the replacement of the fence created a revocable license and that the plaintiff is within her rights to revoke that license.

The Driveway

The court finds that the driveway was utilized by the defendants since 1985 when they purchased the property has not been increased in width although the original driveway has been removed, replaced by gravel and subsequently replaced with asphalt. The court further finds that the driveway has existed in its present dimension since at least 1985 and has always been located on the defendant's side of the original fence.

Adverse Possession

The evidence establishes that the defendants maintained the driveway and the land on their side of the old fence from the time of the purchase of the property until well after the year 2000. Accordingly, the evidence clearly establishes that the defendants exclusively maintained the property on their side of the fence for well over 15 years.

"The essential elements of an adverse possession sufficient to create title to the land in the claimant are that the owner shall be ousted of his possession and kept out uninterruptedly for a period of fifteen years, by

an open, visible and exclusive possession by the claimant without the license or consent of the owner and under a claim of right." Wadsworth Realty Co. v. Sundberg, 165 Conn. 457, 462, 338 A.2d 470 (1973). By such adverse possession, the original owner is barred from making entry into the subject lands by the statute of limitations. General Statutes §52-575. Ruick v. Twarkins, 171 Conn. 149, 155, 367 A.2d 1380 (1976). "The requirement that the [use] must be exercised under a claim of right does not necessitate proof of a claim actually made and brought to the attention of the owner…It means nothing more than a [use] as of right, that is, without recognition of the right of the landowner, and that phraseology more accurately describes it than to say that is must be under a claim of right…[When] there is no proof of an express permission from the owner of the servient estate, on the one hand, or of an express claim of right by the person or persons using the way, on the other, the character of the [use], whether adverse or permissive, can be determined as an inference from the circumstances of the parties and the nature of the [use]…" Slack v. Greene, 294 Conn. 418, 428, 984 A.2d 734 (2009).

The principles of adverse possession apply even though the person claiming title does not formally declare the right of ownership. The act of taking possession to the exclusion of the owner is sufficient even though the possessor mistakenly believed that he had title. See such cases as Loewenberg v. Wallace, 151 Conn. 355, 357, 197 A.2d 634 (1964); Ahern v. Travelers' Ins. Co., 108 Conn. 1, 5, 142 A. 400 (1928); Searles v. De Ladson, 81 Conn. 133, 136, 70 A. 589 (1908).

Accordingly, the court finds that the defendants acquired title to all the property, by adverse possession, on their side of the old fence.

Future Action

The court there holds the new fence should be removed and that the boundary line between the property of the plaintiff and the defendants is established by the line of the old fence that was removed in 2003. There was testimony by the defendant, Mr. Vanderlip, as to the number of inches that various fence poles were moved when the new fence was installed. The court credits that testimony and together with other testimony (e.g., the fence ran in a straight line), the court would have the ability to establish the boundary line. However, such a line, if established by the court would be more difficult if the new fence were removed and would be unsatisfactory to a surveyor.

Therefore if either party wishes to present testimony by a surveyor to establish the line of the old fence, either party may file a notice, so indicating, within 30 days, and the court will hold an additional hearing to establish the line based upon the testimony already heard by the court.

This decision will not be effective pending further order of the court and all parties are hereby requested not to intentionally remove or dismantle, in whole or in part, the existing fence.

Case Questions

1. How does the court distinguish between a lease, an easement, and a license?
2. Does a license create an interest in the land?

Additional Case Analysis

1. Homeowners had a swimming pool on their property which they did not use, so they had it drained, removed its protective tarp, and took out fencing on two sides of the pool. Rainwater collected in the empty pool, and the homeowners failed to have it drained. Eventually, the pool became a pond, its sides slick with algae; frogs and tadpoles lived in the pool.

   The homeowners knew that three children lived next door and, whereas there was a fence between the two properties, there was an eight-foot gap in the fencing. One day one of the neighbor's children went to the pool, attempted to catch a tadpole, and fell in. His mother came rushing over to save him, but both mother and child became unconscious and died. The husband/father sued the homeowners, alleging that they had created an attractive nuisance. How would you decide the case? Would the doctrine of an attractive nuisance apply to the adult mother as well? See *Bennett v Stanley,* 92 Ohio St. 3d 35; 748 N.E.2d 41 (2001).
2. Homeowners had a trampoline in their unenclosed backyard. Under no supervision, the homeowners' 6-year-old son was jumping on the trampoline and invited his 12-year-old neighbor to join in. This was the first time the two children had ever spoken and was also the first time that the 12-year-old had ever been on a trampoline. When the neighbor child jumped, she hurt her knee.

   The homeowners admitted that they had seen other uninvited children jumping on the trampoline but had never seen this neighbor on the apparatus. The parents of the 12-year-old sued the homeowners, alleging that they had created an attractive nuisance. How would you decide the case? Was there an express invitation to the injured child to use the trampoline? See *Kopczynski v. Barger*, 887 N.E. 2d 928 (Ind. 2008).

4 Conveyancing

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Define "conveyancing"
- Discuss a basic contract for the sale of realty
- Explain the requirements to create a valid contract
- Discuss the concept of equitable conversion
- Explain the implications of the Vendor and Purchaser Risk Act on real estate contracts
- List the methods for describing real property
- Indicate all of the clauses that should appear in a contract for the sale of realty
- Define "earnest money"
- Indicate what might place a cloud on a title to realty
- Discuss the various types of listing agreements that are used to sell realty
- List the different types of warranties that may appear in a contract for the sale of realty
- Discuss what is necessary to be considered a deed
- List the different types of deeds that may be used to transfer title to realty
- Explain the covenants that appear in the different types of deeds
- Discuss how a mortgage works
- Explain the mortgagee's rights in the case of default by the mortgagor
- Discuss the different types of foreclosure that may exist
- Understand the different types of recording statutes and the concept of priority
- Apply some practical tips to assist you in a real estate conveyancing practice

CHAPTER OUTLINE

CHAPTER OVERVIEW

Conveyancing refers to the legal process whereby title to real estate is transferred from one person to another. Transfer of realty typically takes one of three forms: gifts, in which the titleholder, the **donor**, gives the property to another, the **donee**, without an exchange of consideration (for free); testamentary transfers, in which title is transferred pursuant to the titleholder's will or by operation of law on the titleholder's death; and by contract, the general bargain and sale exchange of property.

A detailed discussion of the law surrounding testamentary transfers is beyond the scope of this text, and a discussion of the law of gifts appears in the last chapter of this book. This chapter concentrates on the process involved in the sale of real property. The process of effectuating a sale of realty generally follows a simple four-step format:

1. The parties to the sale enter into a contract for the sale of the property that contains certain **warranties**, or guarantees, with respect to the nature of the interest being transferred.
2. After the contract is executed, the buyer checks the seller's title to the property and demands that any defects in the title (see below) be cured prior to the closing date. Also, during this period the buyer will enter into a mortgage agreement with a bank or financial institution if financing will be necessary to complete the purchase.
3. On the **closing date,** title passes from the seller to the buyer by the delivery to the buyer of a validly executed deed. The delivery of the valid deed extinguishes any contract rights that may have existed between the parties, and all legal rights of the buyer and seller are now based on the provisions of the deed.
4. The buyer records the deed in the county recorder's office in the county in which the property is located in order to protect his or her title against any subsequent transfer of the title by the former owner (seller).

This chapter explores each of these steps in the sale of realty in detail.

Contracts for the Sale of Realty

Land Sales Contracts

Pursuant to the Statute of Frauds, in order to be enforceable in a court of law, all contracts for the sale of

an interest in realty must be in writing. This provision of the Statute of Frauds may also apply to the lease of property as well (see Chapter 7). To meet this statutory requirement, the document must

1. be an actual writing;
2. be signed by the party who is to be charged, i.e., the party against whom the document is attempting to be enforced; and
3. contain all of the essential terms of the agreement, including the parties to the contract, a legally sufficient description of the property being transferred, and the purchase price.

 **EXAMPLE:**

A father wishes to sell his home to his son and daughter-in-law. To meet the provisions of the Statute of Frauds, the father drafts a contract in which he identifies himself as the seller and the son and daughter-in-law as the buyers; specifies the purchase price; and identifies the property by the description that appears in his deed to the land. This document contains sufficient information to make it enforceable under the Statute of Frauds.

A court may enforce a contract for the sale of real estate that is not in writing or sufficiently detailed if the parties to the agreement have completely or partially performed their obligations, such as paying the purchase price, living on the property for a significant period of time, or making substantial improvements on the land.

 **EXAMPLE:**

A father decides to sell his farm to his son. The father and son do not sign any contract, but the son takes possession of the land, farms the property for over five years, pays all property taxes on the land, makes payments to the father as part of the oral purchase agreement, and makes substantial improvements to the house and farm buildings. After five years the father decides to sell the farm to a third party. In this instance, based on the son's performance, the court would probably enforce the oral agreement between the father and son.

In addition to the provisions of the Statute of Frauds, a contract for the sale of realty must meet all of the requirements of every valid contract:

1. There must be a valid **offer**, which is defined as a proposal by one party, the **offeror**, to another to enter into a valid contract. The offer must contain all of the essential terms of what will be the contract —parties, price, description of the land, and so forth.
2. The person to whom the offer was made, the **offeree,** must agree to all of the terms of the proposal as specified by the offeror. An offeree may not vary any of the essential terms of the offer.
3. The agreement must be supported by legally sufficient **consideration.** Consideration is generally

defined as a benefit conferred or a detriment incurred at the request of the other party. For contracts for the sale of realty, the consideration is the land and the purchase price. To have a valid contract, both parties must give and receive something of value (the land and the money).

4. The parties must actually intend to enter into the agreement. A presumed contract will fail if it can be demonstrated that one or another of the parties was forced into entering into the agreement, was mistaken as to the provisions of the agreement, or any other factor can be demonstrated that indicates a lack of intent to contract.
5. The parties must have **contractual capacity,** which is the legal ability to enter into a contract. Generally, this means that they must have attained the age deemed by the state statute to be a legally sufficient age to contract (18 years of age is considered to be legally sufficient in every state, but many jurisdictions provide for younger persons to enter into certain types of contracts—the provisions of each state statute must be individually analyzed). Also the person must have the mental ability to understand the nature of the agreement.
6. Finally, the contract provisions may not violate any law.

The moment at which the contract comes into effect is crucial in determining the parties' rights.

First, once the contract exists, if either side breaches the contract—fails to fulfill his or her contractual obligations—the other side is entitled to certain remedies in court. The non-breaching party may be entitled to **damages,** a monetary award based on the degree of financial injury the non-breaching party has suffered based on the breach, or the non-breaching party may be entitled to **specific performance,** a non-monetary remedy available pursuant to the court's equitable powers. Specific performance is generally only permitted for unique property, and all land, under the law, is considered to be unique. Therefore, the non-breaching party may be able to have the court order the breaching party to purchase or convey the realty in question.

Second, once the contract is validly formed, the risk of loss of the property may be transferred. In the United States there are two theories concerning the risk of loss or destruction of real property. The first is known as the **doctrine of equitable conversion**. Under this concept, once the contract is signed the buyer is considered to be the owner of the realty, and the seller is considered only to have the right to receive the purchase price. Consequently, if the property is damaged or destroyed after the contract is signed (but before title passes—see below) the resultant loss may be borne by the buyer. The second theory, more recently adopted, is called the **Vendor and Purchaser Risk Act.** Pursuant to this theory, the risk of loss remains with the seller until the buyer takes actual possession of the property and makes some improvement to the realty. Each state's statute must be examined to determine which theory is prevalent in a particular jurisdiction.

 EXAMPLE:

Buyer and seller enter into a valid contract for the sale of Blackacre. The seller remains in possession of the property until the closing date, which is set for six weeks after the contract is signed. Two weeks after the signing, a hurricane totally destroys Blackacre. If the jurisdiction follows the doctrine of equitable conversion, the risk was on the buyer and the seller has the right to receive the complete purchase price for the property. Conversely, if the jurisdiction has adopted the Vendor and

Purchaser Risk Act, the risk remained with the seller and the buyer may either avoid the contract or demand a reduction of the purchase price to reflect the destruction of Blackacre.

The typical contract for the sale of real estate usually contains the following specific provisions in addition to the foregoing general contract requirements (see Exhibit 4.3 at the end of this chapter):

(a) *The parties:* The parties to the contract must be named, including their addresses and indicating the legal titles by which they are making the purchase and sale, such as the officer of a corporation, a partner, and so forth.

(b) *Consideration:* The contract must recite the consideration for the agreement—the purchase price, including any method of payment that will be made, such as an **installment sale** in which the purchase price is to be paid over a specified number of years. The recitation of the consideration should also include any and all financing provisions that have been made with respect to the sale of the property (see below). The consideration should also detail the description of the property. See Exhibit 4.1. Real property is described according to several methods:

(i) **Plat description:** This method of land description is based on a **survey**, which is a written evaluation and description of real property. The plat indicates the dimensions and boundaries of the property, and is often used in a description of planned subdivisions. The plat will include the following information:

- the state, county, and district in which the property is located,

---

Exhibit 4.1:Real Property Description

ALL that certain lot or piece of ground situated in the City of Pittsburgh, County of Allegheny, and Commonwealth of Pennsylvania, bounded and described as follows, to wit:

BEGINNING at a point on the Westerly line of South Graham (formerly Graham) Street distant 371.961 feet Northerly from the intersection of the Westerly line of South Graham Street and the Northerly line of Baum Boulevard as formerly located; thence along said line of South Graham Street in a Northeasterly direction, 40.00 feet to a point; thence extending back in a Northwesterly direction a distance of 150.00 feet to the Easterly line of Vintage Way; thence Southerly by said line of Vintage Way and parallel with South Graham Street, a distance of 40 feet to a point; thence in a Southeasterly direction and preserving the same width throughout of 40.00 feet, a distance of 150 feet to South Graham Street, at the place of beginning.

HAVING erected thereon a residential dwelling being municipally known and numbered as 432 South Graham Street.

BEING FURTHER DESIGNATED as Block & Lot 51-G-255 in the Deed Registry Office of Allegheny County, Pennsylvania.

BEING the same property which Susan E. Carr, unmarried by her deed dated October 15, 1993 and recorded in the Recorder's Office of Allegheny County, Pennsylvania, in Deed Book Volume 9205, Page 104, granted and conveyed unto Edward J. Petrick, Jr., unmarried, the grantor herein.

- the subdivision name and lot, block, and unit name; and
- a reference to the **plat book** that appears in the county recorder's office.

(ii) **Metes and bounds description:** This method indicates the area following a course from a specified starting point, usually a natural or artificial focal point such as a monument, and then follows a course so many feet or yards to another point in a given direction. Eventually the course returns to the starting point to create an enclosed area, which is the property in question.

(iii) **Rectangular survey description:** The method of dividing land into rectangular lots was established in 1785 and is used by approximately 30 states. The system is based on lots formed by the intersection of hypothetical lines: the **principal meridians,** which are north-south lines, and **base lines**, which run horizontally east-west. In this fashion the states that use this method have divided up the land into specified rectangular quadrants.

(c) *Title:* The agreement should specify the exact nature of the title the seller possesses. In order for the property to be salable, the seller is expected to provide the buyer with a **marketable title**. A marketable title is one that gives the buyer title to the property free from all **encumbrances.** Encumbrances are any defects in the chain of title that could potentially cause a lawsuit over the right to the property. The most commonly encountered encumbrances are:

(i) **Liens**, which are creditors' claims on the property to satisfy debts. Liens may take the form of government liens for nonpayment of taxes, **mechanics' liens** for work performed on the property, or a general lien imposed by the court in order to satisfy claims of general creditors of the titleholder.

 EXAMPLE:

A homeowner hires a contractor to construct an addition to her house. The homeowner pays the contractor a portion of the total price when the work begins, but fails to pay the contractor the balance due when the work is completed. The homeowner has no valid complaint with respect to the quality of the work performed by the contractor. Automatically, under the common law, the contractor has a mechanic's lien on the property for the balance of the payment owed to him.

 EXAMPLE:

A property owner fails to pay his real estate taxes on some undeveloped property he is holding as an investment. The government imposes a tax lien on the property.

EXAMPLE:

A property owner is found liable, by a competent court, of having severely injured a woman by failing to observe the ordinary standard of care while driving his car. The woman is awarded a large judgment by the court, but the property owner refuses to pay. The injured woman may be able to have a lien imposed on the property to satisfy the judicially imposed debt of the property owner.

Liens are generally recorded on the title to the property at the county recorder's office and represent a claim on the property.

(ii) Mortgages, which are a special category of security interest held by a person who extends financing for the purchase of realty. Mortgages are discussed in detail later in this chapter.

(iii) **Clouds on title,** which are any breaks in the chain of title that could give rise to a lawsuit with respect to ownership of the property. Titles and transfers of title should be recorded in the county recorder's office, but occasionally such recording is neglected, or a grantor may attempt to pass title to several persons, all of whom claim ownership. The specifics of recording title are discussed later in this chapter.

Any potential claim or challenge to title renders the title unmarketable. However, the seller is only required to provide a marketable title at the closing (see below), so any encumbrance that is in fact cured by the closing does not render the title unmarketable. Furthermore, a purchaser may be willing, under the contract, to purchase an **insurable title,** one in which the title is not totally clear but which is capable of having insurance issued to cover any potential claim. If a purchaser is willing to accept anything less than a fully marketable title, the contract for sale must specify which encumbrances the buyer is willing to accept.

(d) *Closing*. The **closing,** or **settlement**, is the date on which all parties to the sale and purchase of the land agree to perform all of their contractual obligations. The sales contract should specify the date, place, and time of the closing. If no closing date is indicated in the contract, most courts will impose a closing date "within a reasonable time" from the date of the execution of the contract.

At the closing the seller is typically required to present the following:

(i) a deed to the property that is in a form that can be recorded at the country recorder's office, specifying the title that is to be acquired by the buyer;

(ii) a **closing statement** that sets forth any adjustments to the costs of the purchase;

(iii) a certified rent roll if the property in question is leased, including a letter sent to the tenants indicating the change in ownership;

(iv) all permits, certificates of occupancy, and licenses issued to the property by government agencies, securing the use and habitability of the property;

(v) an affidavit that the seller knows of no proceeding or threatened proceeding against the property;

(vi) plans of any improvements designed for the property;

(vii) all keys to the property; and

(viii) all other documents that the seller would reasonably suppose would be necessary for the purchaser as the new title-holder of the property.

The buyer is required to present the following at the closing:

(i) an **assumption agreement** whereby the buyer assumes all liabilities on the property and agrees to perform all current obligations of the seller with respect to the property;

(ii) a copy of the *closing statement;* and

(iii) the purchase price or the portion of the purchase price that the parties have agreed is to be paid at the closing.

(e) *Transfer of possession.* The sales contract should specify the date on which possession of the property passes from the seller to the buyer. Usually this occurs at the closing, but may be advanced or postponed depending on the wishes of the parties.

 **EXAMPLE:**

The contract for the sale of a house indicates the closing date to be October 1. The buyer would like to take possession on September 15 to settle in, and the seller agrees to vacate the property by midnight on September 14. The agreement with respect to the transfer of possession should appear in the contract.

(f) *Risk of loss.* As discussed above, depending on the jurisdiction, the shifting of the risk of loss or damage to the property may pass from the seller to the buyer at the date of the contract or when possession actually transfers. However, the parties may specify who bears the risk for various types of damage to the property, as well as who will be responsible for maintaining insurance on the property.

(g) *Earnest money.* **Earnest money,** sometimes referred to as the **deposit** or the **down payment,** is the portion of the full purchase price the buyer gives at the time of the signing of the sales contract. Earnest money may be given credit as a partial payment or as a penalty should the buyer default, or back out, of the contract. The sales contract should specify exactly what the earnest money represents, and the funds should be placed in a trust, or **escrow,** account until the sale is consummated. Note that this trust account does not belong to either party until the obligations of the contract have been fulfilled. Furthermore, the contract should indicate who will be entitled to any interest earned on the funds in the account until the funds are finally transferred.

(h) *Rights of the broker.* If the parties utilize the services of a real estate broker, the contract should identify the rights of the broker with respect to a commission, including when the commission is to be paid and by whom. A **commission** is the fee the broker earns for his or her services.

Contracts with real estate brokers with respect to their commissions, known as **listing agreements,** fall into several categories:

(i) **Open listing:** With this type of agreement the property owner engages several brokers to help sell the property, and any commission goes to the one who completes the sale.

(ii) **Exclusive listing:** In this type of agreement the property owner only hires one broker, but

retains the right to sell the property himself. If the owner sells the property, the broker receives no commission.

(iii) Exclusive right to sell: With this agreement the broker is the only one who may sell the property, and she receives a commission if anyone, including the owner, consummates the sale. (See Exhibit 4.2.)

(i) *Assignments.* An assignment is the transfer of contractual rights. Generally, most contracts are freely assignable, or transferable, provided that the assignment does not unduly burden the other party to the contract, or the contract was not one that was based on the personal confidence of the transferring party. Such types of confidences in a real estate contract would arise when financing is an issue and one party is lending the other the funds to acquire the property. This type of agreement is based on the personal creditworthiness of the borrower, so the contract is usually nonassignable unless the lending party agrees. Furthermore, the parties to a contract may specify that the contract is or is not assignable, and if it is assignable, what conditions, if any, must be met prior to the transfer.

Exhibit 4.2: Real Estate Listing Agreement

T 486—Real Estate Listing Agreement: Non-exclusive. 11-78

JULIUS BLUMBERG, INC., PUBLISHER, NYC 10013

REAL ESTATE LISTING AGREEMENT

BROKER:	OWNER:	PREMISES:
Address		
	Address	
Telephone No.		
Broker is Licensed in The State of	Telephone No.	Date:

Owner hereby lists the above Premises with Broker for sale in accordance with the information, terms and conditions set forth above and following:

Licensed broker 1. *Broker is a licensed real estate broker under the laws of the state set forth above.*

When Commissions earned 2. *Broker shall not earn the Commission unless:*
a) *a contract of sale has been signed by the Owner and a purchaser upon terms acceptable to the Owner in the Owner's sole judgment*
b) *the contract was brought about through the Broker's efforts*
c) *the deed conveying title is delivered in accordance with the contract and the full purchase price is paid.*

Failure to close title 3. *If a contract of sale has been signed by Owner and a purchaser and title does not close,*
a) *because owner does not have good title conveyable in accordance with the contract, broker is not entitled to the Commission.*
b) *Broker is not entitled to the Commission unless Owner intentionally defaulted.*
c) *because purchaser defaults, Owner is not required to enforce purchaser's obligations and Broker is not entitled to the Commission.*

Price change 4. *The purchase price at which the Premises are listed with Broker may be changed by Owner without liability to Broker. Owner is not liable to Broker for any expenses, fees or disbursements paid or incurred by Broker in connection with Broker's efforts to sell the Premises.*

Commission Payable 5. *If earned, the Commission payable to Broker, shall be paid upon the delivery of the deed.*

Termination, withdrawal 6. *Owner may terminate this agreement or withdraw the Premises from sale at any time by either oral or written notice to Broker without liability.*

Non-exclusive 7. *Owner may list Premises with other Brokers*

Margin headings 8. *The margin headings are for convenience only.*

This agreement contains all the terms and conditions of the listing and shall not be changed except by a written agreement signed by both Owner and Broker.

This agreement has been signed by Broker and Owner on the date set forth above.

Broker: ..... *Owner:*

By ....

.....

This form is reprinted with permission. It may be purchased from BlumbergExcelsior, Inc.

(www.blumberg.com). Reproduction prohibited.

 **EXAMPLE:**

"Purchaser shall have the right to assign this agreement provided that the Seller be given 30 days' prior written notice and agrees to the assignment in writing within 10 days of the transfer. Seller may withhold agreement of the assignment if the Seller, in his sole discretion, believes the assignee to lack sufficient financial resources to conclude the sale."

(j) *Warranties.* A warranty is a statement by a party to a contract in which the party guarantees certain aspects of the agreement. If the party making the warranty fails to fulfill its obligations, the injured party may sue for a breach of the warranty. If the warranty goes to the heart of the contract, a breach of the warranty may be considered a breach of the entire contract.

The typical warranties given by a seller are:

- the seller has title to the property equal to the title being conveyed
- the seller will fulfill all contractual obligations
- the seller has the right to enter into the contract
- there are no claims on the property
- the seller will cause no change in the zoning of the property
- the seller knows of no governmental action against the property
- utilities are available to the property
- the property is accessible by public roads
- the property contains a minimum number of acres or square feet

The typical warranties given by the purchaser are:

- the purchaser has the right to enter into the contract
- the purchaser can finance the purchase
- the purchaser will perform all contractual obligations
- there are no actions pending against the purchaser that will affect the purchaser's ability to perform the contract obligations
- the purchaser will do nothing that diminishes the seller's title prior to the closing

(k) *Time is of the essence clause.* Many contracts specify that **time is of the essence,** meaning that all obligations must be fulfilled on the dates and times specified in the agreement or the contract will be deemed breached, thereby relieving the other party from all further obligations. If such a clause does not appear in the contract, the courts usually infer "reasonable time" for the parties to perform.

(l) *Conditions.* A contractual **condition** is a fact or event, the occurrence or nonoccurrence of which creates or extinguishes an absolute duty to perform. What this means is that the parties are expected to fulfill their contractual obligations *unless* the fact or event specified occurs. Many real estate contracts include a **condition precedent** with respect to financing the sale. A condition precedent is a fact or event that must occur before the party must perform a contractual obligation. In this instance, the condition may specify that the purchaser's obligation to buy is conditioned upon his

obtaining financing for the purchase within a specified number of days. If the buyer makes a reasonable effort to secure financing and fails to obtain the necessary funds, the buyer will no longer be obligated to purchase the property.

(m) *Notice.* The contract should specify the manner in which the parties to the agreement wish to receive notice of the various events that are noted in the contract. Typically such notice mandates written notice be posted by certified mail to an address indicated in the contract. All parties to the contract must give all required written notice in the manner specified in the agreement.

(n) *Other provisions*. Real estate contracts, like all contracts, contain certain **boilerplate,** or standard, formalized provisions with respect to the definitions of the terms used in the agreement, for example, which state's law is to apply to its interpretation, arbitration provisions, and so forth. These clauses appear in all contracts and are not specifically related to real property transactions.

(o) *Execution*. The term **execution** refers to the signing of the agreement. The parties should sign according to their position, for example, as an individual, an officer of a corporation, a partner for the partnership, and so forth. The contract does not need to be notarized or witnessed, and the contract itself is generally not recorded with the county recorder's office. After the closing, the deed (see below) is the document that will be used to record the transfer of the title from the seller to the buyer.

After the contract for the sale of the property is executed, the buyer will usually conduct a **title search** to make sure that the seller's title is clear and capable of being transferred subject to the contract. If a cloud on the title appears that the seller does not cure by the closing, the purchaser may avoid the sale or may acquire **title insurance** to protect against a claim by a party asserting title to all or part of the property. The methods for recording titles will be discussed below.

See Exhibits 4.3 and 4.4 at the end of this chapter for examples of a Contract of Sale and a Rider to a Residential Contract of Sale.

Deeds

A **deed** is a document that is used to transfer title to real property. To be valid, the deed must:

1. be in writing;
2. be signed by the grantor;
3. reasonably identify the parties; and
4. describe the land in question in a legally sufficient manner (see above).

If the deed neglects to name the **grantee,** the person who is acquiring the title, the court will assume that the person in possession of the deed is the grantee. However, if the land is not sufficiently described, the deed is considered to be incomplete. The property will be considered sufficiently described, even if not in accordance with its legal description as it appears in the county recorder's office, if it gives sufficient information so that a reasonable person could identify the property. The court will permit oral evidence to complete the description of the land if the description given provides a reasonable lead to the land in question,

but cannot accept oral evidence if the overall description is totally inadequate.

 **EXAMPLE:**

A man owns three tracts of land in the same county. In the deed he indicates that he is transferring title to the property he refers to as Honeywell Cottage. The court will permit oral testimony to indicate which of the three parcels the grantor calls "Honeywell Cottage" because the description in the deed is sufficient to provide a lead as to which property is meant.

In order to transfer the title, the deed must be delivered to the grantee. This delivery must indicate a present intention on the part of the grantor to pass the title, even if the right of possession to the property is delayed. This delivery requirement can be satisfied in several ways:

(a) a manual delivery to the grantee or the grantee's agent. Note that a delivery to the grantor's agent with instructions to pass the deed to the grantee does not constitute delivery to the grantee. The delivery must be a direct transfer to the grantee's control.

 **EXAMPLE:**

A woman intends to give some property she owns to her niece. She executes a deed and gives the deed to her lawyer, telling the lawyer to send the deed to the niece. Because the lawyer is the woman's agent, no delivery has yet taken place. When the lawyer gives the deed to the niece, or the niece's lawyer, the delivery is then complete.

(b) a recording of the deed in the county recorder's office; or
(c) a notarized statement by the grantor indicating the intention to transfer the title.

Once a deed has been delivered, the grantor cannot revoke the deed unless the transfer was subject to a condition.

 **EXAMPLE:**

A man gives the deed to his house to his son, telling the son that the property will be his (the son's) on the man's death. The man's death is a condition to the transfer and so the man may revoke the deed prior to his death.

Finally, to complete the transfer, the grantee must accept the deed; most courts assume acceptance unless the grantee indicates a rejection of the property.

There are three types of deeds used to convey title to property: the general warranty deed, the special warranty deed, and the quitclaim deed. The differences between these types of deed concern the warranties, known as **covenants,** that they contain.

See Exhibit 4.5 at the end of this chapter for an example of a deed.

General Warranty Deed

The general warranty deed usually includes the following covenants, referred to as the **common law covenants:**

1. **Covenant of seizin:** This covenant states that the grantor has the title to the property he or she is purporting to convey and also has possession of the property at the time of the conveyance.
2. **Covenant of right to convey:** This covenant specifies that the grantor has the legal authority to convey the title. In most instances having the title to the property will satisfy this covenant.
3. **Covenant against encumbrances:** In this covenant the grantor warrants against any liens, mortgages, or clouds on title on the property (see above).

These three preceding covenants are breached, if at all, at the time of the closing.

4. **Covenant of quiet enjoyment:** This covenant states that the grantor warrants that the grantee will not have his or her possession of the property disturbed by anyone with a lawful claim to the property. Note that this does not protect the grantee from specious lawsuits filed by persons who have no lawful claim to the property.
5. **Covenant of warranty:** In this covenant the grantor agrees to defend the grantee against claims to the property made by third persons, and to reimburse the grantee for any loss that the grantee may suffer from claims by persons with a superior title. Note that the covenant for quiet enjoyment concerns possession, whereas this covenant concerns title.
6. **Covenant of further assurances:** In this covenant the grantor agrees to do all things necessary to perfect title in the grantee should any claim against title occur in the future. The distinction between the covenant of warranty and the covenant of further assurances is one of degree; with the former the grantor will protect the grantee from loss, with the latter the grantor will go further and do all things necessary to establish lawful title in the grantee. This last covenant does not form a part of what is called the **usual covenants** and is often deleted, but is always included if the deed calls for the "common law covenants."

Special Warranty Deed

This deed is created by state statute and protects the grantee against two specific acts of the grantor:

1. that the grantor has not conveyed the property to anyone other than the grantee; and
2. that the property is free from any encumbrances created by the grantor.

This type of deed protects the grantee only from these two specific acts, and only if they were caused by

the grantor herself. The scope of this type of deed is more limited than the general warranty deed.

Quitclaim Deed

This deed simply conveys to the grantee whatever title the grantor has; no representations are made with respect to the nature of that title or interest. It contains absolutely no covenants whatsoever, and the grantee acquires whatever title that grantor has, which could be none at all.

 **EXAMPLE:**

A man convinces two foreign tourists in New York City to purchase the Brooklyn Bridge from him. He executes a quitclaim deed in their favor, and they pay him a sum of money. When they discover that he had no title to the bridge at all, the couple has no claim against the man for breach of warranty, because he has conveyed exactly the interest he possessed. (Note that the couple may institute other proceedings against the man not based on property law.)

The rights of the grantee and the grantor are determined by the nature of the covenants in the deed conveying the property. However, if a person conveys a title he or she does not possess, but then subsequently acquires that title, the law, under a doctrine known as **estoppel by deed,** will inure that title to the benefit of the grantee of the deed (not for a quitclaim deed, however). See Exhibit 4.6 at the end of this chapter for an example of a quitclaim deed.

 **EXAMPLE:**

A woman purports, by general warranty deed, to sell some property to a third person. The buyer is unaware that the property in question is owned by the woman's father, and the woman only resides on the land. Several months later the woman's father dies and she inherits the property. Pursuant to the doctrine of estoppel by deed, the title now vests in the purchaser.

Mortgages

A **mortgage** is a security interest given by a debtor to his or her creditor to guarantee the repayment of a loan. Simply put, if the person who is purchasing the property requires financing, he or she will obtain a loan from an individual or institution who then becomes the buyer's creditor. To secure that loan, which is evidenced by a written document referred to as a **bond** or a **note**, the lender will require the borrower to provide another document, the mortgage, that gives the lender the right to attach specified property (the realty) to satisfy the debt should the borrower default on the loan. The borrower/debtor is referred to as the **mortgagor,** the one who gives the security interest, and the lender/creditor is referred to as the **mortgagee.**

 **EXAMPLE:**

A young couple wants to purchase their first home but cannot pay the complete purchase price. To

acquire the property, the couple arrange for a loan from their bank. To ensure that the bank will not lose the money loaned, the bank insists that the couple give it a mortgage on the house. Should the couple default on the loan, the bank as the mortgagee will have the right to attach the house to satisfy the outstanding debt.

Because the mortgage represents an interest in land, pursuant to the Statute of Frauds the mortgage must be in writing in order to be enforceable. However, certain transactions that do not meet this requirement may still be enforced under a concept known as an **equitable mortgage.** This doctrine arises whenever a person acquires a deed to property under circumstances in which the apparent intention is to transfer a deed as a security interest rather than as a title. If this situation can be proved, a court may find, under its equitable jurisdiction, that the person in possession of the deed does not have title to the property but merely a security interest in the land.

 EXAMPLE:

A man needs money to pay for his daughter's college education. He is the sole owner of a house he inherited from his father. The man approaches a friend for a loan, and the friend agrees, provided that the man transfers the deed to his house to him until the loan is repaid. The father gives the man the deed, and the friend loans the money. When the loan is repaid, the "friend" claims that the money was intended as a sale of the house, not a loan. Under these circumstances, the court may find that the friend has only an equitable mortgage.

Note that some jurisdictions require some other documentary evidence in addition to the deed to meet the requirements of an equitable mortgage.

A mortgage may be used as a security interest not only for the purchase of realty, but also for improvements on the property and to secure a preexisting obligation.

Any transferable interest in real property may be mortgaged; however, the mortgagor is incapable of mortgaging any interest greater than the one he or she possesses. Consequently if a husband who holds title to property as a tenant by the entirety mortgages his interest, the mortgagee may only attach the property if the wife joins in the mortgage or the wife predeceases the husband, thereby creating a tenancy in severalty in the surviving spouse (see Chapter 1).

A legal axiom holds that the mortgage follows the note. In other words, if the underlying debt obligation is found invalid, so is the mortgage that attaches to it. The validity of the mortgage is controlled by the validity of the underlying note.

 EXAMPLE:

A woman is defrauded into signing a loan agreement and gives a mortgage to secure the debt. If the court deems that the loan agreement is void because of the fraud, the mortgage automatically becomes void as well.

The mortgagor is required to inform and obtain approval from the mortgagee before any changes are made to the subject property because such changes affect the mortgagee's interest. Most mortgages require the mortgagor to obtain **mortgage insurance** to provide funds should the mortgagor be found in default. Also, many mortgage agreements provide for **acceleration payments** if the mortgagor does anything to impinge on the mortgagee's rights, such as changing the nature of the property or defaulting, thereby making the remainder of the unpaid debt immediately due.

 EXAMPLE:

A couple has acquired a house by borrowing money from the bank to which they have executed a mortgage. The mortgage includes an acceleration provision in case the couple default on the note or make substantial changes to the nature of the property without first obtaining the bank's consent. Ten years later the couple decide to demolish the freestanding garage on the property. If they do so without the bank's consent they may be obligated to repay the outstanding debt at once, because the property is now arguably less valuable (see the discussion on waste in Chapter 2).

If the mortgagor transfers the property, the transferee acquires the property either subject to the mortgage or by assuming the mortgage. A transfer **subject to the mortgage** means that the transferor remains principally liable on the debt, and the property can be attached if the transferor defaults. This could mean that the transferee will lose the property if the transferor fails to discharge the debt to the mortgagee.

A transfer in which the transferee **assumes the mortgage** means that the transferee now becomes liable for the underlying debt, and the transferor will only be liable secondarily (if the transferee defaults). To effectuate an assumption of the mortgage:

1. there must be a writing stating that the transferee intends to assume the mortgage; and
2. there must be a document that indicates the assumption of the mortgage.

A transferee who acquires property as an inheritance acquires the property subject to the mortgage, meaning that the estate of the deceased mortgagor is obligated for the debt, not the heir.

 EXAMPLE:

A couple has lived in a small house for three years and are now planning a family and want to purchase a larger home. They sell the house to an elderly woman who wants a small home. The woman agrees to assume the mortgage so that she can buy the property for a lower purchase price, the difference being made up by the mortgage. One year later the woman dies and the house is willed to her granddaughter. The woman's estate must discharge the mortgage. If the estate assets are insufficient, the mortgagee may be able to attach the house to satisfy the obligation, and the granddaughter will inherit nothing. Furthermore, the original young couple may be liable for any money still outstanding after the house is sold by the mortgagee.

If the mortgagor defaults, the mortgagee is permitted the following remedies:

1. **Action in default**—the mortgagee can sue the mortgagor in a court of law for the amount of the loan that is outstanding.
2. Judicial foreclosure—the mortgagee can request the court to order a foreclosure sale of the property in which the property is attached and sold at public auction. If the proceeds of the resulting sale exceed the amount of the debt, the excess is given to the mortgagor; if the proceeds of the sale are insufficient to satisfy the debt, the mortgagee may then proceed against the mortgagor in an action for debt for the difference.
3. Foreclosure by advertisement—several jurisdictions, such as New York, permit the mortgagee, provided that such right appears in the mortgage, to foreclose on the property without court order if the mortgagee places a notice of the foreclosure sale for a statutory period of time.

Note that the mortgagee may not proceed in an action in debt and a foreclosure simultaneously. The mortgagee must select which cause of action to pursue first, and if the results of that action are insufficient to satisfy the note, the mortgagee may then seek the alternative remedy.

A mortgagor may be able to stop or redeem a foreclosure under a concept known as redemption. Redemption refers to the mortgagor's payment of the debt so as to be able to reclaim title to the property. There are two types of redemption procedures:

1. Redemption in equity—at any time prior to the foreclosure sale the mortgagor may redeem the property by satisfying the debt. Virtually every jurisdiction permits this type of redemption.
2. Statutory redemption—several jurisdictions also permit a mortgagor to redeem the property within a statutory period of time after the foreclosure sale by satisfying the underlying debt. Note that this form of redemption creates uncertainty for the purchaser of the property in the foreclosure sale, and so is generally not favored.

Mortgages are an important facet of real estate conveyancing because few people are able to purchase property without some form of financing. The mortgage becomes an important aspect of the closing as well (see Chapter 5).

Mortgages, like deeds, are recorded with the county recorder's office to protect the mortgagee, and mortgages form an encumbrance on the property. In many instances, property owners will refinance their property, thereby creating several mortgages on the same realty. The impact of multiple mortgages on the mortgagee is determined by the nature of the priorities afforded under the particular state law (see below).

See Exhibit 4.7 at the end of this chapter for an example of a Uniform Residential Loan Application.

Sub-prime Mortgages and the Credit Crunch

No discussion of mortgages would be complete without some reference to the current national economic situation.

Recent events have focused attention on what are referred to as sub-prime mortgages and their effect on

overall credit. Simply stated, a **sub-prime mortgage** is a loan secured by a mortgage given by a financial institution to a borrower who is considered to be a poor credit risk. Interest rates on mortgage loans are based on the **prime rate**, which is the interest rate that banks charge to their best, i.e., most credit-worthy, customers. When a bank or other financial institution agrees to lend money to a person who is considered to be a credit risk, in order to minimize that risk, the lender loans the funds at a higher interest rate than it would to its credit-worthy borrowers.

In most of the instances in which mortgage loans were given to sub-prime borrowers, in order to entice borrowers, the lender structured the loan with an **adjustable rate mortgage (ARM)**, by which the interest payments on the loan were fairly low for the first few years. However, after a short period of time, generally three to five years, the interest rate on the loan ballooned up to a fairly high percentage. Because the borrower was a high-risk mortgagor, in most instances he or she could not afford the loan once the interest rate increased. As a consequence, many homes went into the foreclosure proceedings discussed above. However, the economic impact was not limited to the particular lender and borrower.

In order to reduce the potential risk of the default of the sub-prime borrower, many financial institutions used these mortgage-backed loans to create a **structured finance transaction**, also referred to as the **securitization of receivables**, whereby the financial institution would sell shares in the mortgages to investors, thereby transferring the risk of default to the investors. This process created a secondary market in mortgages as investment securities for persons not involved in the actual loan. Because of the potential high rate of return, based on the high interest rate of these mortgages, many corporations and pension funds invested in these securities.

When the borrower defaulted on the mortgage loan, not only did the borrower face losing his or her home, but the lender lost the capital it loaned the borrower as well as the cash flow from the interest payments, and the investors in the structured finance transaction lost their investment and cash flow as well. The result of these defaults has been considered one of the main factors causing the economic decline of the past few years.

Priorities and Recording Statutes

The concept of "priority" refers to the right afforded to persons each of whom has acquired an interest in realty. When multiple persons all assert claims to the same property the law and the courts must devise a system whereby the divergent rights can be satisfied and in which order. To this end, every jurisdiction has enacted **recording acts** that establish a chain of priority with respect to claims against property. The recording acts provide public notice to all persons asserting an interest in realty as to who may have a right to the property.

There are three types of recording acts in effect, and the specifics of each state's statutes must be individually analyzed. The three methods to establish priority are:

1. **Notice:** Under this type of recording statute, a subsequent bona fide purchaser for value of the property will prevail over an earlier grantee who fails to record his or her interest. Because the subsequent purchaser had no actual or constructive notice of any other interest in the property at the time of the creation of the interest, he or she will prevail.

 EXAMPLE:

A man sells some property to Buyer One on August 15, but Buyer One does not record the transaction at the county recorder's office. On August 20 the man sells the same property to Buyer Two, who immediately records the transaction. In a lawsuit to determine title, Buyer Two will prevail in a notice state because he had no notice of the sale to Buyer One at the time of his purchase. Note, however, if Buyer Two did not purchase the property but was given the property as a gift from the man, the title would vest in Buyer One because Buyer Two did not give value to acquire the title.

2. **Race:** In this type of jurisdiction, the first to record prevails regardless of the date of the transaction creating the interest.

 EXAMPLE:

Assume that in the prior example Buyer Two knew of the sale to Buyer One but convinced the man to sell the property anyway. Buyer Two records the conveyance before Buyer One. In a pure race jurisdiction Buyer Two would prevail because his actual knowledge of the earlier conveyance is irrelevant since he recorded first. In a notice jurisdiction Buyer One would prevail.

3. **Race-notice:** Under this type of statute, the subsequent purchaser for value must record first *and* have no notice of an earlier conveyance.

 EXAMPLE:

Using the parties from the previous examples, assume that Buyer Two has no notice of the sale to Buyer One. After the sale to Buyer Two, Buyer One records. The next day Buyer Two records. Buyer One prevails because Buyer Two did not record first.

In those jurisdictions that require notice to obtain a priority, the transferee must perform a title search to determine whether an earlier claim has been recorded. A title search is merely the process of examining the record books for the subject property at the county recorder's office.

Record offices use one of two methods to record titles. The first method is referred to as a **tract index** or **block and lot index,** in which the searcher looks at the record pages that are indexed by the physical description of the land (see above). The other method utilized by record offices is the **grantor-grantee index** in which the search is conducted by the names of the parties, looking first for the immediate transferor as a grantee, then his or her grantor as grantee, and so on back in the chain of title.

Once a claim is recorded, it protects the claimant from subsequent purchasers or claimants because recording provides notice. Consequently, to protect the rights of the parties, all interests in realty should be

recorded in the county recorder's office, which is the official office for recording interests in realty.

Practical Tips

- The legal professional must be accurate and specific in creating a deed.
- Be careful in the description of the property—reference to prior deeds is useful.
- If the seller is the representative of an estate, the representative's name and address must appear on the documents, including his or her authority to act for the estate.
- Check whether the recorder's office requires a cover sheet.
- In many counties, personal checks are not permitted for filing fees—only certified or attorney checks will be allowed.
- Review the lien law of the particular jurisdiction to make sure all requirements for recording liens are met.
- Carefully review all mortgage documents.

Chapter Review

Conveyancing is the process whereby title to realty is transferred from one person to another. The most common method of conveyancing is by means of a sale. To effectuate a sale of realty, two documents are necessary: the contract for the sale of the property and the deed that transfers the title to the property.

All agreements that concern an interest in realty are required to be in writing to be enforceable pursuant to the Statute of Frauds. Furthermore, all contracts for the sale of real estate must meet all of the general contract law requirements to create any valid contract: offer, acceptance, consideration, capacity of the parties, legality of the subject matter, and contractual intent. In addition to these general requirements, certain provisions are specific to real estate transactions, such as the allocation of risk, the date of the closing, financing provisions, and so forth.

At the closing the seller presents to the buyer a deed that transfers the title. The nature of the deed determines the nature of the covenants, or warranties, that the grantor is making to the grantee with respect to the nature of the protection of the title being transferred. There are three types of deeds in common use: the general warranty deed that contains the common law covenants; the special warranty deed that only protects against specific acts committed by the grantor; and the quitclaim deed in which no warranties at all are given.

In order to consummate the sale, most purchasers require a loan. To secure the loan, the lender typically has the borrower give a mortgage—a security interest in the property—to the lender that gives the lender certain rights with respect to the property. The mortgage creates an encumbrance on the title, and affects the rights of all subsequent grantees.

To protect rights with respect to realty, all interests—the deed, all mortgages, and all appropriate liens—should be recorded at the county recorder's office in the county in which the property is located. This recordation puts all subsequent claimants on notice of prior rights to the land.

Ethical Concern

To complete a conveyance of real property much specific information is required. To speed up the process there may be a real temptation to provide information that may not be accurate but seems reasonable to save time and expense. Such conduct is considered to be an ethical violation as a falsification of a legal document. Take the time to check all facts that appear on a contract of sale or a deed.

Key Terms

Acceleration payment
Action in default
Adjustable rate mortgage (ARM)
Assignment
Assume the mortgage
Assumption agreement
Base line
Block and lot index
Boilerplate
Bond
Closing
Closing date
Closing statement
Cloud on title
Commission
Common law covenants
Condition
Condition precedent
Consideration
Contractual capacity
Conveyancing
Covenant
Covenant against encumbrances
Covenant of further assurances
Covenant of quiet enjoyment
Covenant of right to convey
Covenant of seizin
Covenant of warranty
Damages
Deed
Deposit
Doctrine of equitable conversion
Donee
Donor

Down payment
Earnest money
Encumbrance
Equitable mortgage
Escrow
Estoppel by deed
Exclusive listing
Exclusive right to sell
Execution
Foreclosure
Foreclosure by advertisement
General warranty deed
Grantee
Grantor-grantee index
Installment sale
Insurable title
Judicial foreclosure
Lien
Listing agreement
Marketable title
Mechanic's lien
Metes and bounds description
Mortgage
Mortgage insurance
Mortgagee
Mortgagor
Note
Notice
Offer
Offeree
Offeror
Open listing
Plat book
Plat description
Prime rate
Principal meridian
Quitclaim deed
Race
Race-notice
Recording act

Rectangular survey description
Redemption
Redemption in equity
Securitization of receivables
Settlement
Special warranty deed
Specific performance
Statutory redemption
Structured finance transaction
Subject to the mortgage
Sub-prime mortgage
Survey
Time is of the essence
Title insurance
Title search
Tract index
Usual covenants
Vendor and Purchaser Risk Act
Warranty

Exercises

1. Search the title to your residence at the county recorder's office.
2. Determine which type of recording act is in effect in your state.
3. Analyze the provisions of mortgage agreement to determine the type of information that will be required of the borrower.
4. Obtain a sample land sales contract and analyze its provisions.
5. Discuss the circumstances under which a person might be willing to accept a quitclaim deed. What could be done to protect this person's interest?

Situational Analysis

A real estate agent induces a couple to buy a house by stating that several famous people have owned and stayed in the house. After the sale, the couple learn that no famous person ever resided or visited the house. What, if anything, can the couple do?

Edited Cases

Many legal problems are the result of contractual conflicts. *City of Ann Arbor Employees' Retirement Sys. v.*

Citigroup Mortgage Loan Trust Inc., discusses the legal and ethical problems associated with securities backed by sub-prime mortgages, and *Stambovsky v. Ackley* concerns a real estate broker's obligation with respect to the sale of realty.

City of Ann Arbor Employees' Retirement System v. Citigroup Mortgage Loan Trust Inc.

703 F. Supp. 2d 253(ED NY 2010)

This is a class action alleging violation of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. The action was commenced in the Supreme Court of the State of New York and was thereafter removed to this court. Presently before the court is Defendants' motion, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, to dismiss. The motion alleges lack of standing, and failure to state a claim upon which relief can be granted. For the reasons that follow, the motion is granted in part and denied in part at this time, with leave to replead.

Background

I. The Parties

Plaintiff is the City of Ann Arbor Employees' Retirement System (Ann Arbor). Ann Arbor brings this action on its own behalf, as well as on behalf of a class of individual investors, as described below (the "Plaintiff Class") (collectively "Plaintiffs").

Named as a defendant is Citigroup Mortgage Loan Trust, Inc., ("Citigroup Mortgage") a Delaware corporation formed for the purpose of acquiring, owning, and transferring mortgage loan assets, and selling interests in them. Also named as defendants are a group of eighteen mortgage loan trusts (the "Trusts"), established by Citigroup Mortgage. The Trusts are common law trusts that are alleged to have issued hundreds of millions of dollars worth of "Mortgage pass-through Certificates and Asset Backed Pass-Through Certificates of Citigroup Mortgage Loan Trust" (the "Certificates"). Additionally named as defendants are certain individuals who are alleged to have signed disclosure documents relating to investment in the Certificates (collectively the "Individual Defendants"). The Plaintiff Class is alleged to consist of individuals and entities that acquired Certificates from the eighteen individually named Trusts, and suffered financial losses as a result of the acts set forth in the complaint.

II. Mortgage Industry Practices Underlying the Allegations of the Complaint

The facts below are outlined in the Amended Complaint (hereinafter the "Complaint"), and set forth to provide background to Plaintiffs' claims. Certain facts detail the historical practices of the mortgage industry. Others describe more recent lending practices by loan originators, certain of which are alleged to have led to Plaintiffs' injury.

A. Evaluating Lending Risk and the Growth of the Sub-Prime Market

When extending credit to a potential property buyer a lender typically considers the borrower's credit profile, the amount requested, and the value of the property being mortgaged. The credit-worthiness of home buyers was, and continues to be, determined by a review of various factors, including the buyer's Fair Isaac and

Company ("FICO") credit score. A borrower with a high FICO score is considered to be more credit worthy than a borrower with a low FICO score, and is more likely the receive a "prime" mortgage, with a low interest rate. Lenders also consider the amount sought to be borrowed as a portion of the value of the property being mortgaged. This relationship is known as the loan to value ("LTV") ratio. A buyer with a high FICO score would likely qualify for a mortgage with a higher LTV ratio than a buyer who is less credit worthy. Thus, a credit-worthy borrower is, generally speaking, able to borrow an amount closer to the actual total value of the property mortgaged than a less credit-worthy borrower. The more credit worthy the buyer, the more likely that the mortgage extended would be one with a high LTV ratio. Because LTV ratios are determined by comparing the amount of the loan to the value of the mortgaged property, an accurate property appraisal is critical to arriving at the proper LTV. If an appraisal is wrongfully inflated, a loan may appear to have a low LTV ratio, whereas in reality, the true value of the home makes the real LTV ratio higher.

Borrowers with high FICO scores, but who are unable to provide income documentation have been able to receive mortgages known as "low-doc" or "Alt-A" loans. Such loans are extended, but with less favorable interest terms than prime mortgages. Buyers with lower FICO scores are typically referred to as "sub-prime" borrowers. Such borrowers are considered to be at higher risk of default, and have been extended mortgages that carry a higher rate of interest than that extended to a prime borrower. The Complaint details the growth of the sub-prime mortgage market over the past thirty years, and how the growth of this market increased lenders' access to capital.

B. Changes to the Traditional Mortgage Model and the Growth of the Mortgaged-Backed Securities Market

The Complaint details mortgage-industry practices forming the basis for it allegations. As explained in the Complaint, the traditional mortgage model involves nothing more than a prospective home buyer seeking, and obtaining a loan from a lending institution (also known as a "loan originator"). An underwriter evaluates the risk of lending, as described above, decides whether or not to recommend that the lender extend the loan, and the terms to be imposed on the borrower. If the loan is approved, the loan originator lends money in exchange for a promissory note pursuant to which the borrower agrees to repay the principle amount of the loan, plus an agreed upon interest. In this traditional model, the loan originator is the holder of the promissory note as well as a lien on the real property underlying the mortgage. That lien is released upon full payment of the loan.

The mortgage industry began to move away from this traditional model in the 1990s, when low interest rates and low inflation led to an increasing demand for mortgages. The market evolved into one where loan originators did not continue to hold loans they extended but, instead, sold mortgages into the financial markets to third-party financial institutions. The fees generated by the sale of mortgages into the secondary market allowed loan originators to amass capital to finance the growing demand for mortgages.

Mortgages sold into the financial markets have been grouped together and securitized, i.e., large groups, or "pools" of mortgages have been grouped together and transformed into securities known as "mortgage-backed securities." The securitization process refers to the packaging of pools of loans into a trust. The trust originator sells interests in the trust to finance the purchase of the pools of mortgages. Interests in the trusts are sold to investors in the form mortgage-backed securities. The value of sub-prime mortgage-backed securities grew from $ 10 billion in 1991, to more than $ 60 billion in 1997 and to over $ 620 billion in 2005.

Investors in mortgaged-backed securities receive monthly payments, representing payments made pursuant to the many underlying pooled mortgages. Interests in trusts are often grouped into different sections or "tranches," which represent different levels of risk. The most senior tranche is the group that is paid first, and is the one that carries the highest rating. The most junior tranche, on the other hand, has the lowest rating, and is paid last. As time passes, the investment ratings on tranches can change, but the most senior tranche is paid before the more junior tranches.

III. Allegations Regarding Practices of Loan Originators and Citibank Mortgage

The complaint sets forth allegations regarding the lending practices of several loan originators, as well as those of Citibank Mortgage. The loan originators referred to in the complaint are: (1) Countrywide Home Loans; (2) Silver State Mortgage; (3) Argent Mortgage Company, LLC; (4) Wells Fargo Bank, N.A.; (5) American Home Mortgage Corp.; (6) Opteum Financial Services, LLC; (7) Accredited Home Lenders, Inc.; (8) Aames Funding. These loan originators (none of which are defendants) are alleged to have extended mortgages to borrowers in violation of accepted underwriting standards and, essentially, without regard as to whether borrowers would be able to make payments pursuant to their mortgages. The Complaint alleges, among other things, that:

- borrowers were coached to misstate their incomes;
- borrowers were steered to loans that exceeded their borrowing capacities;
- borrowers were approved at low "teaser" rates with the full knowledge that they could not pay the full rate, and
- unqualified borrowers were allowed to qualified based upon "compensating factors" without requiring proper documentation.

Essentially, these loan originators are alleged to have extended loans with little or no documentation, in violation of industry standards, and with false LTV's based upon knowingly inflated appraisals. All of these practices are alleged to have been undertaken in the name of generating fees when reselling the mortgages into the secondary market.

As to Citibank Mortgage, the Complaint alleges the acquisition of mortgage loan pools, containing, in some cases, thousands of sub-prime and/or Alt-A loans for transfer to the Trusts. According to the Complaint, Citigroup Mortgage managers pressured underwriters charged with evaluating the pools of mortgages to accept all loans. These managers are alleged to have set the underwriting guidelines so low that any mortgage would pass, even if it was clear that the borrower was unable to repay the loan. Pursuant to the mortgaged-backed security procedure described above, the pools of loans acquired by Citibank Mortgage were transferred to the Defendant Trusts. The Trusts thereafter issued the Certificates that were eventually sold to investors pursuant to the disclosure documents described below.

IV. The Alleged Securities Act Violations

As securities, mortgaged-backed security instruments are subject to the registration and disclosure

requirements of the federal securities laws. Such disclosure documents must contain information that is neither false nor misleading, either in statement or omission. The specific federal securities laws at issue here are Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (the "1933 Act"). 15 U.S.C. "77k, 771(a)(2), and 77o. The Sections 11 and 12(a)(2) claims assert false statements and/or omissions. Section 11 applies to statements made in Registration Statements, and Section 12(a)(2) applies to statements made in Prospectuses. See *In re Morgan Stanley Information Fund Securities Litigation,* 592 F.3d 347, 358 (2d Cir. 2010). Plaintiff's third cause of action, alleged pursuant to Section 15 of the 1933 Act, 15 U.S.C. 77o, is asserted against the Individual Defendants and Citigroup Mortgage. The Individual Defendants are alleged to have been "control persons" of Citigroup Mortgage and the Trusts, by virtue of their positions as directors and/or senior officers of Citigroup Mortgage. Liability against the Individual Defendants is alleged on the ground that they signed and, along with Citigroup Mortgage, were responsible for the preparation of the false disclosure documents.

Plaintiffs allege that they purchased the Certificates in reliance on false statements contained in the disclosure documents relating to the Certificates that were filed with the Securities and Exchange Commission between December 2006 and October of 2007. The particular disclosure documents at issue are: (1) the shelf registration statement (the " Registration Statement"); (2) the base prospectus statement (the "Base Prospectus") and, (3) the prospectus supplements (the "Prospectus Supplements"). The Registration Statement and the Base Prospectus Statement apply to each of the eighteen Trusts at issue. As to these individual Trusts, each was issued pursuant to a different Prospectus Supplement, which supplement applied only to the particular Trust to which each refers. Thus, as the each of the eighteen Trusts, there are shared Registration and Base Prospectus statements, and an individual, Trust-specific, Prospectus Supplement.

The disclosures made pursuant to the offering of the Certificates are alleged to have misrepresented, and more specifically, underrepresented, the risk profile of the investment described. According to Plaintiffs, the relevant documents contained false statements about the underwriting standards used in connection with the underlying mortgages, including statements regarding: (1) the origination of the underlying mortgage loans; (2) the maximum LTV ratio used to qualify home buyers; (3) the appraisals of properties underlying the mortgage loans and, (4) the debt to income ratios permitted in the granting of the loans.

Plaintiffs' complaint alleges that by the Fall of 2007, the truth about the performance of mortgage loans underlying the Certificates began to be revealed to the public. This increased the risk of the Certificates receiving less absolute cash flow in the future, as well as the likelihood that investors would not receive a timely return on their investment. At the same time, credit agencies began to downgrade and put negative watch labels on the Certificate classes. The Certificates are allegedly no longer marketable at any price near the prices paid by Plaintiff. In sum, it is alleged that Plaintiff is now exposed to much more risk with respect to the investment in the Certificates than the risk represented in the disclosure documents.

V. The Motion

Defendants move to dismiss the Complaint in its entirety. First, it is argued that the Plaintiffs lack standing, both statutory and in the Constitutional sense, to pursue claims with respect to all but two of the Certificates issued by the Defendant Trusts. This argument is based on the fact that Ann Arbor purchased interests only in two of the eighteen Trusts alleged to have issued Certificates pursuant to false disclosures. As to the two Trusts in which interests were purchased, Defendants argue that dismissal is warranted because the

disclosures made warned precisely of the risks of which Plaintiffs now complain. It is argued that having agreed to assume the risks disclosed, in return for potentially high returns, Plaintiffs cannot now complain when those risks have come to fruition. Finally, dismissal is sought on the ground that the purchase of the Certificates was accompanied by Defendants' promise to repurchase or substitute mortgages that did not comply with the terms of the offering materials. Defendants argue that since Plaintiffs have never sought to take advantage of this provision, they cannot complain that Defendants have failed to perform as promised.

Discussion

I. Standards on Motion to Dismiss and Pleading Standards of the PSLRA [partially omitted]

II. Legal Principles

A. Stating a Claim for a Violation of Securities Act of 1933

The Securities Act of 1933 imposes liability on those who sign certain false and/or misleading disclosure documents. Section 11 applies to disclosures made in connection with registration statements, while Section 12(a)(2) applies to disclosures made in connection with prospectuses. See 15 U.S.C. 77k, 77l(a)(2). Finally, Section 15 of the 1933 Act provides for liability to be imposed on certain individuals on the ground that they signed unlawful disclosure documents. See 15 U.S.C. 77o. Liability under Section 15 is, for the most part, contingent upon the imposition of liability under either Sections 11 or 12(a)(2). See *In re Morgan Stanley Information Fund Securities Litigation,* 592 F.3d 347, 358 (2d Cir. 2010).

Section 11 provides that every signer and underwriter may be held liable for a registration statement which "includes untrue statements of material facts or fails to state material facts necessary to make the statements therein not misleading." 15 U.S.C. 77k; see *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 208, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976). A proper Section 11 claim must allege: (1) the purchase of a "registered security, either directly from the issuer or in the aftermarket following the offering"; (2) that the named defendant participated in the offering in a manner sufficient to give rise to liability under Section 11; and (3) that the registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." *In re Morgan Stanley,* 592 F.3d at 358.

Section 12(a)(2) similarly imposes liability on any person who "offers or sells" a security by means of, *inter alia*, a prospectus containing a materially false statement or that "omits to state a material fact necessary to make the statements, in the light of the circumstances under which they were made, not misleading" 15 U.S.C. 77l (a)(2). To be liable under Section 12(a)(2), the named defendant must be a "statutory seller." A "statutory seller" if is one who: (1) "passed title, or other interest in the security, to the buyer for value," or (2) "successfully solicit[ed] the purchase [of a security], motivated at least in part by a desire to serve his own financial interests or those of the securities ["] owner" *In re Morgan Stanley,* 592 F.3d at 358 (citations omitted).

Liability pursuant to Sections 11 and 12(a)(2) is imposed only if the statements or omissions relied upon are "material." A statement or omission is deemed material if "taken together and in context," it "would have misled a reasonable investor" Id. at 360. The Second Circuit has observed that materiality is "a mixed question

of law and fact." Thus, it has been stated, dismissal on the ground of materiality is not warranted "unless [the statements and/or omissions] are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." Id., quoting, *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 197 (2d Cir. 2009*)*.

B. Standing [omitted]

III. Disposition of the Motion

/././

B. Failure to State a Claim

i. Statements and Omissions

The court turns next to consider whether, with respect to the Trusts in which Plaintiffs have standing to assert a claim, such a claim is stated. Defendants claim that their disclosures were honest and adequate. It is therefore necessary, when evaluating whether a claim is stated, to compare the statements and omission alleged against the risks disclosed.

General statements regarding the misstatements and omissions relied upon by Plaintiffs are referred to above. Those statements—regarding underwriting practices, LTV's, appraisals, and borrower income—refer generally to the risk profile of the loans in the underlying pools of mortgages contained within the Trusts. As to the Trusts purchased by Plaintiffs (which are the only causes of action not dismissed for lack of standing), those statements and omissions are those that refer to the particular lending practices of Wells Fargo, as set forth in paragraphs 168-180 of the Complaint. Specifically, the Complaint alleges that the relevant Prospectus Supplements stated that:

> Wells Fargo stated that its "underwriting standards are applied by or on behalf of Wells Fargo Bank to evaluate the applicant's credit standing and ability to repay the loan, as well as the value and adequacy of the mortgaged property as collateral." (Complaint P169).

As to "stated income" loans, the Complaint alleges that the Prospectus Supplements stated that:

> the borrower's income as stated must be reasonable for the borrower's occupation as determined at the discretion of the loan underwriter. (Complaint P 170).
>
> The Complaint alleges that these statements were materially false because Wells Fargo's underwriting standards were not, in fact, concerned with the borrower's ability to repay the loan. Instead, it is alleged that the focus was simply on making loans to repackage as securities, without any regard as to whether the borrower could repay the loan. As a result of this poor underwriting, Wells Fargo is alleged to have made 'subpar' loans that should not have been extended in the first place. Well's Fargo's Alt-A division is alleged to have underwritten loans that were "overwhelmingly sub-prime loans or subpar loans, or loans that should not have ever been made to the people to whom they were given." This group is alleged to have written a variety of Alt-A and sub-prime liens that required no documentation of information relevant to the assessment of risk. The Wells Fargo loans are also alleged to have included "no income verification" loans, "no-doc" loans and "stated-income" loans.

The Complaint also makes reference to Wells Fargo's practice of acquiring loans pursuant to a "Delegated Underwriting" arrangement with outside mortgage brokers. Such loans are alleged to have been

acquired by Wells Fargo pursuant to underwriting agreements that were "not reviewed prior to acquisition of the mortgage loan," but as to which Wells Fargo stated that "the file is reviewed…to confirm that certain documents are included in the file…." Additionally, these loan originators were stated to have been required to "meet certain requirements including, among other things, certain quality, operational, and financial guidelines." In truth, according to the Complaint, Wells Fargo did not confirm the standards used by third parties from which it acquired mortgages. Therefore, these third parties were able to engage in "serious underwriting deficiencies without review or correction by Wells Fargo."

For their part, Defendants seek dismissal on the ground that Plaintiffs were adequately advised of the risks attendant to the purchase of the Certificates. Those disclosures appear in the general Prospectus as well as in the trust-specific Prospectus Supplements. General warnings regarding the suitability of investing in mortgage-backed securities appear throughout the disclosure documents, including the statements that:

> the offered securities are not suitable investments for all investors (Exhibit B at 5);
> [t]he Securities Will have Limited Liquidity So Investors May Be Unable To Sell Their Securities or May Be Forced to Sell them at a Discount from Their Initial Offering Price (Ex B at 5) (emphasis in original);
> The Types of Loans Included in the Trust Fund Related to Your Securities May be Especially Prone to Defaults Which May Expose Your Securities to Greater Losses (Ex B at 5) (emphasis in original).

As to the types of loans included in the underlying mortgage pools, the disclosures state clearly that such loans include negatively amortizing loans, balloon loans, multifamily loans, high LTV loans, and junior-lien mortgage loans. Specific statements regarding high LTV ratio loans, and the increased likelihood of default appear throughout the Trusts' disclosure documents. As to LTV ratios, the disclosure documents state that mortgages in the underlying pools may have LTV ratios in excess of 80% and as high as 125%. Additionally, it is stated that

> "high LTV loans with combined loan-to-value ratios in excess of 100% may have been originated with a limited expectation of recovering any amounts from the foreclosure of the related mortgaged property…but that such loans were underwritten with an emphasis on the credit worthiness of the related borrower." (Exhibit B at 8).

Particular statements regarding the loans underlying the mortgage pools in the trusts at issue refer to practices of Wells Fargo, and those companies with which it did business. The Prospectus Supplements refer to the approval of borrowers pursuant to "No-Documentation" and "Stated-Income" programs. The trust documents disclose, as pointed out by Defendants, that borrowers approved under a "No-Documentation" program would not be required to provide any information regarding employment, and any information provided would not be verified. As to "Stated-Income," borrowers, the trust documents state (as noted by Plaintiffs), that the stated income (while not verified by any documents) must be "reasonable for the borrower's occupation as determined at the discretion of the loan underwriter," and the assets stated must be similarly reasonable.

> With respect to underwriting standards, the Prospectus Supplements at issue refer to a Wells Fargo program designed to "make prudent loans available to customers where such loans may have been denied in the past because of underwriter hesitancy to maximize the use of their ability to consider compensating factors to permitted by the underwriting guidelines." The Prospectus Supplement goes on to disclose that the successful implementation of this initiative may result in an increase in the amount of delinquencies and foreclosures. (Exhibit S-52)

ii. Disposition of the Motion to Dismiss

The court's extensive review of the disclosure documents, only a few of which are described above, reveal that the high-risk profile of the investment offered was disclosed. The mortgages in the pools underlying the trusts are disclosed to include sub-prime, balloon or second-lien mortgages. They are clearly described as issued with little or no documentation, based upon high LTV ratios with an accompanying high risk of default. All of this is acknowledged by Plaintiffs. However, according to Plaintiffs, while the disclosure documents state the high risk of default, they also state the existence of at least some level of underwriting standards. This low standard, however, is alleged to have not existed at all. For example, Plaintiffs argue the falsity of statements regarding the loan originators' investigation, and the conclusion that the income stated by an applicant is at least reasonable given the occupation stated.

The strong nature of the cautionary language contained in the disclosure materials brings this case very close to the dismissal line, and at least one other court has dismissed a similar case on the pleadings. See *Nomura,* 658 F. Supp.2d 299. However, given the length of the Complaint (261 paragraphs spanning 89 pages), and the fact that most of Plaintiffs' claims have been dismissed on the ground that Plaintiffs lack standing, the court will not dismiss the case at this time. Instead, the court gives Plaintiffs leave to replead the causes of action that remain. The amended pleading (which will be the second such pleading) shall plead only the causes of action with respect to the Trusts actually purchased by Plaintiffs. With respect to those Trusts, Plaintiffs shall specify the tranches in which they invested. They shall also plead the false statements and/or omissions upon which they rely. They shall plead how those statements and/or amended pleading (which will be the second such pleading) They shall plead how those statements and/or omissions are tied to the loans in which they invested, and the basis for their damages claim. In particular, Plaintiffs shall state whether their damages claims arise from the nonpayment of amounts due under the Certificates or the inability to sell their interests in those Certificates in a secondary market. Such pleading will put the court in a better position from which to evaluate the merits of the claims alleged, particularly the issues of materiality and the impact of any promise to repurchase or substitute mortgages that did not comply with the terms of the offering materials.

Plaintiffs shall serve and file the amended pleading within thirty days of the date of this Memorandum and Order. Defendants shall answer, or otherwise move, without the necessity of a conference with the court, thirty days thereafter.

Conclusion

For the foregoing reasons, the motion to dismiss is granted in part and denied in part. Plaintiffs are given leave to re-plead as set forth above.

Case Questions

1. How does the court's analysis of the mortgage-backed securities market help your understanding of the current economic situation?

2. What information does the court indicate that it needs in order to resolve this matter? Why do you think this information is necessary?

Stambovsky v. Ackley

169 A.D.2d 254, 572 N.Y.S.2d 672 (1991)

Plaintiff, to his horror, discovered that the house he had recently contracted to purchase was widely reputed to be possessed by poltergeists, reportedly seen by defendant seller and members of her family on numerous occasions over the last nine years. Plaintiff promptly commenced this action seeking rescission of the contract of sale. Supreme Court reluctantly dismissed the complaint, holding that plaintiff has no remedy at law in this jurisdiction.

The unusual facts of this case, as disclosed by the record, clearly warrant a grant of equitable relief to the buyer who, as a resident of New York City, cannot be expected to have any familiarity with the folklore of the Village of Nyack. Not being a "local," plaintiff could not readily learn that the home he had contracted to purchase is haunted. Whether the source of the spectral apparitions seen by defendant seller are parapsychic or psychogenic, having reported their presence in both a national publication (*Reader's Digest*) and the local press (in 1977 and 1982, respectively), defendant is estopped to deny their existence and, as a matter of law, the house is haunted. More to the point, however, no divination is required to conclude that it is defendant's promotional efforts in publicizing her close encounters with these spirits which fostered the home's reputation in the community. In 1989, the house was included in a five-home walking tour of Nyack and described in a November 27th newspaper article as "a riverfront Victorian (with ghost)." The impact of the reputation thus created goes to the very essence of the bargain between the parties, greatly impairing both the value of the property and its potential for resale. The extent of this impairment may be presumed for the purpose of reviewing the disposition of this motion to dismiss the cause of action for rescission (*Harris v. City of New York*, 147 A.D.2d 186, 188—189) and represents merely an issue of fact for resolution at trial.

While I agree with Supreme Court that the real estate broker, as agent for the seller, is under no duty to disclose to a potential buyer the phantasmal reputation of the premises and that, in his pursuit of a legal remedy for fraudulent misrepresentation against the seller, plaintiff hasn't a ghost of a chance, I am nevertheless moved by the spirit of equity to allow the buyer to seek rescission of the contract of sale and recovery of his down payment. New York law fails to recognize any remedy for damages incurred as a result of the seller's mere silence, applying instead the strict rule of caveat emptor. Therefore, the theoretical basis for granting relief, even under the extraordinary facts of this case, is elusive if not ephemeral.

"Pity me not but lend thy serious hearing to what I shall unfold" (William Shakespeare, Hamlet, Act I, Scene V [Ghost]).

From the perspective of a person in the position of plaintiff herein, a very practical problem arises with respect to the discovery of a paranormal phenomenon: "Who you gonna call?" as a title song to the movie *Ghostbusters* asks. Applying the strict rule of caveat emptor to a contract involving a house possessed by poltergeists conjures up visions of a psychic or medium routinely accompanying the structural engineer and Terminix man on an inspection of every home subject to a contract of sale. It portends that the prudent attorney will establish an escrow account lest the subject of the transaction come back to haunt him and his

client—or pray that his malpractice insurance coverage extends to supernatural disasters. In the interest of avoiding such untenable consequences, the notion that a haunting is a condition which can and should be ascertained upon reasonable inspection of the premises is a hobgoblin which should be exorcised from the body of legal precedent and laid quietly to rest.

It has been suggested by a leading authority that the ancient rule which holds that mere nondisclosure does not constitute actionable misrepresentation "finds proper application in cases where the fact undisclosed is patent, or the plaintiff has equal opportunities for obtaining information which he may be expected to utilize, or the defendant has no reason to think that he is acting under any misapprehension" (Prosser, Torts Sec. 106, at 696 [4th ed 1971]). However, with respect to transactions in real estate, New York adheres to the doctrine of caveat emptor and imposes no duty upon the vendor to disclose any information concerning the premises (*London v. Courduff*, 141 A.D.2d 803) unless there is a confidential or fiduciary relationship between the parties (*Moser v. Spizzirro*, 31 A.D.2d 537, *aff'd* 25 N.Y.2d 941; *IBM Credit Fin. Corp. v. Mazda Motor Mfg. [USA] Corp.*, 152 A.D.2d 451) or some conduct on the part of the seller which constitutes "active concealment" (see *17 E. 80th Realty Corp. v. 68th Assocs.*, A.D.2d [1st Dept., May 9, 1991][dummy ventilation system constructed by seller]; *Haberman v. Greenspan*, 82 Misc. 2d 263 [foundation cracks covered by seller]). Normally, some affirmative misrepresentation (e.g., *Tahini Invs. v. Bobrowsky*, 99 A.D.2d 489 [industrial waste on land allegedly used only as farm]; *Jansen v. Kelly*, 11 A.D.2d 587 [land containing valuable minerals allegedly acquired for use as campsite]) or partial disclosure (*Junius Constr. Corp. v. Cohen*, 257 N.Y. 393 [existence of third unopened street concealed]; *Noved Realty Corp. v. A.A.P. Co.*, 250 App. Div. 1 [escrow agreements securing lien concealed]) is required to impose upon the seller a duty to communicate undisclosed conditions affecting the premises (contra, *Young v. Keith*, 112 A.D.2d 625 [defective water and sewer systems concealed]).

Caveat emptor is not so all-encompassing a doctrine of common law as to render every act of nondisclosure immune from redress, whether legal or equitable.

> In regard to the necessity of giving information which has not been asked, the rule differs somewhat at law and in equity, and while the law courts would permit no recovery of damages against a vendor, because of mere concealment of facts under certain circumstances, yet if the vendee refused to complete the contract because of the concealment of a material fact on the part of the other, equity would refuse to compel him so to do, because equity only compels the specific performance of a contract which is fair and open, and in regard to which all material matters known to each have been communicated to the other.

(*Rothmiller v. Stein*, 143 N.Y. 581, 591—592). Even as a principle of law, long before exceptions were embodied in statute law (see, e.g., UCC 2-312, 2-313, 2-314, 2-315; 3-417[2][e]), the doctrine was held inapplicable to contagion among animals, adulteration of food, and insolvency of a maker of a promissory note and of a tenant substituted for another under a lease (see *Rothmiller v. Stein*, supra, at 592-593, and cases cited therein). Common law is not moribund. Ex facto jus oritur (law arises out of facts). Where fairness and common sense dictate that an exception should be created, the evolution of the law should not be stifled by rigid application of a legal maxim.

The doctrine of caveat emptor requires that a buyer act prudently to assess the fitness and value of his purchase and operates to bar the purchaser who fails to exercise due care from seeking the equitable remedy of rescission (see, e.g., *Rodas v. Manitaras*, 159 A.D.2d 341). For the purposes of the instant motion to dismiss

the action pursuant to CPLR 3211(a)(7), plaintiff is entitled to every favorable inference which may reasonably be drawn from the pleadings (*Arrington v. New York Times Co.*, 55 N.Y.2d 433, 442; *Rovello v. Orofino Realty Co.*, 40 N.Y.2d 633, 634), specifically, in this instance, that he met his obligation to conduct an inspection of the premises and a search of available public records with respect to title. It should be apparent, however, that the most meticulous inspection and the search would not reveal the presence of poltergeists at the premises or unearth the property's ghoulish reputation in the community. Therefore, there is no sound policy reason to deny plaintiff relief for failing to discover a state of affairs which the most prudent purchaser would not be expected to even contemplate (see *Da Silva v. Musso*, 53 N.Y.2d 543, 551).

The case law in this jurisdiction dealing with the duty of a vendor of real property to disclose information to the buyer is distinguishable from the matter under review. The most salient distinction is that existing cases invariably deal with the physical condition of the premises (e.g., *London v. Courduff*, supra [use as a landfill]; *Perin v. Mardine Realty Co.*, 5 A.D.2d 685, *aff'd* 6 N.Y.2d 920 [sewer line crossing adjoining property without owner's consent]); defects in title (e.g., *Sands v. Kissane*, 282 App. Div. 140 [remainderman]); liens against the property (e.g., *Noved Realty Corp. v. A.A.P. Co.*, supra); expenses or income (e.g., *Rodas v. Manitaras*, supra [gross receipts]) and other factors affecting its operation. No case has been brought to this court's attention in which the property value was impaired as the result of the reputation created by information disseminated to the public by the seller (or, for that matter, as a result of possession by poltergeists).

Where a condition which has been created by the seller materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care with respect to the subject transaction, nondisclosure constitutes a basis for rescission as a matter of equity. Any other outcome places upon the buyer not merely the obligation to exercise care in his purchase but rather to be omniscient with respect to any fact which may affect the bargain. No practical purpose is served by imposing such a burden upon a purchaser. To the contrary, it encourages predatory business practice and offends the principle that equity will suffer no wrong to be without a remedy.

Defendant's contention that the contract of sale, particularly the merger or "as is" clause, bars recovery of the buyer's deposit is unavailing. Even an express disclaimer will not be given effect where the facts are peculiarly within the knowledge of the party invoking it (*Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 322; *Tahini Invs. v. Bobrowsky*, supra). Moreover, a fair reading of the merger clause reveals that it expressly disclaims only representations made with respect to the physical condition of the premises and merely makes general reference to representations concerning "any other matter or things affecting or relating to the aforesaid premises." As broad as this language may be, a reasonable interpretation is that its effect is limited to tangible or physical matters and does not extend to paranormal phenomena. Finally, if the language of the contract is to be construed as broadly as defendant urges to encompass the presence of poltergeists in the house, it cannot be said that she has delivered the premises "vacant" in accordance with her obligation under the provisions of the contract rider.

To the extent New York law may be said to require something more than "mere concealment" to apply even the equitable remedy of rescission, the case of *Junius Constr. Corp. v. Cohen* (257 N.Y. 393, supra), while not precisely on point, provides some guidance. In that case, the seller disclosed that an official map indicated two as yet unopened streets which were planned for construction at the edges of the parcel. What was not disclosed was that the same map indicated a third street which, if opened, would divide the plot in half. The

court held that, while the seller was under no duty to mention the planned streets at all, having undertaken to disclose two of them, he was obliged to reveal the third (see also *Rosenschein v. McNally*, 17 A.D.2d 834).

In the case at bar, defendant seller deliberately fostered the public belief that her home was possessed. Having undertaken to inform the public-at-large, to whom she has no legal relationship, about the supernatural occurrences on her property, she may be said to owe no less a duty to her contract vendee. It has been remarked that the occasional modern cases which permit a seller to take unfair advantage of a buyer's ignorance so long as he is not actively misled are "singularly unappetizing" (Prosser, Torts Sec. 106, at 696 '4th ed. 1971'). Where, as here, the seller not only takes unfair advantage of the buyer's ignorance but has created and perpetuated a condition about which he is unlikely to even inquire, enforcement of the contract (in whole or in part) is offensive to the court's sense of equity. Application of the remedy of rescission, within the bounds of the narrow exception to the doctrine of caveat emptor set forth herein, is entirely appropriate to relieve the unwitting purchaser from the consequences of a most unnatural bargain.

Accordingly, the judgment of the Supreme Court, New York County (Edward H. Lehner, J.), entered April 9, 1990, which dismissed the complaint pursuant to CPLR 3211(a)(7), should be modified, on the law and the facts, and in the exercise of discretion, and the first cause of action seeking rescission of the contract reinstated, without costs.

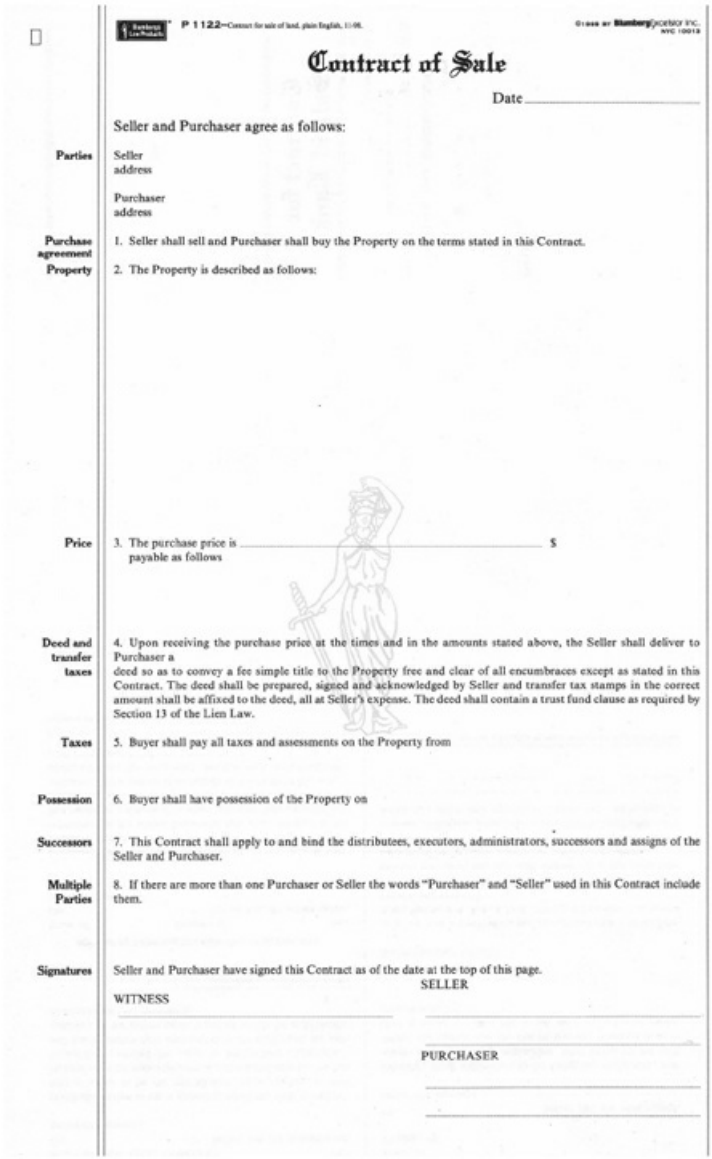
Case Questions

1. What does the court conclude are the obligations of the real estate agent?
2. How does the court interpret the vendor's duty to disclose in this case?

Additional Case Analysis

1. A junior lienholder assigned his rights to another, who attempted to redeem the property after a foreclosure sale. Another junior lienholder also wanted to redeem the property. Would either of them be entitled to a statutory right of redemption? If so, does a junior lienholder have priority over the assignee of another junior lienholder? See *Western Bank v. Malooly,* 119 N.M. 743, 895 P. 2d 2265 (1995).
2. A junior mortgagee foreclosed on the mortgage, along with the foreclosure of the senior mortgagee, and obtained a deficiency judgment. The junior mortgagee assigned its rights to the purchaser at the foreclosure, who then attempted to redeem the property after the foreclosure sale. Subsequently, another assignee also wanted to redeem the property. After foreclosure of the property, did the holder of the junior mortgage remain a junior mortgagee, with an assignable right to redemption? If so, which assignee would have priority to the right of redemption? See *Electronic Registration Systems, Inc. v. Montoya,* 114 N.M. 264 (2008).

Exhibit 4.3: Contract of Sale



P 1122—Contract for sale of land, plain English, 11/08.

Form of BlumbergExcelsior Inc. NYC 10013

Contract of Sale

Date _____

Seller and Purchaser agree as follows:

Parties Seller
address

Purchaser
address

Purchase agreement 1. Seller shall sell and Purchaser shall buy the Property on the terms stated in this Contract.

Property 2. The Property is described as follows:

Price 3. The purchase price is _____ $
payable as follows

Deed and transfer taxes 4. Upon receiving the purchase price at the times and in the amounts stated above, the Seller shall deliver to Purchaser a
deed so as to convey a fee simple title to the Property free and clear of all encumbraces except as stated in this Contract. The deed shall be prepared, signed and acknowledged by Seller and transfer tax stamps in the correct amount shall be affixed to the deed, all at Seller's expense. The deed shall contain a trust fund clause as required by Section 13 of the Lien Law.

Taxes 5. Buyer shall pay all taxes and assessments on the Property from

Possession 6. Buyer shall have possession of the Property on

Successors 7. This Contract shall apply to and bind the distributees, executors, administrators, successors and assigns of the Seller and Purchaser.

Multiple Parties 8. If there are more than one Purchaser or Seller the words "Purchaser" and "Seller" used in this Contract include them.

Signatures Seller and Purchaser have signed this Contract as of the date at the top of this page.

SELLER

WITNESS

PURCHASER

This form is reprinted with permission. It may be purchased from BlumbergExcelsior, Inc. (www.blumberg.com). Reproduction prohibited.

Exhibit 4.4:Rider to a Residential Contract of Sale

RIDER TO CONTRACT OF SALE
between

_____ (the "Seller")

and

_____ (the "Purchaser")

for the Sale of

_____ (the "Premises")

1. CONFLICT: In the event of a conflict between the terms of the printed portion of the Contract and the terms of this Rider, the terms of this Rider shall control, govern and prevail and the contradicted and/or inconsistent provisions of the printed portion of the Contract shall be deemed amended and superseded accordingly.

2. TITLE: Purchaser agrees to order a title report within ten (10) days after the date hereof, and to deliver or make sure that the title insurance company delivers to Seller's attorney, copies of the title insurance company's report, including the exception sheets, tax searches, property description, departmental searches and, if ordered, survey and survey reading, when issued. Since Purchaser is currently an owner of the Premises, Seller shall not be obligated to take any action to clear title and to cure any other violations under this Contract, and shall not be required to bring any action or proceeding or make any expenditure.

3. INSPECTION, CONDITION OF PREMISES: Purchaser acknowledges and represents to Seller that Purchaser has inspected or has had inspected by an inspector of Purchaser's choice, the Premises and all items of personal and real property included in the sale of the Premises, and is fully familiar with and satisfied with the physical nature and condition of same and will accept the Premises and all items of personal and real property included in the sale of the Premises "AS IS." On advance notice to Seller and reasonable appointment within 24 hours prior to closing, Purchaser shall be given the opportunity to reinspect the Premises, only for the purpose of determining whether the Premises are in the condition required by this Contract.

4. REPRESENTATIONS, NON-SURVIVAL: Purchaser expressly acknowledges, agrees and represents that no broker, representative, agent, employee, or attorney of Seller previously did nor does now make, and Purchaser is not relying upon, and has not been induced to enter into this Contract on the basis of, any warranties, representations, information, broker setups, inducements, or other statements (expressed or implied) as to the past, present or future physical condition of the Premises, the status of any termite infestation, or of any material or chemical, the expenses, taxes, operation, or maintenance, the school district, the quantity, quality or condition of the articles of personal property, fixtures, utilities and equipment agreed to be sold with the Premises, or as to the Premises, except as and only to the extent in this Contract specifically set forth. Acceptance by Purchaser of the deed at closing shall be and be deemed to be full compliance, performance and discharge of every agreement, representation and obligation expressed or implied (other than as required by law) on the part of Seller contained anywhere in this Contract. No representation, warranty or guarantee of Seller shall be deemed to survive the earlier of closing or possession by Purchaser or be the basis of any claim against Seller unless specifically and expressly stated in this Contract to survive.

5. NOTICE: _____ is the attorney for Purchaser, and _____ are the attorneys for Seller. The aforesaid addresses are the respective addresses for notices to said attorneys pursuant to this Contract. Notices shall be deemed valid and effective when received by the notified party's attorney, at the above address, and mailed to the party to be notified, addressed to the party at the party's address stated at the beginning of this Contract; or to such other address as the party or attorney may hereafter designate by notice as herein provided. Any and

all notice, demands or requests required or permitted to be given by any of the provisions of this Contract must be in writing and shall be validly given or made and effective the date when delivered personally against receipt, or actually received, or three (3) days after mailing with postage prepaid by either U.S. certified mail, return receipt requested, or by regular mail receipt of which is acknowledged by the receiving party or attorney. The attorneys are hereby expressly authorized, on behalf of their respective clients, to serve, and/or receive any written notice, whenever such notice is permitted to be given under the terms and conditions of this Contract; and to extend any of the time limitations as provided in this Contract; any such notice and/or extension, if any, shall be in writing and duly signed by said party or said party's attorney.

6. MISCELLANEOUS:

a. No Recording: This Contract or any memorandum of notice of same shall not be recorded or tendered for recording by or on behalf of Purchaser and any attempt to record the same by or on behalf of Purchaser shall be deemed a default by Purchaser; and thereupon, at Seller's election, this Contract shall be deemed canceled and Seller shall have any and all remedies for a default by Purchaser provided for herein and by law. If Purchaser files a notice of pendency of action or any other notice or memorandum in any court or land records department and either fails to commence a court action against Seller, or does not obtain judgment against Seller based on said court action, Purchaser agrees to pay Seller interest at the prime rate plus 1% as published in the New York Times on the unpaid balance of the purchase price commencing on date of filing the notice and ending when the notice is removed, together with reasonable legal, bonding and other costs and expenses, including attorneys fees, incurred by Seller in the defense of said action and as to removal of said notice.

b. No Offer: The transmittal of this document or any written or oral communication by Seller or of any attorney, broker or agent shall not be deemed a binding or continuing offer to sell or a meeting of the minds of the prospective parties on material terms and conditions, nor shall it be deemed a consummation of a contract or an accepted offer. The subject Premises are subject to prior sale, price change and/or withdrawal from sale and there shall be no binding contract unless and until Seller executes and delivers to Purchaser a fully executed Contract.

c. Assessments: Seller represents to Purchaser that Seller is not aware of any assessments affecting the Premises either pending or threatened. If at the time of closing, the Premises are affected by an assessment or assessments which are or may become payable in annual installments, the assessments payable after closing of the title shall be payable by Purchaser and by the owner of the Premises if payable on the date of or prior to closing of title.

d. Fire, Other Major Casualty: If prior to closing there shall be any fire, flood, explosion or other casualty, or condemnation affecting the Premises or any of the property to be conveyed in connection therewith, the New York General Obligations Law, Section 5-1311 shall apply, except that there shall be no abatement of purchase price.

e. Liens at Closing: If there be a mortgage or other lien on the Premises, the Premises shall be conveyed subject to said mortgage or other lien. The existence of said mortgage or other lien shall not constitute an objection to title if Purchaser's title insurance company omits such mortgage or other lien as an exception to title.

7. DOWN PAYMENT, ESCROW: The down payment shall be deemed paid to Seller on account of the purchase price, but shall be paid by check to the Seller's attorney, who shall also act as Escrow Agent. Purchaser's check payable to P.C. ("Escrow Agent"), is to be deposited in escrow by the Escrow Agent subject to clearance and the funds held in escrow in accordance with the provisions of this Contract. The escrow deposit may be delivered to or for Seller, on the stated closing date unless (1) upon Purchaser's default, to Seller, or (2) if Purchaser shall sooner be entitled to a refund thereof pursuant to this Contract, in which case shall be paid to Purchaser, or (3) if Seller shall default or cannot give title as required by this Contract, the escrow deposit shall be repaid to Purchaser. Interest accrued on the down payment will be paid to the party to whom the down payment is paid or refunded.

If the Escrow Agent is notified by a party of an escrow dispute, the Escrow Agent may (i) retain the funds in escrow until receipt by Escrow Agent of a written agreement and authorization from Seller and Purchaser directing the disposition of the funds; or (ii) at any time deposit the escrow funds with the Clerk of the Court, County, or by direction of any Court having jurisdiction over the parties, and thereby be released and discharged by the parties for any and all costs, responsibilities, obligations and liabilities as to the escrow fund; and the Escrow Agent shall be compensated as to any expenses by the losing party. The Escrow Agent shall not be liable for any error, omission or action taken unless resulting from the Escrow Agent's gross negligence or willful breach of the terms of this section. By signing this Rider, who is Seller's agent as to receipt of the funds, agrees to act as the Escrow Agent for the down payment subject to the terms of this Section. In case of a dispute or any threatened or actual litigation, notwithstanding acting as the Escrow Agent, may represent Seller. If Purchaser's down payment check is dishonored for any reason by the bank upon which it is drawn, then Seller, in addition to any other rights and remedies Seller may have, may, at Seller's option, declare this Contract null and void and at an end and thereupon Seller shall be relieved and released from all obligations hereunder.

_____
Seller

_____
Seller

_____
Purchaser

By:_____

_____

Exhibit 4.5: Deed

M 919—Bargain and sale deed, covenant as to grantor's acts, statutory deed language, ind. or corp., 1-83

Consult your Lawyer before signing this deed — it has important legal consequences.

Deed

Date

Parties

Grantor
Full name(s) and post office address

This Deed is made on between

Grantor, and

Grantee
Full name(s) and post office address

Grantee.

(The words "Grantor" and "Grantee" include all Grantors and all Grantees under this Deed.)

Consideration

In return for the payment to the Grantor by the Grantee of Dollars ($),

Conveyance

the Grantor grants and conveys to the Grantee all of the land located in the of County of and State of New Jersey, specifically described as follows:

Description of Land

This Deed was prepared by .....
Print or type name.

.....
Signature

Municipal Lot and Block or Account Number

The land is now designated as Lot in Block on the municipal tax map (or as Account No.).

Check box if applicable

☐ No property tax identification number for the land is available at the time of this conveyance.

Covenant as to Grantor's Acts

The Grantor covenants that the Grantor has done no act to encumber the land.

Receipt of Consideration

The Grantor has received the full payment from the Grantee.

Signature of Grantor

The Grantor signs this Deed on the first date above. If the Grantor is a corporation this Deed is signed by its corporate officers and its corporate seal is affixed.

Signed, sealed and delivered in the presence of or attested by: ..... SEAL

.... SEAL

..... SEAL

..... SEAL

CERTIFICATE OF ACKNOWLEDGMENT BY INDIVIDUAL

State of New Jersey, County of

I am a

an officer authorized to take acknowledgments and proofs in this State. I sign this acknowledgment below to certify that it was made before me.

On....., ..., ...

.....

appeared before me in person. *(If more than one person appears, the words "this person" shall include all persons named who appeared before the officer and made this acknowledgment).* I am satisfied that this person is the person named in and who signed this Deed. This person acknowledged signing, sealing and delivering this Deed as this person's act and deed for the uses and purposes expressed in this Deed.

This person also acknowledged that the full and actual consideration paid or to be paid for the transfer of title to realty evidenced by this Deed, as such consideration is defined in P.L. 1968, c. 49, §1(c), is $.....

.....

Officer's signature. Print, stamp or type name and title directly beneath.

CORPORATE PROOF BY THE SUBSCRIBING WITNESS

State of New Jersey, County of

I am a

an officer authorized to take acknowledgments and proofs in this State.

On....., ..., ...

(from now on called the "Witness") appeared before me in person. The Witness was duly sworn by me according to law under oath and stated and proved to my satisfaction that:

1. The Witness is the.....Secretary of the Corporation which is the Grantor in this Deed.
2. .....the officer who signed this Deed, is the.....President of the Corporation (from now on called the "Corporate Officer").
3. The making, signing, sealing, and delivery of this Deed have been duly authorized by a proper resolution of the Board of Directors of the Corporation.
4. The Witness knows the corporate seal of the Corporation. The seal affixed to this Deed is the corporate seal of the Corporation. The seal was affixed to this Deed by the Corporate Officer. The Corporate Officer signed and delivered this Deed as and for the voluntary act and deed of the Corporation. All this was done in the presence of the Witness who signed this Deed as attesting witness. The Witness signs this proof to attest to the truth of these facts.

The Witness also acknowledged that the full and actual consideration paid or to be paid for the transfer of title to realty evidenced by this Deed, as such consideration is defined in P.L. 1968, c. 49, §1(c), is $.....

Sworn to and signed before me on the date written above.

.....

Witness: sign above and print or type name below.

.....

Officer's signature. Print, stamp or type name and title directly beneath.

Exhibit 4.6: Quitclaim Deed

Quitclaim Deed

_____ of _____ County, Massachusetts, being unmarried, for consideration paid, and in full consideration of _____ grants to _____ of _____ with quitclaim covenants the land in

(description and encumbrances, if any)

WITNESS _____ hand and seal this _____ day of _____

Commonwealth of Massachusetts

_____ County

On this _____ day of _____, 20 , before me, the undersigned notary public, personally appeared _____, proved to me through satisfactory evidence of identification, consisting of a Massachusetts Driver's license, to be the person whose name is signed on the preceding or attached document, and acknowledged to me that (s)he signed it voluntarily for its stated purpose.

_____
Notary Public

My commission expires:

Exhibit 4.7: Uniform Residential Loan Application

Uniform Residential Loan Application

This application is designed to be completed by the applicant(s) with the Lender's assistance. Applicants should complete this form as "Borrower" or "Co-Borrower," as applicable. Co-Borrower information must also be provided (and the appropriate box checked) when ☐ the income or assets of a person other than the Borrower (including the Borrower's spouse) will be used as a basis for loan qualification or ☐ the income or assets of the Borrower's spouse or other person who has community property rights pursuant to state law will not be used as a basis for loan qualification, but his or her liabilities must be considered because the spouse or other person has community property rights pursuant to applicable law and Borrower resides in a community property state, the security property is located in a community property state, or the Borrower is relying on other property located in a community property state as a basis for repayment of the loan.

If this is an application for joint credit, Borrower and Co-Borrower each agree that we intend to apply for joint credit (sign below):

Borrower _____ Co-Borrower _____

I. TYPE OF MORTGAGE AND TERMS OF LOAN

Mortgage Applied for:	☐ VA ☐ FHA	☐ Conventional ☐ USDA/Rural Housing Service	☐ Other (explain):	Agency Case Number	Lender Case Number

Amount $	Interest Rate %	No. of Months	**Amortization Type:**	☐ Fixed Rate ☐ GPM	☐ Other (explain): ☐ ARM (type):

II. PROPERTY INFORMATION AND PURPOSE OF LOAN

Subject Property Address (street, city, state & ZIP)	No. of Units
Legal Description of Subject Property (attach description if necessary)	Year Built

Purpose of Loan	☐ Purchase ☐ Construction ☐ Other (explain): ☐ Refinance ☐ Construction Permanent	Property will be: ☐ Primary Residence ☐ Secondary Residence ☐ Investment

Complete this line if construction or construction-permanent loan.

Year Lot Acquired	Original Cost	Amount Existing Liens	(a) Present Value of Lot	(b) Cost of Improvements	Total (a + b)
	$	$	$	$	$

Complete this line if this is a refinance loan.

Year Acquired	Original Cost	Amount Existing Liens	Purpose of Refinance	Describe Improvements ☐ made ☐ to be made	
	$	$		Cost: $	

Title will be held in what Name(s)	Manner in which Title will be held	Estate will be held in: ☐ Fee Simple ☐ Leasehold (show expiration date)
Source of Down Payment, Settlement Charges, and/or Subordinate Financing (explain)		

III. BORROWER INFORMATION

Borrower				**Co-Borrower**			
Borrower's Name (include Jr. or Sr. if applicable)				Co-Borrower's Name (include Jr. or Sr. if applicable)			
Social Security Number	Home Phone (incl. area code)	DOB (mm/dd/yyyy)	Yrs. School	Social Security Number	Home Phone (incl. area code)	DOB (mm/dd/yyyy)	Yrs. School
☐ Married ☐ Unmarried (include single, divorced, widowed) ☐ Separated	Dependents (not listed by Co-Borrower) no.	ages		☐ Married ☐ Unmarried (include single, divorced, widowed) ☐ Separated	Dependents (not listed by Borrower) no.	ages	
Present Address (street, city, state, ZIP) ☐ Own ☐ Rent ___No. Yrs.				Present Address (street, city, state, ZIP) ☐ Own ☐ Rent ___No. Yrs.			
Mailing Address, if different from Present Address				Mailing Address, if different from Present Address			
If residing at present address for less than two years, complete the following:							
Former Address (street, city, state, ZIP) ☐ Own ☐ Rent ___No. Yrs.				Former Address (street, city, state, ZIP) ☐ Own ☐ Rent ___No. Yrs.			

IV. EMPLOYMENT INFORMATION

Borrower			**Co-Borrower**		
Name & Address of Employer ☐ Self Employed	Yrs. on this job	Yrs. employed in this line of work/profession	Name & Address of Employer ☐ Self Employed	Yrs. on this job	Yrs. employed in this line of work/profession
Position/Title/Type of Business	Business Phone (incl. area code)		Position/Title/Type of Business	Business Phone (incl. area code)	

If employed in current position for less than two years or if currently employed in more than one position, complete the following:

Borrower	IV. EMPLOYMENT INFORMATION (cont'd)	Co-Borrower
Name & Address of Employer ☐ Self Employed	Dates (from – to) / Monthly Income	Name & Address of Employer ☐ Self Employed	Dates (from – to) / Monthly Income
	$		$
Position/Title/Type of Business	Business Phone (incl. area code)	Position/Title/Type of Business	Business Phone (incl. area code)
Name & Address of Employer ☐ Self Employed	Dates (from – to) / Monthly Income	Name & Address of Employer ☐ Self Employed	Dates (from – to) / Monthly Income
	$		$
Position/Title/Type of Business	Business Phone (incl. area code)	Position/Title/Type of Business	Business Phone (incl. area code)

V. MONTHLY INCOME AND COMBINED HOUSING EXPENSE INFORMATION

Gross Monthly Income	Borrower	Co-Borrower	Total	Combined Monthly Housing Expense	Present	Proposed
Base Empl. Income*	$	$	$	Rent	$	
Overtime				First Mortgage (P&I)		$
Bonuses				Other Financing (P&I)		
Commissions				Hazard Insurance		
Dividends/Interest				Real Estate Taxes		
Net Rental Income				Mortgage Insurance		
Other (before completing, see the notice in "describe other income," below)				Homeowner Assn. Dues		
				Other:		
Total	$	$	$	**Total**	$	$

* **Self Employed Borrower(s) may be required to provide additional documentation such as tax returns and financial statements.**

Describe Other Income *Notice:* **Alimony, child support, or separate maintenance income need not be revealed if the Borrower (B) or Co-Borrower (C) does not choose to have it considered for repaying this loan.**

B/C		Monthly Amount
		$

VI. ASSETS AND LIABILITIES

This Statement and any applicable supporting schedules may be completed jointly by both married and unmarried Co-Borrowers if their assets and liabilities are sufficiently joined so that the Statement can be meaningfully and fairly presented on a combined basis; otherwise, separate Statements and Schedules are required. If the Co-Borrower section was completed about a non-applicant spouse or other person, this Statement and supporting schedules must be completed about that spouse or other person also.

Completed ☐ Jointly ☐ Not Jointly

ASSETS Description	Cash or Market Value
Cash deposit toward purchase held by:	$
List checking and savings accounts below	
Name and address of Bank, S&L, or Credit Union	
Acct. no.	$
Name and address of Bank, S&L, or Credit Union	
Acct. no.	$
Name and address of Bank, S&L, or Credit Union	
Acct. no.	$

Liabilities and Pledged Assets. List the creditor's name, address, and account number for all outstanding debts, including automobile loans, revolving charge accounts, real estate loans, alimony, child support, stock pledges, etc. Use continuation sheet, if necessary. Indicate by (*) those liabilities, which will be satisfied upon sale of real estate owned or upon refinancing of the subject property.

LIABILITIES	Monthly Payment & Months Left to Pay	Unpaid Balance
Name and address of Company	$ Payment/Months	$
Acct. no.		
Name and address of Company	$ Payment/Months	$
Acct. no.		
Name and address of Company	$ Payment/Months	$
Acct. no.		

VI. ASSETS AND LIABILITIES (cont'd)

Name and address of Bank, S&L, or Credit Union		Name and address of Company	$ Payment/Months	$
Acct. no.	$	Acct. no.		
Stocks & Bonds (Company name/ number & description)	$	Name and address of Company	$ Payment/Months	$
		Acct. no.		
Life insurance net cash value Face amount: $	$	Name and address of Company	$ Payment/Months	$
Subtotal Liquid Assets	$			
Real estate owned (enter market value from schedule of real estate owned)	$			
Vested interest in retirement fund	$			
Net worth of business(es) owned (attach financial statement)	$	Acct. no.		
Automobiles owned (make and year)	$	Alimony/Child Support/Separate Maintenance Payments Owed to:	$	
Other Assets (itemize)	$	Job-Related Expense (child care, union dues, etc.)	$	
		Total Monthly Payments	$	
Total Assets a.	$	Net Worth (a minus b) ▶ $	**Total Liabilities b.**	$

Schedule of Real Estate Owned (If additional properties are owned, use continuation sheet.)

Property Address (enter S if sold, PS if pending sale or R if rental being held for income) ▼	Type of Property	Present Market Value	Amount of Mortgages & Liens	Gross Rental Income	Mortgage Payments	Insurance, Maintenance, Taxes & Misc.	Net Rental Income
		$	$	$	$	$	$
Totals		$	$	$	$	$	$

List any additional names under which credit has previously been received and indicate appropriate creditor name(s) and account number(s):

Alternate Name	Creditor Name	Account Number

VII. DETAILS OF TRANSACTION

a.	Purchase price	$
b.	Alterations, improvements, repairs	
c.	Land (if acquired separately)	
d.	Refinance (incl. debts to be paid off)	
e.	Estimated prepaid items	
f.	Estimated closing costs	
g.	PMI, MIP, Funding Fee	
h.	Discount (if Borrower will pay)	
i.	Total costs (add items a through h)	

VIII. DECLARATIONS

If you answer "Yes" to any questions a through i, please use continuation sheet for explanation.

	Borrower		Co-Borrower	
	Yes	**No**	**Yes**	**No**
a. Are there any outstanding judgments against you?	☐	☐	☐	☐
b. Have you been declared bankrupt within the past 7 years?	☐	☐	☐	☐
c. Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years?	☐	☐	☐	☐
d. Are you a party to a lawsuit?	☐	☐	☐	☐
e. Have you directly or indirectly been obligated on any loan which resulted in foreclosure, transfer of title in lieu of foreclosure, or judgment? (This would include such loans as home mortgage loans, SBA loans, home improvement loans, educational loans, manufactured (mobile) home loans, any mortgage, financial obligation, bond, or loan guarantee. If "Yes," provide details, including date, name, and address of Lender, FHA or VA case number, if any, and reasons for the action.)	☐	☐	☐	☐

VII. DETAILS OF TRANSACTION

j.	Subordinate financing	
k.	Borrower's closing costs paid by Seller	
l.	Other Credits (explain)	
m.	Loan amount (exclude PMI, MIP, Funding Fee financed)	
n.	PMI, MIP, Funding Fee financed	
o.	Loan amount (add m & n)	
p.	Cash from/to Borrower (subtract j, k, l & o from i)	

VIII. DECLARATIONS

If you answer "Yes" to any questions a through i, please use continuation sheet for explanation.

		Borrower Yes	Borrower No	Co-Borrower Yes	Co-Borrower No
f.	Are you presently delinquent or in default on any Federal debt or any other loan, mortgage, financial obligation, bond, or loan guarantee?	☐	☐	☐	☐
g.	Are you obligated to pay alimony, child support, or separate maintenance?	☐	☐	☐	☐
h.	Is any part of the down payment borrowed?	☐	☐	☐	☐
i.	Are you a co-maker or endorser on a note?	☐	☐	☐	☐
j.	Are you a U.S. citizen?	☐	☐	☐	☐
k.	Are you a permanent resident alien?	☐	☐	☐	☐
l.	**Do you intend to occupy the property as your primary residence?** If Yes," complete question m below.	☐	☐	☐	☐
m.	Have you had an ownership interest in a property in the last three years?	☐	☐	☐	☐
	(1) What type of property did you own—principal residence (PR), second home (SH), or investment property (IP)?				
	(2) How did you hold title to the home— by yourself (S), jointly with your spouse (SP), or jointly with another person (O)?				

IX. ACKNOWLEDGEMENT AND AGREEMENT

Each of the undersigned specifically represents to Lender and to Lender's actual or potential agents, brokers, processors, attorneys, insurers, servicers, successors and assigns and agrees and acknowledges that: (1) the information provided in this application is true and correct as of the date set forth opposite my signature and that any intentional or negligent misrepresentation of this information contained in this application may result in civil liability, including monetary damages, to any person who may suffer any loss due to reliance upon any misrepresentation that I have made on this application, and/or in criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Sec. 1001, et seq.; (2) the loan requested pursuant to this application (the "Loan") will be secured by a mortgage or deed of trust on the property described in this application; (3) the property will not be used for any illegal or prohibited purpose or use; (4) all statements made in this application are made for the purpose of obtaining a residential mortgage loan; (5) the property will be occupied as indicated in this application; (6) the Lender, its servicers, successors or assigns may retain the original and/or an electronic record of this application, whether or not the Loan is approved; (7) the Lender and its agents, brokers, insurers, servicers, successors, and assigns may continuously rely on the information contained in the application, and I am obligated to amend and/or supplement the information provided in this application if any of the material facts that I have represented herein should change prior to closing of the Loan; (8) in the event that my payments on the Loan become delinquent, the Lender, its servicers, successors or assigns may, in addition to any other rights and remedies that it may have relating to such delinquency, report my name and account information to one or more consumer reporting agencies; (9) ownership of the Loan and/or administration of the Loan account may be transferred with such notice as may be required by law; (10) neither Lender nor its agents, brokers, insurers, servicers, successors or assigns has made any representation or warranty, express or implied, to me regarding the property or the condition or value of the property; and (11) my transmission of this application as an "electronic record" containing my "electronic signature," as those terms are defined in applicable federal and/or state laws (excluding audio and video recordings), or my facsimile transmission of this application containing a facsimile of my signature, shall be as effective, enforceable and valid as if a paper version of this application were delivered containing my original written signature.

Acknowledgement. Each of the undersigned hereby acknowledges that any owner of the Loan, its servicers, successors and assigns, may verify or reverify any information contained in this application or obtain any information or data relating to the Loan, for any legitimate business purpose through any source, including a source named in this application or a consumer reporting agency.

Borrower's Signature	Date	Co-Borrower's Signature	Date
X		X	

X. INFORMATION FOR GOVERNMENT MONITORING PURPOSES

The following information is requested by the Federal Government for certain types of loans related to a dwelling in order to monitor the lender's compliance with equal credit opportunity, fair housing and home mortgage disclosure laws. You are not required to furnish this information, but are encouraged to do so. The law provides that a lender may not discriminate either on the basis of this information, or on whether you choose to furnish it. If you furnish the information, please provide both ethnicity and race. For race, you may check more than one designation. If you do not furnish ethnicity, race, or sex, under Federal regulations, this lender is required to note the information on the basis of visual observation and surname if you have made this application in person. If you do not wish to furnish the information, please check the box below. (Lender must review the above material to assure that the disclosures satisfy all requirements to which the lender is subject under applicable state law for the particular type of loan applied for.)

BORROWER ☐ I do not wish to furnish this information	**CO-BORROWER** ☐ I do not wish to furnish this information
Ethnicity: ☐ Hispanic or Latino ☐ Not Hispanic or Latino	**Ethnicity:** ☐ Hispanic or Latino ☐ Not Hispanic or Latino
Race: ☐ American Indian or Alaska Native ☐ Asian ☐ Black or African American ☐ Native Hawaiian or Other Pacific Islander ☐ White	**Race:** ☐ American Indian or Alaska Native ☐ Asian ☐ Black or African American ☐ Native Hawaiian or Other Pacific Islander ☐ White
Sex: ☐ Female ☐ Male	**Sex:** ☐ Female ☐ Male

To be Completed by Loan Originator:
This information was provided:
- ☐ In a face-to-face interview
- ☐ In a telephone interview
- ☐ By the applicant and submitted by fax or mail
- ☐ By the applicant and submitted via e-mail or the Internet

Loan Originator's Signature		Date
X		
Loan Originator's Name (print or type)	Loan Originator Identifier	Loan Originator's Phone Number (including area code)
Loan Origination Company's Name	Loan Origination Company Identifier	Loan Origination Company's Address

CONTINUATION SHEET/RESIDENTIAL LOAN APPLICATION		
Use this continuation sheet if you need more space to complete the Residential Loan Application. Mark **B** for Borrower or **C** for Co-Borrower.	Borrower:	Agency Case Number:
	Co-Borrower:	Lender Case Number:

I/We fully understand that it is a Federal crime punishable by fine or imprisonment, or both, to knowingly make any false statements concerning any of the above facts as applicable under the provisions of Title 18, United States Code, Section 1001, et seq.

Borrower's Signature	Date	Co-Borrower's Signature	Date
X		**X**	

5 Real Estate Closing Procedures

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Understand what occurs at a real estate closing
- Discuss the responsibilities of the purchaser between the time of entering into the contract for the sale of the property and the closing
- Explain the provisions of the Real Estate Settlement Procedure Act
- Complete the HUD-1 Uniform Settlement Statement
- Discuss the responsibilities of the seller between the time of entering into the contract for the sale of the property and the closing
- Explain the importance of a certificate of occupancy
- Understand the nature of all of the documents that must be prepared for the actual real estate closing
- Explain all of the post-closing procedures
- Apply practical tips to assist you in completing a real estate closing

CHAPTER OUTLINE

CHAPTER OVERVIEW

Chapter 4, Conveyancing, provided an introduction to the concept of the real estate closing. The purpose of this chapter is to detail the formalities of the closing procedure, including aspects of the pre- and post-closing process. For the legal professional working in a general and real estate practice, the closing is one of the mainstays of the office.

Prior to the actual closing, the day on which the title to the property passes from the seller to the buyer, certain information must be gathered to assure that the parties are appropriately protected. Many of these items have already been addressed in Chapter 4 in the discussion of the real estate sales contract; however, certain other items must be included as well. Before entering into the sales contract, the buyer must be aware of all the costs that will be involved in the sale. These costs include not only the actual purchase price of the property, but also the financing costs and overall fees associated with purchasing the realty. Generally, the following items are included in the final closing costs:

(a) attorneys' fees, which include the preparation of all legal documents involved in the sale as well as out-of-pocket expenses;
(b) the cost of a title search and the premiums on title insurance if such is deemed advisable with respect to the property (also, many financial institutions require a borrower to acquire title insurance as a condition of granting a mortgage);
(c) surveys;
(d) recording costs—the cost of recording the deed in the county recorder's office;
(e) if the sale involves the purchase of a condominium or cooperative, there may be special assessments that are paid to the home-owners' association, but the specifics vary with each such purchase;
(f) inspection fees for examining the property for safety and code provisions; and
(g) certain costs that are involved in obtaining mortgage loan financing, which may include:
    - application fee
    - credit check
    - financing fee
    - loan decision fee
    - processing fee
    - appraisal fee
    - inspection fee
    - lender's attorney's fee
    - escrow fee
    - document preparation fee
    - any other fees, including fees for interim loans.

As can be seen, the costs involved in the sale of real estate can far exceed the base purchase price, and many people discover to their chagrin that they can afford the purchase price but not the additional costs involved in the closing. Consequently, all of these financial considerations must be addressed prior to the parties' actually entering into the contract for sale.

This chapter analyzes the procedures involved in three separate time frames: the period between the contract and the closing date, the actual closing, and the period following the closing.

Between the Contract of Sale and the Closing Date

The responsibilities of the parties between the signing of the contract and the transfer of title at the closing vary depending on whether one is the purchaser or the seller.

The Purchaser

After the contract has been entered into, it is the responsibility of the buyer to make sure that any contingencies or conditions in the contract that are her responsibilities are fulfilled. One of the most common of these preliminary steps is to contract for the services of various experts who are responsible for making the many inspection reports that are necessary prior to consummating the sale. Generally, before a financial institution is willing to lend money to the purchaser of realty it wants to make sure that there are no internal problems with the property, and the institution uses these experts' reports to make that decision.

The result of these reports may give rise to a claim that the property contains a defect. A **defect** can be any adverse impact of a physical or structural nature that would cause a significant reduction in the value of the property. If such a condition is discovered as a result of the inspection, the purchaser may be able to seek a reduction in the purchase price or to require the seller to remedy the defect prior to the closing.

If the property passes the inspection satisfactorily, or any discovered defect is cured, the buyer typically submits an application to a financial institution to obtain a mortgage loan. As a rule of thumb, if the purchaser is putting down less than 30 percent of the total purchase price, the lender requires the purchaser to obtain mortgage insurance. **Mortgage insurance** operates to discharge the loan obligation if the insured borrower dies or meets any other condition specified in the contract to trigger the obligation of the insurer. This insurance protects both the lender who is guaranteed repayment of the loan and the borrower who is protected from having the property foreclosed on (see Chapter 4).

Once financing has been arranged, the buyer and the seller agree on the date for the closing, which typically occurs between 30 and 90 days after the signing of the contract or the buyer obtains financing, whichever occurs first.

Many sellers of realty who have covenanted for title will acquire **title insurance** to protect them against claims of ownership to the property. To acquire the insurance, a title search must be conducted to determine the current status of the title, and the cost of the insurance may be borne by either party to the sale, depending on the terms of the sales contract. The title search alerts the purchaser to any encumbrances on the property that might render it unmarketable, and if it is unmarketable, the buyer may avoid the contract (see Chapter 4) if the encumbrance is not removed by the seller by the closing date. As discussed in previous chapters, examples of encumbrances would be existing mortgages, judgments on the property, liens for taxes and other government charges, and mechanics' liens.

During the period between the contract and the closing, the purchaser will conduct a survey of the property to make sure that the property being conveyed corresponds to the terms of the contract for sale. Not only could this have an effect on the sales contract, if the realty turns out to be more or less than described in the contract, but the financial institution providing the funds for the purchase may require the survey prior to approving the loan.

Finally, pursuant to the **Real Estate Settlement Procedure Act**, the federal statute governing all federally guaranteed mortgage loans, a **settlement statement** must be prepared. This form is prepared by the United States Department of Housing and Urban Development, and is usually referred to as the **HUD-1 Uniform Settlement Statement.** This is the standard form used in most real estate transactions, even if no federal mortgage loans are involved. The HUD-1 specifies all items of closing costs, and serves two specific purposes: to reflect the amount to be paid by the seller and to specify the amount to be paid by the purchaser to close the sale. (See Exhibit 5.1. This form can also be accessed online at www.hud.gov.)

Exhibit 5.1: HUD-1 Settlement Statement

OMB Approval No. 2502-0265

A. Settlement Statement (HUD-1)

B. Type of Loan			
1. ☐ FHA 2. ☐ RHS 3. ☐ Conv. Unins. 4. ☐ VA 5. ☐ Conv. Ins.	6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

D. Name & Address of Borrower:	E. Name & Address of Seller:	F. Name & Address of Lender:
G. Property Location:	H. Settlement Agent: Place of Settlement:	I. Settlement Date:

J. Summary of Borrower's Transaction		K. Summary of Seller's Transaction	
100. Gross Amount Due from Borrower		**400. Gross Amount Due to Seller**	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)		403.	
104.		404.	
105.		405.	
Adjustment for items paid by seller in advance		**Adjustment for items paid by seller in advance**	
106. City/town taxes to		406. City/town taxes to	
107. County taxes to		407. County taxes to	
108. Assessments to		408. Assessments to	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
120. Gross Amount Due from Borrower		**420. Gross Amount Due to Seller**	
200. Amount Paid by or in Behalf of Borrower		**500. Reductions In Amount Due to seller**	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)		502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
Adjustments for items unpaid by seller		**Adjustments for items unpaid by seller**	
210. City/town taxes to		510. City/town taxes to	
211. County taxes to		511. County taxes to	
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. Total Paid by/for Borrower		**520. Total Reduction Amount Due Seller**	
300. Cash at Settlement from/to Borrower		**600. Cash at Settlement to/from Seller**	
301. Gross amount due from borrower (line 120)		601. Gross amount due to seller (line 420)	
302. Less amounts paid by/for borrower (line 220)	( )	602. Less reductions in amounts due seller (line 520)	( )
303. Cash ☐ From ☐ **To Borrower**		**603. Cash** ☐ To ☐ **From Seller**	

The Public Reporting Burden for this collection of information is estimated at 35 minutes per response for collecting, reviewing, and reporting the data. This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number. No confidentiality is assured; this disclosure is mandatory. This is designed to provide the parties to a RESPA covered transaction with information during the settlement process.

Previous edition are obsolete | Page 1 of 3 | HUD-1

L. Settlement Charges

700. Total Real Estate Broker Fees	Paid From Borrower's Funds at Settlement	Paid From Seller's Funds at Settlement
Division of commission (line 700) as follows :		
701. $ to		
702. $ to		
703. Commission paid at settlement		
704.		

800. Items Payable in Connection with Loan				
801. Our origination charge	$	(from GFE #1)		
802. Your credit or charge (points) for the specific interest rate chosen	$	(from GFE #2)		
803. Your adjusted origination charges		(from GFE #A)		
804. Appraisal fee to		(from GFE #3)		
805. Credit report to		(from GFE #3)		
806. Tax service to		(from GFE #3)		
807. Flood certification to		(from GFE #3)		
808.				
809.				
810.				
811.				

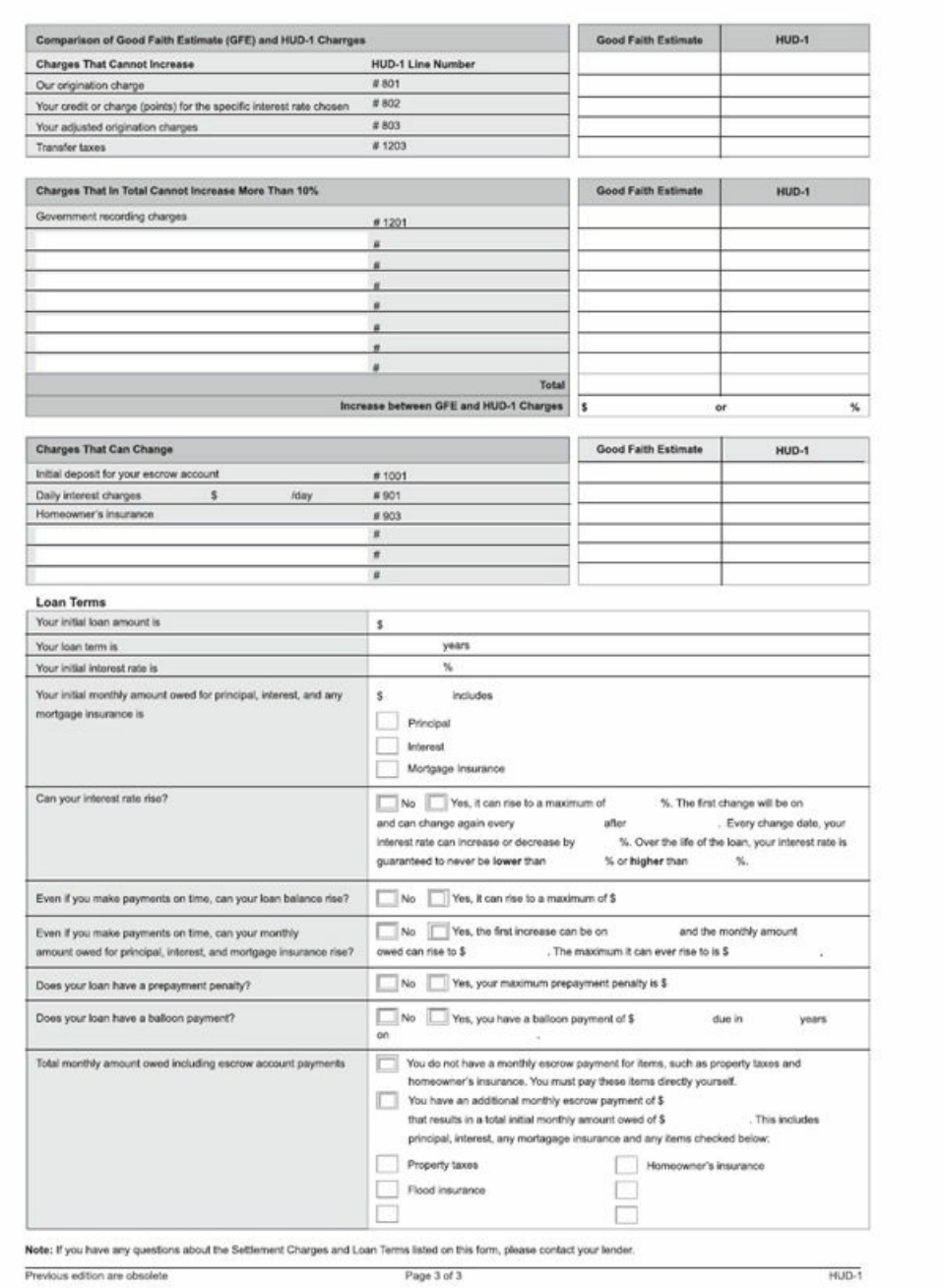
900. Items Required by Lender to be Paid in Advance				
901. Daily interest charges from to @ $ /day		(from GFE #10)		
902. Mortgage insurance premium for months to		(from GFE #3)		
903. Homeowner's insurance for years to		(from GFE #11)		
904.				

1000. Reserves Deposited with Lender				
1001. Initial deposit for your escrow account		(from GFE #9)		
1002. Homeowner's insurance	months @ $	per month	$	
1003. Mortgage insurance	months @ $	per month	$	
1004. Property Taxes	months @ $	per month	$	
1005.	months @ $	per month	$	
1006.	months @ $	per month	$	
1007. Aggregate Adjustment			-$	

1100. Title Charges				
1101. Title services and lender's title insurance		(from GFE #4)		
1102. Settlement or closing fee	$			
1103. Owner's title insurance		(from GFE #5)		
1104. Lender's title insurance	$			
1105. Lender's title policy limit $				
1106. Owner's title policy limit $				
1107. Agent's portion of the total title insurance premium to	$			
1108. Underwriter's portion of the total title insurance premium to	$			
1109.				
1110.				
1111.				

1200. Government Recording and Transfer Charges				
1201. Government recording charges		(from GFE #7)		
1202. Deed $ Mortgage $ Release $				
1203. Transfer taxes		(from GFE #8)		
1204. City/County tax/stamps Deed $	Mortgage $			
1205. State tax/stamps Deed $	Mortgage $			
1206.				

1300. Additional Settlement Charges				
1301. Required services that you can shop for		(from GFE #6)		
1302.	$			
1303.	$			
1304.				
1305.				
1400. Total Settlement Charges (enter on lines 103, Section J and 502, Section K)				



Comparison of Good Faith Estimate (GFE) and HUD-1 Charges		Good Faith Estimate	HUD-1
Charges That Cannot Increase	**HUD-1 Line Number**		
Our origination charge	# 801		
Your credit or charge (points) for the specific interest rate chosen	# 802		
Your adjusted origination charges	# 803		
Transfer taxes	# 1203		

Charges That In Total Cannot Increase More Than 10%		Good Faith Estimate	HUD-1
Government recording charges	# 1201		
	#		
	#		
	#		
	#		
	#		
	#		
	#		
	Total		
	Increase between GFE and HUD-1 Charges	$ or	%

Charges That Can Change		Good Faith Estimate	HUD-1
Initial deposit for your escrow account	# 1001		
Daily interest charges $ /day	# 901		
Homeowner's insurance	# 903		
	#		
	#		
	#		

Loan Terms

Your initial loan amount is	$
Your loan term is	years
Your initial interest rate is	%
Your initial monthly amount owed for principal, interest, and any mortgage insurance is	$ includes ☐ Principal ☐ Interest ☐ Mortgage Insurance
Can your interest rate rise?	☐ No ☐ Yes, it can rise to a maximum of %. The first change will be on and can change again every after . Every change date, your interest rate can increase or decrease by %. Over the life of the loan, your interest rate is guaranteed to never be **lower** than % or **higher** than %.
Even if you make payments on time, can your loan balance rise?	☐ No ☐ Yes, it can rise to a maximum of $
Even if you make payments on time, can your monthly amount owed for principal, interest, and mortgage insurance rise?	☐ No ☐ Yes, the first increase can be on and the monthly amount owed can rise to $. The maximum it can ever rise to is $.
Does your loan have a prepayment penalty?	☐ No ☐ Yes, your maximum prepayment penalty is $
Does your loan have a balloon payment?	☐ No ☐ Yes, you have a balloon payment of $ due in years on .
Total monthly amount owed including escrow account payments	☐ You do not have a monthly escrow payment for items, such as property taxes and homeowner's insurance. You must pay these items directly yourself. ☐ You have an additional monthly escrow payment of $ that results in a total initial monthly amount owed of $. This includes principal, interest, any mortgage insurance and any items checked below: ☐ Property taxes ☐ Homeowner's insurance ☐ Flood insurance ☐

Note: If you have any questions about the Settlement Charges and Loan Terms listed on this form, please contact your lender.

Previous edition are obsolete Page 3 of 3 HUD-1

The Seller

Between the contract and the closing, the seller has fewer obligations to perform than the purchaser. Generally, the responsibilities of the seller during this period can be summed up as making sure that he or she can transfer a marketable title on the closing date.

Certain local governments require that a seller produce a certificate of occupancy if the property has buildings on it. This certificate is the result of a general inspection of the premises to ascertain that the building is fit to be occupied. If such certificate is required and not provided, the purchaser may avoid the sale.

If the seller utilized the services of a real estate broker to make the sale, the seller must make sure that all commissions owed to the broker are paid prior to the closing, and the seller should obtain a receipt to document the payment. As a general rule, the seller's commission for the seller's broker is simply deducted from the purchase price that is received at the closing.

If any cloud appears on the title to the property, it is the seller's responsibility to see that such cloud is removed pursuant to the provisions of the deed that has been contracted to be conveyed (see Chapter 4).

Finally, during this period the seller must prepare all the documents that he is required to present at the closing. These documents include the following:

- **The deed:** The deed must conform to the nature of the title that has been agreed to in the sales contract (see Chapter 4).
- **Affidavit of title:** This is a separate document made by the seller that specifies his title to the property and indicates all improvements made on the property since the seller first acquired the title.
- **Form 1099-S:** This is an IRS form that must be filed for real estate transactions, except for the following:
  Gifts
  Refinancings
  Commercial property
  (See Exhibit 5.2.)
- **Certificate of non-foreign status:** The IRS also requires this form if the parties are U.S. citizens; foreign nationals are required to make certain payments pursuant to section 1445 of the Internal Revenue Code. (See Exhibit 5.3.)
- Survey affidavit, if the seller agrees to provide one to the buyer.
- Settlement statement (discussed above).
- All documents relating to the seller's mortgage.
- **Notice to attorn:** This document applies to property that has been leased to a tenant not a party to the sale. This notice alerts the tenant of the transfer of ownership of the property.
- The seller is usually required to pay a **realty transfer fee** mandated by the government.
- **Payoff amount:** This reflects the amount that is still outstanding on the seller's mortgage and is used by the purchaser to make sure that this encumbrance is discharged by the date of the closing (typically, a portion of the buyer's loan is used to discharge this obligation).
- The seller should have all utility companies provide a final reading of all charges due by the date of the closing so that such charges are allocated between the parties.
- Any other documents affecting the right to the property, such as foreclosure papers if the property was acquired by means of a foreclose sale, or estate papers if the property was inherited.

Exhibit 5.2: Form 1099-S

7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number	1 Date of closing	OMB No. 1545-0997	Proceeds From Real Estate Transactions
	2 Gross proceeds $	2014 Form 1099-S	

FILER'S federal identification number	TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2014 General Instructions for Certain Information Returns.
TRANSFEROR'S name			
Street address (including apt. no.)			
City or town, state or province, country, and ZIP or foreign postal code		4 Check here if the transferor received or will receive property or services as part of the consideration ► ☐	
Account or escrow number (see instructions)		5 Buyer's part of real estate tax $	

Form 1099-S Cat. No. 64292E www.irs.gov/form1099s Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

☐ CORRECTED (if checked)

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number	1 Date of closing	OMB No. 1545-0997	Proceeds From Real Estate Transactions
	2 Gross proceeds $	2014 Form 1099-S	

FILER'S federal identification number	TRANSFEROR'S identification number	3 Address or legal description	Copy B For Transferor This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported.
TRANSFEROR'S name			
Street address (including apt. no.)			
City or town, state or province, country, and ZIP or foreign postal code		4 Transferor received or will receive property or services as part of the consideration (if checked) ► ☐	
Account or escrow number (see instructions)		5 Buyer's part of real estate tax $	

Form 1099-S (keep for your records) www.irs.gov/form1099s Department of the Treasury - Internal Revenue Service

Instructions for Transferor

For sales or exchanges of certain real estate, the person responsible for closing a real estate transaction must report the real estate proceeds to the Internal Revenue Service and must furnish this statement to you. To determine if you have to report the sale or exchange of your main home on your tax return, see the instructions for Schedule D (Form 1040). If the real estate was not your main home, report the transaction on Form 4797, Form 6252, and/or the Schedule D for the appropriate income tax form. If Box 4 is checked and you received or will receive like-kind property, you must file Form 8824.

Federal mortgage subsidy. You may have to recapture (pay back) all or part of a federal mortgage subsidy if all the following apply.

- You received a loan provided from the proceeds of a qualified mortgage bond or you received a mortgage credit certificate.
- Your original mortgage loan was provided after 1990.
- You sold or disposed of your home at a gain during the first 9 years after you received the federal mortgage subsidy.
- Your income for the year you sold or disposed of your home was over a specified amount.

This will increase your tax. See Form 8828 and Pub. 523.

Transferor's identification number. For your protection, this form may show only the last four digits of your SSN, ITIN, or ATIN. However, the issuer has reported your complete identification number to the IRS, and, where applicable, to state and/or local governments.

Account number. May show an account or other unique number the filer assigned to distinguish your account.

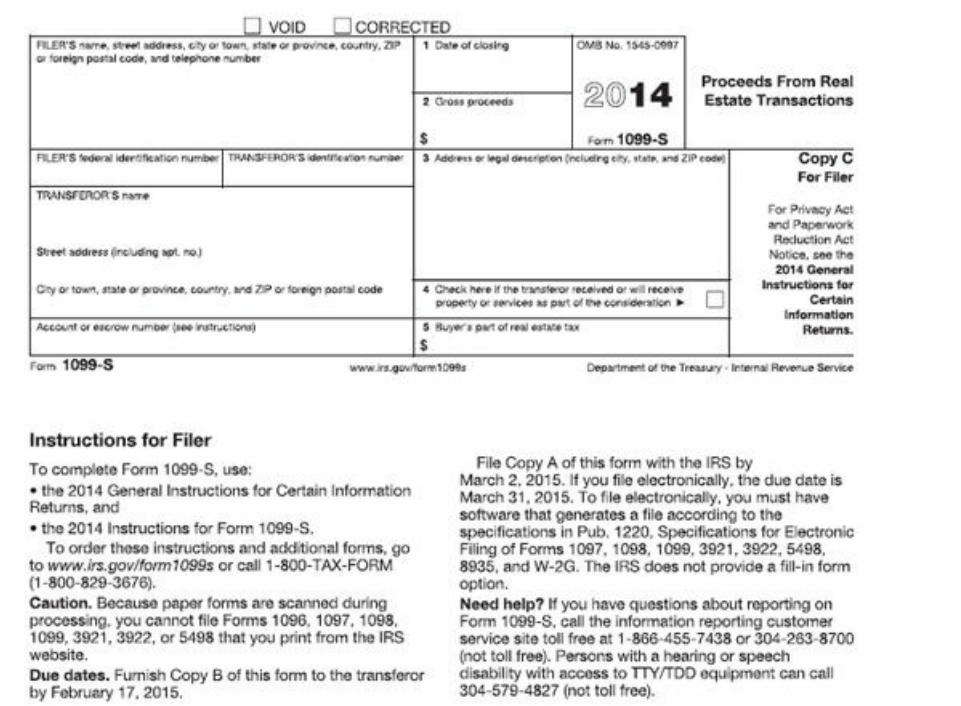
Box 1. Shows the date of closing.

Box 2. Shows the gross proceeds from a real estate transaction, generally the sales price. Gross proceeds include cash and notes payable to you, notes assumed by the transferee (buyer), and any notes paid off at settlement. Box 2 does not include the value of other property or services you received or will receive. See Box 4.

Box 3. Shows the address or legal description of the property transferred.

Box 4. If marked, shows that you received or will receive services or property (other than cash or notes) as part of the consideration for the property transferred. The value of any services or property (other than cash or notes) is not included in Box 2.

Box 5. Shows certain real estate tax on a residence charged to the buyer at settlement. If you have already paid the real estate tax for the period that includes the sale date, subtract the amount in box 5 from the amount already paid to determine your deductible real estate tax. But if you have already deducted the real estate tax in a prior year, generally report this amount as income on the "Other income" line of the appropriate income tax form. For more information, see Pub. 523, Pub. 525, and Pub. 530.



☐ VOID ☐ CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number	1 Date of closing	OMB No. 1545-0997	Proceeds From Real Estate Transactions
	2 Gross proceeds $	2014 Form 1099-S	

FILER'S federal identification number	TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)	Copy C For Filer
TRANSFEROR'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		4 Check here if the transferor received or will receive property or services as part of the consideration ► ☐	For Privacy Act and Paperwork Reduction Act Notice, see the 2014 General Instructions for Certain Information Returns.
Account or escrow number (see instructions)		5 Buyer's part of real estate tax $	

Form 1099-S www.irs.gov/form1099s Department of the Treasury - Internal Revenue Service

Instructions for Filer

To complete Form 1099-S, use:

- the 2014 General Instructions for Certain Information Returns, and
- the 2014 Instructions for Form 1099-S.

To order these instructions and additional forms, go to *www.irs.gov/form1099s* or call 1-800-TAX-FORM (1-800-829-3676).

Caution. Because paper forms are scanned during processing, you cannot file Forms 1096, 1097, 1098, 1099, 3921, 3922, or 5498 that you print from the IRS website.

Due dates. Furnish Copy B of this form to the transferor by February 17, 2015.

File Copy A of this form with the IRS by March 2, 2015. If you file electronically, the due date is March 31, 2015. To file electronically, you must have software that generates a file according to the specifications in Pub. 1220, Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, 8935, and W-2G. The IRS does not provide a fill-in form option.

Need help? If you have questions about reporting on Form 1099-S, call the information reporting customer service site toll free at 1-866-455-7438 or 304-263-8700 (not toll free). Persons with a hearing or speech disability with access to TTY/TDD equipment can call 304-579-4827 (not toll free).

Exhibit 5.3:F.I.R.P.T.A. Non-Foreign Certification by Individual Transferor

1. Section 1445 of the Internal Revenue Code provides that a transferee of a United States real property interest must withhold tax if the transferor is a foreign person.
2. In order to inform the transferee that withholding of tax is not required upon the disposition by [name of transferor(s)] of the United States real property described as follows:
   the undersigned transferor certifies and declares by means of this certification, the following

a. I (we) am (are) not non-resident alien(s) for purposes of United States income taxation and,

b. My United States taxpayer identifying number (Social Security number) is

NAME	SOCIAL SECURITY NUMBER
_____	_____
_____	_____

c. My home address is _____
_____

d. There are not other persons who have an ownership interest in the above described property other than those persons set forth above in subparagraph b.

3. The undersigned hereby further certified and declares

a. I (we) understand that the purchaser of the above described property intends to rely on the foregoing representations in connection with the United States Foreign Investment in Real Property Tax Act. (94 Stat 2682 as amended)

b. I (we) understand this certification may be disclosed to the Internal Revenue Service by transferee and that any false statement contained in this certification may be punished by fine, imprisonment or both.

Under penalties of perjury I (we) declare I (we) have examined carefully this certification and it is true, correct and complete.

Date: _____
_____

_____

Exhibit 5.3: F.I.R.P.T.A. (Foreign Investment in Real Property Tax) Affidavit of Facts Relating to the Withholding of Tax Upon the Disposition of United States Real Property Interests Pursuant to 26 U.S.C. 1445(B)(2)

STATE OF NEW YORK)
) SS.:
COUNTY OF)

The Undersigned, being duly sworn, deposes and says:

1. That the Undersigned are/is the owner(s) of the premises known as _____
being conveyed this date to _____

2. That the Undersigned are/is not a foreign person(s) as defined at 26 U.S.C. 1445 (f)(3).

3. That the Undersigned's United States Taxpayer Identification Number appears following his/her signature below.

_____ _____
_____ _____
_____ _____
_____ _____

Sworn to before me this _____
day of _____ 199__

_____
Notary Public

The Closing

The actual closing usually occurs at the office of the buyer's attorney, but may occur at any mutually agreed-upon location. Generally, the attorneys for the buyer and the seller attend, along with the parties and a representative of the financial institution providing the mortgage loan.

The purchaser usually contacts the title company 24 to 48 hours before the day of the closing to make sure that the title is still free of all clouds and encumbrances. At this point the purchaser will **mark up** the title instrument, meaning that he or she will tick off any item specified in the contract—grantor, grantee, liens, mortgages, judgments, etc.—to indicate that the title is marketable.

When all of the foregoing has taken place, the buyer and the seller transfer all documents and the deed is given to the buyer. In many instances the seller does not appear in person but is represented by an attorney.

The typical closing can be completed in less than two hours.

Post-Closing Procedures

Once the actual closing has taken place, there still remain many items to complete to protect the transferee. The most important of these is to record all the documents necessary to provide a clear chain of title. This includes recording the deed and any mortgage with the county recorder's office.

The financial institution that provides the funds for the purchase will usually create a packet of closing

instruments for the borrower, and all the requirements specified in this packet must be completed by the mortgagor. If the purchase includes paying off an existing mortgage, the purchaser must make sure that this encumbrance is discharged and must receive a release from the mortgagee to clear any potential problem with respect to any encumbrance on the property.

Following the purchase of a newly constructed cooperative or condominium, the purchaser can create a **punch list** of items that still require attention, for example, a problem with the flooring. The developer has a specified period of time in which to correct these problems.

Finally, all professionals involved in the transaction must be paid.

Practical Tips

- Be sure to make a complete file of all necessary documents, such as title searches, financing papers, and the parties' information sheets.
- Make a summary of all of the contract information.
- Make sure all contract contingencies have been met.
- Check local rules to determine what searches may be required.
- It is safer to deliver all title documents by hand to minimize the risk of loss or delay.
- Check local statutes to determine what affidavits may be required.
- Check with the local court to determine if there are any special requirements for completing the closing.
- Prepare a log of all important dates and information.
- Prepare the IRS Form 1099-S.

Chapter Review

The process of closing a real estate transaction is a fairly formalized affair that follows set procedures and formats. During the period between the contract and the closing date, most of the burden is on the purchaser to make sure that no problem exists with regard to the property being purchased. No one wants to buy a potential lawsuit.

For the most part, during the pre-closing period the seller is merely required to see that he or she is in a position to provide a marketable title at the closing date.

The closing itself is generally a simple, straightforward, and quick affair in which all documents are signed and transferred, the purchase price is paid, and any existing encumbrances on the property are discharged. After the closing, the purchaser must see that all documents are properly recorded to protect his or her title, and must complete any other documents required by the institution financing the purchase.

Ethical Concern

Once a person is represented by counsel it is unethical for the opposing side to have direct contact with that party. All communication must be made through the attorney. In a real estate closing, because so much

information and documents must be gathered, it is tempting to contact the parties directly. Do not do so when the party is represented by counsel.

Key Terms

Affidavit of title
Certificate of non-foreign status
Certificate of occupancy
Deed
Defect
Form 1099-S
HUD-1 Uniform Settlement Statement
Mark up
Mortgage insurance
Notice to attorn
Payoff amount
Punch list
Real Estate Settlement Procedure Act
Realty transfer fee
Settlement statement
Title insurance

Exercises

1. What are some of the reasons a person would acquire mortgage insurance?
2. What is the benefit of title insurance?
3. Prepare a closing packet based on the documents discussed in this chapter.
4. Indicate the problems that would permit a purchaser to avoid a real estate contract.
5. Analyze the provisions of the HUD-1 statement included in this chapter.

Situational Analysis

Your office represents the buyer of a residential house. The day before the closing you discover that the seller still has not fulfilled all the contract obligations. What are the steps you would take to protect your client's interests?

Edited Cases

The following two cases discuss various problems associated with real estate closings. The first decision, *Rochester Home Equity, Inc.*, concerns recovering fees for a mortgage application that was never consummated,

and the second opinion, although fairly lengthy, provides an important discussion of the unauthorized practice of law as it relates to real estate settlements and the details of closing procedures.

Rochester Home Equity, Inc. v. Upton

1 Misc. 3d 412; 767 N.Y.S.2d 201; 2003 N.Y. Misc. LEXIS 1391 (N.Y. Sup. Ct. 2003)

The plaintiff here is suing for application and lock-in fees in a mortgage application that was never consummated. The defendant, in turn, argues that the plaintiff failed to make a federally-mandated disclosure at a time when she could cancel the transaction without penalty. This would appear to be a simple question, and the dispute involves a negligible amount of money—a mere $1,200. Nonetheless, it raises an important point that, to the court's knowledge, has never been resolved by any court in the United States. It requires the court to look at a number of federal and state statutes and regulations that rarely refer to one another and whose combination into a coherent scheme is left to the judiciary. In the end, the court's decision must be based on the evident intent of the legislatures involved, an intent that would be frustrated unless the defendant's position is adopted.

The defendant, who lives in a suburb in the Albany area, was seeking to refinance the house she lived in with her husband. (Although it seems that he was intended to be a party to the mortgage as well, he did not participate in the negotiations and initial document exchanges and thus is not involved in this lawsuit.) She dealt with the plaintiff firm, some 200 miles away, by telephone and fax. The record contains documents signed by the defendant showing receipt of a preapplication disclosure of a $100 application fee and a few other fees, for appraisals and similar charges. She also signed and faxed back a lock-in agreement in full compliance with *3 NYCRR 38.6*. This document secures an offer of a fixed rate mortgage at 5.75% with no points, good for one month, in consideration of a payment of $1,100 (one percent of the loan principal). As the regulations require, this payment would be refunded at the closing of the loan, or if the loan were rejected because of the results of an appraisal, the failure of a third-party lender to cooperate, or the credit worthiness of the applicant. The defendant also signed a credit card authorization for these fees.

After these documents were exchanged the plaintiff took the information needed for a full mortgage application over the telephone. The application was then faxed to the defendant for her signature. At about this time (there is some dispute about the timing of these exchanges) plaintiff also sent defendant a disclosure, in the form required by *12 USC §2605(a)*, of the number of mortgages routinely assigned or sold on the secondary mortgage by plaintiff.

This was the deal breaker. The document revealed that plaintiff disposed of most of its mortgages—anywhere from 76 to 100%. The defendant, who has maintained that she repeatedly told plaintiff's employees she did not want her mortgage assigned, refused to sign the application once she learned this. She also refused to pay the fees, and this proceeding followed.

The parties have differing views on the timing of the disclosure and its relation to the delivery of the application to the defendant. These arguments may be put to one side. The issue, it seems to the court, is whether the disclosure was made before the transaction was consummated. Because the lock-in agreement secures all relevant terms of the mortgage, the court holds that the disclosure made after defendant signed the lock-in agreement was untimely.

There is nothing in the New York regulations concerning lock-in agreements that sets out what

disclosures are required and when they must be made; nor does *3 NYCRR §38.1 et seq.* provide any guidance on questions regarding the interplay between such agreements and the mortgage application. It is necessary, then, to consult the two federal statutes that control such loans: the Truth in Lending Act (*15 USC §1601 et seq.*) and the Real Estate Settlement Procedures Act (*12 USC §2601*), and the regulations under both these statutes.

It is only the Real Estate Settlement Procedures Act (RESPA) which requires disclosure of the number of mortgage loans assigned or sold. To add to the confusion, most other disclosure requirements are found in the Truth in Lending Act. RESPA regulations require that the disclosure be made "[a]t the time an application for a mortgage servicing loan is submitted, or within 3 business days after submission of the application" (*24 CFR 3500.21[b][1]*). They further specify that disclosure must be made at the time of the application when there is a face-to-face interview (*24 CFR 3500.21[c][1]*) and is to be mailed within three days if no such interview takes place (*24 CFR 3500.21[c][2]*).

The parties have also debated whether a telephone application is one made face-to-face. The court finds no merit in any claim that a transaction conducted between two parties in different buildings in different cities is somehow face-to-face because it happens in real time. Surely the letter of these regulations would be met under these circumstances by mailing the disclosure.

But this does not end the discussion. RESPA does not address lock-in agreements, and in the matter of disclosures is basically an appendix to the Truth in Lending Act (TILA). The court has to ask what purpose is to be served by this disclosure, and which party's arguments in the present case best effectuate that purpose.

Fortunately, the announced purpose of TILA is consistent with the timing requirement in that statute. In keeping with the trend toward supplying consumers with more information than market forces alone would provide, TILA is meant to permit a more judicious use of credit by consumers through a "meaningful disclosure of credit terms" (*15 USC §1601 [a]*). For that reason the disclosures must be made conspicuously and in writing, and they must be made "before consummation of the transaction" (*12 CFR 226.17[b]*).

These two provisions clearly support one another. The purpose of a disclosure is frustrated if one could not act on the information without incurring a penalty. The information required by TILA must be given at a time when the consumer can back out of the transaction. In any other case they would be useless.

This regulation—disclosure before consummation—was promulgated under TILA. What relevance does it have to RESPA? At least one federal court has considered the matter, at least obliquely, holding that RESPA disclosures must be made "within three days of the application,…not at closing when it may be literally or at least practically too late for the borrower to use the information…RESPA (and TILA) require an 'up front' disclosure, at the application stage—not the closing stage—of the loan process." (*Anderson v. Wells Fargo Home Mtge., 259 F. Supp. 2d 1143, 1147 [WD Wash]*.) This language suggests that the three-day requirement was intended to be consistent with the preconsummation standard in TILA.

Applying this principle to the present case is not straightforward. As noted above, the lock-in agreement and the New York regulations governing them are both silent on the applicability of federal law. Although both TILA and RESPA preempt any inconsistent state law, neither of these statutes nor the *Anderson* case deals with lock-in agreements.

The defendant, no doubt aware of the silence of the statute, has argued that the fees are not enforceable because the lock-in agreement is not a binding contract, simply an agreement to agree. The court finds this

unpersuasive. The better interpretation, in fact, is that so far from being a mere agreement to agree the lock-in agreement is the functional equivalent of a mortgage commitment. It sets out all the substantive provisions of a mortgage: the property secured, the interest rate, the principal and the duration of payments. It is a lock-in agreement in a double sense. The applicant obtains assurance that she will have the benefit of a particular interest rate; but once she signs the lock-in agreement she is also "locked in" to a particular mortgage lender. All that is left is the information-gathering needed to complete a credit check and to conduct the appraisal.

It would clearly violate the purpose behind TILA and RESPA to allow fees to be levied before all disclosures were made. To do so would be to postpone the disclosure obligation until it was "literally or at least practically too late for the borrower to use the information." Reading these statutes together, it is clear that they aim at providing consumers with all information deemed relevant to a credit decision before the consumer risks any money. A posttransaction disclosure would be pointless at best and a mockery at worst; what good would it do to reveal important details of the transaction when it would cost $1,200 for the borrower to change his mind? For that reason, the court holds that contracts to pay fees such as the lock-in agreement must be preceded by all the disclosures that federal law requires. In a real sense the lock-in agreement is more akin to a consummation of the process than it is to a mere preliminary stage.

This is the only way that the disclosures required by TILA and RESPA would be of any use to the consumer. It would be manifestly improper for the defendant to be penalized for changing her mind on the basis of information supplied pursuant to that federal law. (She also claims that she had not realized until this disclosure that she was dealing with a mortgage broker; this is an error, as plaintiff is a mortgage *banker*—something of a hybrid, but licensed to act as a bank with respect to mortgages.) She did so in a timely fashion, as well. Regardless of the timing of the disclosures vis-à-vis the application, the defendant told the plaintiff that she wished to discontinue the transaction as soon as she received the document. There is no reason not to honor her decision.

The court therefore orders the complaint dismissed, with costs.

Case Questions

1. What factors resulted in the mortgage loan not going through?
2. Discuss the legal purpose of disclosure, and how that affected this case.

In Re Opinion No. 26 of the Committee on the Unauthorized Practice of Law

139 N.J. 323, 654 A.2d 1344 (1995)

We again confront another long-simmering dispute between realtors and attorneys concerning the unauthorized practice of law. See *New Jersey State Bar Assn. v. New Jersey Assn. of Realtor Bds.*, 93 N.J. 470, 461 A.2d 1112 (1983). Title companies are also involved. Our resolution of the dispute turns on the identification of the public interest. Since our decision today permits sellers and buyers in real estate transactions involving the sale of a home to proceed without counsel, we find it necessary to state the Court's view of the matter at the outset. The Court strongly believes that both parties should retain counsel for their own protection and that the savings in lawyers fees are not worth the risks involved in proceeding without

counsel. All that we decide is that the public interest does not require that the parties be deprived of the right to choose to proceed without a lawyer.

The question before us is whether brokers and title company officers, who guide, control and handle all aspects of residential real estate transactions where neither seller nor buyer is represented by counsel, are engaged in the unauthorized practice of law. That many aspects of such transactions constitute the practice of law we have no doubt, including some of the activities of these brokers and title officers. Our power to prohibit those activities is clear. We have concluded, however, that the public interest does not require such a prohibition. Sellers and buyers, to the extent they are informed of the true interests of the broker and title officer, sometimes in conflict with their own interests, and of the risks of not having their own attorney, should be allowed to proceed without counsel. The South Jersey practice, for it is in that part of the state where sellers and buyers are most often unrepresented by counsel in residential real estate transactions, may continue subject to the conditions set forth in this opinion. By virtue of this decision, those participating in such transactions shall not be deemed guilty of the unauthorized practice of law so long as those conditions are met. Our decision in all respects applies not only to South Jersey, but to the entire state.

Under our Constitution, this Court's power over the practice of law is complete. N.J. Const. art. 6, Sec. 2, P 3. We are given the power to permit the practice of law and to prohibit its unauthorized practice. We have exercised that latter power in numerous cases. *In re Application of N.J. Soc'y of Certified Public Accountants*, 102 N.J. 231, 507 A.2d 711 (1986); *New Jersey State Bar Assn. v. New Jersey Assn. of Realtor Bds.*, 93 N.J. 470, 461 A.2d 1112 (1983); *Cape May County Bar Assn. v. Ludlam*, 45 N.J. 121, 211 A.2d 780 (1965); *New Jersey State Bar Assn. v. Northern N.J. Mortgage Assocs.*, 22 N.J. 184 (1956); *In re Baker*, 8 N.J. 321, 85 A.2d 505 (1951); *Stack v. P.G. Garage*, 7 N.J. 118, 80 A.2d 545 (1951).

The question of what constitutes the unauthorized practice of law involves more than an academic analysis of the function of lawyers, more than a determination of what they are uniquely qualified to do. It also involves a determination of whether non-lawyers should be allowed, in the public interest, to engage in activities that may constitute the practice of law. As noted later, the conclusion in these cases that parties need not retain counsel to perform limited activities that constitute the practice of law and that others may perform them does not imply that the public interest is thereby advanced, but rather that the public interest does not require that those parties be deprived of their right to proceed without counsel. We reach that conclusion today given the unusual history and experience of the South Jersey practice as developed in the record before us.

We determine the ultimate touchstone—the public interest—through the balancing of the factors involved in the case, namely, the risks and benefits to the public of allowing or disallowing such activities. In other words, like all of our powers, this power over the practice of law must be exercised in the public interest; more specifically, it is not a power given to us in order to protect lawyers, but in order to protect the public, in this instance by preserving its right to proceed without counsel. We believe that parties to the sale of a family home, both seller and buyer, would be better served if each were represented by counsel from the beginning to the end of the transaction, from contract signing through closing. We are persuaded, however, that they should continue to have the right to choose not to be represented. They should, of course, be informed of the risks. The record fails to demonstrate that the public interest has been disserved by the South Jersey practice over the many years it has been in existence. While the risks of non-representation are many and serious, the

record contains little proof of actual damage to either buyer or seller. Moreover, the record does not contain proof that, in the aggregate, the damage that has occurred in South Jersey exceeds that experienced elsewhere. In this case, the absence of proof is particularly impressive, for the dispute between the realtors and the bar is of long duration, with the parties and their counsel singularly able and highly motivated to supply such proof as may exist. The South Jersey practice also appears to save money. For the record demonstrates what is obvious, that sellers and buyers without counsel save counsel fees. We believe, given this record, that the parties must continue to have the right to decide whether those savings are worth the risks of not having lawyers to advise them in what is almost always the most important transaction they will ever undertake. We realize this conclusion means that throughout the transaction, sellers and buyers may not have the benefit of their own counsel but will look to brokers and title officers, often with conflicting interests, for practical guidance and advice.

I

Proceedings Below

Opinion No. 26 of the Committee on the Unauthorized Practice of Law, 130 N.J.L.J. 882 (March 16, 1992), was issued in response to an inquiry, one of many, from the New Jersey State Bar Association. The inquiry sought a determination of whether the South Jersey practice constituted the unauthorized practice of law. That practice, described in detail later, concerns the sale of a home generally financed by a purchase money mortgage. The essence of the South Jersey practice is that from the beginning of the transaction to the end, neither seller nor buyer is represented by counsel. Every aspect of the transaction is handled by others, every document drafted by others, including the contract of sale, affidavit of title, bond and mortgage. The Committee on the Unauthorized Practice of Law (the Committee), relying largely on our decisions in *New Jersey State Bar Association v. New Jersey Association of Realtor Boards*, 93 N.J. 470, 461 A.2d 1112 (1983); *Cape May County Bar Association v. Ludlam*, 45 N.J. 121, 211 A.2d 780 (1965); *New Jersey State Bar Association v. Northern New Jersey Mortgage Associates*, 32 N.J. 430, 161 A.2d 257 (1960), and its own prior determination in Opinion No. 11 of the Committee on the Unauthorized Practice of Law, 95 N.J.L.J. 1345 (December 28, 1972), ruled that the ordering of a title search by the broker, the preparation of conveyancing and other documents by title officers, their clearing of title questions, and indeed the activities of both broker and title officers at the closing itself, where neither buyer nor seller was represented by counsel, that all of these activities constituted the unauthorized practice of law. The decision was interpreted widely as prohibiting the South Jersey practice, in effect prohibiting a seller and buyer from proceeding with the sale of a home without counsel.

On July 20, 1992, the Committee issued a notice to the bar and the public, clarifying its opinion. 131 N.J.L.J. 910 (July 20, 1992). The Committee explained that it did not intend to prohibit a seller or a buyer from proceeding in these matters without counsel. But at the same time the Committee adhered to its determination concerning what constituted the unauthorized practice of law in these matters, without in any way changing that determination. The result, it appeared to many, was that the right of seller and buyer to proceed without counsel was theoretical, for those whose help they would inevitably require to go through with the transaction seemed, by virtue of the Committee's opinion, to be able to give such help only by

engaging in the unauthorized practice of law. Given the concerns of both potential sellers and buyers, as well as those of brokers and title officers, and given the fact that the South Jersey practice had continued for so long, we stayed the effect of Opinion No. 26 pending review by this Court.

Following briefing and oral argument by those interested in the matter—the organized bar, brokers, title officers—we remanded the matter to develop a fuller record, referring it to Judge Edward S. Miller, as Special Master, for that purpose. After sixteen days of hearing, Judge Miller rendered his report to us. While personally strongly favoring a requirement that sellers and buyers be represented by counsel, Judge Miller recommended essentially that we allow the South Jersey practice to continue subject to certain conditions.

The hearing conducted by Judge Miller, leading to his findings and recommendations, is critical to our decision. It was directed not only at determining the extent of the practice of law engaged in by non-lawyers, a circumstance generally known and relatively uncomplicated, but more so at the consequences and implications of the practice. The purpose of the remand was to examine in depth the many factors that would enable this Court to determine whether and to what extent allowing parties to proceed without counsel in such transactions disserved the public interest. That remand was similar to the action taken by this Court in other unauthorized practice of law cases described later, although the depth and detail of both our inquiry and Judge Miller's hearing and report went beyond most such remands. We asked that the scope of the remand include not only all of the factual aspects of the South Jersey practice, but also its impact on buyers and sellers including both costs and risks; the knowledge of the parties of those risks, and of the conflicting interests of brokers and title officers; the frequency of transactions in which neither party is represented by counsel; comparable advantages and disadvantages to consumers in South Jersey transactions as compared to transactions where both are represented by counsel; the actual incidence of problems in both cases; remedies available to both buyers and sellers for damage caused by brokers or title officers; consumer satisfaction; and other matters. Judge Miller responded to all of our inquiries, and his recommendations covered the issues posed as well as some that arose during the hearings.

Judge Miller found that there had been no proof of actual damage resulting from the South Jersey practice, or more accurately that whatever problems existed did not in the aggregate exceed those in matters where the parties were represented by counsel, that many of the activities undertaken by brokers and title officers, taken in isolation, did not involve the practice of law in any sense, and that, if informed of the risks, and of the interests of those who might otherwise be thought to represent them—including the conflicting interests of the brokers and title officers—sellers and buyers should have the right to decide whether or not to have counsel.

Judge Miller found that when both buyer and seller are represented by counsel, the fees in South Jersey are lower than those in North Jersey. Although he made no explicit finding on the point, implicit in all of his findings is the obvious fact that the unrepresented buyers and sellers in the South Jersey practice save the entire counsel fee they would otherwise have to pay, a fairly substantial sum. He was strongly of the opinion that those savings were not worth the risk that inevitably existed where either seller or buyer went unrepresented. Given this Court's prior decisions on related matters, however, he concluded that the judiciary could not, or would not, mandate representation, but rather that all of the foregoing circumstances called for a determination allowing the continuation of the South Jersey practice subject to various conditions. He recommended that the Court allow brokers to order title reports, contrary to the opinion of the Committee;

that only attorneys be allowed to draft the bargain and sale deed, but where that drafting was not accompanied by true representation and advice of counsel, it could be done by others only through the explicit request in writing of the seller; that any other similar conveyancing documents, presumably the bond and mortgage, could be drafted by lawyers representing the title company, again only at the specific written request of either the buyer or mortgagee; that neither the broker nor the title officers present at the closing, or at any other time, could render legal advice; that while the title company could attempt to resolve certain kinds of problems affecting the title, such as arranging to pay off prior mortgages and judgment liens, it could not attempt to resolve others, or presumably give any advice concerning others, such as restrictions on use, easements, and rights of way. Finally, he recommended that the practice, especially the South Jersey practice, of title companies conducting settlements where both buyer and seller are unrepresented be allowed, thereby disagreeing with the Committee's conclusion that such conduct constituted the unauthorized practice of law. He agreed with the Committee's condemnation of conduct that encourages the parties not to retain counsel.

Judge Miller so ruled even though it was his opinion that practically every aspect of a real estate transaction involving the sale of a home constituted the practice of law. As he put it, if he thought he had the power, he would require that both seller and buyer be represented by counsel.

While technically the matter now before us is the review of the opinion of the Committee, R. 1:22-7(b) and R. 1:19-8, we now have the benefit of a full hearing, along with the findings of fact and recommendations that are part of the Special Master's report. The subsequent oral argument and briefing by the parties who participated in that hearing, the New Jersey State Bar Association, the New Jersey Association of Realtors and the New Jersey Land Title Association, focused on both Opinion No. 26 and Judge Miller's report. Our decision today, substantially in accord with Judge Miller's recommendations, affirms portions of Opinion No. 26 and reverses others. Specifically, we rule as follows: a real estate broker may order a title search and abstract; an attorney retained by a title company or a real estate broker may not prepare conveyance documents for a real estate transaction except at the specific written request of the party on whose behalf the document is to be prepared; a title company may not participate in the clearing of certain legal objections to title, see infra at 58; and the practice of conducting closings or settlements without the presence of attorneys shall not constitute the unauthorized practice of law. We hold further, however, that unless the broker conforms to the conditions set forth later in this opinion, all participants at the closing who have reason to believe those conditions have not been complied with will be engaged in the unauthorized practice of law, and any attorney with similar knowledge so participating in such a transaction will have committed unethical conduct.

II

The South Jersey Practice

Although the variations are numerous, the South Jersey practice complained of typically involves residential real estate closings in which neither buyer nor seller is represented by counsel, and contrasts most sharply with the North Jersey practice if one assumes both parties are represented there. Obviously, that is not always the case: the record shows that about sixty percent of the buyers and about sixty-five percent of the sellers in South Jersey are not represented by counsel. In North Jersey, only one half of one percent of buyers, and

fourteen percent of sellers, proceed without counsel.

In North Jersey, when both seller and buyer are represented by counsel, they sign nothing, agree to nothing, expend nothing, without the advice of competent counsel. If, initially without counsel, they sign a contract of sale prepared by the broker, they ordinarily then retain counsel who can revoke that contract in accordance with the three-day attorney review clause. They are protected, and they pay for that protection. The seller in North Jersey spends on average $750 in attorney fees, and the buyer in North Jersey spends on average $1,000. The buyer in South Jersey who chooses to proceed without representation spends nothing. The South Jersey seller whose attorney does no more than prepare the deed and affidavit of title, usually without even consulting with the seller, spends about $90. South Jersey buyers and sellers who are represented throughout the process, including closing, pay an average of $650 and $350, respectively. Savings obviously do not determine the outcome of this case; they are but one factor in the mix of competing considerations.

The typical South Jersey transaction starts with the seller engaging a broker who is ordinarily a member of the multiple listing system. The first broker to find an apparently willing buyer gets in touch with the seller and ultimately negotiates a sale price agreeable to both. The potential buyer requires financing arrangements which are often made by the broker. Before the execution of any sales contract the broker puts the buyer in touch with a mortgage company to determine if the buyer qualifies for the needed loan.

At this preliminary stage, no legal obligations of any kind are likely to have been created, except for those that arise from the brokerage relationship itself.

Assuming the preliminary understanding between the seller and buyer remains in effect, the broker will present the seller with the standard form of contract used in that area (usually a New Jersey Association of Realtors Standard Form of Real Estate Contract). That form includes, pursuant to our opinion in *New Jersey State Bar Association v. New Jersey Association of Realtor Boards*, 93 N.J. 470, 461 A.2d 1112 (1983), notice that the attorney for either party can cancel the contract within three business days. If the seller signs the contract, and does not within three days retain counsel, the seller will have become legally bound to perform numerous obligations without the benefit of any legal advice whatsoever, some of which may turn out to be onerous, some costly, some requiring unanticipated expense, and some beyond the power of the seller to perform, with the potential of substantial liability for such nonperformance. Many sellers will not understand just what those obligations are, and just what the risks are. Not only has the seller not retained a lawyer, the only person qualified to explain those risks. Worse yet, the only one the seller has had any contact with in the matter is the broker, whose commission depends entirely on consummation of the transaction, and whose interest is primarily—in some cases it is fair to say exclusively—to get the contract signed and the deal closed.

After the seller signs the contract, the broker delivers it to the buyer for execution. The buyer may not know if the description of the property is precisely that assumed to be the subject of the purchase. The buyer may have no idea if the title described in the contract is that with which he would be satisfied, no sound understanding of what the numerous obligations on the part of the seller mean, and no fair comprehension of whether all of the possible and practical concerns of a buyer have been addressed by the contract. No lawyer is present to advise or inform the buyer; indeed, there is no one who has the buyer's interest at heart, only the broker, whose interests are generally in conflict with the buyer's. Although the record does not dispose of the issue, and although Judge Miller explicitly left it undecided, he noted concern that the broker, through his or her actions, may lead the buyer to believe that the broker is looking out for the buyer's interests. Therefore,

without independent advice, the buyer signs the contract. If no attorney is retained within three days, the buyer is bound by all of its terms.

For both seller and buyer, it is that contract that substantially determines all of their rights and duties. Neither one of them can be regarded as adequately informed of the import of what they signed or indeed of its importance. At that point the broker, who represents only the seller and clearly has an interest in conflict with that of the buyer (the broker's interest is in consummation of the sale, the buyer's in making certain that the sale does not close unless the buyer is fully protected) performs a series of acts on behalf of the buyer, and is the only person available as a practical matter to explain their significance to the buyer. The broker orders a binder for title insurance, or a title commitment to make sure that the buyer is going to get good title. The buyer has no idea, and hopefully never will have, whether the broker ordered the right kind of title search, a fairly esoteric question that only an experienced attorney can determine.

The broker also orders numerous inspection and other reports, all primarily of interest to the buyer, to make certain that not only is the title good, but that there are no other problems affecting the premises, the house and their use. Those reports can have substantial legal consequences for both seller and buyer. For example, at what threshold dollar amount of required repairs should the seller (or the buyer) be able to cancel the contract? At what dollar amount should the buyer ignore the repairs? At what dollar amount should the buyer be able to compel the seller to make the repairs, and within what time frame? At this stage of the transaction the help of a lawyer could be invaluable, and the advice of a broker problematic.

The seller in the meantime is happy to hear from no one, for it suggests there are no problems. Eventually, the seller is told that a deed will be arriving drafted by an attorney selected by the broker, the instrument that our decisions clearly require may be drafted only by the seller's attorney. *Cape May County Bar Assn. v. Ludlam*, 45 N.J. 121, 211 A.2d 780 (1965). Of course, the purpose of that ruling was to assure competent counsel in the drafting of such a uniquely legal document, but "competent" always meant counsel who understood the entire transaction. In South Jersey, the attorney selected by the broker, while theoretically representing the seller, may be primarily interested in the broker, the source of the attorney's "client" and the likely source of future "clients," and consequently primarily interested in completing the sale. That attorney is likely to prepare a deed satisfactory to the title company—in fact that attorney often does not even contact the seller. He or she may have no idea of anything in the contract of sale other than the description of the land and the fact that a certain kind of deed is required. No advice on the substance of the transaction comes from such an attorney even though the seller may get the impression that, since an attorney drafted the deed, the seller's interests are somehow being protected. In fact, the only protection those interests ever received, other than those that happened to appear in the form contract, is in the numbers inserted in that contract, the total purchase price, the down payment, and the closing date, for those are probably the only terms of that contract fully understood by the seller.

The buyer's position is even worse when the closing occurs. The seller will at least know that he or she got paid. Legal training is not required for that fact, even though there is no practical assurance that the seller will not thereafter be sued. The buyer, on the other hand, wants something that is largely incomprehensible to almost all buyers, good and marketable title, one that will not result in problems in the future. What the buyer gets before closing is a "title binder," a piece of paper that may suggest something about the quality of the seller's title, but that is very much in need of explanation for any substantial understanding of its meaning.

The title company is required to mail to the unrepresented buyer notice of any exceptions or conditions associated with the title insurance policy. N.J.S.A. 17:46B-9. This notice, which must be sent five days prior to the closing, must also notify the buyer of the right to review the title commitment with an attorney. Ibid. If the buyer chooses not to retain an attorney, there is no one to give the buyer that understanding other than the broker and the title agent. The broker's knowledge will often be inadequate, and the conflicting interest apparent. The title company similarly has a conflicting interest, for it too is interested in completion of the transaction, the sine qua non of its title premium. But the title company is also interested in good title, for it is guaranteeing that to the mortgage company, as well as to the buyer. "Good title," however, may be one on which the title company and the mortgagee are willing to take a risk, but one on which a buyer might or should not be willing to, if the buyer knew what the risk was. Again, there is no one to tell the buyer what those risks are, and in some cases the explicit exceptions found in a title policy, those matters that the title company will not guarantee, are of the greatest importance. The significance of those matters is conceded by all to be something that only attorneys can give advice on, and it is contended by all that they never give such advice. Yet such exceptions exist, and title still closes, and the buyer is totally unrepresented by counsel. One must assume that somewhere, somehow, the buyer is satisfied that there is nothing to worry about, leading to the inescapable conclusion that either the broker or the title officer provides some modicum of assurance or explanation.

The day for closing arrives and everyone meets, usually at the offices of the title company. Seller and buyer are there, each without an attorney; the broker is there, and the title officer is there, representing both the title company and the mortgagee. The funds are there. And the critical legal documents are also on hand: the mortgage and the note, usually prepared by the mortgagee; the deed, along with the affidavit of title, prepared by the attorney selected by the broker or by the title company; the settlement statement, usually prepared by the title company, indicating how much is owed, what deductions should be made for taxes and other costs and what credits are due; and the final marked-up title binder, which evidences the obligation of the title company to issue a title policy to the buyer, and which at that point is probably practically meaningless to the buyer. All are executed and delivered, along with other documents, and the funds are delivered or held in escrow until the title company arranges to pay off prior mortgages and liens.

It would take a volume to describe each and every risk to which the seller and buyer have exposed themselves without adequate knowledge. But it takes a very short sentence to describe what apparently occurs: the deal closes, satisfactory to buyer and seller in practically all cases, satisfactory both at the closing and thereafter.

III

The Unauthorized Practice of Law

As noted above, this transaction in its entirety, the sale of real estate, especially real estate with a home on it, is one that cannot be handled competently except by those trained in the law. The most important parts of it, without which it could not be accomplished, are quintessentially the practice of law. The contract of sale, the obligations of the contract, the ordering of a title search, the analysis of the search, the significance of the title search, the quality of title, the risks that surround both the contract and the title, the extent of those risks, the

probability of damage, the obligation to close or not to close, the closing itself, the settlement, the documents there exchanged, each and every one of these, to be properly understood must be explained by an attorney. And the documents themselves to be properly drafted, must be drafted by an attorney. Mixed in with these activities are many others that clearly do not require an attorney's knowledge, such as the ordering of inspection and other reports, and the price negotiation. But after that, even though arguably much can be accomplished by others, practically all else, to be done with full understanding, requires the advice of counsel.

Practically all of the cases in this area are relatively recent. They consistently reflect the conclusion that the determination of whether someone should be permitted to engage in conduct that is arguably the practice of law is governed not by attempting to apply some definition of what constitutes that practice, but rather by asking whether the public interest is disserved by permitting such conduct. The resolution of the question is determined by practical, not theoretical, considerations; the public interest is weighed by analyzing the competing policies and interests that may be involved in the case; the conduct, if permitted, is often conditioned by requirements designed to assure that the public interest is indeed not disserved.

In *Auerbacher v. Wood*, 142 N.J. Eq. 484, 59 A.2d 863 (E. & A. 1948), our then highest court held that someone who performs the usual functions of a labor relations consultant is not guilty of the unauthorized practice of law. The court noted that the issue could not be determined by reference to any satisfactory definition. "What constitutes the practice of law does not lend itself to precise and all inclusive definition. There is no definitive formula which automatically classifies every case." Id. at 485. The court noted that in drawing the line between that which is and is not permitted, "guidance is to be found in the consideration that the licensing of law practitioners is not designed to give rise to a professional monopoly, but rather to serve the public right to protection against unlearned and unskilled advice and service in matters relating to the science of the law." Id. at 486. In *In re Baker*, 8 N.J. 321, 334, 85 A.2d 505 (1951), this Court, holding respondents in contempt for their unauthorized practice of law, similarly observed that "the reason for prohibiting the unauthorized practice of the law by laymen is not to aid the legal profession but to safeguard the public from the disastrous results that are bound to flow from the activities of untrained and incompetent individuals," those not only lacking the many years of preparation, but also the high standards of professional conduct imposed on members of the bar and enforced by the Court.

In a case involving some of the same questions now before us, *New Jersey State Bar Association v. Northern New Jersey Mortgage Associates*, 22 N.J. 184, 123 A.2d 498 (1956), an appeal was taken from the trial court's dismissal of a suit alleging unauthorized practice of law, the trial court concluding that the Supreme Court had exclusive jurisdiction over such matters. The action had been brought by the New Jersey State Bar Association and five individual attorneys. The practice complained of was quite similar to that found in South Jersey, although in fact the business was conducted in North Jersey. The defendants, in the business of searching titles, acting as agents for title companies, and handling the closing of transactions involving sellers, buyers, and mortgagees, admitted that they prepared bonds, mortgages and other instruments connected with titles and mortgage loans, and that the services performed incidental to closing included the giving of legal advice in connection with those transactions. Id. at 190–92.

We ruled that our exclusive power over the practice of law did not divest a court of chancery (the trial court) of its jurisdiction to enjoin the unauthorized practice of law. Id. at 193. We further ruled that the individual plaintiffs could maintain the action only if they could show irreparable damage to their own

individual financial interests, and since they could not, the dismissal of the action as to them was affirmed. Id. at 196, 199. The Bar Association, however, was placed on a different footing, for in its attempts to enjoin the unauthorized practice of law it sought to protect the public interest, for the protection of which an injunction could be granted. Id. at 194, 196. In that respect the action was deemed to be "on behalf of the public." Id. at 194.

In analyzing the Bar Association's claim to represent the public interest, we noted that, concerning the nature of the right to practice law, the more recent attitude in New Jersey has been "that admission to our bar is a privilege granted in the interest of the public to those who are morally fit and mentally qualified, solely for the purpose of protecting the unwary and the ignorant from injury at the hands of persons unskilled or unlearned in the law" and that "attorneys enjoy rights peculiar to themselves, not enjoyed by those outside the profession, but only as an incident to the public welfare." Id. at 195. We further noted that the licensing of attorneys "'is not designed to give rise to a professional monopoly, but rather to serve the public right to protection against unlearned and unskilled advice and service in matters relating to the science of the law.'" Ibid. (quoting *Auerbacher v. Wood*, supra, 142 N.J. Eq. at 486).

The case was remanded to the Chancery Division to develop a more complete record, similar to the remand in this case to the Special Master. The host of issues set forth by the Court on which further evidence was required before a determination could be made are similar to those in this matter on which we sought further information, at least in the sense that they asked more than questions obviously directed at specific conduct that might constitute the practice of law: the questions sought to know more about the business that was going on, the relationships between the parties, the possibility that independent counsel was being discouraged, the charges made, the exact fee and compensation arrangements, and the percentage of occasions when parties were represented by counsel, id. at 199, all obviously for the purpose of enabling the Court to make a sound decision based on the public interest rather than one premised on some abstract definition of the practice of law.

After remand and plenary hearing, this Court again certified the appeal, on its own motion, from the trial court's dismissal of the charge that defendants were engaged in the unauthorized practice of law. *New Jersey State Bar Assn. v. Northern N.J. Mortgage Assocs.*, 32 N.J. 430 (1960). In passing on the issues the Court repeated again that the restrictions against the practice of law by non-lawyers "are designed to serve the public interest by protecting 'the unwary and the ignorant from injury at the hands of persons unskilled or unlearned in the law.'" Id. at 436 (citation omitted). Noting that "the line between such activities and permissible business and professional activities by non-lawyers is indistinct," id. at 437, and that some fields may in some areas properly overlap the law, we went on to observe that "each individual set of circumstances must be passed upon 'in a common-sense way which will protect primarily the interest of the public and not hamper or burden that interest with impractical and technical restrictions which have no reasonable justification.'" Ibid. (quoting *Gardner v. Conway*, 234 Minn. 468, 48 N.W.2d 788, 797 (Minn. 1951)).

The message is clear: not only is the public interest the criterion for determining what is the unauthorized practice of law, but in making that determination practical considerations and common sense will prevail, not impractical and technical restrictions that may hamper or burden the public interest with no reasonable justification. That language is from a court that previously had remanded the case to get the full record that would give it all of the facts that would enable it to determine that public interest. The title

company, the company that had succeeded to the interests of defendants in the prior case, claimed that on the basis of the entire record its activities did not constitute the unauthorized practice of the law. By then the measuring rod was clear, for the title company's contention was that "the public policy of this State" compelled that conclusion. Id. at 447. The Court disagreed, but not with the standard against which the issue would be determined, for it found that by enjoining the practices involved in the case "the public interest will not be disserved but on the contrary will be significantly advanced." Ibid. There, the public interest consisted of removing "unwarranted charges imposed by the Title Company on purchasers" and encouraging "parties to obtain the important protection of independent counsel." Ibid.

In *State v. Bander*, 56 N.J. 196, 265 A.2d 671 (1970), we sounded the same theme, although in a different context. There we held that the disorderly persons act definition of the unauthorized practice of law did not cover a broker who had prepared a contract for the sale of land even though that conduct, as implied by the decision, clearly constituted the practice of law. We concluded that even if it was the unauthorized practice of law, the broker not being an attorney, the Legislature was free to exclude it (as it did) from its criminal sanctions without offending this Court's exclusive power to determine what constitutes the unauthorized practice of law: in other words, while we may have that exclusive power, it does not prevent the Legislature from criminalizing only certain conduct that constitutes the unauthorized practice of law, leaving others unaffected by the criminal law, although still vulnerable to such prohibitions and remedies as this Court may devise outside of the criminal law. As a result of that conclusion, we noted that we did not have to reach the question "whether defendant's actions constituted an unauthorized practice of law." Id. at 202. The significance of the case, insofar as the present issue is concerned, was in our subsequent discussion of that issue, which "was partially explored at the oral argument" of the case. Ibid.

It developed that the problem has so many ramifications that it could not be intelligently considered on the present record. As to that issue it is suggested that an answer might be obtained in a separate suit for an injunction against the type of acts undertaken by defendant or for a declaratory judgment. In this manner a complete and detailed record could be made disclosing, inter alia, the extent, length of existence, effect and result of the performance of similar acts by real estate brokers generally and the public need for such service. This Court could then give a valued and intelligent reply to such an inquiry. [Id. at 202–203.]

That opinion, commenting on an activity that clearly involved the practice of law—the drafting of a contract for the sale of land by a non-lawyer—suggested our approach to the public interest standard that governed determinations of what constituted the unauthorized practice of law. It was an interest to be determined not by any abstract definition, but by a "complete and detailed record," including "the extent, length of existence, effect and result of the performance of similar acts by real estate brokers," and ultimately a record that would show "the public need for such service." That is, of course, precisely the record developed thereafter in order to determine that specific issue, the public interest in the right of parties to decline legal representation in the drafting of real estate sales contracts. *New Jersey Assn. of Realtor Bds.*, supra.

Although the public interest standard for determination of the issue of unauthorized practice of law remained intact, Opinion No. 11 of the Committee on the Unauthorized Practice of Law, 95 N.J.L.J. 1345 (Dec. 28, 1972), reached a conclusion on it different from what we have determined in this case. The issue there was practically identical to that now before us. What was involved was the South Jersey practice. The Committee decided, contrary to our decision today, and based largely on the decision in *Northern New Jersey*

Mortgage Associates, supra, 32 N.J. at 430, that title companies are engaged in the unauthorized practice of law when they issue a title search or policy or abstract at the request of a broker and that they are similarly guilty when they conduct real estate settlements on their premises without the presence of an attorney for any of the parties to the transaction. While the facts in the case were somewhat different from those here (the Committee finding that the parties to the transaction were discouraged by brokers from retaining counsel, that this practice was encouraged when title companies paid rebates to referring brokers for their business, and that apparently practically all documents were drafted by the title company) their similarity is remarkable. Indeed, if that opinion were to be followed we would be obliged to declare the acts challenged before us the unauthorized practice of law. The critical difference, of course, is that there was no showing in that case before the Committee similar to that found in the record before us of the impact on the public interest in allowing the South Jersey practice to continue. Apparently, all that the Committee had before it was an unadorned description of what occurs prior to and during the closing, without any evaluation of its benefits and detriments, without any evaluation of the advantages and disadvantages to the public. For present purposes, however, Opinion No. 11 is of note in its firm adherence to the standards set by the prior cases. In determining the issue the Committee said, "the measuring rod is the public interest," 95 N.J.L.J. at 1345, and asked, "Does this practice serve the public interest?" Id. at 1360. Its conclusion was that it did not. In support of its ultimate conclusion prohibiting settlements without the presence of attorneys, the Committee said, "Since the practice does constitute the practice of law and such practice by a lay corporation or person is not in the public interest, it constitutes the unauthorized practice of law." Ibid. It is of course remarkable that despite Opinion No. 11 the South Jersey practice flourished, leading ultimately to Opinion No. 26, the matter before us today. The approach we take in this case, the imposition of conditions to assure the public interest is not disserved, as well as that taken in the important cases involving the preparation of real estate contracts by brokers, *New Jersey Association of Realtor Boards*, supra, and inheritance tax returns by accountants, *In re Application of New Jersey Society of Certified Public Accountants*, 102 N.J. 231, 507 A.2d 711 (1986).

In what is undoubtedly the clearest example of the dominating influence of the public interest in this area, we decided in *New Jersey Association of Realtor Boards*, supra, that real estate brokers may draft contracts for the sale of residential property if the contract contains a prominent clause informing the parties of their right, through counsel, to cancel it within three days. While our decision took the form of the approval of a settlement reached between the brokers and the bar, our approval was explicitly based on a finding by Justice Sullivan, sitting as the trial judge, that the settlement was in the public interest, a finding with which we concurred. The initially proposed settlement of the matter had previously been submitted to us and subjected to a public hearing, but after being informed that the settlement had unraveled, we remanded the matter for trial to Justice Sullivan. At that trial a new settlement was arrived at and again subjected to a public hearing before the trial court.

Noting the position of those who objected to the settlement in its entirety, Justice Sullivan concisely summed up the entire law in this area with the observation that "the basic question is how is the public interest best served." *New Jersey State Bar Assn. v. New Jersey Assn. of Realtor Bds.*, 186 N.J. Super. 391, 396, 452 A.2d 1323 (Ch. Div. 1982). He concluded that "the settlement is in the public interest" and that the three-day cancellation clause "affords adequate protection to purchasers and sellers of residential real estate or lessors and lessees thereof." Id. at 398. In so concluding, he noted that it had been asserted "without

contradiction that 'no State in the Country has prohibited Brokers from completing form contracts in connection with residential property sales.'" Id. at 396. The record in this case also demonstrates that the conduct in question is permitted in many other states….

Our holding today, therefore, accords with the Court's consistent treatment of this issue. Although technically we have overruled the holding of *Northern New Jersey Mortgage Associates*, supra, 32 N.J. 430, that case applied precisely the same standard in passing on the challenged conduct before it—the public interest. As we view it, the real difference is found in the differing records before the Court in the two cases, for in that case the public interest in allowing the challenged practices to continue was apparently nowhere demonstrated, and certainly not with the force of the record before us. Indeed, since the practice challenged apparently related solely to one firm located in North Jersey, and not to the South Jersey practice, it may have seemed that such showing would be irrelevant. More than that, at the time of our decision in that case, we had not yet ruled that brokers could prepare contracts of sale, a change which has affected the entire landscape in this area.

In this case, the record clearly shows that the South Jersey practice has been conducted without any demonstrable harm to sellers or buyers, that it apparently saves money, and that those who participate in it do so of their own free will presumably with some knowledge of the risk; as Judge Miller found, the record fails to demonstrate that brokers are discouraging the parties from retaining counsel, or that the conflict of interest that pervades the practice has caused material damage to the sellers and buyers who participate in it. Given that record, and subject to the conditions mentioned hereafter, we find that the public interest will not be compromised by allowing the practice to continue. We note again that our prior decisions and those of the Committee on this issue did not have the benefit of such a record and were premised on the irrefutable finding that the activities of the non-lawyers in the South Jersey practice constituted the practice of law. That they do, but with the benefit of the record before us it is equally clear that the practice does not disserve the public interest.

Of decisive weight in our determination is the value we place on the right of parties to a transaction to decide whether or not they will retain counsel. We should not force them to do so absent persuasive reasons. Given the importance in our decision of the assumption that the parties have chosen not to retain counsel, and without coercion have made that decision, we have attached a condition to the conclusion that the South Jersey practice does not constitute the unauthorized practice of law. The condition is designed to assure that the decision is an informed one. If that condition is not met, the brokers (and title officers, if aware of the fact) are engaged in the unauthorized practice of law, and attorneys with knowledge of that fact who participate are guilty of ethical misconduct. That ruling is similar to the clear implication in the brokers' and accountants' cases that unless those professions conform to the conditions mentioned in those decisions, they will be guilty of the unauthorized practice of law. *New Jersey Assn. of Realtor Bds.*, supra, 93 N.J. at 472 ("Licensed real estate brokers and salespersons shall be permitted to prepare certain types of residential sales and lease agreements if these agreements contain specified provisions."); *In re Application of N.J. Soc'y of Certified Public Accountants*, supra, 102 N.J. at 242 (permitting certified public accountants to prepare and file inheritance tax returns "subject to the condition" that client be notified in writing that review by counsel may be desirable).

The public needs protection in these matters. The Legislature has recognized such need and afforded

statutory protection for both buyers and sellers at various stages of the real estate transaction. N.J.S.A. 46:3B-1 to -20 (New Home Warranty and Builders' Registration Act); N.J.S.A. 45:15-1 to -42 (Real Estate Broker Regulations); N.J.S.A. 45:22A-1 to -20 (Retirement Community Full Disclosure Act); N.J.S.A. 45:22A-21 to -56 (Planned Real Estate Development Full Disclosure Act); N.J.S.A. 17:46B-1 to -62 (Title Insurance Act); N.J.S.A. 46:10A-6 ("closed shop law" providing that mortgage lenders cannot require borrowers to employ their attorney or to pay lenders' attorney fees and that lenders must also disclose that their attorney works for them and that borrowers should retain their own attorney). In addition, Congress has recognized the need for uniformity in consumer real estate transactions. 12 U.S.C.A. Secs. 2601-2617 (Real Estate Settlement Procedures Act); 15 U.S.C.A. Secs. 1601-1693 (Truth in Lending Act); see Gerald S. Meisel, RESPA: Federal Control of Residential Real Estate, 98 N.J.L.J. 713 (August 21, 1975).

We do not here adopt a "consumerism" that invariably requires that services be made available at the lowest price no matter how great the risk. The record suggests that despite their conflict of interest, brokers' ethical standards have resulted in some diminishment of those risks. Unlike prior cases, there is no finding here, for instance, that brokers are discouraging retention of counsel, no suggestion that title companies are paying rebates to referring brokers. Today's public, furthermore, not only has the benefit of the attorney review clause, but is presumably better educated about the need for counsel, the function of attorneys, and the legal aspects of the sale of the home. The public continues, in South Jersey, to choose not to be represented. We assume that the public has simply concluded that the perceived advantages are worth those risks.

We do not adopt a rule, however, that so long as informed consent from the parties is obtained, any conduct that might otherwise constitute the unauthorized practice of law is permitted. Most of the practices restricted to attorneys can be performed, and may be performed, only by them regardless of the informed consent of the parties and regardless of the lower cost of using non-attorneys. All we decide is that in this case, concerning this practice, the record demonstrates that the public interest will not be compromised by allowing what would otherwise be the unauthorized practice of law if the parties are adequately informed of the conflicting interests of brokers and title officers and of the risks involved in proceeding without counsel.

We emphasize the nature of the public interest standard applied in this case. It is the same as in the cases allowing brokers to prepare real estate sales contracts and certified public accountants to prepare inheritance tax returns. No suggestion was made or implied in those cases that the public was better served if they used brokers and certified public accountants rather than lawyers for the services involved. On the contrary, the conditions imposed by this Court in both—requiring that the parties be informed in advance of their right to retain counsel—reflect our judgment that the parties would be well advised to obtain counsel. We decided only that the protection that lawyers provide and parties need—the basic rationale for prohibiting the unauthorized practice of law—was sufficiently addressed in those cases by assuring that the parties knowingly rejected it; we decided only that the public interest in those cases did not require depriving parties of their right to proceed without counsel, did not require the protection of counsel against their will. That is all we decide here today. We do not conclude that the public is better off without lawyers in the South Jersey practice. As stated several times above, we firmly believe the parties should retain counsel. We decide only that given the history and experience of the South Jersey practice, the public interest will not be disserved by allowing the parties, after advance written notice of their right to retain counsel and the risk of not doing so, to choose to proceed without a lawyer; we decide only that the public interest does not require that the

protection of counsel be forced upon the parties against their will. Our required disclosure notice goes beyond that of other cases, reflecting our determination to assure that the parties who decide not to retain lawyers know the conflicting interests of others and know that there are risks of proceeding without one.…

IV

Conclusion and Conditions

We premise our holding on the condition that both buyer and seller be made aware of the conflicting interests of brokers and title companies in these matters and of the general risks involved in not being represented by counsel.

We shall ask the Civil Practice Committee to recommend to us practical methods for achieving those aims. Presumably, that Committee will want to form a subcommittee including those who have been involved with this problem for many years. Obviously, the best way to achieve the goal is to have a knowledgeable disinterested attorney sit down with both buyer and seller and carefully explain both the conflict factor and the risk factor, but we doubt if that would be practical. Pending the report of that Committee and our action on it, we have decided to adopt an interim notice requirement that the broker must comply with. If that notice is not given, the broker will be engaged in the unauthorized practice of law. Furthermore, anyone who participates in the transaction, other than buyer and seller, knowing that the notice has not been given when and as required, will also be engaged in the unauthorized practice of law. As for any attorney who, under the same circumstances, continues to participate in the transaction, that attorney will also be subject to discipline for unethical conduct. At the commencement of the closing or settlement, the title officer in charge shall inquire of both buyer and seller whether, how, and when, the notice was given, and shall make and keep a record of the inquiry and the responses at that time.

The interim notice that we require is attached as Appendix A (Appendix A is not provided). It is a written notice, and it shall be attached to the proposed contract of sale as its cover page. The notice may be appropriately revised if the broker represents the buyer or is a dual agent, one who represents both seller and buyer. Whenever a broker presents either buyer or seller with the proposed contract, that cover page shall be so attached, and the broker shall personally advise the buyer or seller at that point that he or she must read it before executing the contract. If the contract is not personally delivered by the broker to the buyer or seller, the broker must make certain, prior to such delivery, that buyer and seller have been so informed, and must do so by speaking to them personally or by phone.

Assuming such notice is given in accordance with the terms and conditions mentioned above, we hold that attendance and participation at the closing or settlement where neither party has been represented by counsel, or where one has not been so represented, does not constitute the unauthorized practice of law; that brokers may order abstracts, title binders, and title policies; that an attorney retained by the broker to draft a deed and/or affidavit of title for the seller may do so but only if the attorney personally consults with the seller; regardless of the prior restriction, any attorney retained by the broker for that purpose, or any attorney acting for the title company, may draft any of the documents involved in the transaction upon written request of the party, be it buyer, seller, lender, mortgagee, bank, or others; that the title company may participate in clearing up those minor objections which Judge Miller refers to as categories one and two: standard exceptions such as

marital status and money liens customarily paid at closing, but not those classified as categories three and four: easements, covenants, or other serious legal objections to title.

Other equally important protections for buyer and seller should exist. Any broker participating in a transaction where buyer and seller are not represented should have the experience and knowledge required at least to identify a situation where independent counsel is needed. Under those circumstances the broker has a duty in accordance with the standards of that profession, to inform either seller or buyer of that fact. N.J.A.C.11:5-1.23(a), (f). Presumably, the same duty applies to any title officer, whether or not an attorney, but especially if an attorney, who becomes aware of the need of either party for independent counsel. In addition to whatever potential action might be taken by the bodies that regulate brokers and title officers, as well as by their own associations, their failure to inform exposes them to the risk of civil liability for resulting damages.

Our decision, while allowing continuation of the South Jersey practice, imposes new conditions on that practice and serious consequences for non-compliance. In order that brokers and others may adjust their practices to comply with those conditions, our decision will not become effective until sixty days from the date of this opinion and will apply to all real estate contracts subject to this opinion that are thereafter executed and to the transactions based on those contracts.

The decision of the Committee, Opinion No. 26, is affirmed in part, and reversed in part, and judgment entered declaring the rights of the participants in New Jersey residential real estate transactions in accordance with this opinion.

Case Questions

1. Why do you think the court spent so much time discussing the unauthorized practice of law? Do you believe such practices are commonplace? Explain.
2. What was the "unauthorized practice of law" discussed in this case?

Additional Case Analysis

1. An attorney represented both the buyer and the seller in the sale of a residential property. The bank that was financing the sale for the buyer wired the funds to the attorney's escrow account on the day of the closing. The buyer partially paid for the property with a personal check, the remainder of the purchase price being a check from the attorney's trust account. When the seller deposited these checks, the check from the attorney's account was returned, marked "insufficient funds." It turned out that the attorney absconded with the funds transferred to him by the bank. The seller sued the buyer. Who bore the risk of this loss, the buyer or the seller? See *Johnson v. Schultz,* 364 N.C. 90, 691 S.E. 2d 701 (2010).
2. The assignee of a mortgagor brought a foreclosure action against the property owners, and a judgment of foreclosure was entered against the owners. The property was then sold at auction. The owners

sought to set the sale aside, basing their position on the allegation that, pursuant to the Truth in Lending Act, they were not provided with a Notice of Right to Cancel at the closing, so that they now wished to rescind the mortgage note. See what the court said in *WM Specialty Mortgage, LLC v. Sparano,* 68 A. D. 3d 987 (2d Dept. 2009).

6 Condominiums, Cooperatives, and Commercial Property

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Define "condominium"
- Understand how a condominium homeowners' association works
- Define "cooperative"
- Understand the considerations that must be addressed when the property in question is commercial property
- Apply some practical tips for guidance in dealing with cooperatives, condominiums, and commercial real estate

CHAPTER OUTLINE

CHAPTER OVERVIEW

At this point it would be beneficial to examine, briefly, certain hybrid situations that are commonly encountered in a real estate law practice. These special situations include condominiums, cooperatives, and commercial property.

Condominiums and cooperatives first appeared over one hundred years ago, exclusively in urban settings. Land had become increasingly scarce with the growth of cities brought about by the Industrial Revolution. People who wanted to own their own homes had to share their houses with others because of escalating land values on limited space. Landowners began to construct taller buildings to increase the number of units that could be rented, further reducing the availability of land for single-family homes. Eventually, the owners of multi-story buildings decided to sell units rather than renting so that people could, in some way, own their own homes. The result was

the condominium and the cooperative. This form of ownership is now popular in suburban and rural areas as well as the cities in which it began.

Although its title tracks the titles of all other property, commercial property involves several additional aspects with regard to its sale, basically because most commercial property involves leases with tenants in possession who have certain rights and obligations that must be taken into consideration when the property is sold.

This chapter briefly examines these three specific situations involving the sale of real property.

Condominiums

A **condominium** is a form of ownership of real property in which the condominium owners hold title outright to a specifically designated unit and, at the same time, hold title as joint tenants with all other condominium unit owners in the development for what are considered to be the "common areas." These common areas include hallways, entryways, roofs, stairways and elevators, and recreational areas such as a common swimming pool, tennis court, and health center. Basically, any area that is used by all of the unit owners may be deemed to be a common area.

 **EXAMPLE:**

> A woman wants to retire to the Sun Belt and no longer wants to worry about maintaining her own home. She purchases a two-bedroom unit in a condominium development that has a golf course. The woman holds title to her unit (basically an apartment or a townhouse) as a tenant in severalty, and is a joint tenant with all other unit owners for the golf course and common walkways and areas.

The concept of a condominium did not exist under the common law, and consequently is a creature of statute. Every state has enacted laws that provide for the creation and regulation of condominiums (and cooperatives), and therefore each jurisdiction's statutes must be individually analyzed to determine particular rights and obligations. In addition to statutory regulation, the person who develops the condominium must also prepare a **condominium declaration** that is recorded with the deed to the land in the county recorder's office. This declaration details the specific rights and obligations of the unit owners (see Exhibit 6.1 at the end of this chapter for an example of a Sales Contract for a Condominium).

When creating a condominium, the developer must, usually by statutory mandate, establish rights and regulations for the governance of the condominium, and furthermore must prepare a plat description that shows the physical size and location of each of the units (see Chapter 4). Also, a **homeowners' association** must be formed to oversee the regulation of the condominium and to have authority to maintain the common areas. Before any units in the condominium can be sold, the condominium declaration, plat description, and homeowners' association must be established.

The homeowners' association, sometimes referred to as the **condominium association**, is formed as a non-profit corporation, and therefore, to be legally organized, is required to file **articles of incorporation** with the state secretary of state. These articles act as the association's creating document. The association must also adopt **bylaws** that detail the day-to-day operations of the association. The condominium unit owners elect some of the residents to act as members of the association's **board of directors** who manage the association for

a stated period of time, at which point a new board will be elected by the unit owners. To maintain the condominium, the unit owners pay an **assessment** to cover the cost of maintaining and repairing the common areas.

 EXAMPLE:

A condominium developer has filed all necessary papers to create a condominium, and has sold almost all the units. The developer has also filed a certificate of incorporation for the homeowners' association with the secretary of state. At this point the developer calls a meeting of the unit owners for the purpose of electing a board of directors. Five people are elected to the board. The board then has the unit owners pay the yearly assessment so that it can maintain the common areas.

With a condominium, each unit owner is liable for the maintenance and repair of his or her own individual unit, and is liable for any injuries that result from the failure to maintain the requisite standard of care associated with property ownership (see Chapter 4). The unit owner is also a joint tenant for the common areas and the owner is jointly liable for any injuries resulting from the failure of the homeowners' association to maintain the common areas in good repair.

Because the condominium represents individual ownership of the unit, the unit owner is free to sell, gift, devise, or rent his or her unit without restriction, *unless* there is some prohibition in the condominium declaration, which is rare. Condominium ownership typically provides for the free transferability of the property.

Cooperatives

A **cooperative** differs from a condominium. Cooperative ownership is considered to be ownership of personal property, not real property, because the owner purchases a share in a cooperative association, and the share entitles the holder to possess a specified unit that is owned by the cooperative. In other words, cooperative ownership is similar to ownership of a corporation. The shareholder owns a share that represents a percentage of corporation, and the share entitles the holder (with the cooperative) to possess, not own, a particular unit. Cooperatives are very popular on the East Coast of the United States.

Because the cooperative owner only holds a share, the shareholder has limited rights with respect to the transferability of that share. The cooperative is managed by a board that is responsible for the financial and physical well-being of the property. As a consequence, the board reviews all prospective purchasers for financial resources and personality, to determine whether the potential owner would be an appropriate tenant in the cooperative. Therefore, if an owner wishes to sell his or her share, the prospective buyer must be approved by the cooperative board. In the case of a stalemate, the cooperative agreement often provides that the cooperative will repurchase the shares from the owner, but the price is usually set at a rate below market value.

 EXAMPLE:

The owner of a cooperative wants to move and has found a prospective buyer for his shares, a well-known rock musician. Although financially sound, the board refuses to approve the musician because they do not want "theatrical people" in the building. Therefore the board may block this potential sale.

Because the units are owned by the cooperative, not the shareholders, financing of the property is made by and through the cooperative, and each shareholder pays an assessment to the board to cover the financing. If a shareholder defaults, the other shareholders must make up the shortfall to maintain the property's financing.

Cooperatives, because of their restrictions on transferability, are usually less expensive than condominiums. See Exhibit 6.2 at the end of this chapter for an example of a Sales Contract for a Cooperative.

Condops

In the past few years, a hybrid of the cooperative and the condominium has developed, known as the **condop**. Legally, a condop is a condominium with two units: (1) a commercial space, which, though treated as a single unit, may be divided into multiple stores, and (2) a residential unit, which typically consists of many apartment units and is owned by a cooperative that sells shares and gives out proprietary leases. In other words, a condop consists of two condominiums, one of which is owned by a cooperative. Simply put, a residential condop has a cooperative legal structure but limited regulation and restrictions on the residential units, and virtually no board approval requirements.

 **EXAMPLE:**

An individual buys a residential unit in a condop, purely as an investment. Although she only owns shares in the cooperative corporation that entitle her to reside in a particular unit, she is not planning on living in the apartment; rather, she intends to rent it on a continual basis to have income. Because the unit is in a condop, she does not have any restrictions on renting the apartment and does not need the board to approve her tenant.

Commercial Property

The term "commercial property," as used in the context of this book, refers to real estate that has been developed for commercial use, such as office and apartment buildings and shopping centers, and consequently have tenants already in situ. Certain additional considerations must be addressed with any sale of this type of property:

- When the property is described in the contract for sale, items of personal property that are used in the operation of the commercial venture are also usually included, such as landscaping and snow removal equipment. If not included in the description of the property being transferred they must be specifically excluded if the items are not intended to be part of the sale.

- Purchasers of commercial property are entitled to a physical inspection of the property prior to the sale. This inspection can include review of all contracts and financial documents associated with the property, and the buyer typically has the right to withdraw from the contract at this time if there are problems with the property that the seller refuses to remedy.
- In addition to the general covenants discussed in the previous chapter, if the sale involves commercial property, the seller is usually required to provide certain guarantees with respect to any leases that exist on the property, as well as all services and utilities in effect with respect to the property. The seller usually warrants that he or she will not enter into any new lease or contract before the closing date without the buyer's consent.
- If the property is leased to tenants at the time of the sale, the tenants may be required to sign an **estoppel letter**, which is a document that warrants the accuracy of the tenant's lease that is provided for the buyer by the seller. A copy of the purported lease is attached to the estoppel letter for this purpose.
- If the commercial property being sold is subject to a mortgage, and the buyer is taking title subject to the mortgage, the buyer will require the mortgagee to provide an **estoppel certificate** that details all the terms of the note and mortgage, indicating the amount of the outstanding balance and any amount in default as of the date of the signing of the estoppel certificate.
- For commercial property that is leased to tenants, the contract for sale will usually require a **proration** of the rent—a delineation of the amount of rent that will belong to the seller and the amount that will belong to the buyer. Furthermore, the contract must specify the taking over of any **security deposits** made by the tenants to the seller, which represent an amount that must be maintained in a trust account for the benefit of the property owner if the tenant defaults on the rent.
- Usually the buyer will require the seller to include an **indemnification** clause whereby the seller agrees to indemnify, or reimburse, the buyer for any cause of action on the property that was occasioned by events that occurred prior to the closing that are attributable to the seller's breach of a legal obligation.

See Exhibit 6.3 at the end of this chapter for a Land Description of a Commercial Property.

Practical Tips

- Make sure that all requirements of the co-op or condominium board have been met to effectuate a transfer.
- For commercial property, if dealing with an artificial entity, make sure that the entity has been lawfully formed; otherwise the transaction may be invalid.
- For commercial sales, make sure all tenants have received and/or prepared all necessary documents.

Chapter Review

Condominiums, cooperatives, and commercial property present special problems for anyone involved in the purchase and sale of realty.

The condominium represents a dual title to property: individual ownership for a given unit and a joint tenancy for the common areas. Condominiums are easy to transfer, but the unit owner has individual liability for his or her own unit and is jointly liable with the other unit owners for injuries resulting from poor maintenance of the common areas.

Cooperatives represent ownership in personal property of a share certificate that entitles the holder to possess, not own, a given unit. Liability for the cooperative owner is joint with all the other shareholders, and transferability of the share is difficult because alienation is restricted and subject to approval by the cooperative board.

Both condominiums and cooperatives are managed by boards pursuant to their certificates of incorporation.

The sale and purchase of commercial real estate, although following all the other categories of realty, require special attention for certain matters that apply only to property that is occupied by tenants who have rights and obligations with respect to the property. These considerations must be addressed in the contract for the sale of all commercial realty.

Ethical Concern

It is an unethical practice to represent both sides in a legal transaction unless both parties are aware of the representation and agree to it. This means that in a real estate transaction the same law office cannot represent the buyer and the seller, unless they both agree. Even if both sides agree, it still may be wise to decline such representations to avoid the appearance of impropriety.

Key Terms

Articles of incorporation
Assessment
Board of directors
Bylaws
Condominium
Condominium association
Condominium declaration
Condop
Cooperative
Estoppel certificate
Estoppel letter
Homeowners' association
Indemnification
Proration
Security deposit

Exercises

1. Review your state's statutes governing cooperatives and condominiums.
2. Briefly discuss the reasons a person might wish to purchase a cooperative rather than a condominium.
3. At the county recorder's office, search for an estoppel letter that appears with a deed to a commercial building.
4. Obtain from a local bank a copy of a mortgage application to purchase a cooperative and analyze its provisions.
5. Briefly discuss the additional factors that must be addressed with the purchase of commercial property.

Situational Analysis

A group of townhouses were constructed as a condominium. After several years the board decides that the exteriors of some of the houses need to be repainted, and it assesses all the unit owners, claiming that this is a common area. Your client is one of the unit owners so assessed whose house is not being painted, and she claims this is not a common area. Argue both sides and decide the case.

Edited Cases

The first case involves the imposition of a "flip tax" imposed when the owner of a cooperative sells his shares. The second case concerns the conversion of rental units to condominiums.

Lioi v. Westview Equities

8 Misc. 3d 719, 795 N.Y.S.2d 442 (2005)

In this small claims action, the plaintiff is seeking the return of a "flip tax" of $ 2,760 (2% of the $ 138,000 sale price) from the defendant cooperative association that he was required to pay when he sold his unit on December 23, 2004.

The plaintiff entered into the contract of sale in October of 2004, which required a down payment of five percent. It contained a form provision that the seller would pay the flip tax, if any. The imposition of a flip tax arose from a resolution of the board of directors passed on October 28, 2004, which read as follows: "A flip tax of 2% of the sale price of a unit was approved by the board, effective November 1, 2004."

On November 30, 2004, the resolution was approved by over 75% of the voting shares required for a change to the proprietary lease. The plaintiff contends that the flip tax should not apply to him because the contract of sale was entered into prior to the effective date of the resolution. The defendant counters that the date of sale which took place after the flip tax came into effect is determinative. But by the time the flip tax became effective, the plaintiff had already entered into the contract of sale and received the down payment. The essence of the transaction was substantially completed, except for board approval, prior to the authorization by the shareholders of HN1the flip tax which should not be applied retroactively. (See McIntyre *v. Royal Summit Owners, Inc., 126 Misc 2d 930, 933, 487 NYS2d 474 [App Term, 1st Dept 1984].*) But the defendant argues that, despite the above, the contract was contingent upon financing and board approval and thus did not become effective until the purchaser, possessed of a bank commitment, was approved by the defendant. These contingencies do not prevent the contract from being a binding obligation. The financing

was obtained before the resolution became effective. As for board approval, which took place the same day the flip tax was ratified by the shareholders, the contract of sale could have been voided by an unfavorable board vote, but as between buyer and seller, the contract was binding as to all terms including the purchase price and down payment, which netted less proceeds with the deduction for the flip tax. As such, it was effective as between them prior to board approval and ratification of the flip tax. Moreover, HN2it would be bad public policy to put the beneficiary of the flip tax, the cooperative association, in a position where by delaying the approval of a candidate, it could insure application of the flip tax. Unlike the case in *Holt v. 45 E. 66th St. Owners Corp.* (161 AD2d 410, 411, 555 NYS2d 340 [1st Dept 1990]), there was no specific agreement that a flip tax would be imposed on the sale. Nor was a flip tax provision contained in the offering plan adopted prior to the date of the contract of sale. (See *1326 Apts. Corp. v. Barbosa, 147 Misc 2d 264, 267–268, 555 NYS2d 560 [Civ Ct, NY County 1990]; Holt v. 45 E. 66th St. Owners Corp., supra*.) The defendant also urges that the plaintiff did not reserve his rights by having the disputed flip tax held in escrow or by paying under protest. However, the defendant's position at the closing was that the flip tax was due and the plaintiff could reasonably have understood that the payment was a necessary condition of the closing. His payment of it cannot be deemed voluntary. (See *Austin Instrument v. Loral Corp. 29 NY2d 124, 133, 272 NE2d 533, 324 NYS2d 22 [1971].)*

For the reasons stated, the plaintiff is entitled to the return of the flip tax of $2,760.

Case Questions

1. What is your opinion of a cooperative board being able to impose a flip tax on the sale of its shares?
2. Research your jurisdiction to determine whether it permits flip taxes.

Fore L Realty Trust v. McManus

71 Mass. App. Ct. 605, 884 N.E.2d 994 (2008)

This is an appeal from a decision of the Appellate Division of the District Court that affirmed a judgment of the District Court in favor of Joseph McManus, the tenant of rental premises being converted to a condominium unit. The sole issue on appeal is whether the statute that abolished rent control, see St. 1994, c. 368 (rent control prohibition act), repealed a previously existing statute that afforded notice and other protections to tenants such as McManus whose rental unit was to be converted to the condominium form of ownership. See St. 1983, c. 527, §4(*a*) (condominium conversion act). We affirm the decision and order of the Appellate Division. We conclude that the rent control prohibition act did not repeal the condominium conversion act and abolish the protections afforded to tenants upon conversion of their rental units to condominium units. By its very terms, the rent control prohibition act prohibits only municipal regulation of rents. The protections afforded to all tenants in §4(*a*)-(*e*) of the condominium conversion act are not a municipal regulation of rents, and therefore are not abrogated by the rent control prohibition act.

1. *Background.* The underlying facts are undisputed. Joseph McManus is an elderly resident of an apartment on Cherry Street in Waltham managed by Fore L Realty Trust (Fore L), which is also his landlord. McManus has lived in his apartment for approximately fifty years. In 2005, Fore L decided to convert the

units in the building where McManus maintains his apartment to condominium units. In June of 2005, Fore L sent McManus a notice to terminate his tenancy, but it did not send him a notice informing him of its intent to convert his unit to a condominium unit and of McManus's rights as set forth in the condominium conversion act. When Fore L sought to evict McManus in a summary process action in the District Court, McManus defended against his eviction on the ground that Fore L had failed to provide the required statutory notice of condominium conversion. Judgment entered in favor of McManus, and the Appellate Division affirmed that judgment, concluding that the repeal of rent control laws did not effect a repeal of statutory requirements on conversion.

Fore L concedes that it did not give McManus the notice required under the condominium conversion act, and that if such notice survived the repeal of rent control, then the judgment in favor of McManus is proper. Fore L argues, however, that such notice is not required, the requirement having been repealed along with rent control. We conclude, favorably to McManus, that the rent control prohibition act did not repeal the requirements of the condominium conversion act.

2. *Discussion*. In 1994, Massachusetts voters passed by initiative petition St. 1994, c. 368, inserting into the General Laws as a chapter numbered 40O, the "Massachusetts Rent Control Prohibition Act," prohibiting *any city or town* from enacting, maintaining or enforcing rent control regulations. The voter initiative defines in *§3* of the act the "rent control" that *§4* of the act prohibits a city or town from enacting, maintaining, or enforcing. See *G. L. c. 40O, §§3*, *4*; St. 1994, c. 368, §§3, 4. *Section 3* declares that "[f]or the purposes of this chapter, the term 'rent control' shall mean: (a) any regulation that in any way requires below-market rents for residential properties; and (b) any regulation that is part of a regulatory scheme of rent control as defined in subsection (a), including the regulation of occupancy, services, evictions, condominium conversion and the removal of properties from such rent control scheme…." *G. L. c. 40O, §3*.

Concerned with the consequences of an immediate cessation of rent control,[4] the Legislature enacted transition legislation, St. 1994, c. 282, to establish a uniform Statewide policy for ending rent control. By its express terms, the transition legislation was to "apply notwithstanding the provisions of chapter forty O of the General Laws, or any general or special law to the contrary." St. 1994, c. 282, §1. Among its other transition provisions, St. 1994, c. 282 excluded the condominium conversion act from the definition of rent control and from the scope of the rent control prohibition act. See St. 1994, c. 282, §3(*e*).[5] While St. 1994, c. 282 included a "sunset provision" that caused certain of its transitional provisions to expire within one year (on December 31, 1996), the sunset provision did not extend to the provision that excluded the condominium conversion act from the definition of rent control. See St. 1994, c. 282, §§3(*e*), 9. In consequence, the provision excluding the condominium conversion act from the definition of rent control did not expire with the sunset provisions of St. 1994, c. 282.

It soon became apparent that the voter initiative that provided for the codification of the rent control prohibition act in *c. 40O of the General Laws* unwittingly created a numerical anomaly. There already existed a *c. 40O of the General Laws* that dealt with an unrelated subject. To eliminate the confusion arising from the duplicate numbering, the Legislature enacted corrective legislation that renumbered *c. 40O* as *c. 40P*, retroactive to January 1, 1995. See St. 1997, c. 19, §10. However, the corrective legislation made no reference to the transition legislation's exclusion of the condominium conversion act from the definition of rent control. Rather, the corrective legislation retained the provision of the original rent control prohibition act and stated

"this chapter shall preempt, supersede or nullify any inconsistent, contrary or conflicting state or local law." *G. L. c. 40P, §5*, as inserted by St. 1997, c. 19, §10. See also St. 1994, c. 368, §5.

The crux of Fore L's contention arises from this legislative correction of the numerical anomaly created by the voter initiative. Fore L argues that the definition of rent control in *G. L. c. 40P, §3*, and the omission in *c. 40P* of any reference to St. 1994, c. 282 (and its exclusion of the condominium conversion act from the definition of rent control), establish that in enacting *c. 40P*, the Legislature intended to abolish not only rent control but also the protections of the condominium conversion act. We disagree. Such an argument misconstrues the scope and purpose of both the rent control prohibition act and the condominium conversion act. Moreover, such an argument attempts, by definitional legerdemain, to transform a purely corrective change in the numbering of a general law prohibiting a city or town from imposing rent control into a repeal by implication of the protections that the condominium conversion act affords to tenants. See *Greater Boston Real Estate Bd. v. Boston, 428 Mass. 797, 799, 705 N.E.2d 256 & n.2 (1999)*; *Gross v. Prudential Ins. Co. of Am., 48 Mass. App. Ct. 115, 117 n.2, 718 N.E.2d 383 (1999)* (redesignation a purely technical amendment in recognition of fact that different *c. 40O* already existed).

We view the condominium conversion act as a protection of Statewide application, afforded to all tenants, that differs materially from a municipal regulation or ordinance that regulates or requires below-market rents for residential properties. Prior to the abolition of rent control, the condominium conversion act afforded *all* tenants—those paying market rents and those paying controlled rents alike—certain rights and protections upon conversion of the tenant's unit to a condominium unit. We discern nothing in the rent control prohibition act that would provide tenants of units formerly subject to rent control fewer protections upon conversion than those who were not.

Fore L's central argument rests on the flawed premise that the rent control prohibition act, which prohibits a "city or town" from enacting, enforcing, or maintaining rent control of any kind (with certain immaterial exceptions) is in conflict with the protections that the condominium conversion act affords to all tenants. There is no such conflict. The condominium conversion act and the rent control prohibition act are part of a delicately balanced legislative approach to addressing the shortage of affordable housing for the citizens of the Commonwealth.[6] The requirements and purposes of the condominium conversion act are related to, but distinct from, the limitation that the rent control prohibition act imposes on a city or town controlling rent at the municipal level. The condominium conversion act is a legislative grant of protections to all tenants of rental units being converted to condominiums. The rent control prohibition act is a legislative restriction on the ability of municipalities to regulate rents at the local level, a factor that may discourage new rental housing production. The condominium conversion act affords tenants notice rights, pre-eviction lease extensions, first rights of refusal, purchasing rights at market price, and relocation assistance. None of these provisions regulates rents. To the extent that §4(*e*) of the condominium conversion act works a limitation on the rental increases that a landlord may lawfully impose upon a tenant in possession at the time of conversion, such a limitation is a legislative determination of Statewide application and not a prohibited municipal regulation of rent within the ambit of the rent control prohibition act.[7] While *§§3* and *4* of the rent control prohibition act preclude a *municipality* from regulating rent (including during a period of condominium conversion), no similar prohibition prevents the Legislature itself doing so, either in that act or elsewhere. See *Greater Boston Real Estate Bd. v. Boston, 428 Mass. at 798–802* (invalidating *city* ordinance enacted under

condominium conversion act as beyond that statute's enabling act and violative of rent control prohibition act).

We also find unpersuasive Fore L's argument that the definition of rent control in *G. L. c. 40P*, and the absence of any reference in that corrective statute to the transition legislation and its exclusion of the condominium conversion act from the definition of rent control, signified the Legislature's intention to repeal the requirements of the condominium conversion act along with the prohibition against municipal control of rents. There was no need to make reference to the condominium conversion act in the corrective statute. As previously discussed, there is simply no conflict between the condominium conversion act and the rent control prohibition act where the challenged rights are those granted by the Legislature itself and not by cities or towns under the enabling provisions of the condominium conversion act. Contrast *Greater Boston Real Estate Bd. v. Boston, supra.* The failure of the Legislature to make specific reference to the transitional legislation in *c. 40P* does not speak to a repeal of the condominium conversion act by implication. See *Salem & Beverly Water Supply Bd. v. Commissioner of Rev., 26 Mass. App. Ct. 74, 78, 523 N.E.2d 473 (1988)* ("Repeals by implication are disfavored by the appellate courts of the Commonwealth, particularly where general statutes are said to supersede earlier special acts"). Rather, such omission only fortifies the conclusion that the rights in question under the condominium conversion act are not a form of municipal rent control and remain unaffected by the rent control prohibition act and its codification in *c. 40P*.

Decision and order of the Appellate

Division affirmed.

Case Questions

1. The case concerns a jurisdiction with rent control regulations. Does your community have rent control? How would this decision affect your location?
2. What is meant by a "serious public emergency"?

Additional Case Analysis

1. The owner of a condominium unit purchased a dog in violation of the building's rule against pets. At the time that the owner purchased the unit, he signed an agreement acknowledging the no-pet rule. When the condominium board became aware that the unit owner had a dog, they commenced proceedings to foreclose on his unit. The owner challenged the board's actions regarding the no-pet rule as unreasonable. What factors should the court consider in rendering its decision? How would you rule? See *Board of Directors of 175 East Delaware Place Homeowners Assn v. Hinojosa*, 287 Ill. App. 3d 886, 679 N.E. 2d 407 (1997).
2. An owner rented her condominium unit to a tenant who kept a dog in violation of the condominium association's rules. The association notified the owner of the violation and allowed time to have it

remedied. When the violation was not cured, the association commenced a foreclosure proceeding against the unit owner. In court, the unit owner challenged the condominium's no dog rule as unreasonable. What factors do you think the court should use in determining reasonableness? How would you rule? See *Stamford Landing Condominium Association v. Charelene Lerman,* 109 Conn, App. 261 (2008).

Exhibit 6.1: Sales Contract for a Condominium

146—Contract of sale, condominium unit, 7-06. ©2006 by Bloomberg Excelsior, Inc., Publisher, NYC 10013 www.bloomberg.com

CONTRACT OF SALE—CONDOMINIUM UNIT (2000): This form was originally prepared by the Real Property Section of the New York State Bar Association and the Committee on Real Property Law and the Committee on Cooperative and Condominium Law of the Association of the Bar of the City of New York.
Note: This form is intended to deal with matters common to most transactions involving the sale of a condominium unit. Provisions should be added, altered or deleted to suit the circumstances of a particular transaction. No representation is made that this form of contract complies with Section 5-702 of the General Obligations Law ("Plain Language Law")

CONSULT YOUR LAWYER BEFORE SIGNING THIS AGREEMENT

Contract of Sale Condominium Unit

Agreement made as of between

residing at

and ("**Seller**")

residing at

("**Purchaser**").

1. Unit: Seller agrees to sell and convey, and Purchaser agrees to purchase, Unit No. ("**Unit**") in the building ("**Building**") known as Condominium ("**Condominium**") and located at , New York, together with a percent undivided interest in the Common Elements (as defined in para. 6) appurtenant thereto, all upon and subject to the terms and conditions set forth herein. The Unit shall be as designated in the Declaration of Condominium Ownership (as the same may be amended from time to time, the "**Declaration**") of the Condominium, recorded in County, New York or the By-Laws (as the same may be amended from time to time, the "**ByLaws**") of the Condominium.

2. Personal Property: (a) The sale includes all of Seller's right, title and interest, if any, in and to:

(i) the refrigerators, freezers, ranges, ovens, built-in microwave ovens, dishwashers, washing machines, clothes dryers, cabinets and counters, lighting and plumbing fixtures, chandeliers, air conditioning equipment, venetian blinds, shades, screens, storm windows and other window treatments, wall-to-wall carpeting, bookshelves, switchplates, door hardware and mirrors, built-ins and articles of property and fixtures attached to or appurtenant to the Unit, except those listed in subpara. 2(b), all of which included property and fixtures are represented to be owned by Seller, free and clear of all liens and encumbrances other than those encumbrances ("**Permitted Exceptions**") set forth on Schedule A annexed hereto and made a part hereof (*strike out inapplicable items*); and

(ii)

(b) Excluded from this sale are:

(i) furniture and furnishings (other than as specifically provided in this Contract); and

(ii)

(c) The property referred to in subpara. 2(a)(i) and (ii) may not be purchased if title to the Unit is not conveyed hereunder.

3. Purchase Price: (a) The purchase price ("**Purchase Price**") is $, payable as follows:

(i) $ ("**Downpayment**") on the signing of this Contract by good check subject to collection, the receipt of which is hereby acknowledged, to be held in escrow pursuant to para. 16; and

(ii) $ constituting the balance of the Purchase Price, by certified check of Purchaser or official bank check (except as otherwise provided in this Contract) on the delivery of the deed as hereinafter provided.

(b) All checks in payment of the Purchase Price shall represent United States currency and be drawn on or issued by a bank or trust company authorized to accept deposits in New York State. All checks in payment of the Downpayment shall be payable to the order of Escrowee (as hereinafter defined). All checks in payment of the balance of the Purchase Price shall be payable to the order of Seller (or as Seller otherwise directs pursuant to subparas. 6(a)(viii) or 18(b)).

(c) Except for the Downpayment and checks aggregating not more than one-half of one percent of the Purchase Price, including payment for closing adjustments, all checks delivered by Purchaser shall be certified or official bank checks as hereinabove provided.

4. Closing of Title: The closing documents referred to in para. 6 shall be delivered, and payment of the balance of the Purchase Price shall be made, at the closing of title ("**Closing**"), to be held on at M., at the offices of or at the office of Purchaser's lending institution or its counsel; provided, however, that such office is located in either the City or County in which either (a) Seller's attorney maintains an office or (b) the Unit is located.

5. Representations, Warranties and Covenants: Seller represents, warrants and covenants that:

(a) Seller is the sole owner of the Unit and the property referred to in subpara. 2(a) and Seller has the full right, power and authority to sell, convey and transfer the same;

(b) The common charges (excluding separately billed utility charges) for the Unit on the date hereof are $ per month;

(c) Seller has not received any written notice of any intended assessment or increase in common charges not reflected in subpara. 5(b). Purchaser acknowledges that it will not have the right to cancel this Contract in the event of the imposition of any assessment or increase in common charges after the date hereof of which Seller has not heretofore received written notice;

(d) The real estate taxes for the Unit for the fiscal year of through are $;

(e) Seller is not a "sponsor" or a nominee of a "sponsor" under any plan of condominium organization affecting the Unit;

(f) All refrigerators, freezers, ranges, dishwashers, washing machines, clothes dryers and air conditioning equipment included in this sale will be in working order at the time of Closing;

(g) If a copy is attached to this Contract, the copy of the Certificate of Occupancy covering the Unit is a true and correct copy; and

(h) Seller is not a "foreign person" as defined in para. 17. (If inapplicable, delete and provide for compliance with Code Withholding Section, as defined in para. 17.)

6. Closing Documents: (a) At the Closing, Seller shall deliver to Purchaser the following:

(i) Bargain and sale deed with covenant against grantor's acts (**"Deed"**), complying with RPL § 339-o and containing the covenant required by LL § 13(5), conveying to Purchaser title to the Unit, together with its undivided interest in the Common Elements (as such term is defined in the Declaration and which term shall be deemed to include Seller's right, title and interest in any limited common elements attributable to or used in connection with the Unit) appurtenant thereto, free and clear of all liens and encumbrances other than Permitted Exceptions. The Deed shall be executed and acknowledged by Seller and, if requested by the Condominium, executed and acknowledged by Purchaser, in proper statutory form for recording;

(ii) If a corporation and if required pursuant to BCL § 909, Seller shall deliver to Purchaser (1) a resolution of its board of directors authorizing the delivery of the Deed and (2) a certificate executed by an officer of such corporation certifying as to the adoption of such resolution and setting forth facts demonstrating that the delivery of the Deed is in conformity with the requirements of BCL § 909. The Deed shall also contain a recital sufficient to establish compliance with such law;

(iii) A waiver of right of first refusal of the board of managers of the Condominium (**"Board"**) if required in accordance with para. 8;

(iv) A statement by the Condominium or its managing agent that the common charges and any assessments then due and payable the Condominium have been paid to the date of the Closing;

(v) All keys to the doors of, and mailbox for, the Unit;

(vi) Such affidavits and/or other evidence as the title company (**"Title Company"**) from which Purchaser has ordered a title insurance report and which is authorized to do business in New York State shall reasonably require in order to omit from its title insurance policy all exceptions for judgments, bankruptcies or other returns against Seller and persons or entities whose names are the same as or are similar to Seller's name;

(vii) New York City Real Property Transfer Tax Return, if applicable, and New York State Real Estate Transfer Tax Return, prepared, executed and acknowledged by Seller in proper form for submission;

(viii) Checks in payment of all applicable real property transfer taxes except a transfer tax which by law is primarily imposed on the purchaser (**"Purchaser Transfer Tax"**) due in connection with the sale. In lieu of delivery of such checks, Seller shall have the right, upon reasonable prior notice to Purchaser, to cause Purchaser to deliver said checks at the Closing and to credit the amount thereof against the balance of the Purchase Price. Seller shall pay the additional transfer taxes, if any, payable after the Closing by reason of the conveyance of the Unit, which obligation shall survive the Closing;

(ix) Certification that Seller is not a foreign person pursuant to para. 17 or a withholding certificate from the Internal Revenue Service. (If inapplicable, delete and provide for compliance with Code Section, as defined in para. 17.); and

(x) Affidavit that a single station smoke detecting alarm device is installed pursuant to New York Executive Law §378(5).

(b) At the Closing, Purchaser shall deliver to Seller the following:

(i) Checks in payment of (y) the balance of the Purchase Price in accordance with subpara. 3(b) and (z) any Purchaser Transfer Tax;

(ii) If required by the Declaration or By-Laws, power of attorney to the Board, prepared by Seller, in the form required by the Condominium. The power of attorney shall be executed and acknowledged by Purchaser and, after being recorded, shall be sent to the Condominium;

(iii) New York City Real Property Transfer Tax Return executed and acknowledged by Purchaser and an Affidavit in Lieu of Registration pursuant to New York Multiple Dwelling Law, each in proper form for submission, if applicable; and

(iv) If required, New York State Equalization Return executed and acknowledged by Purchaser in proper form for submission.

(c) It is a condition of Purchaser's obligation to close title hereunder that:

(i) All notes or notices of violations of law or governmental orders, ordinances or requirements affecting the Unit and noted or issued by any governmental department, agency or bureau having jurisdiction which were noted or issued on or prior to the date hereof shall have been cured by Seller;

(ii) Any written notice to Seller from the Condominium (or its duly authorized representative) that the Unit is in violation of the Declaration,

By-Laws or rules and regulations of the Condominium shall have been cured; and

(iii) The Condominium is a valid condominium created pursuant to RPL Art. 9-B and the Title Company will so insure.

7. Closing Adjustments: (a) The following adjustments shall be made as of 11:59 P.M. of the day before the Closing:

(i) Real estate taxes and water charges and sewer rents, if separately assessed, on the basis of the fiscal period for which assessed, except that if there is a water meter with respect to the Unit, apportionment shall be based on the last available reading, subject to adjustment after the Closing, promptly after the next reading is available; provided, however, that in the event real estate taxes have not, as of the date of Closing, been separately assessed to the Unit, real estate taxes shall be apportioned on the same basis as provided in the Declaration or By-Laws or, in the absence of such provision, based upon the Unit's percentage interest in the Common Elements;

(ii) Common charges of the Condominium; and

(iii) If fuel is separately stored with respect to the Unit only, the value of fuel stored with respect to the Unit at the price then charged by Seller's supplier (as determined by a letter or certificate to be obtained by Seller from such supplier), including any sales taxes.

(b) If at the time of Closing the Unit is affected by an assessment which is or may become payable in installments, then, for the purposes of this Contract, only the unpaid installments which are then due shall be considered due and are to be paid by Seller at the Closing. All subsequent installments at the time of Closing shall be the obligation of Purchaser.

(c) Any errors or omissions in computing closing adjustments shall be corrected. This subpara. 7(c) shall survive the Closing.

(d) If the Unit is located in the City of New York, the "customs in respect to title closings" recommended by The Real Estate Board of New York, Inc., as amended and in effect on the date of Closing, shall apply to the adjustments and other matters therein mentioned, except as otherwise provided herein.

8. Right of First Refusal: If so provided in the Declaration or ByLaws, this sale is subject to and conditioned upon the waiver of a right of first refusal to purchase the Unit held by the Condominium and exercisable by the Board. Seller agrees to give notice promptly to the Board of the contemplated sale of the Unit to Purchaser, which notice shall be given in accordance with the terms of the Declaration and By-Laws, and Purchaser agrees to provide promptly all applications, information and references reasonably requested by the Board. If the Board shall exercise such right of first refusal, Seller shall promptly refund to Purchaser the Downpayment (which term, for all purposes of this Contract, shall be deemed to include interest, if any, earned thereon) and upon the making of such refund this Contract shall be deemed cancelled and of no further force or effect and neither party shall have any further rights against, or obligations or liabilities to, the other by reason of this Contract. If the Board shall fail to exercise such right of first refusal within the time and in the manner provided for in the Declaration or By-Laws or shall declare in writing its intention not to exercise such right of first refusal (a copy of which writing shall be delivered to Purchaser promptly following receipt thereof), the parties hereto shall proceed with this sale in accordance with the provisions of this Contract.

9. Processing Fee: Seller shall, at the Closing, pay all fees and charges payable to the Condominium (and/or its managing agent) in connection with this sale, including, without limitation, any processing fee, the legal fees, if any, of the Condominium's attorney in connection with this sale and, unless otherwise agreed to by Seller and Purchaser in writing, all "flip taxes," transfer or entrance fees or similar charges, if any, payable to or for the Condominium or otherwise for the benefit of the Condominium unit owners, which arise by reason of this sale.

10. No Other Representations: Purchaser has examined and is satisfied with the Declaration, By-Laws and rules and regulations of the Condominium, or has waived the examination thereof. Purchaser has inspected the Unit, its fixtures, appliances and equipment and the personal property, if any, included in this sale, as well as the Common Elements of the Condominium, and knows the condition thereof and, subject to subpara. 5(f), agrees to accept the same "as is," i.e., in the condition they are in on the date hereof, subject to normal use, wear and tear between the date hereof and the Closing. Purchaser has examined or waived examination of the last audited financial statements of the Condominium, and has considered or waived consideration of all other matters pertaining to this Contract and to the purchase to be made hereunder, and does not rely on any representations made by any broker or by Seller or anyone acting or purporting to act on behalf of Seller as to any matters which might influence or affect the decision to execute this Contract or to buy the Unit, or said personal property, except those representations and warranties which are specifically set forth in this Contract.

11. Possession: Seller shall, prior to the Closing, remove from the Unit all furniture, furnishings and other personal property not included in this sale, shall repair any damage caused by such removal, and shall deliver exclusive possession of the Unit at the Closing, vacant, broom-clean and free of tenancies or other rights of use or possession.

12. Access: Seller shall permit Purchaser and its architect, decorator or other authorized persons to have the right of access to the Unit between the date hereof and the Closing for the purpose of inspecting the same and taking measurements, at reasonable times and upon reasonable prior notice to Seller (by telephone or otherwise). Further, Purchaser shall have the right to inspect the Unit at a reasonable time during the 24-hour period immediately preceding the Closing.

13. Defaults and Remedies: (a) If Purchaser defaults hereunder, Seller's sole remedy shall be to retain the Downpayment as liquidated damages, it being agreed that Seller's damages in case of Purchaser's default might be impossible to ascertain and that the Downpayment constitutes a fair and reasonable amount of damages under the circumstances and is not a penalty.

(b) If Seller defaults hereunder, Purchaser shall have such remedies as Purchaser shall be entitled to at law or in equity, including, but not limited to, specific performance.

14. Notices: Any notice, request or other communication ("Notice") given or made hereunder (except for the notice required by para. 12), shall be in writing and either (a) sent by any of the parties hereto or their respective attorneys, by registered or certified mail, return receipt requested, postage prepaid, or (b) delivered in person or by overnight courier, with

receipt acknowledged, to the address given at the beginning of this Contract for the party to whom the Notice is to be given, or to such other address for such party as said party shall hereafter designate by Notice given to the other party pursuant to this para. 14, or (c) with respect to para. 6(a)(viii) or para. 18(b), sent by fax to the party's attorney. Each Notice mailed shall be deemed given on the third business day following the date of mailing the same and each Notice delivered in person or by overnight courier shall be deemed given when delivered. A copy of each notice sent to a party shall also be sent to the party's attorney. Each notice sent by fax shall be deemed given when transmission is confirmed by the sender's fax machine. The attorneys for the parties are hereby authorized to give and receive on behalf of their clients all Notices and deliveries.

15. Purchaser's Lien: The Downpayment and all other sums paid on account of this Contract and the reasonable expenses of the examination of title to, and departmental violation searches in respect of, the Unit are hereby made a lien upon the Unit, but such lien shall not continue after default by Purchaser hereunder.

16. Downpayment in Escrow: (a) Seller's attorney (**"Escrowee"**) shall hold the Downpayment in escrow in a segregated bank account at the depository identified at the end of this Contract until Closing or sooner termination of this Contract and shall pay over or apply the Downpayment in accordance with the terms of this para. 16. Escrowee shall hold the Downpayment in a(n) bearing account for the benefit of the parties. If interest is held for the benefit of the parties, it shall be paid to the party entitled to the Dowepayment and the party receiving the interest shall pay any income taxes thereon. If interest is not held for the benefit of the parties, the Downpayment shall be placed in an IOLA account or as otherwise permitted or required by law. The Social Security or Federal Identification numbers of the parties shall be furnished to Escrowee upon request. At Closing, the Downpayment shall be paid by Escrowee to Seller. If for any reason Closing does not occur and either party gives Notice (as defined in paragraph 14) to Escrowee demanding payment of the Downpayment, Escrowee shall give prompt Notice to the other party of such demand. If Escrowee does not receive Notice of objection from such other party to the proposed payment within 10 business days after the giving of such Notice, Escrowee is hereby authorized and directed to make such payment. If Escrowee does receive such Notice of objection within such 10 day period or if for any other reason Escrowee in good faith shall elect not to make such payment, Escrowee shall continue to hold such amount until otherwise directed by Notice from the parties to this Contract or a final, nonappealable judgment, order or decree of a court. However, Escrowee shall have the right at any time to deposit the Downpayment with the clerk of a court in the county in which the Unit is located and shall give Notice of such deposit to Seller and Purchaser. Upon such deposit or other disbursement in accordance with the terms of this para. 16, Escrowee shall be relieved and discharged of all further obligations and responsibilities hereunder.

(b) The parties acknowledge that Escrowee is acting solely as a stakeholder at their request and for their convenience and that Escrowee shall not be liable to either party for any act or omission on its part unless taken or suffered in bad faith or in willful disregard of this Contract or involving gross negligence on the part of Escrowee. Seller and Purchaser jointly and severally (with right of contribution) agree to defend (by attorneys selected by Escrowee), indemnify and hold Escrowee harmless from and against all costs, claims and expenses (including reasonable attorneys' fees) incurred in connection with the performance of Escrowee's duties hereunder, except with respect to actions or omissions taken or suffered by Escrowee in bad faith or in willful disregard of this Contract or involving gross negligence on the part of Escrowee.

(c) Escrowee may act or refrain from acting in respect of any matter referred to herein in full reliance upon and with the advice of counsel which may be selected by it (including any member of its firm) and shall be fully protected in so acting or refraining from action upon the advice of such counsel.

(d) Escrowee acknowledges receipt of the Downpayment by check subject to collection and Escrowee's agreement to the provisions of this para. 16 by signing in the place indicated in this Contract.

(e) Escrowee or any member of its firm shall be permitted to act as counsel for Seller in any dispute as to the disbursement of the Downpayment or any other dispute between the parties whether or not Escrowee is in possession of the Downpayment and continues to act as Escrowee.

(f) The party whose attorney is Escrowee shall be liable for loss of the Downpayment.

17. FIRPTA: Seller represents and warrants to Purchaser that Seller is not a "foreign person" as defined in IRC § 1445, as amended, and the regulations issued thereunder (**"Code Withholding Section"**). At the Closing Seller shall deliver to Purchaser a certificate stating that Seller is not a foreign person in the form then required by the Code Withholding Section or a withholding certificate from the Internal Revenue Service. In the event Seller fails to deliver the aforesaid certificate or in the event that Purchaser is not entitled under the Code Withholding Section to rely on such certificate, Purchaser shall deduct and withhold from the Purchase Price a sum equal to 10% thereof and shall at Closing remit the withheld amount with the required forms to the Internal Revenue Service.

18. Title Report; Acceptable Title: (a) Purchaser shall, promptly after the date hereof, or after receipt of the mortgage commitment letter, if applicable, order a title insurance report from the Title Company. Promptly after receipt of the title report and thereafter of any continuations thereof and supplements thereto, Purchaser shall forward a copy of each such report, continuation or supplement to the attorney for Seller. Purchaser shall further notify Seller's attorney of any other objections to title not reflected in such title report of which Purchaser becomes aware following the delivery of such report, reasonably promptly after becoming aware of such objections.

(b) Any unpaid taxes, assessments, water charges and sewer rents, together with the interest and penalties thereon to a date not less than two days following the date of Closing, and any other liens and encumbrances which Seller is obligated to pay and discharge or which are against corporations, estates or other persons in the chain of title, together with the cost of recording or filing any instruments necessary to discharge such liens and encumbrances of record, may be paid out of the proceeds of the monies payable at the Closing if Seller delivers to Purchaser at the Closing official bills for such taxes, assessments, water charges, sewer rents, interest and penalties and instruments in recordable form sufficient to discharge any other liens and encumbrances of record. Upon request made a reasonable time before the Closing, Purchaser shall provide at the Closing separate checks for the foregoing payable to the order of the holder of any such lien, charge or encumbrance and otherwise complying with subpara. 3(b). If the Title Company is willing to insure Purchaser that such charges, liens and encumbrances will not be collected out of or enforced against the Unit and is willing to insure the lien of Purchaser's

Institutional Lender (as hereinafter defined) free and clear of any such charges, liens and encumbrances, then Seller shall have the right in lieu of payment and discharge to deposit with the Title Company such funds or to give such assurances or to pay such special or additional premiums as the Title Company may require in order to so insure. In such case the charges, liens and encumbrances with respect to which the Title Company has agreed so to insure shall not be considered objections to title.

(c) Seller shall convey and Purchaser shall accept fee simple title to the Unit in accordance with the terms of this Contract, subject only to: (a) the Permitted Exceptions and (b) such other matters as (i) the Title Company or any other title insurer licensed to do business by the State of New York shall be willing, without special or additional premium, to omit as exceptions to coverage or to except with insurance against collection out of or enforcement against the Unit and (ii) shall be accepted by any lender which has committed in writing to provide mortgage financing to Purchaser for the purchase of the Unit (**"Purchaser's Institutional Lender"**), except that if such acceptance by Purchaser's Institutional Lender is unreasonably withheld or delayed, such acceptance shall be deemed to have been given.

(d) Notwithstanding any contrary provisions in this Contract, express or implied, or any contrary rule of law or custom, if Seller shall be unable to convey the Unit in accordance with this Contract (provided that Seller shall release, discharge or otherwise cure at or prior to Closing any matter created by Seller after the date hereof and any existing mortgage, unless this sale is subject to it) and if Purchaser elects not to complete this transaction without abatement of the Purchase Price, the sole obligation and liability of Seller shall be to refund the Downpayment to Purchaser, together with the reasonable cost of the examination of title to, and departmental violation searches in respect of, the Unit, and upon the making of such refund and payment, this Contract shall be deemed cancelled and of no further force or effect and neither party shall have any further rights against, or obligations or liabilities to, the other by reason of this Contract. However, nothing contained in this subpara. 18(d) shall be construed to relieve Seller from liability due to a willful default.

19. Risk of Loss; Casualty: (a) The risk of loss or damage to the Unit or the personal property included in this sale, by fire or other casualty, until the earlier of the Closing or possession of the Unit by Purchaser, is assumed by Seller, but without any obligation of Seller to repair or replace any such loss or damage unless Seller elects to do so as hereinafter provided. Seller shall notify Purchaser of the occurrence of any such loss or damage to the Unit or the personal property included in this sale within 10 days after such occurrence or by the date of Closing, whichever first occurs, and by such notice shall state whether or not Seller elects to repair or restore the Unit and/or the personal property, as the case may be. If Seller elects to make such repairs and restorations, Seller's notice shall set forth an adjourned date for the Closing, which shall be not more than 60 days after the date of the giving of Seller's notice. If Seller either does not elect to do so or, having elected to make such repairs and restorations, fails to complete the same on or before said adjourned date for the Closing, Purchaser shall have the following options:

(i) To declare this Contract cancelled and of no further force or effect and receive a refund of the Downpayment in which event neither party shall thereafter have any further rights against, or obligations or liabilities to, the other by reason of this Contract; or

(ii) To complete the purchase in accordance with this Contract without reduction in the Purchase Price, except as provided in the next sentence. If Seller carries hazard insurance covering such loss or damage, Seller shall turn over to Purchaser at the Closing the net proceeds actually collected by Seller under the provisions of such hazard insurance policies to the extent that they are attributable to loss of or damage to any property included in this sale, less any sums theretofore expended by Seller in repairing or replacing such loss or damage or in collecting such proceeds; and Seller shall assign (without recourse to Seller) Seller's right to receive any additional insurance proceeds which are attributable to the loss of or damage to any property included in this sale.

(b) If Seller does not elect to make such repairs and restorations, Purchaser may exercise the resulting option under (i) or (ii) of (a) above only by notice given to Seller within 10 days after receipt of Seller's notice. If Seller elects to make such repairs and restorations and fails to complete the same on or before the adjourned closing date, Purchaser may exercise either of the resulting options within 10 days after the adjourned closing date.

(c) In the event of any loss of or damage to the Common Elements which materially and adversely affects access to or use of the Unit, arising after the date of this Contract but prior to the Closing, Seller shall notify Purchaser of the occurrence thereof within 10 days after such occurrence or by the date of Closing, whichever occurs first, in which event Purchaser shall have the following options:

(i) To complete the purchase in accordance with this Contract without reduction in the Purchase Price; or

(ii) To adjourn the Closing until the first to occur of (1) completion of the repair and restoration of the loss or damage to the point that there is no longer a materially adverse effect on the access to or use of the Unit or (2) the 60th day after the date of the giving of Seller's aforesaid notice. In the event Purchaser elects to adjourn the Closing as aforesaid and such loss or damage is not so repaired and restored within 60 days after the date of the giving of Seller's aforesaid notice, then Purchaser shall have the right either to (x) complete the purchase in accordance with this Contract without reduction in the Purchase Price or (y) declare this Contract cancelled and of no further force or effect and receive a refund of the Downpayment, in which latter event neither party shall thereafter have any further rights against, or obligations or liabilities to, the other by reason of this Contract.

(d) In the event of any loss of or damage to the Common Elements which does not materially and adversely affect access to or use of the Unit, Purchaser shall accept title to the Unit in accordance with this Contract without abatement of the Purchase Price.

20. Internal Revenue Service Reporting Requirement: Each party shall execute, acknowledge and deliver to the other party such instruments, and take such other actions, as such other party may reasonably request in order to comply with IRC § 6045(e), as amended, or any successor provision or any regulations promulgated pursuant thereto, insofar as the same requires reporting of information in respect of real estate transactions. The provisions of this para. 20 shall survive the Closing. The parties designate

as the attorney responsible for reporting this information as required by law.

21. Broker: Seller and Purchaser represent and warrant to each other that the only real estate broker with whom they have dealt in connection

with this Contract and the transaction set forth herein is

and that they know of no other real estate broker who has claimed or may have the right to claim a commission in connection with this transaction. The commission of such real estate broker shall be paid by Seller pursuant to separate agreement. If no real estate broker is specified above, the parties acknowledge that this Contract was brought about by direct negotiation between Seller and Purchaser and each represents to the other that it knows of no real estate broker entitled to a commission in connection with this transaction. Seller and Purchaser shall indemnify and defend each other against any costs, claims or expenses (including reasonable attorneys' fees) arising out of the breach on their respective parts of any representation, warranty or agreement contained in this para. 21. The provisions of this para. 21 shall survive the Closing or, if the Closing does not occur, the termination of this Contract.

22. Mortgage Commitment Contingency. *(Delete paragraph if inapplicable)* (a) The obligation of Purchaser to purchase under this Contract is conditioned upon issuance, on or before days after a fully executed copy of this Contract is given to Purchaser or Purchaser's attorney in the manner set forth in paragraph 14 or subparagraph 22(k) (the **"Commitment Date"**), of a written commitment from an Institutional Lender pursuant to which such Institutional Lender agrees to make a first mortgage loan, other than a VA, FHA or other governmentally insured loan, to Purchaser, at Purchaser's sole cost and expense, of $ for a term of at least years (or such lesser sum or shorter term as Purchaser shall be willing to accept) at the prevailing fixed or adjustable rate of interest and on other customary commitment terms (the **"Commitment"**). To the extent a Commitment is conditioned on the sale of Purchaser's current home, payment of any outstanding debt, no material adverse change in Purchaser's financial condition or any other customary conditions, Purchaser accepts the risk that such conditions may not be met; however, a commitment conditioned on the Institutional Lender's approval of an appraisal shall not be deemed a "Commitment" hereunder until an appraisal is approved (and if that does not occur before the Commitment Date, Purchaser may cancel under subparagraph 22(e) unless the Commitment Date is extended). Purchaser's obligations hereunder are conditioned only on issuance of a Commitment. Once a Commitment is issued, Purchaser is bound under this Contract even if the lender fails or refuses to fund the loan for any reason.

(b) Purchaser shall (i) make prompt application to one or, at Purchaser's election, more than one Institutional Lender for such mortgage loan, (ii) furnish accurate and complete information regarding Purchaser and members of Purchaser's family, as required, (iii) pay all fees, points and charges required in connection with such application and loan, (iv) pursue such application with diligence, and (v) cooperate in good faith with such Institutional Lender(s) to obtain a Commitment. Purchaser shall accept a Commitment meeting the terms set forth in subparagraph 22(a) and shall comply with all requirements of such Commitment (or any other commitment accepted by Purchaser). Purchaser shall furnish Seller with a copy of the Commitment promptly after receipt thereof.

(c) *(Delete this subparagraph if inapplicable)* Prompt submission by Purchaser of an application to a mortgage broker registered pursuant to Article 12D of the New York Banking Law (**"Mortgage Broker"**) shall constitute full compliance with the terms and conditions set forth in subparagraph 22(b)(i), provided that such Mortgage Broker promptly submits such application to such Institutional Lender(s). Purchaser shall cooperate in good faith with such Mortgage Broker to obtain a Commitment from such Institutional Lender(s).

(d) If all Institutional Lenders to whom applications were made deny such applications in writing prior to the Commitment Date, Purchaser may cancel this Contract by giving Notice thereof to Seller, with a copy of such denials, provided that Purchaser has complied with all its obligations under this paragraph 22.

(e) If no Commitment is issued by the Institutional Lender on or before the Commitment Date, then, unless Purchaser has accepted a written commitment from an Institutional Lender that does not conform to the terms set forth in subparagraph 22(a), Purchaser may cancel this Contract by giving Notice to Seller within 5 business days after the Commitment Date, provided that such Notice includes the name and address of the Institutional Lender(s) to whom application was made and that Purchaser has complied with all its obligations under this paragraph 22.

(f) If this Contract is canceled by Purchaser pursuant to subparagraphs 22(d) or (e), neither party shall thereafter have any further rights against, or obligations or liabilities to, the other by reason of this Contract, except that the Downpayment shall be promptly refunded to Purchaser and except as set forth in paragraph 21.

(g) If Purchaser fails to give timely Notice of cancellation or if Purchaser accepts a written commitment from an Institutional Lender that does not conform to the terms set forth in subparagraph 22(a), then Purchaser shall be deemed to have waived Purchaser's right to cancel this Contract and to receive a refund of the Downpayment by reason of the contingency contained in this paragraph 22.

(h) If Seller has not received a copy of a commitment from an Institutional Lender accepted by Purchaser by the Commitment Date, Seller may cancel this Contract by giving Notice to Purchaser within 5 business days after the Commitment Date, which cancellation shall become effective unless Purchaser delivers a copy of such commitment to Seller within 10 business days after the Commitment Date. After such cancellation neither party shall have any further rights against, or obligations or liabilities to, the other by reason of this Contract, except that the Downpayment shall be promptly refunded to Purchaser (provided Purchaser has complied with all of its obligations under this paragraph 22) and except as set forth in paragraph 21.

(i) The attorneys for the parties are hereby authorized to give and receive on behalf of their clients all Notices and deliveries under this paragraph 22.

(j) For purposes of this Contract, the term **"Institutional Lender"** shall mean any bank, savings bank, private banker, trust company, savings and loan association, credit union or similar banking institution whether organized under the laws of this state, the United States or any other state; foreign banking corporation licensed by the Superintendent of Banks of New York or regulated by the Comptroller of the Currency to transact business in New York State; insurance company duly organized or licensed to do business in New York State; mortgage banker licensed pursuant to Article 12-D of the Banking Law; and any instrumentality created by the United States or any state with the power to make mortgage loans.

(k) For purposes of subparagraph (a), Purchaser shall be deemed to have been given a fully executed copy of this Contract on the third business day following the date of ordinary or regular mailing, postage prepaid.

23. Gender, Etc.: As used in this Contract, the neuter includes the masculine and feminine, the singular includes the plural and the plural includes the singular, as the context may require.

24. Entire Contract: All prior understandings and agreements between Seller and Purchaser are merged in this Contract and this Contract supersedes any and all understandings and agreements between the parties and constitutes the entire agreement between them with respect to the subject matter hereof.

25. Captions: The captions in this Contract are for convenience and reference only and in no way define, limit or describe the scope of this Contract and shall not be considered in the interpretation of this Contract or any provision hereof.

26. No Assignment by Purchaser: Purchaser may not assign this Contract or any of Purchaser's rights hereunder.

27. Successors and Assigns: Subject to the provisions of para. 26, the provisions of this Contract shall bind and inure to the benefit of both Purchaser and Seller and their respective distributees, executors, administrators, heirs, legal representatives, successors and permitted assigns.

28. No Oral Changes: This Contract cannot be changed or terminated orally. Any changes or additional provisions must be set forth in a rider attached hereto or in a separate written agreement signed by both parties to this Contract.

29. Contract Not Binding Until Signed: This Contract shall not be binding or effective until properly executed and delivered by Seller and Purchaser.

30. Lead-Based Paint: If applicable, the complete and fully executed disclosure of information on lead-based paint and/or lead-based paint hazards is attached hereto and made a part hereof.

In Witness Whereof, the parties hereto have duly executed this Contract on the day and year first above written.

Seller (Soc. Sec. No.)	Purchaser (Soc. Sec. No.)
Seller (Soc. Sec. No.)	Purchaser (Soc. Sec. No.)
Agreed to as to para. 16: _____ Escrowee	Escrow Depository: _____
	Address: _____

SCHEDULE A—Permitted Exceptions

1. Zoning laws and regulations and landmark, historic or wetlands designation which are not violated by the Unit and which are not violated by the Common Elements to the extent that access to or use of the Unit would be materially and adversely affected.

2. Consents for the erection of any structure or structures on, under or above any street or streets on which the Building may abut.

3. The terms, burdens, covenants, restrictions, conditions, easements and rules and regulations set forth in the Declaration, By-Laws and rules and regulations of the Condominium, the Power of Attorney from Purchaser to the board of managers of the Condominium and the floor plans of the Condominium, all as may be amended from time to time.

4. Rights of utility companies to lay, maintain, install and repair pipes, lines, poles, conduits, cable boxes and related equipment on, over and under the Building and Common Elements, provided that none of such rights imposes any monetary obligation on the owner of the Unit or materially interferes with the use of or access to the Unit.

5. Encroachments of stoops, areas, cellar steps, trim, cornices, lintels, window sills, awnings, canopies, ledges, fences, hedges, coping and retaining walls projecting from the Building over any street or highway or over any adjoining property and encroachments of similar elements projecting from adjoining property over the Common Elements.

6. Any state of facts which an accurate survey or personal inspection of the Building, Common Elements or Unit would disclose, provided that such facts do not prevent the use of the Unit for dwelling purposes. For the purposes of this Contract, none of the facts shown on the survey, if any, identified below, shall be deemed to prevent the use of the Unit for dwelling purposes, and Purchaser shall accept title subject thereto.

The survey referred to in No. 6 above was prepared by

dated and last revised .

7. The lien of any unpaid common charge, real estate tax, water charge, sewer rent or vault charge, provided the same are paid or apportioned at the Closing as herein provided.

8. The lien of any unpaid assessments to the extent of installments thereof payable after the Closing.

9. Liens, encumbrances and title conditions affecting the Common Elements which do not materially and adversely affect the right of the Unit owner to use and enjoy the Common Elements.

10. Notes or notices of violations of law or governmental orders, ordinances or requirements (a) affecting the Unit and noted or issued subsequent to the date of this Contract by any governmental department, agency or bureau having jurisdiction and (b) any such notes or notices affecting only the Common Elements which were noted or issued prior to or on the date of this Contract or at any time hereafter.

11. Any other matters or encumbrances subject to which Purchaser is required to accept title to the Unit pursuant to this Contract.

Exhibit 6.2: Sales Contract for a Cooperative

123—Contract of sale cooperative apartment, 7-01
Prepared by The Committee on Condominiums and Cooperatives of the Real Property Section of the New York State Bar Association
Bloomberg Law Reports, Inc., Publisher, NYC 10013
www.bloomberg.com

CONSULT YOUR LAWYER BEFORE SIGNING THIS AGREEMENT

Contract of Sale – Cooperative Apartment

This Contract is made as of between the **"Seller"** and the **"Purchaser"** identified below.

1 Certain Definitions and Information

1.1 The "Parties" are:

1.1.1 "Seller":

Prior names used by Seller:
Address:

S.S. No.:

1.1.2 "Purchaser":

Address:

S.S. No.:

1.2 The "Attorneys" are *(name, address and telephone, fax):*

1.2.1 "Seller's Attorney"

1.2.2 "Purchaser's Attorney"

1.3 The "Escrowee" is the [*Seller's*] [*Purchaser's*] Attorney.

1.4 The Managing Agent is *(name, address and telephone, fax):*

1.5 The real estate "Broker(s)" (see ¶12) is/are:

Company Name:

1.6 The name of the cooperative housing corporation ("Corporation") is:

1.7 The "Unit" number is:

1.8 The Unit is located in "Premises" known as:

1.9 The "Shares" are the shares of the Corporation allocated to the Unit.

1.10 The "Lease" is the Corporation's proprietary lease or occupancy agreement for the Unit, given by the Corporation which expires on

1.11 "Personalty" is the following personal property, to the extent existing in the Unit on the date hereof: the refrigerators, freezers, ranges, ovens, built-in microwave ovens, dishwashers, garbage disposal units, cabinets and counters, lighting fixtures, chandeliers, wall-to-wall carpeting, plumbing and heating fixtures, central air-conditioning and/or window or sleeve units, washing machines, dryers, screens and storm windows, window treatments, switch plates, door hardware, mirrors, built-ins not excluded in ¶ 1.12 and

1.12 Specifically excluded from this sale is all personal property not included in ¶ 1.11 and:

1.13 The sale [*does*] [*does not*] include Seller's interest in [*Storage*]/[*Servant's Rm*]/[*Parking Space*] ("Included Interests")

1.14 The "Closing" is the transfer of ownership of the Shares and Lease.

1.15 The date scheduled for Closing is ("Scheduled Closing Date") at .M (See ¶¶ 9 and 10)

1.16 The "Purchase Price" is: $

1.16.1 The "Contract Deposit" is: $

1.16.2 The "Balance" of the Purchase Price due at Closing is: $ (See ¶ 2.2.2)

1.17 The monthly "Maintenance" charge is $ (See ¶ 4)

1.18 The "Assessment", if any, payable to the Corporation, at the date of this Contract is $, payable as follows:

1.19 [*Seller*] [*Purchaser*] shall pay the Corporation's flip tax, transfer fee (apart from the transfer agent fee) and/or waiver of option fee ("Flip Tax"), if any.

1.20 Financing Options *(Delete **two** of the following ¶¶ 1.20.1, 1.20.2 or 1.20.3)*

1.20.1 Purchaser may apply for financing in connection with this sale and Purchaser's obligation to purchase under this Contract is contingent upon issuance of a Loan Commitment Letter by the Loan Commitment Date (¶ 18.1.2).

1.20.2 Purchaser may apply for financing in connection with this sale but Purchaser's obligation to purchase under this Contract is not contingent upon issuance of a Loan Commitment Letter.

1.20.3 Purchaser shall not apply for financing in connection with this sale.

1.21 If ¶ 1.20.1 or 1.20.2 applies, the "Financing Terms" for ¶ 18 are: a loan of $ for a term of years or such lesser amount or shorter term as applied for or acceptable to

Purchaser; and the "Loan Commitment Date" for ¶ 18 is calendar days after the Delivery Date.

1.22 The "Delivery Date" of this Contract is the date on which a fully executed counterpart of this Contract is deemed given to and received by Purchaser or Purchaser's Attorney as provided in ¶ 17.3.

1.23 All "Proposed Occupants" of the Unit are:

1.23.1 persons and relationship to Purchaser:

1.23.2 pets:

1.24 The Contract Deposit shall be held in [*a non-*] [*an*] IOLA escrow account. If the account is a non-IOLA account then interest shall be paid to the Party entitled to the Contract Deposit. The Party receiving the interest shall pay any income taxes thereon. The escrow account shall be a segregated bank account at

Depository:

Address:

(See ¶ 27)

1.25 This Contract is [*not*] continued on attached rider(s).

2 Agreement to Sell and Purchase; Purchase Price; Escrow

2.1 Seller agrees to sell to Purchaser, and Purchaser agrees to purchase from Seller, the Seller's Shares, Lease, Personalty and any Included Interests and all other items included in this sale, for the Purchase Price and upon the terms and conditions set forth in this Contract.

2.2 The Purchase Price is payable to Seller by Purchaser as follows:

2.2.1 the Contract Deposit at the time of signing this Contract, by Purchaser's good check to the order of Escrowee; and

2.2.2 the Balance at Closing, only by cashier's or official bank check or certified check of Purchaser payable to the direct order of Seller. The check(s) shall be drawn on and payable by a branch of a commercial or savings bank, savings and loan association or trust company located in the same City or County as the Unit. Seller may direct, on reasonable Notice (defined in ¶ 17) prior to Closing, that all or a portion of the Balance shall be made payable to persons other than Seller (see ¶ 17.7).

3 Personalty

3.1 Subject to any rights of the Corporation or any holder of a mortgage to which the Lease is subordinate, this sale includes all of the Seller's interest, if any, in the Personalty and the Included Interests.

3.2 No consideration is being paid for the Personalty or for the Included Interests; nothing shall be sold to Purchaser if the Closing does not occur.

3.3 Prior to Closing, Seller shall remove from the Unit all the furniture, furnishings and other property not included in this sale, and repair any damage caused by such removal.

4 Representations and Covenants

4.1 Subject to any matter affecting title to the Premises (as to which Seller makes no representations or covenants), Seller represents and covenants that:

4.1.1 Seller is, and shall at Closing be, the sole owner of the Shares, Lease, Personalty and Included Interests, with the full right, power and authority to sell and assign them. Seller shall make timely provision to satisfy existing security interest(s) in the Shares and Lease and have the same delivered at Closing (See ¶ 10.1);

4.1.2 the Shares were duly issued, fully paid for and are non-assessable;

4.1.3 the Lease is, and will at Closing be, in full force and effect and no notice of default under the Lease is now or will at Closing be in effect;

4.1.4 the Maintenance and Assessments payable as of the date hereof are as specified in ¶ 1.17 and 1.18;

4.1.5 as of this date, Seller neither has actual knowledge nor has received any written notice of any increase in Maintenance or any Assessment which has been adopted by the Board of Directors of the Corporation and is not reflected in the amounts set forth in ¶¶ 1.17 and 1.18;

4.1.6 Seller has not made any material alterations or additions to the Unit without any required consent of the Corporation or, to Seller's actual knowledge, without compliance with all applicable law. This provision shall not survive Closing.

4.1.7 Seller has not entered into, shall not enter into, and has no actual knowledge of any agreement (other than the Lease) affecting title to the Unit or its use and/or occupancy after Closing, or which would be binding on or adversely affect Purchaser after Closing (e.g. a sublease or alteration agreement);

4.1.8 Seller has been known by no other name for the past 10 years except as set forth in ¶ 1.1.1.

4.1.9 at Closing in accordance with ¶ 15.2:

4.1.9.1 there shall be no judgments outstanding against Seller which have not been bonded against collection out of the Unit ("Judgments");

4.1.9.2 the Shares, Lease, Personalty and any Included Interests shall be free and clear of liens (other than the Corporation's general lien on the Shares for which no monies shall be owed), encumbrances and adverse interests ("Liens");

4.1.9.3 all sums due to the Corporation shall be fully paid by Seller to the end of the payment period immediately preceding the date of Closing;

4.1.9.4 Seller shall not be indebted for labor or material which might give rise to the filing of a notice of mechanic's lien against the Unit or the Premises; and

4.1.9.5 no violations shall be of record which the owner of the Shares and Lease would be obligated to remedy under the Lease.

4.2 Purchaser represents and covenants that:

4.2.1 Purchaser is acquiring the Shares and Lease for residential occupancy of the Unit solely by the Proposed Occupants identified in ¶ 1.23

4.2.2 Purchaser is not, and within the past 7 years has not been, the subject of a bankruptcy proceeding;

4.2.3 if ¶ 1.20.3 applies, Purchaser shall not apply for financing in connection with this purchase.

4.2.4 Each individual comprising Purchaser is over the age of 18 and is purchasing for Purchaser's own account (beneficial and of record);

4.2.5 Purchaser shall not make any representations to the Corporation contrary to the foregoing and shall provide all documents in support thereof required by the Corporation in connection with Purchaser's application for approval of this transaction; and

4.2.6 there are not now and shall not be at Closing any unpaid tax liens or monetary judgments against Purchaser.

4.3 Each Party covenants that its representations and covenants contained in ¶ 4 shall be true and complete at Closing and, except for ¶ 4.1.6, shall survive Closing but any action based thereon must be instituted within one year after Closing.

5 Corporate Documents

Purchaser has examined and is satisfied with, or (except as to any matter represented in this Contract by Seller) accepts and assumes the risk of not having examined, the Lease, the Corporation's Certificate of Incorporation, By-laws, House Rules, minutes of shareholders' and directors' meetings, most recent audited financial statement and most recent statement of tax deductions available to the Corporation's shareholders under Internal Revenue Code ("IRC") §216 (or any successor statute).

6 Required Approval and References

6.1 This sale is subject to the unconditional consent of the Corporation.

6.2 Purchaser shall in good faith:

6.2.1 submit to the Corporation or the Managing Agent an application with respect to this sale on the form required by the Corporation, containing such data and together with such documents as the Corporation requires, and pay the applicable fees and charges that the Corporation imposes upon Purchaser. All of the foregoing shall be submitted within 10 business days after the Delivery Date, or, if ¶ 1.20.1 or 1.20.2 applies and the Loan Commitment Letter is required by the Corporation, within 3 business days after the earlier of (i) the Loan Commitment Date (defined in ¶ 1.21) or (ii) the date of receipt of the Loan Commitment Letter (defined in ¶ 18.1.2);

6.2.2 attend (and cause any Proposed Occupant to attend) one or more personal interviews, as requested by the Corporation; and

6.2.3 promptly submit to the Corporation such further references, data and documents reasonably requested by the Corporation.

6.3 Either Party, after learning of the Corporation's decision, shall promptly advise the other Party thereof. If the Corporation has not made a decision on or before the Scheduled Closing Date, the Closing shall be adjourned for 30 business days for the purpose of obtaining such consent. If such consent is not given by such adjourned date, either Party may cancel this Contract by Notice, provided that the Corporation's consent is not issued before such Notice of cancellation is given. If such consent is refused at any time, either Party may cancel this Contract by Notice. In the event of cancellation pursuant to this ¶ 6.3, the Escrowee shall refund the Contract Deposit to Purchaser.

6.4 If such consent is refused, or not given, due to Purchaser's bad faith conduct, Purchaser shall be in default and ¶ 13.1 shall govern.

7 Condition of Unit and Personalty; Possession

7.1 Seller makes no representation as to the physical condition or state of repair of the Unit, the Personalty, the Included Interests or the Premises. Purchaser has inspected or waived inspection of the Unit, the Personalty and the Included Interests and shall take the same "as is", as of the date of this Contract, except for reasonable wear and tear. However, at the time of Closing, the appliances shall be in working order and required smoke detector(s) shall be installed and operable.

7.2 At Closing, Seller shall deliver possession of the Unit, Personalty and Included Interests in the condition required by ¶ 7.1, broom-clean, vacant and free of all occupants and rights of possession.

8 Risk of Loss

8.1 The provisions of General Obligations Law Section 5-1311, as modified herein, shall apply to this transaction as if it were a sale of realty. For purposes of this paragraph, the term "Unit" includes built-in Personalty.

8.2 Destruction shall be deemed "material" under GOL 5-1311, if the reasonably estimated cost to restore the Unit shall exceed 5% of the Purchase Price.

8.3 In the event of any destruction of the Unit or the Premises, when neither legal title nor the possession of the Unit has been transferred to Purchaser, Seller shall give Notice of the loss to Purchaser ("Loss Notice") by the earlier of the date of Closing or 7 business days after the date of the loss.

8.4 If there is material destruction of the Unit without fault of Purchaser, this Contract shall be deemed canceled in accordance with ¶ 16.3, unless Purchaser elects by Notice to Seller to complete the purchase with an abatement of the Purchase Price; or

8.5 Whether or not there is any destruction of the Unit, if, without fault of Purchaser, more than 10% of the units in the Premises are rendered uninhabitable, or reasonable access to the Unit is not available, then Purchaser shall have the right to cancel this Contract in accordance with ¶ 16.3 by Notice to Seller.

8.6 Purchaser's Notice pursuant to ¶ 8.4 or ¶ 8.5 shall be given within 7 business days following the giving of the Loss Notice except that if Seller does not give a Loss Notice, Purchaser's Notice may be given at any time at or prior to Closing

8.7 In the event of any destruction of the Unit, Purchaser shall not be entitled to an abatement of the Purchase Price (i) that exceeds the reasonably estimated cost of repair and restoration or (ii) for any loss that the Corporation is obliged to repair or restore; but Seller shall assign to Purchaser, without recourse, Seller's claim, if any, against the Corporation with respect to such loss.

9 Closing Location

The Closing shall be held at the location designated by the Corporation or, if no such designation is made, at the office of Seller's Attorney.

10 Closing

10.1 At Closing, Seller shall deliver or cause to be delivered:

10.1.1 Seller's certificate for the Shares duly endorsed for transfer to Purchaser or accompanied by a separate duly executed stock power to Purchaser, and in either case, with any guarantee of Seller's signature required by the Corporation;

10.1.2 Seller's counterpart original of the Lease, all assignments and assumptions in the chain of title and a duly executed assignment thereof to Purchaser in the form required by the Corporation;

10.1.3 FIRPTA documents required by ¶ 25;

10.1.4 keys to the Unit, building entrance(s), and, if applicable, garage, mailbox, storage unit and any locks in the Unit;

10.1.5 if requested, an assignment to Purchaser of Seller's interest in the Personalty and Included Interests;

10.1.6 any documents and payments to comply with ¶ 15.2

10.1.7 If Seller is unable to deliver the documents required in ¶ 10.1.1 or 10.1.2 then Seller shall deliver or cause to be delivered all documents and payments required by the Corporation for the issuance of a new certificate for the Shares or a new Lease.

10.2 At Closing, Purchaser shall:

10.2.1 pay the Balance in accordance with ¶ 2.2.2;

10.2.2 execute and deliver to Seller and the Corporation an agreement assuming the Lease, in the form required by the Corporation; and

10.2.3 if requested by the Corporation, execute and deliver counterparts of a new lease substantially the same as the Lease, for the balance of the Lease term, in which case the Lease shall be canceled and surrendered to the Corporation together with Seller's assignment thereof to Purchaser.

10.3 At Closing, the Parties shall complete and execute all documents necessary:

10.3.1 for Internal Revenue Service ("IRS") form 1099-S or other similar requirements;

10.3.2 to comply with smoke detector requirements and any applicable transfer tax filings; and

10.3.3 to transfer Seller's interest, if any, in and to the Personalty and Included Interests.

10.4 Purchaser shall not be obligated to close unless, at Closing, the Corporation delivers:

10.4.1 to Purchaser a new certificate for the Shares in the name of Purchaser; and

10.4.2 a written statement by an officer or authorized agent of the Corporation consenting to the transfer of the Shares and Lease to Purchaser and setting forth the amounts of and payment status of all sums owed by Seller to the Corporation, including Maintenance and any Assessments, and the dates to which each has been paid.

11 Closing Fees, Taxes and Apportionments

11.1 At or prior to Closing,

11.1.1 Seller shall pay, if applicable:

11.1.1.1 the cost of stock transfer stamps; and

11.1.1.2 transfer taxes, except as set forth in ¶ 11.1.2.2

11.1.2 Purchaser shall pay, if applicable:

11.1.2.1 any fee imposed by the Corporation relating to Purchaser's financing; and

11.1.2.2 transfer taxes imposed by statute primarily on Purchaser (e.g., the "mansion tax").

11.2 The Flip Tax, if any, shall be paid by the Party specified in ¶ 1.19.

11.3 Any fee imposed by the Corporation and not specified in this Contract shall be paid by the Party upon whom such fee is expressly imposed by the Corporation, and if no Party is specified by the Corporation, then such fee shall be paid by Seller.

11.4 The Parties shall apportion as of 11:59 P.M. of the day preceding the Closing, the Maintenance, and any other periodic charges due the Corporation (other than Assessments) and STAR Tax Exemption (if the Unit is the beneficiary of same), based on the number of the days in the month of Closing.

11.5 Assessments, whether payable in a lump sum or installments, shall not be apportioned, but shall be paid by the Party who is the owner of the Shares on the date specified by the Corporation for payment. Purchaser shall pay any installments payable after Closing provided Seller had the right and elected to pay the Assessment in installments.

11.6 Each Party shall timely pay any transfer taxes for which it is primarily liable pursuant to law by cashier's, official bank, certified, or attorney's escrow check. This ¶ 11.6 shall survive Closing.

11.7 Any computational errors or omissions shall be corrected within 6 months after Closing. This ¶ 11.7 shall survive Closing.

12 Broker

12.1 Each Party represents that such Party has not dealt with any person acting as a broker, whether licensed or unlicensed, in connection with this transaction other than the Broker(s) named in ¶ 1.5.

12.2 Seller shall pay the Broker's commission pursuant to a separate

agreement. The Broker(s) shall not be deemed to be a third-party beneficiary of this Contract.

12.3 This ¶ 12 shall survive Closing, cancellation or termination of this Contract.

13 Defaults, Remedies and Indemnities

13.1 In the event of a default or misrepresentation by Purchaser, Seller's sole and exclusive remedies shall be to cancel this Contract, retain the Contract Deposit as liquidated damages and, if applicable, Seller may enforce the indemnity in ¶ 13.3 as to brokerage commission or sue under ¶ 13.4. Purchaser prefers to limit Purchaser's exposure for actual damages to the amount of the Contract Deposit, which Purchaser agrees constitutes a fair and reasonable amount of compensation for Seller's damages under the circumstances and is not a penalty. The principles of real property law shall apply to this liquidated damages provision.

13.2 In the event of a default or misrepresentation by Seller, Purchaser shall have such remedies as Purchaser is entitled to at law or in equity, including specific performance, because the Unit and possession thereof cannot be duplicated.

13.3 Subject to the provisions of ¶ 4.3, each Party indemnifies and holds harmless the other against and from any claim, judgment, loss, liability, cost or expense resulting from the indemnitor's breach of any of its representations or covenants stated to survive Closing, cancellation or termination of this Contract. Purchaser indemnifies and holds harmless Seller against and from any claim, judgment, loss, liability, cost or expense resulting from the Lease obligations accruing from and after the Closing. Each indemnity includes, without limitation, reasonable attorneys' fees and disbursements, court costs and litigation expenses arising from the defense of any claim and enforcement or collection of a judgment under this indemnity, provided the indemnitee is given Notice and opportunity to defend the claim. This ¶ 13.3 shall survive Closing, cancellation or termination of this Contract.

13.4 In the event any instrument for the payment of the Contract Deposit fails of collection, Seller shall have the right to sue on the uncollected instrument. In addition, such failure of collection shall be a default under this Contract, provided Seller gives Purchaser Notice of such failure of collection and, within 3 business days after Notice is given, Escrowee does not receive from Purchaser an unendorsed good certified check, bank check or immediately available funds in the amount of the uncollected funds. Failure to cure such default shall entitle Seller to the remedies set forth in ¶ 13.1 and to retain all sums as may be collected and/or recovered.

14 Entire Agreement; Modification

14.1 All prior oral or written representations, understandings and agreements had between the Parties with respect to the subject matter of this Contract, and with the Escrowee as to ¶ 27, are merged in this Contract, which alone fully and completely expresses the Parties' and Escrowee's agreement.

14.2 The Attorneys may extend in writing any of the time limitations stated in this Contract. Any other provision of this Contract may be changed or waived only in writing signed by the Party or Escrowee to be charged.

15 Removal of Liens and Judgments

15.1 Purchaser shall deliver or cause to be delivered to Seller or Seller's Attorney, not less than 10 calendar days prior to the Scheduled Closing Date a Lien and Judgment search, except that Liens or Judgments first disclosed in a continuation search shall be reported to Seller within 2 business days after receipt thereof, but not later than the Closing. Seller shall have the right to adjourn the Closing pursuant to ¶ 16 to remove any such Liens and Judgments. Failure by Purchaser to timely deliver such search or continuation search shall not constitute a waiver of Seller's covenants in ¶ 4 as to Liens and Judgments. However, if the Closing is adjourned solely by reason of untimely delivery of the Lien and Judgment search, the apportionments under ¶ 11.3 shall be made as of 11:59 P.M. of the day preceding the Scheduled Closing Date in ¶ 1.15.

15.2 Seller, at Seller's expense, shall obtain and deliver to the Purchaser the documents and payments necessary to secure the release, satisfaction, termination and discharge or removal of record of any Liens and Judgments. Seller may use any portion of the Purchase Price for such purposes.

15.3 This ¶ 15 shall survive Closing.

16 Seller's Inability

16.1 If Seller shall be unable to transfer the items set forth in ¶ 2.1 in accordance with this Contract for any reason other than Seller's failure to make a required payment or other willful act or omission, then Seller shall have the right to adjourn the Closing for periods not exceeding 60 calendar days in the aggregate, but not extending beyond the expiration of Purchaser's Loan Commitment Letter, if ¶ 1.20.1 or 1.20.2 applies.

16.2 If Seller does not elect to adjourn the Closing or (if adjourned) on the adjourned date of Closing Seller is still unable to perform, then unless Purchaser elects to proceed with the Closing without abatement of the Purchase Price, either Party may cancel this Contract on Notice to the other Party given at any time thereafter.

16.3 In the event of such cancellation, the sole liability of Seller shall be to cause the Contract Deposit to be refunded to Purchaser and to reimburse Purchaser for the actual costs incurred for Purchase's lien and title search, if any.

17 Notices and Contract Delivery

17.1 Any notice or demand ("Notice") shall be in writing and delivered either by hand, overnight delivery or certified or registered mail, return receipt requested, to the Party and simultaneously, in like manner, to such Party's Attorney, if any, and to Escrowee at their respective addresses or to such other address as shall hereafter be designated by Notice given pursuant to this ¶ 17.

17.2 The Contract may be delivered as provided in ¶ 17.1 or by ordinary mail.

17.3 The Contract or each Notice shall be deemed given and received:

17.3.1 on the day delivered by hand;

17.3.2 on the business day following the date sent by overnight delivery;

17.3.3 on the 5th business day following the date sent by certified or registered mail; or

17.3.4 as to the Contract only, 3 business days following the date of ordinary mailing.

17.4 A Notice to Escrowee shall be deemed given only upon actual receipt by Escrowee.

17.5 The Attorneys are authorized to give and receive any Notice on behalf of their respective clients.

17.6 Failure or refusal to accept a Notice shall not invalidate the Notice.

17.7 Notice pursuant to ¶¶ 2.2.2 and 13.4 may be delivered by confirmed facsimile to the Party's Attorney and shall be deemed given when transmission is confirmed by sender's facsimile machine.

18 Financing Provisions

18.1 The provisions of ¶¶ 18.1 and 18.2 are applicable only if ¶ 1.20.1 or 1.20.2 applies.

18.1.1 An "Institutional Lender" is any of the following that is authorized under Federal or New York State law to issue a loan secured by the Shares and Lease and is currently extending similarly secured loan commitments in the county in which the Unit is located: a bank, savings bank, savings and loan association, trust company, credit union of which Purchaser is a member, mortgage banker, insurance company or governmental entity.

18.1.2 A "Loan Commitment Letter" is a written offer from an Institutional Lender to make a loan on the Financing Terms (see ¶ 1.21) at prevailing fixed or adjustable interest rates and on other customary terms generally being offered by Institutional Lenders making cooperative share loans. An offer to make a loan conditional upon obtaining an appraisal satisfactory to the Institutional Lender shall not become a Loan Commitment Letter unless and until such condition is met. An offer conditional upon any factor concerning Purchaser (e.g. sale of current home, payment of outstanding debt, no material adverse change in Purchaser's financial condition, etc.) is a Loan Commitment Letter whether or not such condition is met. Purchaser accepts the risk that, and cannot cancel this Contract if, any condition concerning Purchaser is not met.

18.2 Purchaser, directly or through a mortgage broker registered pursuant to Article 12-D of the Banking Law, shall diligently and in good faith:

18.2.1 apply only to an Institutional Lender for a loan on

the Financing Terms (see ¶ 1.21) on the form required by the Institutional Lender containing truthful and complete information, and submit such application together with such documents as the Institutional Lender requires, and pay the applicable fees and charges of the Institutional Lender, all of which shall be performed within 5 business days after the Delivery Date;

18.2.2 promptly submit to the Institutional Lender such further references, data and documents requested by the Institutional Lender; and

18.2.3 accept a Loan Commitment Letter meeting the Financing Terms and comply with all requirements of such Loan Commitment Letter (or any other loan commitment letter accepted by Purchaser) and of the Institutional Lender in order to close the loan; and

18.2.4 furnish Seller with a copy of the Loan Commitment Letter promptly after Purchaser's receipt thereof.

18.2.5 Purchaser is not required to apply to more than one Institutional Lender.

18.3 If ¶ 1.20.1 applies, then

18.3.1 provided Purchaser has complied with all applicable provisions of ¶ 18.2 and this ¶ 18.3, Purchaser may cancel this Contract as set forth below, if:

18.3.1.1 any Institutional Lender denies Purchaser's application in writing prior to the Loan Commitment Date (see ¶ 1.21); or

18.3.1.2 a Loan Commitment Letter is not issued by the Institutional Lender on or before the Loan Commitment Date; or

18.3.1.3 any requirement of the Loan Commitment Letter other than one concerning Purchaser is not met (e.g. failure of the Corporation to execute and deliver the Institutional Lender's recognition agreement or other document, financial condition of the Corporation, owner occupancy quota, etc.); or

18.3.1.4 (i) the Closing is adjourned by Seller or the Corporation for more than 30 business days from the Scheduled Closing Date and (ii) the Loan Commitment Letter expires on a date more than 30 business days after the Scheduled Closing Date and before the new date set for Closing pursuant to this paragraph and (iii) Purchaser is unable in good faith to obtain from the Institutional Lender an extension of the Loan Commitment Letter or a new Loan Commitment Letter on the Financing Terms without paying additional fees to the Institutional Lender, unless Seller agrees, by Notice to Purchaser within 5 business days after receipt of Purchaser's Notice of cancellation on such ground, that Seller will pay such additional fees and Seller pays such fees when due. Purchaser may not object to an adjournment by Seller for up to 30 business days solely because the Loan Commitment Letter would expire before such adjourned Closing date.

18.3.2 Purchaser shall deliver Notice of cancellation to Seller within 5 business days after the Loan Commitment Date if cancellation is pursuant to ¶ 18.3.1.1 or 18.3.1.2 and on or prior to the Scheduled Closing Date if cancellation is pursuant to ¶ 18.3.1.3 or 18.3.1.4.

18.3.3 If cancellation is pursuant to ¶ 18.3.1.1, then Purchaser shall deliver to Seller, together with Purchaser's Notice, a copy of the Institutional Lender's written denial of Purchaser's loan application. If cancellation is pursuant to ¶ 18.3.1.3, then Purchaser shall deliver to Seller together with Purchaser's Notice evidence that a requirement of the Institutional Lender was not met.

18.3.4 Seller may cancel this Contract by Notice to Purchaser, sent within 5 days after the Loan Commitment Date, if Purchaser shall not have sent by then either (i) Purchaser's Notice of cancellation or (ii) a copy of the Loan Commitment Letter to Seller, which cancellation shall become effective if Purchaser does not deliver a copy of such Loan Commitment Letter to Seller within 10 business days after the Loan Commitment Date.

18.3.5 Failure by either Purchaser or Seller to deliver Notice of cancellation as required by this ¶ 18.3 shall constitute a waiver of the right to cancel under this ¶ 18.3.

18.3.6 If this Contract is canceled by Purchaser pursuant to this ¶ 18.3, then thereafter neither Party shall have any further rights against, or obligations or liabilities to, the other by reason of this Contract, except that the Contract Deposit shall be promptly refunded to Purchaser and except as set forth in ¶ 12. If this Contract is canceled by Purchaser pursuant to ¶ 18.3.1.4, then Seller shall reimburse Purchaser for any non-refundable financing and inspection expenses and other sums reimbursable pursuant to ¶ 16.

18.3.7 Purchaser cannot cancel this Contract pursuant to ¶ 18.3.1.4 and cannot obtain a refund of the Contract Deposit if the Institutional Lender fails to fund the loan:

18.3.7.1 because a requirement of the Loan Commitment Letter concerning Purchaser is not met (e.g., Purchaser's financial condition or employment status suffers an adverse change; Purchaser fails to satisfy a condition relating to the sale of an existing residence, etc.) or

18.3.7.2 due to the expiration of a Loan Commitment Letter issued with an expiration date that is not more than 30 business days after the Scheduled Closing Date.

19 Singular/Plural and Joint/Several

The use of the singular shall be deemed to include the plural and vice versa, whenever the context so requires. If more than one person constitutes Seller or Purchaser, their obligations as such Party shall be joint and several.

20 No Survival

No representation and/or covenant contained herein shall survive Closing except as expressly provided. Payment of the Balance shall constitute a discharge and release by Purchaser of all of Seller's obligations hereunder except those expressly stated to survive Closing.

21 Inspections

Purchaser and Purchaser's representatives shall have the right to inspect the Unit within 48 hours prior to Closing, and at other reasonable times upon reasonable request to Seller.

22 Governing Law and Venue

This Contract shall be governed by the laws of the State of New York without regard to principles of conflict of laws. Any action or proceeding arising out of this Contract shall be brought in the county or Federal district where the Unit is located and the Parties hereby consent to said venue.

23 No Assignment by Purchaser; Death of Purchaser

23.1 Purchaser may not assign this Contract or any of Purchaser's rights hereunder. Any such purported assignment shall be null and void.

23.2 This Contract shall terminate upon the death of all persons comprising Purchaser and the Contract Deposit shall be refunded to the Purchaser. Upon making such refund and reimbursement, neither Party shall have any further liability or claim against the other hereunder, except as set forth in Par. 12.

24 Cooperation of Parties

24.1 The Parties shall each cooperate with the other, the Corporation and Purchaser's Institutional Lender and title company, if any, and obtain, execute and deliver such documents as are reasonably necessary to consummate this sale.

24.2 The Parties shall timely file all required documents in connection with all governmental filings that are required by law. Each Party represents to the other that its statements in such filings shall be true and complete. This ¶ 24.2 shall survive Closing.

25 FIRPTA

The parties shall comply with IRC §§ 897, 1445 and the regulations thereunder as same may be amended ("FIRPTA"). If applicable, Seller shall execute and deliver to purchaser at Closing a Certification of Non-Foreign Status ("CNS") or deliver a Withholding Certificate from the IRS. If Seller fails to deliver a CNS or a Withholding Certificate, Purchaser shall withhold from the Balance, and remit to the IRS, such sum as may be required by law. Seller hereby waives any right of action against Purchaser on account of such withholding and remittance. This ¶ 25 shall survive Closing.

26 Additional Requirements

26.1 Purchaser shall not be obligated to close unless all of the following requirements are satisfied at the time of the Closing:

26.1.1 the Corporation is in good standing;

26.1.2 the Corporation has fee or leasehold title to the Premises, whether or not marketable or insurable; and

26.1.3 there is no pending *in rem* action, tax certificate/lien sale or foreclosure action of any underlying mortgage affecting the Premises.

26.2 If any requirement in ¶ 26.1 is not satisfied at the time of the Closing, Purchaser shall give Seller Notice and if the same is not satisfied within a reasonable period of time thereafter, then either Party may cancel this Contract (pursuant to ¶ 16.3) by Notice.

27 Escrow Terms

27.1 The Contract Deposit shall be deposited by Escrowee in an escrow account as set forth in ¶ 1.24 and the proceeds held and disbursed in accordance with the terms of this Contract. At Closing, the Contract Deposit shall be paid by Escrowee to Seller. If the Closing does not occur and either Party gives Notice to Escrowee demanding payment of the Contract Deposit, Escrowee shall give prompt Notice to the other Party of such demand. If Escrowee does not receive a Notice of objection to the proposed payment from such other Party within 10 business days after the giving of Escrowee's Notice, Escrowee is hereby authorized and directed to make such payment to the demanding party. If Escrowee does receive such a Notice of objection within said period, or if for any reason Escrowee in good faith elects not to make such payment, Escrowee may continue to hold the Contract Deposit until otherwise directed by a joint Notice by the Parties or a final, non-appealable judgment, order or decree of a court of competent jurisdiction. However, Escrowee shall have the right at any time to deposit the Contract Deposit and the interest thereon, if any, with the clerk of a court in the county as set forth in ¶ 22 and shall give Notice of such deposit to each Party. Upon disposition of the Contract Deposit and interest thereon, if any, in accordance with this ¶ 27, Escrowee shall be released and discharged of all escrow obligations and liabilities.

27.2 The Party whose Attorney is Escrowee shall be liable for loss of the Contract Deposit. If the Escrowee is Seller's attorney, then Purchaser shall be credited with the amount of the contract Deposit at Closing.

27.3 Escrowee will serve without compensation. Escrowee is acting solely as a stakeholder at the Parties' request and for their convenience. Escrowee shall not be liable to either Party for any act or omission unless it involves bad faith, willful disregard of this Contract or gross negligence. In the event of any dispute, Seller and Purchaser shall jointly and severally (with right of contribution) defend (by attorneys selected by Escrowee), indemnify and hold harmless Escrowee from and against any claim, judgment, loss, liability, cost and expenses incurred in connection with the performance of Escrowee's acts or omissions not involving bad faith, willful disregard of this Contract or gross negligence. This indemnity includes, without limitation, reasonable attorneys' fees either paid to retain attorneys or representing the fair value of legal services rendered by Escrowee to itself and disbursements, court costs and litigation expenses.

27.4 Escrowee acknowledges receipt of the Contract Deposit, by check subject to collection.

27.5 Escrowee agrees to the provisions of this ¶ 27.

27.6 If Escrowee is the Attorney for a Party, Escrowee shall be permitted to represent such Party in any dispute or lawsuit.

27.7 This ¶ 27 shall survive Closing, cancellation or termination of this Contract.

28 Margin Headings

The margin headings do not constitute part of the text of this Contract.

29 Miscellaneous

This Contract shall not be binding unless and until Seller delivers a fully executed counterpart of this Contract to Purchaser (or Purchaser's Attorney) pursuant to ¶17.2 and 17.3. This Contract shall bind and inure to the benefit of the Parties hereto and their respective heirs, personal and legal representatives and successors in interest.

30 Lead Paint

If applicable, the complete and fully executed Disclosure of Information on Lead Based Paint and or Lead-Based Paint Hazards is attached hereto and made a part hereof.

In Witness Whereof, the Parties hereto have duly executed this Contract as of the date first above written.

ESCROW TERMS AGREED TO:	SELLER:	PURCHASER:
_____	_____	_____
ESCROWEE	_____	_____

Rider to, and Part of, Contract of Sale Between **as Seller**
and **as Purchaser for Unit** **at**

Suggested Purchaser's representations for use when applicable.

31 Purchaser's Additional Representations and Covenants

31.1 Supplementing ¶ 4.2 of the Contract. Purchaser also represents and covenants that:

31.1.1 Purchaser has, and will at Closing have, available unencumbered cash and cash equivalents (including publicly traded securities) in a sum at least equal to (and having a then current value of) the Balance; and

31.1.2 Purchaser has, and will at and immediately following the Closing have, a positive net worth.

31.2 the Maintenance and the monthly amount of the Assessment (if any) do not aggregate more than 25% of the current total gross monthly income of the individuals comprising the Purchaser;

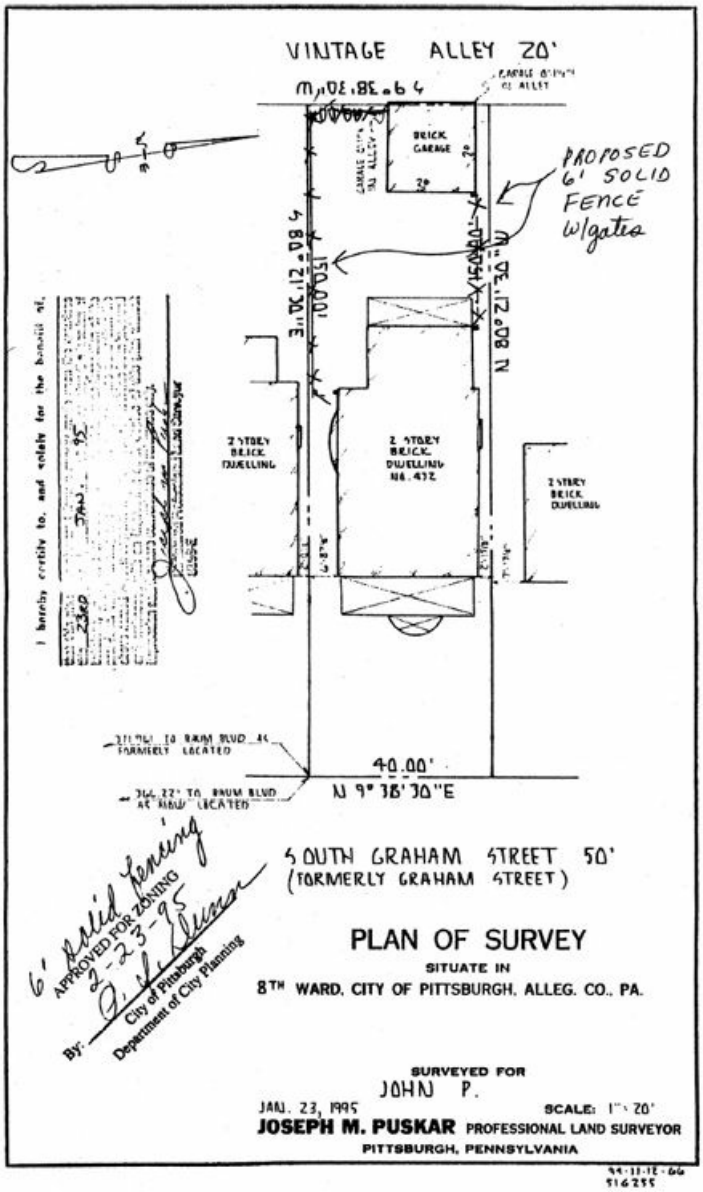
31.3 (if ¶ 1.20.1 or ¶ 1.20.2 applies) the monthly debt service (interest and amortization of principal, if any) of the proposed financing, together with the Maintenance and the monthly Assessment amount (if any), do not aggregate more than 35% of said current total gross monthly income.

32 Supplementing paragraph 4.1. Seller has no actual knowledge of a material default or condition which the Lessee is required to cure under the Lease and which remains uncured. If, prior to Closing, Seller acquires knowledge of a such default or condition which the Lessee would be required to cure, then Seller shall cure same at or prior to Closing. This provision shall not survive closing.

The Parties have duly executed this Rider as of the same date as the Contract.

SELLER:	PURCHASER:
_____	_____
_____	_____

Exhibit 6.3: Land Description of a Commercial Property



---

4. The rent control prohibition act took effect on January 1, 1995. St. 1994, c. 368, §2.

5. Statute 1994, c. 282, §3(*e*) provides:

> "(e) 'Rent Control' means any controls, restrictions or other regulations imposed *by any city or town* with respect to the rents which may be charged for any residential housing accommodations, the conversion of such housing accommodations to the condominium or [***6] cooperative form of ownership, or the removal of such housing accommodations from the rental market, including without limitation those regulatory schemes currently in effect in…[Boston, Brookline, and Cambridge] pursuant to…[various acts], *but excluding Chapter 527 of the Acts of 1983* [the condominium conversion statute]" (emphasis supplied).

6. As noted in the Declaration of Emergency to the condominium conversion act:

"[A] serious public emergency exists…with respect to the housing of a substantial number of the citizens of the commonwealth. This rental housing emergency has been created by [inter alia]…the effect of conversion of rental housing into condominiums.…[A]bsent sufficient new rental housing production, such conversion necessarily reduces the stock of rental housing otherwise available. A substantial and increasing shortage of rental housing accommodations, especially for the elderly, the handicapped, and persons and families of low and moderate income, has been and will continue to be the result of this emergency.…It is therefore necessary that such emergency be dealt with immediately." St. 1983, c. 527, §1.

Similarly, the rent control prohibition act declares:

"The purpose of this chapter is to establish a uniform statewide policy that broadly prohibits any regulatory scheme based upon or implementing rent control.…This policy is based on the belief that the public is best served by free-market rental rates for residential properties and by unrestricted home ownership." St. 1994, c. 368, §2.

7. Statute 1983, c. 527, §4(*e*), permits a landlord to impose reasonable cost of living rent increases during the applicable notice period, but limits such increases to increases in the consumer price index. Absent such limitation, a landlord might well impose rent increases in an amount designed to displace tenants during the conversion period and thwart the purposes of the condominium conversion act.

7 Landlord-Tenant Law

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Explain the concept of a leasehold
- Define "lessor" and "lessee"
- Explain a tenancy for years
- Understand the landlord's right of reentry
- Explain a periodic tenancy
- Discuss a tenancy at will
- Define a tenancy at sufferance
- Discuss implications of the holdover doctrine
- List the different types of rent arrangements that may exist
- Explain what is meant by a "radius clause" in a lease
- Discuss a tenant's duties with respect to a leasehold
- Define "mitigation of damages"
- Discuss a landlord's duties with respect to a leasehold
- List the different types of evictions to which a tenant may be subject
- Explain the concept of a warranty of habitability
- Differentiate an assignment from a sublease
- Apply some practical tips to assist you in a landlord-tenant practice

CHAPTER OUTLINE

CHAPTER OVERVIEW

As explained in Chapter 1, property is divided into two broad categories: freeholds and leaseholds. The preceding chapters concentrated on various aspects of freehold estates; this chapter focuses on the second group of estates—the leasehold.

A **leasehold** is a possessory interest in property, either real or personal, that is created and governed by the terms of a lease. A **lease** is the contract that establishes the possessory rights and obligations and, for the most part, is governed by general contract law. Various aspects of contract law have been discussed in earlier chapters and a detailed examination of the law of contracts is beyond the scope of this text. However, the legal professional must always be cognizant of the fact that the rights and obligations of the lessor and the lessee are determined by the provisions of the lease.

This chapter highlights the various types of leasehold arrangements that may exist, as well as the rights (and responsibilities) of both the landlord and the tenant. Note that personal property as well as real property can be subject to lease arrangements.

The Lease

A *lease* is a contract that establishes the relationship between the lessor and the lessee. The **lessor** is the person who has rights in the subject property sufficient to permit him or her to transfer a right of possession. The **lessee** is the person who contracts for the right of possession of the leased property. It must be borne in mind that the lessee, as such, only acquires a possessory right in the property.

 EXAMPLE:

A widow decides to take a one-year trip around the world and to let her house for that period. The widow owns the house as a tenant in severalty, which gives her the right to transfer any estate up to the one she has to another person. She rents her house for the one-year period to a middle-aged couple who, pursuant to the terms of the lease, have the right to use and enjoy the house for the year, but they do not "own" the house, and the lease has prohibitions against the couple transferring their interests (see below).

If the property that is subject to the lease is realty, it is referred to as a *leasehold;* leases of personalty are referred to simply as leases.

Generally, there are four types of leaseholds that may be created:

1. **Tenancy for years:** These tenancies are created for a fixed period of time. If the leasehold period is intended to exist for more than one year, the Statute of Frauds requires that the lease be in writing to

be enforceable, and the lease automatically terminates at the date specified in the lease. Furthermore, most jurisdictions permit the landlord to retain a **right of entry** to gain access to the premises in the event the tenant breaches any of the lease covenants. **Landlord** is the term generally employed to refer to the lessor of realty.

 **EXAMPLE:**

A student has enrolled in a law school in a city several hundred miles from her home. She enters into a lease for an apartment near the school for a term of three years. At the end of three years the lease will automatically terminate.

A tenancy for years may be terminated by the landlord earlier than the termination date if the tenant fails to pay the specified rent (see below), or the tenant may surrender the property to the landlord prior to the expiration of the lease, which will excuse further obligations *if* the landlord accepts such early termination. The rights of early termination depend on the specific jurisdiction in which the property is located.

2. **Periodic tenancy:** This type of lease continues for successive periods specified in the lease until terminated by notice of either party. Periodic tenancies may be created by:
   (a) an express agreement;
   (b) implication, if the lease specifies a monthly or weekly rental and no specific termination; and
   (c) operation of law if a tenant remains in possession after the termination of a tenancy for years.

Periodic tenancies typically remain in effect until one party informs the other of its termination.

 **EXAMPLE:**

A student rents an apartment for a one-year lease for a yearly rental of $6000, payable in monthly installments of $500. At the termination of the lease the student does not leave, and the landlord continues to accept the student's rent check of $500 for each of the next three months. After the third month the landlord sends the student a notice of termination to be effective at the end of the current month. The tenancy for years turned into a periodic tenancy but was terminated by the landlord's notice.

3. **Tenancy at will:** This tenancy is created by the will and intent of either the lessor or the lessee, and must be created by an express agreement (not necessarily a writing). This type of tenancy may be terminated at any time without notice, or automatically by operation of law if one of the parties dies or the tenant acquires title to the property.

 EXAMPLE:

A writer who lives in the city wants to go into seclusion to complete his novel. His friend has a mountain cabin that he uses infrequently, and the friend agrees to let the writer live in the cabin to finish the novel. In consideration of this use, the writer agrees to pay all utilities and taxes due on the property while he is in possession. After six months the novel is complete and the writer quits the cabin. The writer is obligated for utilities and taxes attributable to these six months, and the tenancy is terminated.

4. **Tenancy at sufferance:** A tenancy at sufferance is created when a tenant unlawfully remains in possession of the property after the termination of a lawful tenancy. This tenancy only remains in effect until the lessor takes steps to evict the tenant, and no notice of the termination is required.

 EXAMPLE:

A tenancy for years has ended, but the tenant refuses to leave. The landlord commences eviction proceedings. Until the tenant is evicted, the tenant is a tenant at sufferance.

If a tenant remains in possession after the termination of the lease, the lessor has two options:

(a) the lessor may commence proceedings in a court of competent jurisdiction to **evict** the tenant, meaning that the court will order the tenant to quit the premises and have the order enforced by a marshal; or
(b) the lessor may bind the lessee to a new periodic tenancy, under the terms of the expired lease or at an increased rent *if* the lessor has notified the lessee of an increased rental prior to the expiration of the valid lease.

Be alert to the fact that this right, known as the **holdover doctrine**, does not apply if the lessee only remains in possession for a few hours after the lease expired or is delayed in quitting because of reasons not the tenant's fault, such as a severe illness.

The typical lease for realty will include the names of the parties; a description of the property to be rented, referred to as the **premises;** the use to which the property may be put; and the termination of the lease. Because the lease is a contract, the tenant's right of possession or use is granted in consideration of the tenant's obligation to compensate the landlord. The most common form of such obligation is the payment of money, referred to as **rent.**

Rent clauses fall into one of two categories: gross lease or a net rent lease. A **gross lease** requires the tenant to pay rent, and all operating costs on the premises—taxes, water, utilities, and so forth—are the obligation of the landlord. In a **net rent lease** the tenant pays the rent to the landlord and further is

responsible for the operating costs, which the tenant pays directly to the provider of such services.

In many instances, residential rent may be regulated by the government, in which case rent renewals of the lease may be guaranteed to the tenant, and rent increases for the new lease are established under the provisions of the particular statute. In other locations and with commercial leases, the lessor may indicate a **rent escalation clause** in which the parties agree to periodic rent increases based on either costs or inflation.

Many commercial leases contain a **percentage rent** that requires the tenant to pay the landlord a set percentage of the tenant's gross sales. With this type of lease rent is usually due on a quarterly or annual basis to correspond to the tenant's payment of taxes. A variation on this type of lease is a **percentage breakpoint** clause in which a set rent is established, but if the tenant's gross receipts exceed a stated dollar amount, called the breakpoint, the landlord is entitled to additional rent based on a percentage of the gross sales above the breakpoint amount. In certain instances, this type of lease may also contain a **radius clause** that prohibits the tenant from operating a similar enterprise within a specific geographic distance from the rented premises, which could limit the tenant's gross sales at the leased location.

 EXAMPLE:

A man rents an apartment under a net rent lease. According to the lease, he must pay the landlord a monthly rental of $750 and is responsible for his own utilities—gas, electricity, and water. The landlord remains responsible for taxes and insurance.

 EXAMPLE:

A man rents a location to open a bookstore. Under the terms of the lease, the tenant must pay the landlord a monthly net rent based on a yearly rental of $200 per square foot of leased space. Furthermore, if the bookstore's gross sales exceed $500,000, the tenant must pay the landlord an additional 1% of all sales in excess of $500,000. This lease also restricts the tenant from opening another bookstore within ten blocks of this location. This is an example of a percentage breakpoint lease with a radius clause.

In addition, a lease will usually indicate which party is responsible for the maintenance and repair of the premises and, for commercial leases, may specify that one of the parties must maintain minimum insurance on the property. See Exhibit 7.1 at the end of this chapter for a sample lease.

Tenants' Duties

Under a typical lease agreement, the tenant warrants to maintain the property in good repair. In this context the tenant is precluded from committing waste on the property (see Chapter 2). If the tenant, under the lease contract, has specifically covenanted to make repairs, the tenant's duty will be higher than that imposed under the law of contract, and she may even be obligated to reconstruct the property if the property is destroyed, even if the property is destroyed without the fault of the tenant or the landlord. Furthermore, even absent such a contract, if the premises are destroyed without fault, in most jurisdictions the tenant, absent an

agreement to the contrary, is still obligated to continue paying rent for the duration of the lease.

 EXAMPLE:

A man enters into a lease to rent a house for a two-year period. Three months later the house is destroyed by a tornado. In most jurisdictions the tenant may still be liable to pay rent on the now nonexistent house for the next 21 months. If the tenant had specifically contracted to make repairs, he might be obligated to rebuild the house. In this type of contract the tenant is usually further obligated to maintain insurance on the property, for obvious reasons.

A tenant is precluded from using the leased premises for an unlawful purpose. Such unlawful use gives the landlord the right to terminate the lease, sue for damages, and/or seek injunctive relief.

 EXAMPLE:

A woman rents a large apartment. She then uses that apartment as a brothel. When the landlord finds out he may either terminate the lease and evict the tenant or seek an injunction, a court order requiring the woman to stop using the premises for an unlawful purpose.

The primary obligation of a tenant is to pay the agreed-upon rent at the time and manner specified in the lease. A landlord may also require the tenant to give a **security deposit** to cover a portion of the rent in the case of a default. At the termination of the lease the tenant's rent obligation terminates and the tenant is entitled to the return of the security deposit, less any amount deducted for damage to the premises caused by the tenant. Also, the tenant is entitled to receive interest accruing on the security deposit during the tenancy.

If the tenant fails to pay the rent when due, the landlord, in most states, is entitled to one of two options:

1. the landlord may sue the tenant for money damages for the amount of rent that was due and unpaid; or
2. the landlord may sue to have the tenant evicted.

If the tenant abandons the premises without justification, most states require the landlord to attempt to re-rent the property to lessen the amount of rent the tenant owes under the lease. This obligation is known as the duty of **mitigation of damages**. If the new tenant pays less rent than the abandoning tenant, the abandoning tenant is obligated to the landlord for the difference. Conversely, if the new tenant pays a higher rent, the abandoning tenant is discharged. Note, though, that if the landlord accepts the surrender of the premises the tenant will not be obligated for rent under the lease.

 EXAMPLE:

The owner of a two-family house rents one of the units to a family. However, the man and the family have constant arguments over matters not concerned with the property. The family decides to

move with nine months left on the lease. If the man accepts their departure, they are not obligated under the lease. If the man does not accept their departure, he must attempt to re-rent the property, and the family will only be obligated for the difference between their rent and the new rent if it is less. If the man refuses to attempt to find a new tenant for the property he may be denied relief from the court for failure to mitigate damages.

Landlord's Duties

Absent a statutory or contractual obligation, under the general law a landlord is under no duty to repair or maintain leased premises. Basically, a landlord's obligations fall into three categories:

1. The landlord has a duty to deliver actual possession to the tenant on the date agreed upon. If there are holdover tenants or squatters on the premises, it is the landlord's duty to see that they are evicted so that the tenant may take possession.
2. The landlord, under all lease agreements, has imposed a covenant of quiet enjoyment (see Chapter 5), meaning that the landlord guarantees that no one, including the landlord, will interfere with the tenant's use and possession of the property. This covenant may be breached in one of the following ways:
   (a) actual eviction, which occurs when the tenant is evicted from the entire property, at which time the tenant's rent obligation is considered terminated;
   (b) **partial eviction**, which occurs when the tenant is precluded from possession of a portion of the property. If the partial eviction is caused by the landlord, as opposed to a third person, the tenant's obligation to pay rent on the entire property is terminated.

 EXAMPLE:

A man rents a house with a garage. There is a mechanic's lien on the garage and the contractor who holds the lien attaches the garage. This is an example of a partial eviction. Because the partial eviction was caused by the landlord's failure to pay the contractor, the tenant is relieved from paying rent on the property.

   (c) **constructive eviction**, which occurs if the landlord does anything that renders the property uninhabitable, such as failing to provide essential services. The tenant may terminate the lease and seek damages from the landlord. However, to terminate the lease and seek damages, the tenant must vacate the property and the condition that caused the problem must be the fault of the landlord, not a third party.

 EXAMPLE:

A man rents a house under a gross rent lease. The landlord refuses to pay any utility bills although it is his obligation, and all utilities are turned off in the house, rendering it uninhabitable. The tenant may terminate the lease by vacating the house and then suing the landlord for damages, or he may pay the utilities himself and sue the landlord for reimbursement.

3. Most jurisdictions impose an implied **warranty of habitability** on residential leases, which is deemed to be non-waivable (exclusively) by the tenant. What is considered "habitable" is determined by local housing codes. If this warranty is breached, the tenant may:
   (a) terminate the lease;
   (b) make the necessary repairs and offset the cost against the rent;
   (c) seek an **abatement** whereby the rent is proportionately reduced for the lack of use; or
   (d) remain in possession but sue for damages.

If a tenant attempts to assert his or her legal rights, the landlord is prohibited, in most states, from terminating the lease or otherwise penalizing the tenant in retribution. Any attempt to do so is considered **retaliatory eviction**, which, depending on the jurisdiction, may entitle the tenant to certain legal remedies against the landlord. Each state's statutes must be individually analyzed.

If the entire property is condemned by the government, or taken over under a right of eminent domain (see Chapter 3), the lease is deemed terminated. However, a partial or temporary taking does not relieve the tenant of his or her obligation under the lease.

Assignments and Subleases

Unless the parties have agreed to the contrary, tenants are typically permitted to assign or sublease their rights. An **assignment** is a transfer of all rights the tenant has under the lease. A **sublease** is a transfer of a portion of the tenant's rights under the lease. If the tenant retains the right to return to the property any time prior to the termination of the lease, including the right to renew the lease, the transfer is deemed to be a sublease.

 EXAMPLE:

Three young women share an apartment, but do not get along. One of them finds a fourth young woman to take over her portion of the lease. When the dissatisfied tenant transfers all of her rights to the fourth woman, she has effectuated an assignment; however, if she retained the right to renew the lease in her own name this is considered a sublease.

The effect of an assignment is to make the **assignee** (the transferee) primarily obligated to the landlord for the rent. The **assignor** (the transferor) remains secondarily liable, meaning that if the assignee defaults the assignor will be liable for the rent to the landlord.

With a sublease, the original tenant remains obligated to the landlord, and he or she is the only one who can enforce the lease's covenants against the landlord. The tenant and the sublessee are contractually obligated to each other, and the sublessee's only remedies are against the tenant/sublessor.

A lease may contain a provision prohibiting assignments and subleases, but such provisions are generally construed against the landlord. In jurisdictions that provide for regulated residential leases, such provisions may be prohibited, but each state's statutes must be independently analyzed. If a transfer is made in violation of the lease, and the landlord knows about it but does not object, the lease provision prohibiting the transfer is deemed waived. If the landlord does object, the landlord may be able to terminate the lease.

 **EXAMPLE:**

A lease contains a non-assignment provision. Six months after the lease starts the tenant must move to a new city, and assigns her lease to a friend. The landlord accepts the friend's rent check. Under these circumstances, the law will assume that the landlord has waived his right to object to the assignment.

The landlord may assign any and all of his or her rights without the tenant's consent. The tenant's obligation will be to the landlord's assignee, and the tenant must be given a notice to attorn (see Chapter 5).

Practical Tips

- Leases for rentals exceeding one year must be in writing, and long-term leases may be recorded to protect the parties.
- If a lease is going to be recorded, only record a memorandum of the lease provisions. It is not necessary to record all the terms of the lease itself.
- Review all leases in the same manner in which a contract would be reviewed—it must meet all the requirements of a valid contract to be enforceable.
- Only use a form lease as a guide; make sure to personalize each lease to protect the client.

Chapter Review

Landlord-tenant law is a subset of general real property law that is governed by contract. This contract, known as a lease, determines the rights and obligations of the parties.

There are four types of lease agreements generally in effect: a tenancy for years, in which property is leased for a fixed period of time; a periodic tenancy, created for successive periods; a tenancy at will, which is formed by agreement and which may be terminated at any time without notice; and a tenancy at sufferance, which comes about when a tenant remains in unlawful possession of a formerly leased premise.

The consideration given to the landlord to support the contract is known as rent, and the tenant may be obligated for utilities, or they may be the landlord's responsibility. For commercial tenants, the landlord may also contract for a portion of the tenant's gross sales or profit.

The tenant is required to maintain the premises in good repair, absent an agreement or statute to the contrary, and may even have to rebuild a premise that is destroyed.

Leases, as a general rule, are freely assignable, which means all the tenant's rights are transferred, and capable of being sublet, which means the tenant retains some interest in the lease, even if just the ability to renew the contract.

Ethical Concern

Leases are fairly common legal documents, and most law offices maintain a form lease on file. It is unethical to charge every client the cost of creating the same lease. This is known as double billing. However, it is permissible to charge each client for the particular work that was performed to personalize that form lease for the client.

Key Terms

Abatement
Assignee
Assignment
Assignor
Constructive eviction
Evict
Gross lease
Holdover doctrine
Landlord
Lease
Leasehold
Lessee
Lessor
Mitigation of damages
Net rent lease
Partial eviction
Percentage breakpoint
Percentage rent
Periodic tenancy
Premises
Radius clause
Rent
Rent escalation clause
Retaliatory eviction
Right of entry
Security deposit

Sublease
Tenancy at sufferance
Tenancy at will
Tenancy for years
Warranty of habitability

Exercises

1. Using the library or the Internet, determine whether your locality provides for residential rent regulation. If so, analyze its provisions.
2. Obtain a form lease for your jurisdiction and analyze its provisions.
3. Determine what constitutes "habitability" in your locality.
4. Many states have a landlord-tenant court for housing disputes. Find out whether such a court exists for your county, and if so, list its jurisdictional requirements.
5. Briefly discuss how the parties could determine "gross sales" under a percentage lease.

Situational Analysis

A tenant leases a two-bedroom apartment in a major city. She is the only tenant on the lease. To meet expenses, she lets one of the bedrooms to another woman by an oral agreement. The other woman is not listed on the lease. Each woman pays one-half the rent by check, and the landlord accepts these checks. After one year they begin to have problems living with each other, and the woman named on the lease asks the other woman to leave, but she refuses. What are the rights of the parties? How would you advise each woman?

Edited Cases

Staley v. Bouril is a Pennsylvania case discussing the warranty of habitability that attaches to all leased properties, and the *Tsitsires* decision concerns the eviction of a mentally ill tenant.

Staley v. Bouril

553 Pa. 112; 718 A.2d 283; 1998 Pa. LEXIS 2120

David Staley, et. al (Tenants), residents in a mobile home park owned by Beatrice Bouril[1] (Landlord), appeal from an Order of the Superior Court that affirmed an Order of the Court of Common Pleas of Beaver County (trial court) dismissing their Complaint against the Landlord. The issue in this appeal is whether the implied warranty of habitability applies to the lease of an improved lot in a mobile home park.

FACTUAL AND PROCEDURAL HISTORY

Pursuant to oral month-to-month leases, the Tenants lease improved lots in the Landlord's mobile home park. The lots include a plot of land, and improvements, such as water and septic services, electrical

connections, and access to a common roadway. The Tenants own their individual dwelling structures, which are placed on the lots and are connected to the utilities.

In 1989, the Department of Environmental Resources (DER) tested the park's water supply, which came from a well, and found it to be contaminated. DER ordered the Landlord either to connect the mobile home park to the public water supply or to apply for a well permit and comply with certain treatment, sampling, and testing requirements. The Landlord did not comply with DER's order, and the Tenants were forced to seek other sources of water for drinking, cooking, and washing clothes.

On April 26, 1995, the Tenants filed a Complaint in Equity against the Landlord, alleging violations of the implied warranty of habitability. The Tenants sought monetary damages, as well as injunctive relief requiring the Landlord to provide and maintain adequate water and septic services. On May 14, 1996, however, the trial court dismissed the Tenants' Complaint, issuing an Adjudication and Decree Nisi in which the court found that the implied warranty of habitability did not apply to the Tenants' leases of improved lots in the mobile home park. The Tenants filed a Motion for Post-Trial Relief, which the trial court denied, and then appealed to the Superior Court. In a Memorandum Opinion, the Superior Court, without dissent, affirmed the Order of the trial court.

DISCUSSION

In deciding whether the implied warranty of habitability applies to leases of improved lots in a mobile home park, we begin with our landmark decision in Pugh v. Holmes, 486 Pa. 272, 405 A.2d 897 (1979). In Pugh, this Court abandoned the doctrine of caveat emptor and adopted the implied warranty of habitability in residential leases "in order to keep in step with the realities of modern day leasing." Pugh, 486 Pa. at 279, 405 A.2d at 900.

Pugh's primary rationale for adopting the implied warranty of habitability is that "the modern tenant is not interested in land, but rather bargains for a dwelling house suitable for habitation." Id. at 282, 405 A.2d at 902. Pugh recognizes that, unlike tenants in feudal society to whom "any shelters or structures existing on the land were 'incidental' concerns,…the modern apartment dweller is a consumer of housing services." Pugh, 486 Pa. at 280-82, 405 A.2d at 901-02 (citation omitted). Thus, "the contemporary leasing of residences envisions one person (landlord) exchanging for periodic payments (rent) a bundle of goods and services, rights and obligations." Id. at 282, 405 A.2d at 902 (citation omitted). Such goods and services include "not merely walls and ceilings, but also adequate heat, light and ventilation, serviceable plumbing facilities, secure windows and doors, proper sanitation, and proper maintenance." Id. (citation omitted).

The Tenants argue, and we do not doubt, that in leasing improved lots in a mobile home park, they bargain for a similar bundle of goods and services. There is no question that potable water, adequate septic service, and proper electrical connections are essential components of a habitable residence. See, e.g., Elderkin v. Gaster, 447 Pa. 118, 288 A.2d 771 (1972) (implied warranty of habitability required vendor-builder of new home to provide potable water supply). We also recognize that landlords of mobile home parks, like other landlords, generally have far greater bargaining power than their tenants.

The typical residential lease, however, is intended primarily to convey an interest in a residence, such as an apartment or house, and not the land that underlies it. By contrast, the Tenants' lease is intended primarily to convey an interest in a plot of land, albeit with some improvements, and has nothing to do with the dwelling structure that sits on top of it. Thus, while the Tenants are undoubtedly consumers of some "housing

services," such as water, septic, and electrical utilities, the bargain embodied in their lease does not give rise to the same implied warranty of habitability that is present in a typical residential lease. Instead, it gives rise to a limited implied warranty of habitability, the scope of which depends on the particular circumstances of the case.

Unlike the lease of an apartment, house, or other dwelling structure, which, by operation of law, compels the landlord to provide certain utilities and other essential services, the lease of a lot in a mobile home park does not necessarily oblige the landlord to provide anything more than a plot of ground. Nevertheless, to the extent that the landlord of a mobile home park chooses to provide utilities and other housing services, and charges tenants rent in exchange therefore, the landlord impliedly warrants to maintain the services according to applicable state and local regulations. Like the implied warranty of habitability in a typical residential lease, this limited implied warranty of habitability and the tenant's obligation to pay rent are mutually dependent, so that "a material breach of one of these obligations will relieve the obligation of the other so long as the breach continues." Pugh, 486 Pa. at 284, 405 A.2d at 903.

In applying the limited implied warranty of habitability, courts should follow the guidelines described in Pugh. Thus, a breach of the warranty occurs where there is a defect "of a nature and kind which will prevent the use of the [lot] for its intended purpose to provide premises fit for habitation.…" Id. at 289, 405 A.2d at 905. "Materiality of the breach is a question of fact to be decided by the trier of fact on a case-by-case basis," and depends on such factors as "the existence of [regulatory] violations and the nature, seriousness and duration of the defect." Id., 405 A.2d at 905-906 (citation omitted). "Additionally,…a tenant must prove [that] he or she gave notice to the landlord of the defect or condition, that [the landlord] had a reasonable opportunity to make the necessary repairs, and that [the landlord] failed to do so." Id. at 290, 405 A.2d at 906 (citation omitted). Remedies for breach of the limited implied warranty of habitability include termination of the obligation to pay rent where the tenant surrenders possession of the premises, rent abatement where the tenant remains in possession, and the "repair and deduct" remedy. Pugh, 486 Pa. at 291-297, 405 A.2d at 907-910.

Here, the Superior Court affirmed the trial court's dismissal of the Tenants' Complaint, concluding that, "the implied warranty of habitability does not apply in this context to provide [the Tenants] with the protection or remedies they seek." Superior Court Memorandum Opinion, at 6. We hold that a limited implied warranty of habitability does apply to the Tenants' lease, and therefore disagree with the Superior Court's conclusion. Accordingly, we reverse the Order of the Superior Court and remand the case to the trial court for further proceedings consistent with this Opinion.

Case Questions

1. How does the lease in this case differ from the typical residential lease?
2. What effect did the *Pugh* decision, referenced by the court, have on the common law doctrine of caveat emptor?

TOA Construction Co., Inc. v. Tsitsires

The laws of rent stabilization do not allow for the indefinite retention of the right to rent-stabilized premises by a tenant who does not actually reside in the premises and has no intent to return to reside there at any point in the future. This is no less true where, as here, the tenant's inability to ever reside there is caused by his mental illness. An apartment used by the tenant solely as a mail drop and storage space and occupied, when it is occupied at all, only by the tenant's companion, should not be treated as the tenant's residence. Unless there is evidence at trial supporting a conclusion that the tenant will at some point be able to actually reside in the apartment, his absence should not be deemed excusable, and his abandonment of the premises as his residence should be acknowledged as such.

The facts of this case were fully presented to the trial court, and that court's findings were not disputed, challenged, or altered by Appellate Term. Indeed, Appellate Term explicitly declined to second-guess either the trial court's assessment of credibility or its conclusion that respondent's mental illness prevented him from actively using the apartment. Although it reversed the trial court's holding, the reversal was based only upon the application of the law to the facts found by the trial court. Yet, our dissenting colleagues would make an entirely new set of findings, based upon their own assessment of the evidence, after rejecting consideration of certain materials upon which they say the trial court improperly relied. Further, the dissent would rely upon materials entirely outside the record, including assertions contained in recent newspaper articles. We reject the implicit suggestion that we adopt the dissent's alternative assessment of the evidence instead of the trial court's assessment. Rather, we rely upon the previously undisturbed findings of the trial court, especially its rejection of respondent's testimony that he resided in the unit for extended periods of time during the *Golub* period (*see Golub v. Frank, 65 NY2d 900, 483 N.E.2d 126, 493 N.Y.S.2d 451 [1985]*).

The sad facts of this case, as found by the trial court, naturally incline one's sympathies toward respondent tenant, who suffers from debilitating mental illness that has propelled him into the life of a homeless person, despite his rights as a tenant in petitioner's deteriorating single-room occupancy (SRO) building. However, the tone employed by the dissent, accusing this Court of "facilitating a notorious slumlord's 20-year effort to empty its building of all tenants by evicting respondent tenant from his rent stabilized apartment," is misguided. It is the responsibility of this Court to dispassionately apply the law to the facts as found, notwithstanding the well-intentioned impulse to protect the interests of a mentally ill individual or the desire to rule against the interests of a party characterized by newspapers as a "slumlord." It is incumbent upon us to correctly frame the rules of law that apply in this primary residence litigation. When the law is accurately stated, and applied neutrally to the facts as found by the trial court, it becomes clear that the findings of fact and conclusions of law of the trial court should have been upheld. We therefore reverse the order of Appellate Term, which, contrary to the ruling of the trial court, held that the tenant's extended absence from the subject premises was excusable and that he had not abandoned the tenancy.

This holdover proceeding to terminate respondent's tenancy, on the ground that the apartment was not his primary residence, was commenced on December 7, 2000, following the landlord's service on July 14, 2000 of a *Golub* notice of expiration of respondent's tenancy as of November 30, 2000.

Respondent has been a rent-stabilized tenant in the SRO since 1970. Over the years, the building fell into a state of chronic disrepair, and the trial court found the apartment to be uninhabitable when it inspected

the premises on April 27, 2005. But, this litigation does not turn on the habitability of the apartment, or even on the nefariousness of the landlord; it simply concerns whether petitioner established that respondent did not maintain his primary residence there during the *Golub* period, December 1, 1998 through November 30, 2000.

Although his exact diagnosis was disputed, it is established that respondent suffers from a mental illness, which includes a panic disorder, that has resulted in his feeling compelled to spend virtually all his time away from the subject apartment. The credible evidence established that respondent lived the lifestyle of a homeless person in a psychologically "safe" area within a 20-block radius of the building. He kept his personal possessions in the apartment, and his mail was delivered there, but notwithstanding his testimony to the contrary, which the trial court rejected as incredible, he rarely went there. He did not even maintain possession of the key, having given it into the custody of his girlfriend of 35 years, who used the apartment somewhat more frequently, as a place to shower and for storage of her personal possessions. The testimony that the trial court found to be credible, which Appellate Term left undisturbed, reflected that during the relevant period respondent stopped in at the apartment a handful of times but cannot be said to have resided there.

To begin the necessary analysis, we must first consider the landlord's initial burden in this unusual situation. The Rent Stabilization Code permits a landlord to recover possession of a rent-stabilized apartment that "is not occupied by the tenant…as his or her primary residence" (*9 NYCRR 2524.4[c]*). Respondent suggests that to do so the landlord has the legal obligation to establish not only that the tenant does not reside in the subject apartment but also that the tenant has an alternative primary residence. In this regard, respondent relies upon this Court's holding that "[i]n a nonprimary residence case, the burden is on the landlord to establish that the tenant maintains a primary residence in a place other than the subject premises" (*Sharp v. Melendez, 139 A.D.2d 262, 264, 531 N.Y.S.2d 554 [1988]).*

Respondent also emphasizes the word "primary" in the phrase "primary residence," arguing that the concept implicitly requires the existence of a second residence, rendering one residence primary and the other secondary, and that the concept of primary residence is therefore, by definition, inapplicable when the tenant concededly has no other residence. Where there is only one residence, respondent contends, that residence is *necessarily* the tenant's primary residence.

We conclude, however, that the dissenting justice at Appellate Term in this case is correct: The statement made in *Sharp v. Melendez* imposing on the landlord the burden of establishing that the tenant maintains a primary residence in a place other than the subject premises is simply inapplicable to circumstances such as these. Importantly, *Sharp v. Melendez* and similar cases involved situations in which the basis of the landlord's claim was that the tenant resided in different premises than the one at issue. But, as the trial court here explained, establishing that the tenant has an alternative primary residence is merely one way for the landlord to meet its evidentiary burden; it is not the only way.

The essence of the nonprimary residence claim is that the tenant lacks an "ongoing, substantial, physical nexus with the controlled premises for actual living purposes" (*Emay Props. Corp. v. Norton, 136 Misc 2d 127, 129, 519 N.Y.S.2d 90 [App Term, 1st Dept 1987]*). The terms of the Rent Stabilization Code do not require proof that the tenant maintain an alternative primary residence (*see 9 NYCRR 2524.4[c]*, *supra*). A prima facie showing of nonprimary residence could be successfully made simply by proof that a rent-paying tenant was

absent from the apartment and kept no belongings there during the relevant period, without the introduction of any information about where the tenant had gone.

The majority at Appellate Term, without rejecting the finding that respondent did not actually live in the apartment, held that his absence must be deemed excusable for purposes of nonprimary residence analysis because the record showed that "there was no abandonment of the premises or establishing of any new residence" (quoting *Katz v. Gelman, 177 Misc 2d 83, 84, 676 N.Y.S.2d 774 [App Term, 1st Dept 1998]*). But, the facts here are not comparable to those in *Katz v. Gelman* or other cases in which tenants established that their extended absences from their apartments were excusable (*see e.g. Coronet Props. Co. v. Brychova, 122 Misc 2d 212, 469 N.Y.S.2d 911 [1983]*, *affd 126 Misc 2d 946, 488 N.Y.S.2d 1020 [App Term, 1st Dept 1984]*). In *Brychova* the tenant demonstrated that she had to be away from home due to the exigencies of her profession. In *Katz*, the tenant was absent because of his health. Importantly, in each instance it was established that the tenant fully intended to return to and reside in the apartment as soon as practicable. In *Brychova*, the tenant was an itinerant professional soprano and voice teacher who spent all but a handful of days each year away from home at professional engagements. In *Katz* the tenant was absent from his leased premises while he was institutionalized in various transitional residential facilities for treatment of depression and substance abuse, with the intent of preparing to return to independent living.

While, as in *Katz* (*177 Misc 2d at 84*), it is clearly a mental health problem that causes respondent to be absent from the subject premises, unlike the situation in *Katz*, there is no credible evidence indicating that respondent will ever return to and reside in the subject premises, or even that he has any intent to do so. Indeed, there is no reason to conclude, based upon the credible evidence in the record, that respondent can be cured of his need or compulsion to stay out of the subject premises. Regardless of how understandable is his decision to decline any offered medication or treatment, nothing in the record supports a conclusion that respondent had any true intent or ability to achieve a cure for his illness that would allow him to take up real residence in the apartment. Since there is no credible basis in the record to conclude that respondent might in the future be willing or able to resume actual residence in the apartment, the logic of *Katz v. Gelman* has no application to this case.

The dissent, while agreeing with the conclusion of Appellate Term that respondent's absence is excusable and that he did not abandon the premises, also emphasizes testimony rejected by the trial court to the effect that respondent actually resided in the apartment during the period in question. While paying lip service to the rule that the trial court's findings of fact should not be disturbed unless they could not be reached under any fair interpretation of the evidence, the dissent essentially relies on the testimony of respondent and his companion to find, contrary to the trial court's finding, that respondent intends to reside in the premises in the future, and, indeed, that he has resided there since at least 2001. The dissent even cites the testimony that the trial court squarely rejected, in which both respondent and his companion stated that during the *Golub* period respondent was present in the apartment every day.

However, we decline to make new findings of fact upon our own review of the record, despite our authority to do so. There are important reasons for the deference with which we generally approach the findings of a trial court, particularly regarding credibility. A decision by a trial court adds up to more than the sum of its parts; it takes into account the judge's firsthand impressions, as well as the judge's experience with similar cases, particularly in specialized courts such as the Housing Court.

The trial court's finding regarding respondent's credibility should stand; by the same token, we should defer to the court's rejection of respondent's and his companion's testimony as to their continued presence in the apartment during the *Golub* period. Reliance on respondent's telephone bills to buttress the conclusion that respondent did not abandon the apartment is misplaced. It is already established that respondent's companion frequently uses the apartment and that respondent keeps personal possessions there and uses it as a mail drop. None of these facts establish his intent to return to live there, and neither do his telephone bills. The manner in which respondent uses the subject premises, as a storage facility and mail drop, should be recognized, and treated, as tantamount to an abandonment of the premises for residential purposes.

The dissent's citation to recent newspaper articles to support its assertion of facts regarding respondent's recent residence at the premises should not be countenanced. When we review an order on appeal, we do so on the evidence presented in the record on appeal, not on purported facts gleaned from newspaper articles. Indeed, in this matter the relevant time period of residency was December 1, 1998 through November 30, 2000. To the extent the respondent's future intent to reside in the premises was relevant, such intent had to be established before the trial court, not in assertions extraneous to the record and not even introduced by the parties. Furthermore, judicial notice of facts is reserved for "matter[s] of common and general knowledge, well-established and authoritatively settled" (*Prince, Richardson on Evidence §2-201*[Farrell 11th ed][internal quotations marks and citation omitted]). Judicial notice of a fact such as a tenant's residency in a building may not properly be based upon a factual assertion simply because the assertion is contained in a newspaper article.

The evidence contained in the record that was accepted as credible by the trial court shows that respondent did not reside in the apartment during the *Golub* period, that he did not intend to return to reside there, and that there is no reason to believe he will be able to reside there in the future. However sympathetic respondent's plight, the concept of rent-stabilized tenancy is warped beyond recognition if a tenant who is permanently absent from the apartment, using it only as showering facilities for his companion and as storage space and mail drop for himself, without any indication that he will ever be able to reside there again, may nevertheless be entitled to be treated as a rent-stabilized tenant who has not abandoned the apartment.

It should be noted that when we conclude that a tenant who does not reside in his apartment may not properly be said to be using it as his primary residence, we are not "finding" that the tenant's primary residence is a park bench. I think we all agree that a person *cannot* maintain a primary residence on a park bench. But, the question for the court is solely whether the tenant has maintained an "ongoing, substantial, physical nexus with the controlled premises for actual living purposes" (*see Emay Props. Corp. v. Norton, 136 Misc 2d 127, 129, 519 N.Y.S.2d 90 [1987]*, *supra)*, or whether, instead, he has abandoned the premises that served at some earlier time as his residence. The answer is, during the relevant period respondent did not maintain the required substantial physical nexus with the premises for actual living purposes, and he had no expectation of doing so.

Having determined that respondent failed to counter petitioner's showing with his own credible evidence demonstrating either that during the *Golub* period he used the premises as his primary residence or that his absence is excusable, we may not allow respondent to claim the rights of primary residency based solely upon the use of the apartment by his longtime companion. This is not because we find that she is some sort of "transient girlfriend," as the dissent implies, but because the record does not establish tenancy rights on her part, despite her longtime relationship with respondent. As the dissent acknowledges, this proceeding did not

raise or address any claim to succession rights or any other rights invested directly in respondent's companion.

I recognize that part of the impetus for the dissent's view is that the landlord here allowed the premises to become uninhabitable with the intent of emptying the SRO building of all tenants. Yet, the landlord's conduct and intentions, whatever we think of them, had no impact on respondent's virtual abandonment of the apartment as his residence. Had respondent successfully demonstrated that his absence from the apartment was due to its uninhabitable condition, and that he would return and reside there if it were made habitable, the landlord's conduct would have been relevant to the question whether respondent's absence from the premises should be considered "excusable" for purposes of primary residence analysis. But, the evidence established that respondent's absence from the premises was due to his mental illness, not the condition of the apartment.

Additionally, the fact that respondent applied for public housing that would accommodate his disability, stating on the application that he was homeless, but failed to take the necessary action to accept the ultimate offer of an apartment within his "safe area" of the city lends further credence to the conclusion that his mental illness was the substantial impediment to his maintaining his residence in the subject apartment, or any apartment. Had he been motivated by the need for a clean and habitable apartment, rather than impelled by his mental illness, he would have done what was necessary to take the offered apartment.

The dissent correctly observes that the goal of the rent stabilization framework, "to alleviate the shortage of housing in New York City by returning underutilized apartments to the market place" (*Matter of Herzog v. Joy, 74 A.D.2d 372, 374, 428 N.Y.S.2d 1 [1980]*, *affd 53 N.Y.2d 821, 422 N.E.2d 582, 439 N.Y.S.2d 922 [1981])*, is not served by permitting the ouster of this tenant, since the landlord's interest is in emptying the building of all tenants, rather than in replacing this tenant with a tenant who will actually reside there. Nevertheless, application of the primary residence rules is not limited to those landlords who can establish that they are acting in good faith to return underutilized housing to the market. Whether the tenant maintains an "ongoing, substantial, physical nexus with the controlled premises for actual living purposes" (*Emay Props. v. Norton, 136 Misc 2d at 129*), depends upon the tenant's conduct in relation to the property, not the landlord's intended future use of the building.

The questions the Court must answer are: (1) did the petitioner establish that the tenant lacked an "ongoing, substantial, physical nexus with the premises for actual living purposes," and (2) if so, did the tenant establish an intent to resume living in the premises when it became possible? Here, petitioner made the requisite showing, and respondent failed to establish an intent to return so as to overcome the prima facie showing. On the evidence before it, the trial court correctly determined that the apartment was not being used as respondent's primary residence and would not be so used in the future.

We conclude that petitioner's claim is established, based upon the facts as found by the trial court, that respondent does not, and will not in the future, use the subject premises "for actual living purposes," and that therefore it is not his residence.

Accordingly, the order of the Appellate Term of the Supreme Court of the State of New York, First Department, entered December 21, 2006, which reversed a final judgment of the Civil Court, New York County (Gerald Lebovits, J.), entered July 7, 2005, awarding possession after nonjury trial to petitioner landlord in a nonprimary residence proceeding, and awarded final judgment to respondent tenant dismissing the petition, should be reversed, on the law, without costs, and the judgment of possession awarded in favor of

petitioner landlord reinstated.

Case Questions

1. What is your opinion of the court's ultimate decision to displace a mentally ill tenant?
2. Should the court have provided a guardian for the respondent? Discuss.

Additional Case Analysis

1. Two individuals reside in apartments that are not subject to any rent-regulation law. The parties never signed a lease with the current owner of the property, but the individuals did have an oral agreement to rent the apartments from the property's former owner. The current owner sues the individuals to gain possession of the apartments, claiming that they are holdover tenants. What arguments would you present for each side? Who should prevail? See *Ballesteros v. Rosello*, 183 Misc. 2d 448, 703 N.Y.S.2d 686 (1999).
2. Premises were leased for a period of ten years, with a provision that the landlord may terminate the lease upon 30 days' written notice to the tenant that the property had been sold. The landlord transferred the property to a new owner, who then served notice on the tenants that the lease was being terminated. Did the new owner have the right to terminate the lease when he purchased the property from the original owner? See what the court said in *Rosemberg v. Brens,* 19 Misc. 3d 1142 (A) (Civ. Ct. 2008).

Exhibit 7.1:Sample Commercial or Residential Lease

This lease made in _____ [*city*], state of _____ [*date*] between _____ of _____ as lessor, and _____ of _____ as lessee, witnesses:

Lessor, for and in consideration of the agreements of lessee mentioned below, hereby leases to lessee, and lessee hereby leases from lessor, the premises [or as the case may be] located at _____ [*city*], state of _____ described as follows: _____ excepting and reserving to lessor _____ including the right to _____.

This lease is for the terms of _____ years [or as the case may be], beginning _____ [*date*], and ending _____ [*date*], unless sooner terminated as provided below.

A. Agreements of Lessee

Lessee, in consideration of the leasing, agrees:

1. To pay as rent for premises the sum of $ _____ per month [or as the case may be], payable on the day of _____ each month [or as the case may be] during the term of this lease, at _____.

2. To pay all charges for light, heat, fuel, power and water furnished or supplied to or on any part of premises.

3. To pay all taxes and assessments, ordinary and extraordinary, general and specific, including the same for _____ [*year*], which may be levied or assessed on premises.

4. To pay all reasonable costs, attorneys' fees and expenses that shall be made and incurred by lessor in enforcing the agreements of this lease.

5. To use and occupy the premises for _____ purposes only, and for no other object or purpose without written consent of lessor, and to not use premises for any unlawful purpose or purpose deemed extra hazardous.

6. To keep the premises in as good repair as the same shall be at the commencement of the term, wear and tear arising from the reasonable use of the same and damages by the elements excepted.

7. To keep the buildings and improvements on the premises insured in a responsible insurance company or companies for not less than $ _____ payable, in case of loss, to lessor as lessor's interest may appear.

8. To permit lessor and lessor's agents to enter on the premises or any part thereof, at all reasonable hours, for purpose of examining or exhibiting same or making such repairs or alterations as may be necessary for safety or preservation thereof; also to permit lessor to place on premises notice of "For Sale" and "To Rent" and not interfere with same.

9. To deliver to lessor within _____ days from execution of this lease a surety bond in amount of $ _____ from a reputable bonding company, guaranteeing faithful performance by lessee of all terms and conditions of this lease.

10. Not to assign this lease nor sublet the premises or any portion thereof without written consent of _____.

11. Not to make any contract for construction, repair, or improvements on, in, of, or to premises, or any part thereof, or for any work to be done or materials to be furnished on or to premises, or any part thereof, without providing in such contract or agreement that no lien of mechanics or materialmen shall be created or shall arise against above-described land and/or the building or improvements at any time located thereon. All persons furnishing any work, labor or materials, as well as all other persons whatever, shall be bound by this provision and by the notice of it from and after date of this lease, and notice is hereby given that no mechanic's lien, materialmen's lien, or any other incumbrance made by or obtained against lessee, or lessee's interest in demised land and/or the building or improvements thereon, shall in any manner or degree affect the title or interest of lessor in land and/or the building or improvements thereon. To that end, lessee agrees not to make any contract or agreement, either oral or written, for any labor, services, fixtures, material or supplies in connection with altering, repairing or improving any building or improvement on premises without providing in such contract or agreement that contractor or contractors waive all right to a mechanic's lien, and waive all right of any subcontractor or subcontractors to mechanics' liens, by reason of furnishing any labor, services and/or material under such contract or contracts, whether written or oral, and that such contract or contracts shall, upon execution, be immediately filed in office of recorder _____ of deeds of _____ county, _____ and a copy thereof lodged with lessor.

12. Lessee has examined and knows condition of premises, and has received same in good order and repair, except as otherwise specified in this lease, and no representations as to condition or repair thereof have been made by lessor or lessor's agent, prior to, or at execution of, this lease.

13. Lessor shall have a lien on all of property of lessee used or situated on premises, to secure payment of

rent (and other indebtedness owing from lessee to lessor at any time during existence of this lease) to become due under this lease, and in default of payment may take possession of and sell such of the property as may be sufficient to pay delinquent rent [or indebtedness].

14. Lessor shall have the right to sell premises, provided, however, that notice of such contemplated sale shall be given in writing to lessee at last prior to time fixed for vacation of premises by lessee, and provided, further, that during such period lessee shall have option to buy premises at price and on terms of such contemplated sale. In event of a sale of premises by lessor, after such notice and failure of lessee to exercise the option to purchase, lessee agrees to vacate and give possession of premises within _____ days after written notice of sale, given by lessor to lessee, and after payment by lessor to lessee of $ _____ on or before the expiration of _____ days' notice.

15. If lessee shall abandon or vacate the premises, they may be relet by lessor for such rent and on such terms as lessor may see fit; and, if a sufficient sum shall not be thus realized, after paying all expenses of such reletting and collecting to satisfy the rent hereby reserved, lessee agrees to satisfy and pay all deficiency.

16. At expiration of this lease, to give peaceable possession of premises to lessor, in as good condition as they now are, the usual wear, inevitable accidents, and loss by fire excepted.

17. The lease may be terminated by lessor in the event of the breach of any of the agreements of lessee contained herein, in which case lessor may reenter on the premises, and this lease shall immediately terminate.

18. This lease, at option of lessor, shall terminate in case lessee shall by any court be adjudged as bankrupt or insolvent, or in case lessee shall make an assignment for benefit of creditors.

19. To observe and comply with all rules, regulations and laws now in effect or which may be enacted during the continuance of this lease by any municipal, county, state or federal authorities having jurisdiction over the premises, and to indemnify lessor for any damage caused by violation thereof.

20. In case lessor, by reason of the failure of lessee to perform any of the agreements or conditions contained herein, shall be compelled to pay or shall pay any sum of money, or shall be compelled to do or shall do any act which requires payment of money, the sum or sums so paid or required to be paid, together with all interest, costs, and damages, shall be added to installment of rent, next becoming due or to any subsequent installment of rent, and shall be collectable as additional rent in same manner and with same remedies as if it had been originally reserved. On failure of lessee to make repairs, as provided for herein, lessor may make necessary repairs, and add the amount of cost of such repairs to the rent due on the first month following date of repairs, and such cost of repairs shall be and constitute such rent together with the rent above provided for.

21. Failure of lessor to insist on the strict performance of the terms, agreements and conditions contained herein, or any of them, shall not constitute or be construed as a waiver or relinquishment of lessor's right to enforce any such term, agreement or condition, but the same shall continue in full force and effect.

22. Lessor shall not be liable for any damage to persons or property occurring or arising on premises from any cause whatever.

23. [*add any other affirmative or negative provisions which lessor and lessee have agreed on*].

B. Agreements of Lessor

Lessor, in consideration of the agreements of lessee set forth above, agrees as follows:

1. To keep leased building [or as the case may be] in good repair.

2. Lessee may make such alterations, additions, or improvements in such parts of building as lessee deems necessary, provided, however, written consent of lessor is first obtained.

3. Lessee shall have the right to assign this lease or sublet the premises or any part thereof, subject to the following limitations, viz.:

4. To extend the term of this lease for a further term of _____ years, at the same rental, payable in like manner, and subject to same agreements as are contained in this lease, provided lessee gives written notice to lessor of a desire to renew lease, at least _____ days [or "months"] before expiration of terms of this lease, and provided lessee is not in default in performance of terms and conditions of this lease, and provided this lease is not terminated before expiration of term thereof as provided for herein.

5. In event that at any time during the term of this lease, _____ [*state occurrence*], lessee shall have the right to terminate this lease on the giving of at least _____ days' written notice to lessor.

6. All fixtures erected in or attached to premises by lessee may be removed by lessee at the termination of this lease, provided (a) lessee shall not then be in default in the performance of any of the agreements herein, (b) that such removal shall not permanently injure the building, and (c) that removal shall be made before the expiration of this lease or any extension thereof.

7. Lessee shall have the right, at the end of the term of this lease, or at any time during the term thereof, to purchase property from lessor, or lessor's heirs, executors, administrators and assigns, for $ _____ and, on tendering of such amount in lawful money of United States by lessee as above provided, lessor agrees immediately to deliver to lessee a sufficient warranty deed of premises.

8. Should any more favorable condition be included in any other leases on space in this building, during the life of the instrument, pertaining to termination of lease or rate of rental per square foot, in particular or other conditions in general, these same conditions are made a part of the contract.

9. Not to engage, during the life of this lease, in the city of _____ directly or indirectly, whether as owner, partner, stockholder, or otherwise, in the _____ [*rival*] business.

10. Not to rent, during the term of this lease, the adjoining premises [or as the case may be], owned by lessor, for a business in competition with that of the lessee which is _____.

C. Mutual Agreements of Lessor and Lessee

1. Lessee agrees to deposit with lessor, on signing of this lease, $ _____ in cash as security for payment of rent herein received and faithful performance by lessee of all terms, conditions and agreements of lease, as well as to indemnify lessor for any costs or expense to which lessor may be put by reason of any default by lessee. Lessor agrees to pay interest to lessee on before-mentioned security deposit of $ _____ at rate of $ _____ per annum and to repay lessee the $ _____ so deposited as security, by crediting same on account of payment of rent for last _____ months of demised term, provided that all terms, conditions and agreements of lease shall have then been fully complied with by lessee.

2. If during the term of this lease the premises shall be destroyed by fire, the elements, or any other cause, this lease shall cease and become null and void from date of such damage or destruction and lessee shall immediately surrender premises to lessor and shall pay rent only to time of such surrender. If premises shall be damaged by fire or other cause so as to be capable of being repaired within a reasonable time, lessor shall have to option to repair the same and during time that repairs are being made lessor shall remit to lessee a just and

fair portion of rent according to nature of damage sustained and according to extent that lessee is deprived of use of premises.

3. This lease shall be deemed renewed and extended for the further term of _____ from expiration of term hereby granted, unless either lessor or lessee, at least _____ months prior to termination thereof, shall give written notice to the other of an intention to take possession of, or to surrender, as the case may be, the premises on date fixed herein for the expiration of term. The rent during such extended term shall be at same rate as rate provided for herein, and extension shall be on the terms, conditions and agreements contained in this lease, including this clause.

4. If default be made in the payment of the rent above reserved, or any part thereof or in any of the agreements herein contained, to be kept by lessee, it shall be lawful for, and lessee hereby requests lessor without notice, to declare said term ended, and to reenter premises or any part thereof, either with or without process of law, and lessee or any other person or persons occupying the same, to expel, remove and put out, using such force as may be deemed necessary in so doing, and premises again to repossess and enjoy as in lessor's first estate; and in order to enforce a forfeiture of this lease for default in any of its conditions it shall not be necessary to make demand or to serve notice on lessee, and lessee waives all right to any demand or notice from lessor of lessor's election to declare this lease at an end or of declaring it so to be; but the fact of nonperformance of any of the agreements of this lease, shall in itself at election of lessor, without notice or demand, constitute a forfeiture of lease, and at any and all times after such default, lessee shall be deemed guilty of a forcible detainer of the premises and all notices required by any statute of the state of or otherwise are hereby waived.

5. If lessee shall hold over, after expiration of the term hereby created, with consent of lessor, if shall be deemed a renewal of this lease, and of all the conditions and agreements therein contained for term of _____ and so on from year to year until lease is terminated by either party giving to the other not less than _____ days' notice of termination prior to end of any term.

6. Notices and demands by either lessor or lessee may be given by registered mail with prepaid postage addressed to lessor at _____ or to lessee at _____ subject to the right of either the lessor or lessee to designate by notice in writing a new address to which such notices or demands must be sent. The agreements, conditions and undertakings herein contained shall extend to and be binding on the representatives, heirs, executors, administrators, successors and assigns, of respective parties hereto as if they were in all cases named.

7. Wherever the worlds "lessor" and "lessee" are used herein they shall be read as "lessors" and "lessees" in all cases where there is more than one lessor or lessee and with necessary grammatical changes as if duly made herein. In witness whereof, the parties have set their hands [and seals] the day and year first above written.

8 Personal Property

LEARNING OBJECTIVES

After studying this chapter you will be able to:

- Distinguish between the different categories of personal property
- Define "tangible," "intangible," and "chose in action"
- Categorize general intangibles
- Explain the difference between stocks and bonds
- Define "promissory note"
- Discuss the concept of intellectual property
- Explain patents, marks, and copyrights
- List the different types of gift transfers
- Understand the concept of a bailment
- Distinguish a bailment from a pledge
- Explain the legal rights and obligations of common carriers and innkeepers
- Discuss the property rights incident to accession
- Discuss the property rights incident to confusion
- Apply some practical tips regarding transferring personal property

CHAPTER OUTLINE

CHAPTER OVERVIEW

As stated in the first chapter, the titles that apply to real estate apply equally to personalty. However, there are certain legal rules and doctrines that are applicable only to personal property. This chapter examines the two different categories of personalty—tangible and intangible property—and then addresses the unique rules with respect to the transfer of these items. Bear in mind that the rules and procedures outlined earlier, excluding those that are exclusive to real estate transactions, apply to personalty as well.

Categories of Personal Property

Generally, all non-real property is considered to be personal property, which is divided into tangible and intangible property. **Tangible property** is anything that can be touched and moved, and its value is intrinsic to the item itself. **Intangible property** is that personal property that may have little monetary value, but is representative of something of value. This type of personal property is often referred to as a **chose in action**.

 EXAMPLE:

A man buys a gold watch from Tiffany's. The watch has intrinsic value, and therefore is tangible personal property.

 EXAMPLE:

A woman opens a bank account with $5,000 and receives a bankbook. The bankbook has little intrinsic value, but it represents her right to possess the $5,000. The bankbook is intangible property.

General Tangibles

Most people are only superficially aware of their personal property. Because they see and use the property every day they tend not to identify it. But if a person wishes to transfer an item of personalty, the item must be identified in such a way that there will be no confusion in determining which item was meant should the transferor own similar types of property. Unlike real estate, there is no deed at a county recorder's office to provide a legally sufficient description.

 **EXAMPLE:**

A man owns two 14K gold chains and wants to sell one. The bill of sale should make specific reference to the chain in question to identify it, such as "the 14K gold rope chain, 18 inches long, manufactured in Italy."

Intangibles

General Intangibles

General intangibles include such items as certificates of deposit, corporate stocks, corporate and government bonds, and so forth. Savings and time accounts are typical of the intangible property many people possess.

 **EXAMPLE:**

A man inherits 1,000 shares of IBM stock. These shares are an example of a general intangible.

Corporate **stocks** are documents that represent the owner's percentage interest in the company that issued the stock. Either these **shares** are traded in the open market (the New York Stock Exchange, the American Stock Exchange, NASDAQ, and so forth) or are **closely held**, meaning that the shares are only owned by a few people. In either event, these shares are known as securities whose value represents the value of the company that issued the shares. Shares that are publicly traded on the open market have values that fluctuate each day; the value, or selling price, is reported in the newspaper. Closely held stock, on the other hand, is not publicly traded, so its value is determined each time the shareholder wishes to transfer his shares. Additionally, most closely held companies restrict the transferability of their shares, meaning that the shareholder may not have the right to sell, give, or leave by will the share to whomever he or she wants.

 **EXAMPLE:**

Three friends decide to start a business that they establish as a corporation. To limit the number of owners, they do not sell shares to the public. Furthermore, to maintain control of the business, they sign an agreement whereby none of them can sell his shares to an outsider. These shares thereby become non-transferable.

Bonds can be issued either by companies or by the government, and are evidences of indebtedness.

Bonds operate by having the bondholder lend money to the issuer for a set number of years, and during the period of the loan the bondholder receives interest on the loan. At the end of the period, the bondholder gets her money back. Bonds are usually publicly traded like stock. Bonds are **secured investments**, meaning that the debtor must set aside some property that the bondholder can attach in the case of default. If a bond is issued that does not have some secured property attached to it, it is called a **debenture.**

 EXAMPLE:

To raise money, a corporation issues a bond for $300,000. It agrees to pay the holder 4% interest on the bond for 30 years. The corporation puts $30,000 into a trust account as security for the bondholder in case it defaults on the bond.

Another form of debt intangibles are **promissory notes** that are loans evidenced by a document stating interest payments and a payback date. They are similar to bonds and debentures except that they are issued for a shorter period of time. They are considered items of value because they represent the promissee's right to receive the money indicated in the note.

 EXAMPLE:

A man lends his friend $250 and has the friend sign a promissory note, due in three months. The note represents the man's right to the return of the money, and he may sue the friend on the note if the friend does not repay the loan.

Another example of intangible property is a mortgage, discussed in previous chapters. The mortgage and underlying note represent a debt, an intangible, secured by realty.

Intellectual Property

Intellectual property is any property that was created by a person to which he or she has exclusive use. Intellectual property falls into three categories: copyrights, patents, and marks.

Copyrights are government grants to the author of a writing or the creator of a work of art. Anyone who creates a book, a poem, or any work of art automatically has a common law right to the exclusive use of the work. However, in order to document and protect this right, the work can be statutorily copyrighted with the federal government in Washington, D.C. Once copyrighted, the author or creator has an exclusive right to use the copyrighted property for his life plus 75 years, meaning that it is an asset that can be inherited.

 EXAMPLE:

A lawyer decides to write a text on property law. Once the work is finished, she has the exclusive right to the material for her life, plus 75 years.

The monetary value of a copyright comes from the owner's licensing of that right. A **license** allows the

licensee to use the copyrighted work, paying the copyright owner a fee for the use. As a typical example, a book is copyrighted by the author, and the publisher is licensed to print and sell that book, paying the author a fee known as a **royalty.**

A **patent** is a government grant of exclusive use of an invention, given to the inventor. The patent must be registered with the U.S. Patent Office, and the exclusive right is good only for a period of 20 years, at which point it passes into the public domain. Like a copyright, a patent can be licensed to produce an income to the patent holder.

A **trademark** is the exclusive right to use a name, symbol, or group of words that signify a particular product or service, distinguishing it from similar products and services. If the item is a product, the mark is called a trademark; if the item is a service, the mark is called a **service mark.** Examples would be "Calvin Klein" for a trademark because it identifies a clothing product, or "Schleppers Movers" for a service mark because it represents a moving company.

Marks are registered with the federal government, and the government grants the owner the exclusive right to use the mark for ten years. The mark may be renewed for unlimited ten-year periods, but if not renewed, the owner loses his rights. Additionally, if the owner permits someone to use the mark without his authorization, the owner will lose this exclusive right to the mark.

Methods of Transferring Personal Property

Gifts

A **gift** is a transfer of property from one person to another without a mutual exchange of consideration. If each party receives consideration, the transfer would be a contract of sale (see Chapter 4). With a gift, the titleholder, known as the **donor**, transfers her title to another, the **donee.** Gifts are characterized by the time and method of their transfer:

1. **Inter vivos gift:** This transfer occurs during the life of both the donor and the donee. Typical examples of inter vivos gifts are birthday and wedding presents.
2. **Testamentary gifts:** These are transfers of property that occur upon the death of the donor. The donor's intent to make the gift is evidenced by a legal document called a will that operates to transfer title to a person's property upon the person's death according to his or her expressed intention.
3. **Gifts causa mortis:** These transfers are gifts made in contemplation of the donor's imminent death. Unlike the other types of gifts, a gift causa mortis may be revoked by the donor any time prior to death, and, if the donor does not succumb to the imminent death, the gift is revoked by operation of law. Furthermore, should the donee predecease the donor, the gift is likewise deemed revoked.

To effectuate a gift, three elements must exist:

1. The donor must evidence a **donative intent**, the present intent to make a gift.
2. There must be a delivery of the gifted object to the donee or the donee's agent in the same fashion as the transfer of a deed discussed in Chapter 5.

3. There must be an acceptance of the gift by the donee; the law presumes acceptance absent an indication to the contrary.

Gifts and sales form the two primary methods of transferring property. Although personal property may be transferred without documentation, to transfer realty by gift the donor must still execute a deed as previously described.

 **EXAMPLE:**

To celebrate her graduation from law school, a woman's friends get together and buy her a pearl necklace. They present it to her at the graduation ceremony. All three elements to perfect a gift of personal property have been met—intent, delivery, and acceptance.

Bailments

A **bailment** is the transfer of possession of personal property from one person, the **bailor**, to another person, the **bailee.** A bailment does not transfer title to the object, simply the right of the bailee to possess, and sometimes use, the object until the item is returned. A bailment may be created by an express agreement. The agreement may be either oral or written.

No bailment exists until the object is physically transferred. Several jurisdictions indicate that possession alone may not be sufficient to create a bailment. To create the bailment, an essential feature is the ability of the bailee to exercise control over the object.

Some states will imply a bailment if mere possession exists, but in those jurisdictions the possession, while creating a bailment, does not impose duties on the bailee. Duties do attach once control is demonstrated (see below). Also, a person may become a bailee even if he or she does not know the precise value of the object but has in fact demonstrated the intent to exercise control over the item. This situation is referred to as a constructive bailment.

 **EXAMPLE:**

A woman brings a cloth coat to a dry cleaner. The owner of the store accepts the coat. Unbeknownst to the owner, the coat is a designer original valued at $8,000, and the woman has left a diamond brooch in the coat's pocket. The dry cleaner is a bailee for the coat, even though he was not aware of its value, but not for the diamond brooch because he did not know of its presence in the pocket, would not expect such an item in the pocket, and cannot have a bailment thrust upon him.

Several specific situations with respect to bailments have given rise over the years to particular rules of law:

- *Pledges*. A **pledge** is a bailment in which the possession of personal property is transferred to secure a

debt, somewhat like the collateral for a loan. The bailee, in this instance the creditor, has possession of the object until the debt is repaid. If the debtor defaults, the bailee acquires title to the property. A pawnbroker typifies this type of relationship. In the normal bailment situation, the transfer of title is not an element.

- *Safe deposit boxes*. Because both the bank and the bank customer have keys to the box, the law has determined that a bailor-bailee relationship exists, holding the bank liable as a bailee.
- *Cloakrooms*. A customer leaving a coat with a cloakroom attendant creates a bailment; however, the liability of the owner of the cloakroom may be limited by specific state statute.
- *Parking lots*. Leaving a car in a parking lot does not in and of itself create a bailment, because no actual transfer of possession has occurred. However, if the car owner leaves the keys to the car with the parking lot attendant, a bailment is been created because the attendant now has control of the car.
- *Health clubs and retail stores*. The owner of a health club is a bailee for the customer's clothing left in a locker while the facility is being used, even if the customer keeps the key to the locker. A retailer is a bailee for items set aside while the customer shops, such as putting down packages while trying on clothes.

A bailment only transfers the right of possession, and sometimes use, of the property. It does not transfer title, as would be the case with a sale or a gift.

Typically, a bailee is entitled to absolute possession of the object during the period of the bailment, and may maintain legal actions against anyone who attempts to interfere with this possessory right. Also, a bailee may have certain rights with respect to the use of the property:

- *Express use*. The parties to the bailment may contract, or agree, that the bailee may use the property during the term of the bailment.
- *Implied use*. Certain types of personal property by their nature indicate that the bailee may use the property.

 **EXAMPLE:**

A man puts his dog in a kennel while he is away on a business trip. As part of her responsibility to care for the dog the kennel owner can take the dog for long walks.

- *Incidental use*. Certain necessary use by the bailee may be expected in order to complete the bailment.

 **EXAMPLE:**

A woman lends her friend a diamond necklace. As an incidental use, the friend can clean and polish

the gems.

If a bailee uses a bailed item for purpose that is not expressly agreed upon, implied, or incidental to the bailment, the bailee will be held liable to the bailor for any damage that results from such unauthorized use of the item.

 **EXAMPLE:**

A couple lends their boat to a neighbor so that the neighbor can row across the lake to the town center rather than drive. While it is in his possession, the neighbor decides to rent the boat to some tourists, who damage the boat. The neighbor is held liable because of this unauthorized use of the item.

The modern trend of the law is to hold the bailee liable for ordinary negligence that causes damage to the bailed items. However, the bailee may be held to a standard of absolute liability if the bailee departs from the terms of the bailment or misdelivers the bailed item to someone other than the bailor.

The parties may agree to a limitation of liability clause in their contract, but a blanket waiver of liability is usually disfavored. The bailor may maintain an action against the bailee for breach of contract, or for any injury or destruction of the item.

Common Carriers and Innkeepers

A **common carrier** is a commercial enterprise that transports goods and people for consideration. The definition does not include public agencies that perform the same services. A common carrier is held to the responsibility of an insurer for all goods it transports, meaning that the common carrier is liable for the value of goods if they are damaged or destroyed, even if the injury or destruction is caused by an act of God. However, unless there is an agreement to the contrary, the carrier will not be liable if goods are not delivered according to its printed timetable or its estimated time of delivery. Note that the common carrier is only held to a standard of ordinary care for any injury to the passengers.

An **innkeeper** is a commercial enterprise that rents temporary accommodation to members of the public. As such, the innkeeper is considered an insurer of the guests' property, similar to the common carrier. However, the innkeeper is not liable if the damage to or destruction of the property is caused by the guests' own negligence or fault, an act of God, or a fire not caused by the innkeeper's lack of care. Moreover, the innkeeper is liable for any loss due to burglary, theft, or negligence. The burden is on the innkeeper to evidence that she was not negligent. The innkeeper may limit her liability for loss if she conspicuously posts a notice of such limitation of liability.

Both common carriers and innkeepers have insurer liability with respect to goods left in their possession. Both types of businesses are entitled to a lien on the property in their possession. A **lien** is a right (intangible personal property) of a person who has improved property to retain possession of that property until the cost of the improvement has been paid. To create a lien, there must be a debt created by the lienor having performed a service on the item. Title to the property remains in the debtor, but possession of the property is

in the lienor.

A common carrier is given a common law lien on all items it has agreed to transport. No lien attaches if the property is received from people other than the owner. Innkeepers have liens on all property a guest brings into the inn, even if the property does not belong to the guest. The lienor has the right to retain possession of the items until the debt is discharged, and if it is not discharged, title will vest in the lienor.

 **EXAMPLE:**

A man travels on the Metroliner from Boston to New York. At the train station in New York someone steals his suitcase. The thief checks into a motel with the suitcase. The thief stays one night and then departs without paying his motel bill. Amtrak is liable to the man for the value of his suitcase unless it has limited its liability, and the motel can keep the suitcase left by the thief, even though the suitcase did not belong to the thief.

Other Issues

In addition to the above-discussed methods of transfer, property may be transferred from one person to another without a specific interest or relationship having been created. These methods of acquiring property —accession and confusion—may operate to transfer both personal and real property.

Accession

Accession occurs when one person's labor or materials are added to another person's property so as to increase the value of that property. If this additional value can be severed (removed) from the original item, the court will order such removal. If removal is impossible, the original party may sue for damages. If the change in the nature of the property is deemed so significant that the object is completely altered and its value is greatly increased, the title to the property will pass to the person whose labor or property caused the change.

 **EXAMPLE:**

A person takes lumber from a hardware store and builds a cabinet with the wood. The hardware store owner is entitled to the value of the lumber taken, but the person who made the cabinet may retain the cabinet because the nature of the lumber has now been completely changed. This result is true if the person took the lumber unintentionally, believing that he had purchased it. If the person intentionally took the lumber knowing that he had no right to it, the cabinet will belong to the hardware store owner.

Confusion

Confusion occurs when the personal property of two individuals is mixed together. If the goods are of the same kind and quality and the mixture occurred by inadvertence, the mixture is deemed owned by both parties as tenants in common. If the confusion was caused by the willful act of one of the parties, the

wrongdoer is required to identify his or her portion. If identification is impossible, the entire mixture belongs to the innocent party. If the mixed property can be separated, the court will order such separation.

 **EXAMPLE:**

Two farmers send their grain to the same mill to have it ground into flour. The mill owner fails to realize that two different farmers have brought the grain because they both use the same carrier. He innocently mills all the grain together, and it cannot be determined how much each farmer owns. In this situation, both farmers as tenants in common will own all the flour.

Practical Tips

- Document transfers of personal property in writing to avoid problems with respect to ownership later on.
- Remember that titles to personal property are the same as those for real property, with all the same rights and obligations.
- Transfers of property may be subject to gift taxation—always check the tax implications of the transfer of valuable property.

Chapter Review

No discussion of the law of property is complete without an examination of the law concerning personal property. Personal property is divided into two broad categories: tangible property, moveable property that has intrinsic value, and intangible property, items whose value is representative.

Tangible property is exemplified by clothing, jewelry, art, antiques, electronic equipment, cars, and so forth. It is the type of property that most people own or possess. Intangible property is exemplified by stocks and bonds, bank savings and checking accounts, loans, and the various types of intellectual property such as copyrights, patents, and marks. The intangible aspect of intellectual property is the grant of exclusive use of the item given by the government to the item's creator, inventor, or owner.

Personal property is transferred using procedures that differ from the general methods of conveyancing used to transfer realty. The most common methods of transfer are by gift, in which title passes from the titleholder to another without consideration; by bailment, in which possession, not title, is transferred to a person not the title holder; and by accession and confusion. Furthermore, specific rules apply to common carriers and innkeepers when they acquire possession of another person's personal property.

Ethical Concern

The legal professional often acts as the agent of the client, and is called upon to keep the client's property. The legal professional may not place the client's property with his or her own, which is known as commingling. Such a practice violates the ethical standards of the legal profession. All client property must be

kept separate and distinct from that of the legal professional.

Key Terms

Accession
Bailee
Bailment
Bailor
Bonds
Chose in action
Closely held
Common carrier
Confusion
Copyright
Debenture
Donative intent
Donee
Donor
Gift
Gift causa mortis
Innkeeper
Intangible property
Inter vivos gift
License
Lien
Patent
Pledge
Promissory note
Royalty
Secured investments
Service mark
Share
Stock
Tangible property
Testamentary gift
Trademark
Will

Exercises

1. Determine the type of duty that is owed by innkeepers in your jurisdiction.
2. Differentiate between tangible and intangible property.
3. Indicate how one might demonstrate donative intent.
4. Give three examples of your own experience with bailments.
5. Briefly discuss the concept of intellectual property.

Situational Analysis

A famous artist finishes a painting just before he leaves for a vacation. He gives the painting to a friend to keep it safe while he is away. The artist says that if anything happens to him the friend can keep the painting. On the flight home the plane on which the artist is traveling crashes and the artist is killed. Both the friend and the estate claim the painting. Argue for both sides and decide the matter.

Edited Cases

The two cases that follow highlight some concepts discussed in this chapter. *Pitchford v. Commonwealth of Virginia* underscores the obligations incident to bailments, and *Elias v. Newman* concerns the standards to demonstrate donative intent.

Pitchford v. Commonwealth of Virginia

50 Va. Cir. 266 (1999)

"In this [case] involving a bailment, [the court] must decide what standard of care is imposed upon the bailee by the relationship." *Morris v. Hamilton*, 225 Va. 372, 302 S.E.2d 51 (1983).

The case was tried to the court on September 8, 1999. The court took the decision under advisement after all the evidence. The term bailment is used advisedly because the defendant argues that no bailment is involved for lack of proof that it ever came into possession of the plaintiff's property. A summary of the salient facts are as follows.

Plaintiff, a nurse employed at the Medical College of Virginia, arrived for work around 8:00 to 8:30 on the evening of May 8, 1999. After parking her vehicle in a parking deck adjacent to the hospital, she was accosted there by two men who attacked and beat her. The two ran away after plaintiff said she thought she heard one of them say others were approaching. Plaintiff testified that the next thing she remembered was looking up at the face of a medical resident who found her lying face up on the parking deck floor.

After being attended to by ambulance personnel and fitted with a neck collar at the scene, the plaintiff was transported to the MCV emergency room. While in the receiving room, nurses in attendance removed her jewelry consisting of earrings and a necklace. This was necessary to take x-rays of her upper extremities. Plaintiff testified that she was told to keep still and close her eyes. She was bloodied and beaten about the face, and blood was present over one eye due to a head wound.

At issue is a diamond pendant which was attached to the necklace plaintiff was wearing. Plaintiff has alleged in four counts that the pendant, though taken, was not returned with her other personal effects. Plaintiff testified that she felt the pendant in the back and around the side of her neck during the process of

removal by the nurse. The two nurses who were present, one of whom actually removed the necklace while the other observed, both testified that, when the necklace came off, no pendant was present. During the hearing, the court examined the necklace. There was no visible sign of damage to it.

After remaining in the emergency room for about six to eight hours, plaintiff was released without being admitted to the hospital. As mentioned, after removal of the necklace and after personal items were placed in a bag, the bag was put on the table beside plaintiff's bed. The bag was eventually turned over to plaintiff's supervisor who in turn gave it to plaintiff or plaintiff's daughter after plaintiff's release. Later at home, she discovered that, while the necklace was present, the pendant was not. The parties have stipulated that the diamond pendant has a value of $6,000.

The court will assume that for purposes of a ruling that the diamond pendant was attached to the necklace at the time of removal. Thus, contrary to the position of the hospital, the court assumes a bailment arose. Again, the question is what standard of care is applicable. As I mentioned during the proceedings, it depends on how the bailment is classified. Applicable here, the circumstances suggest either a bailment for mutual benefit or a gratuitous one.

In a bailment "for the mutual benefit of the bailor and bailee, the bailee must use ordinary care for the protection, preservation, and return of the bailed property. If the bailee fails to use ordinary care, he is liable to the bailor for any loss or damage to the property resulting from the bailee's failure." *Volvo White Truck Corp. v. Vineyard*, 239 Va. 87, 91, 387 S.E.2d 763 (1990) (citation omitted). A gratuitous bailment, on the other hand, is one where the possession is given the bailee solely for the benefit of the bailor. "A bailee who acts gratuitously is not held to the same standard of care as one who enters upon the same undertaking for pay. The latter owes a duty of reasonable or ordinary care, while a gratuitous bailee owes only a duty of slight care. Thus, in order for a bailor to recover from a gratuitous bailee, he must prove the bailee was guilty of gross negligence." *Morris v. Hamilton* at 375 (citation omitted).

As noted, plaintiff was asked to remove her personal effects including the necklace, to facilitate the taking of x-rays of her upper extremities, where she had sustained injury. There was testimony that this was needed to exclude skull and bone fracture, among other things. Under these circumstances the hospital came by possession of the necklace for the benefit of plaintiff in the rendition of medical care.

As has also been noted, plaintiff was not admitted to the hospital, but was rather treated in the emergency room and released. Contrary to plaintiff's contention, the evidence does not establish a contract of bailment. Were this the case "[a] different set of principles would apply." *Volvo White Truck Corp. v. Vineyard*, 239 Va. 87, 92, 387 S.E.2d 763 (1990). In such an instance the bailee, here the hospital, would have the burden of persuasion of showing the exercise of "due care to prevent the damage." Id. at 92.

Here, the proof falls short of demonstrating the applicable standard, gross negligence in the instance of a gratuitous bailment; given this finding, plaintiff cannot recover on this basis.

This outcome applies to three of the counts plaintiff has raised: detinue, contract of bailment, and tort of bailment. To the extent that the plaintiff relies on bailment as a basis for detinue, her action fails.

As to the remaining count, conversion, the court will not rely on the assumption that the property was given over. This count alleges essentially a theft of the pendant to the extent that there was an unauthorized exercise of dominion and control with intent to permanently deprive the plaintiff thereof, either by taking or embezzlement. Here the testimony is equally believable as to a taking and a nontaking, plaintiff's testimony

that she felt the pendant around her neck when the nurses were removing it and the nurses' who both testified they did not observe it when the necklace was pulled away. There is no evidence of who may have deprived the plaintiff of the pendant after it came in rightful possession to constitute an embezzlement. Accordingly, the conversion count also fails.

For the foregoing reasons, the court has entered judgment for the defendant.

Case Questions

1. What factors did the court look to to determine that a bailment existed?
2. How does the court define a "conversion"?

Elias v. Newman

2007 U.S. Dist. LEXIS 39303 (S. D. Miss 2007)

This cause came before the Court on May 2, 2007, for trial without a jury pursuant to Fed. R. Civ. P. 52. This is a diversity case requiring application of the law of the State of Louisiana. After careful consideration of the testimony presented at trial and the exhibits introduced into evidence, the Court finds that the Defendant, Gregory Newman, has proven that Gladys Salloum Newman intended to give, and ultimately transfer to him 61,052.65 units of UIH stock and a naked interest in certain funds in her SII account in the amount of $200,670.00. The Court further finds that the Plaintiff, Sandra Newman Elias, has failed to demonstrated that the donations made by Gladys Salloum Newman to Gregory Newman were the product of undue influence, breach of fiduciary duty, or fraud.

FINDINGS OF FACT

Gladys Salloum Newman ("Gladys") was married to Holyne Newman ("Holyne"), and they resided in Franklinton, Louisiana. Holyne and Gladys had three children: Sandra, Gregory, and Cynthia. Holyne and his son, Gregory, both served on the Board of Directors of United Investments Holding, Inc., ("UIH") and some of Holyne's stock certificates with UIH were in the name of "Holyne or Gregory Newman." Additionally, several of Holyne's mutual fund accounts listed Gregory and Holyne as "joint tenants," "tenants in common," or "joint tenants with rights of survivorship." One promissory note from UIH that was in the possession of Holyne was made payable to "Gladys or Holyne or Gregory H. Newman." Another unsigned promissory note dated May 1, 1991, in the sum of $100,000 was made payable to "Holyne or Gregory H. Newman."

Holyne died in 1995, and all of the above-described stock certificates, mutual fund accounts, and promissory notes were inherited by Gladys as dictated by Holyne's will and Louisiana's Succession Law. Holyne and Gladys' daughter, Cynthia, died in approximately 1998, leaving one child, Barry John ("B.J.") Muldrey.

The evidence tends to show that Gladys wanted to carry out Holyne's wishes that certain property be inherited by Gregory and, as a result, she decided to transfer property to Gregory. On April 23, 2001, Gladys signed over in blank a stock certificate for 61,052.65 units of UIH stock. She and her son, Gregory, took the certificate to a neighbor, Susan Corkern's home, so that she could witness Gladys's signature on the

certificate. The stock certificate was later turned in at UIH, and was reissued solely to Gregory. On October 3, 2001, Gladys signed a Ratification of Donation of the 61,052.65 units of UIH stock to Gregory. The Ratification of Donation was prepared by Lamar Richardson, an attorney, using information provided to him by Michael Burris, Gladys's certified public accountant. Richardson testified that he spoke with Gladys concerning the Ratification, and that she was very familiar with the document and understood the transaction. He further testified that she exhibited no reluctance in signing the Ratification.

On June 21, 2002, Gladys executed a Donation Inter Vivos that transferred a naked interest in a SII Investments Account to Gregory and reserved a usufructory interest for life. The Donation Inter Vivos was witnessed by Michael Burris and Michael Andries and was notarized by an attorney, E.B. Dittmer. Andries testified that Gladys was alert and attentive while they were discussing the transaction. The written Donation Inter Vivos provided that the SII account had a balance of $200,670.00. On the same day, she signed a document transferring the funds in her Merrill Lynch account to the SII account. On July 11, 2002, Gladys signed a check in the amount of $100,000.00 made payable to the SII account. The check was filled out by Burris and represented the funds that she had received from a promissory note issued by UIH. Another promissory note was cashed in during the summer of 2002, and a check in the amount of $100,541.67 was made payable to Gladys or Gregory Newman. Gregory endorsed the check and deposited it in his business account. Gregory wrote two checks on his business account, one of which was made payable to the SII usufructory account in the amount of $50,000.00 and another that was made payable to a separate SII account solely owned by Gladys in the amount of $50,000.00. Gregory testified that he overlooked the remaining $541.67, and he has not returned Gladys's portion of those funds. As a result of these three transactions, the SII account eventually had a balance of $283,000.00 by August of 2002.

Michael Burris testified that all of the donations by Gladys appeared to be voluntary. He also testified that he and Gladys frequently discussed her desire that her late husband's wishes be carried out by giving certain property to Gregory. Gregory testified that he never attempted to coerce his mother and that he never yelled at her or made her cry. According to Gregory, he merely asked her to carry out what he believed to be his father's wishes.

In 2003, Gladys moved to the Methodist Seashore Manor in Biloxi, Mississippi. Her daughter, Sandra Elias, was appointed as conservator of Gladys's estate, in February of 2004. In March of 2004, the Chancery Court of Harrison County, Mississippi, authorized a lawsuit on behalf of the conservatorship against Gregory in an attempt to recover the donations made to Gregory by Gladys. On April 8, 2005, Gladys's deposition was taken, and she testified that she may have been doing what she thought was right when she gave the gifts to Gregory. However, at other times, Gladys gave testimony that she intended for her property to be divided equally among her three children. Gladys did not appear at the trial due to her age and health.

CONCLUSIONS OF LAW

Under Louisiana law, "[a] donation inter vivos (between living persons) is an act by which the donor divests himself, at present and irrevocably, of the thing given, in favor of the donee who accepts it." LA. Civ. Code Ann. Art. 1468. Donative intent must be present in order for a donation to be valid. Rose v. Johnson, 940 So. 2d 181, 184 (La. Ct. App. 2006). The donee has the burden of demonstrating donative intent by "strong and convincing evidence." Thomson v. Thomson, 778 So. 2d 736, 739 (La. Ct. App. 2001). A litigant's testimony in his own favor as to donative intent is received with great caution and cannot serve as a

basis for judgment unless strongly corroborated. Fogg v. Fogg, 571 So. 2d 838, 842 (La. Ct. App. 1990). Donative intent "is an invisible thing existing only in the donor's mind, however, where an authentic act is required, the intent can be inferred from the execution of the authentic act." Anderson v. Aetna Life & Casualty, 535 So. 2d 1070, 1073 (La. Ct. App. 1988); see also Phillipe v. Baker, 953 So. 2d 209 (La. Ct. App. Mar. 28, 2007). An authentic act is the signing of a document before a notary and two witnesses. Brown v. Estate of Brown, 635 So. 2d 255, 259 (La. Ct. App. 1994). The general rule, under Louisiana law, is that an authentic act is full proof of the agreement contained therein. Anderson, 535 So. 2d at 1073. LA. Civ. Code Ann. Art. 1536 provides that an authentic act is required for every donation inter vivos of immovable property or incorporeal things. Accounts on deposit and stock certificates are incorporeal movables. Kanz v. Wilson, 703 So. 2d 1331, 1338 (La. Ct. App. 1997) (holding that accounts on deposit are incorporeal); Moncrief v. Succession of Armstrong, 939 So. 2d 714, 721 (La. Ct. App. 2006) (noting that stock certificates are incorporeal). However, money is a corporeal movable that can be donated by manual gift, which is defined as delivery by which the donor relinquishes control or dominion over the property and places it in the dominion of the donee irrevocably. Thomson v. Thomson, 778 So. 2d 736, 739 (La. Ct. App. 2001). Donations inter vivos by manual gift require the simultaneous occurrence of donative intent and actual possession by delivery. Montet v. Lyles, 638 So. 2d 727, 730 (La. Ct. App. 1994).

In this case, Gladys made two separate written transfers by authentic act to Gregory. First, the stock certificate and second, the naked interest in the SII account. Therefore, under Louisiana law, the Court can infer donative intent from those authentic acts. Here, the authentic act only applied to $200,670 of the $283,000 ultimately deposited in the SII account. The Defendant presented the testimony of witnesses who stated that all of the transactions were fully explained to Gladys, and that she was alert, attentive, and understood the transactions. Michael Burris further testified that Gladys acted voluntarily. However, this testimony only pertained to conversations with Gladys that occurred concerning the authentic acts that were executed, and thus, the testimony does not support a finding of donative intent as to the subsequent deposit of an additional $82,330.00 in the SII account. The Court does not find Defendant's evidence of donative intent persuasive as it pertains to the additional $82,330.00 that was deposited into the account. In fact, the Court finds that the best evidence of Gladys's donative intent is what was actually represented in the written document.

Plaintiff attempted to rebut the inference of donative intent using Gladys's deposition testimony that she would like for her estate to be divided three ways. However, Gladys's testimony only reveals her present intent, since she claims that she does not remember making the gifts during 2001 and 2002. Therefore, Plaintiff has failed to rebut the inference of donative intent. As a result, the Court finds that Gladys intended to donate the stock and a naked interest in an account with a balance of $200,670.00. However, the Court finds that Gregory has not demonstrated by strong and convincing evidence that Gladys intended to donate a naked interest in the additional $82,330.00 that was eventually deposited in the SII account.

Plaintiff also argued that the donations should be voided since they were the product of undue influence and/or fraud. The person seeking to set aside a donation inter vivos has the burden of proving fraud or undue influence by clear and convincing evidence. LA. Civ. Code Ann. Art. 1483. The clear and convincing evidence standard requires a party to prove that the existence of either fraud or undue influence is highly probable or much more probable than its nonexistence. Succession of Culotta, 900 So. 2d 137, 142-143 (5th

Cir. 2005). In order to prove fraud, a party must show that there was an intent to defraud or gain an unfair advantage and a resulting loss or damage. Rose, 940 So. 2d at 188 (quoting LA. Civ. Code Ann. Art. 1953). In order to prove undue influence, the plaintiff must prove that the donation inter vivos was "the product of influence by the donee or another person that so impaired the volition of the donor as to substitute the volition of the donee or other person for the volition of the donor." LA. Civ. Code Ann. Art. 1479. "Mere advice, or persuasion, or kindness and assistance, should not constitute influence that would destroy the free agency of the donor and substitute someone else's volition for his own." Succession of Jack Berman, 937 So. 2d 437, 440 (La. Ct. App. 2006) (quoting LA. Civ. Code Ann. Art. 1479, Comment (b)).

In support of the argument that the donations were the product of fraud and/or undue influence, Plaintiff relied upon Gladys's testimony that she would like for her estate to be divided equally among her children. She also relied on the testimony of Gladys's former neighbor, Susan Corkern, who testified that Gladys had told her that she wanted her estate divided equally among her children. Additionally, Gladys's friend, Colleen Magee, testified that she heard Gregory yelling at Gladys over the phone and that the phone conversation caused Gladys to cry. However, Mrs. Magee testified that she [*12] did not know what Gregory and Gladys were discussing during that phone call. Finally, Plaintiff relies upon four wills that Gladys has executed, which specified that her estate should be divided equally among her three children.

In this case, the person in the best position to shed light on the questions of donative intent and undue influence is Gladys. Unfortunately, her deposition testimony is not helpful. Whether Gladys's lapse of memory is genuine or whether her testimony is influenced by a mother's desire to reunite a discordant family, the result is the same. The finder of fact can weigh and consider only the facts presented at trial. In the Court's opinion, the evidence presented by Plaintiff does not meet the exacting burden of demonstrating undue influence or fraud by clear and convincing evidence.

Finally, Plaintiff contends that the donations were the product of a breach of fiduciary duty owed to Gladys. Plaintiff argued that Michael Burris was acting as Gregory's agent during the transactions and that he breached the fiduciary duty he owed to Gladys. However, there was no evidence that Burris was acting as Gregory's agent, and Burris testified that Gladys, not Gregory, was his client. Plaintiff also argued that Gregory breached fiduciary duties he owed to Gladys by virtue of a power of attorney. However, Plaintiff stipulated that Gregory did not abuse the power of attorney. Therefore, Plaintiff did not demonstrate a breach of a fiduciary duty for which Gregory is liable.

CONCLUSION

It is the Court's opinion that Plaintiff has failed to meet her burden of proof, demonstrating by clear and convincing evidence that the donations made by Gladys Salloum Newman to Gregory Newman were the product of undue influence or fraud. The Court also finds that Plaintiff has not demonstrated any breach of a fiduciary duty for which Defendant is liable. Defendant has the burden of demonstrating that Gladys intended to make the donations. In the opinion of the Court, Defendant has established that Gladys intended the donation of the 61,052.65 units of UIH stock and a naked interest in the SII account in the amount of $200,670.00. Defendant has failed to establish Gladys intended to create a naked interest in the additional funds deposited into the SII account in the amount of $82,330.00.

IT IS THEREFORE ORDERED AND ADJUDGED that the Plaintiff is entitled to a Judgment to recover from the Defendant the naked interest in Gladys Newman's SII account in the amount of $82,330.00

All other relief is denied. The Court will enter a judgment accordingly pursuant to FED. R. CIV. P. 58.

Case Questions

1. What factors did the court use to determine that the plaintiff failed to meet her burden of demonstrating a lack of donative intent?
2. What standard did the court articulate is necessary to prove undue influence or fraud?

Additional Case Analysis

1. Two scientists were employed by a university to conduct research into developing new processes relating to MRIs. The employees signed a one-page document in which they agreed to assign their royalties for any patentable inventions they develop to the university. This document also stated that the agreement was not a waiver of their rights pursuant to the university's patent policy, which stated that the university would share royalties on a 50-50 basis with inventors. When the two scientists patented a new MRI process, which was extremely profitable, the university failed to share the monies it received with them, and they sued. The university claimed that the payments that it received were nonshared research fees from licensees, not royalties. How would you decide the case? See *Singer v. Regents of the University of California*, 1997 Cal. App. Unpub. LEXIS 3 (Ct. of App. 1997).
2. The inventor of patented products sold his patents, assets, and world sales rights to a neighbor in exchange for a down payment and 120 monthly installments. Until all the payments were made, the inventor would retain the patents as a security interest. The neighbor then decided to sell the rights to a third person, against the wishes of the inventor, who claimed that the neighbor did not have the right to make the transfer and requested a reversion of all selling rights back to him. The neighbor argued that the selling rights are not personal services and are, therefore, freely assignable. How would you decide the case? See *Superbrace, Inc. v. Tidwell,* 124 Cal. App. 4th 388 (2004).

Glossary

Abatement: Reduction of rent due to lack of habitability.

Absolute ownership doctrine: Allows an owner the unrestricted use of ground water.

Abstract of title: Summary of title transfers of realty maintained by the county recorder's office.

Acceleration payment: Mortgage clause that requires immediate repayment of the outstanding balance if certain occurrences take place.

Accession of the loan: Increase in value of property caused by an act of someone not the property's owner.

Adjustable rate mortgage (ARM): Mortgage with low interest rate the first few years that increases over time.

Adverse possession: Obtaining title to property by possessing the property in an open and notorious manner that is adverse to the interests of the true owner.

Alienate: Transfer property.

Ameliorative waste: Action of a life tenant or possessor that changes the character of the property in a way that increases its value.

Appropriation rights doctrine: Allows water use based on historical use; used in several western states.

Articles of incorporation: Document filed with the secretary of state to create a cooperative or condominium board.

Assessment: Financial obligation of condominium and cooperative unit owners to maintain common areas.

Assignee: Transferee of contractual rights.

Assignment: Transfer of contract rights.

Assignor: Transferor of contractual rights.

Assume the mortgage: The mortgagor's transferee becomes primarily liable on the mortgage.

Assumption agreement: Contract by which a mortgage is assumed.

Attractive nuisance: A natural or artificial situation on land that would entice children onto the realty.

Bailee: Person who acquires possession of personalty.

Bailment: Transfer of possession of personalty.

Bailor: Transferor of the possession of personalty.

Base line: Artificial line used to create rectangular indexing of land; runs east-west.

Block and lot index: Method of recording title to land by the land's description.

Board of directors: Manager of the condominium and cooperative.

Boilerplate: Standard clauses not specifically related to real estate.

Bond: Underlying loan for a mortgage. When issued by the government or a company, it is evidence of indebtedness.

Building code: Government rules regarding construction of buildings.

Bylaws: Document establishing day-to-day operations of an enterprise.

Certificate of non-foreign status: IRS document filed by U.S. citizens involved in a real estate transfer.

Certificate of occupancy: Document prepared by the government indicating that a building is safe to be occupied.

Chattel: Tangible personal property.

Chose in action: Another name for intangibles.

Closely held: Corporation whose shares are not publicly traded.

Closing: The formality of completing the transfer of realty and transferring title; can also refer to the date on which title to property is transferred.

Closing statement: Document determining all costs of a closing.

Cloud on title: Any break in the chain of title that could give rise to a lawsuit with respect to ownership of the property.

Commission: Broker's fee.

Common carrier: Transporter of goods and people.

Common enemy: Concept of draining and removing surface water by any method the landowner chooses.

Common law covenants: Covenants of seizin, right to convey, against encumbrances, quiet enjoyment, warranty, and further assurances.

Community property: Form of title in nine jurisdictions in the United States for legally married couples in which each spouse is deemed to own one-half of the property outright.

Concurrent ownership: Title to property shared by two or more persons collectively.

Condemn: To destroy property for public welfare and safety.

Condition: Fact or event that creates or extinguishes a contractual duty.

Condition precedent: Condition that must occur to create a contractual duty.

Condominium: Form of ownership in which a person owns a portion of the property outright and is a tenant in common with others for common areas.

Condominium association: Group that oversees regulation of the condominium and has authority to maintain common areas.

Condominium declaration: Document used to create a condominium.

Condops: A condominium divided into two parts; a commercial unit and a residential unit, wherein the residential unit is owned by a cooperative.

Confusion: Mixture of personal property that cannot be separated after the mixing.

Consideration: Benefit conferred or a detriment incurred at the request of the other party.

Constructive eviction: Action by the landlord that interferes with tenant's possession.

Contingent remainder: Future interest that takes effect only if a condition is met.

Contractual capacity: Legal ability to contract.

Conveyancing: The process of transferring title to land.

Cooperative: Ownership of shares in an association that permits the holder to possess a unit of the association's property.

Copyright: Exclusive right to a work of art.

Correlative rights doctrine: California doctrine permitting landowner reasonable use of ground water.

Co-tenant: A person who shares title to property.

Covenant: Permanent restriction on land use.

Covenant against encumbrances: Warranty that there are no liens, mortgages, or clouds on the title on the property.

Covenant of further assurances: Warranty that the grantor will protect the grantee from claims on the title in the future.

Covenant of quiet enjoyment: Warranty that no one else has a lawful claim on the property.

Covenant of right to convey: Warranty that the grantor has the legal ability to transfer the title.

Covenant of seizin: Warranty that the grantor has title to and possession of the property.

Covenant of warranty: Warranty that a good title will be passed.

Damages: Monetary remedy.

Debenture: Unsecured corporate loan.

Deed: Document that transfers title to realty.

Defeasible fee: Interest that can be totally lost upon the occurrence of a specified event.

Defect: Condition that causes a significant reduction in the value of property.

Deposit: Money paid to secure a sales contract; a portion of the purchase price.

Doctrine of equitable conversion: Risk of loss passes to the buyer on the signing of the contract.

Dominant tenement: Property that holds an easement.

Donative intent: Desire to make a gift.

Donee: Recipient of a gift.

Donor: Giver of a gift.

Down payment: Portion of the purchase price given to the seller to secure the sale.

Earnest money: Another name for the deposit given when the sales contract is signed.

Easement: The right of access over or use of another's property.

Easement appurtenant: Easement created by adjoining properties.

Easement by necessity: Easement that arises in landlocked situations to give property owner access to public roads.

Easement by prescription: Easement that is created over time in a manner similar to adverse possession.

Easement in gross: Easement that is created for non-adjoining properties.

Emblements: Profits from land use, such as crops, minerals, and timber.

Eminent domain: Power of the government to take private property for the welfare and safety of the public.

Encumber: Place a cloud on title; give a third person some right to the property.

Encumbrance: Anything that puts a cloud on title.

Equitable mortgage: Mortgage is assumed if deed is transferred to secure a loan.

Equitable redemption: A right of a defaulting mortgagor to reacquire the property by paying the loan prior to the foreclosure sale.

Equitable servitude: Restriction on land use enforceable by an injunction.

Equitable waste: Waste arising from the failure to exercise good husbandry.

Escrow: Trust account where funds are held until contract is completed.

Estate: Title to real or personal property.

Estoppel by deed: Doctrine whereby a purchaser of property not owned by the seller will acquire title if the seller subsequently acquires ownership.

Estoppel certificate: Document provided to the buyer by the seller's mortgagee in a sale of commercial realty.

Estoppel letter: Letter provided by tenants in a commercial building indicating the accuracy of their leases.

Eviction: Process of having a tenant removed from a leased premise.

Exclusive listing: Only broker or owner may sell the property.

Exclusive right to sell: Broker receives commission regardless of who sells the property.

Execution: Signing of an agreement.

Executory interest: Future interest that takes effect after a gap in an earlier interest.

Express grant: Easement created by agreement.

Fee: Type of freehold estate.

Fee simple absolute: Complete, unfettered ownership of property.

Fee simple determinable: Fee interest that is lost if a specified use of the property changes.

Fee simple subject to a condition subsequent: Fee interest that can be lost if a specified condition occurs.

Fee simple subject to an executory interest: Fee interest that takes place after a gap.

Fee tail: Fee interest that can only pass to lineal descendants.

Fixture: Chattel that is permanently affixed to the land.

Foreclosure: Right of the mortgagee to sell the land to satisfy the debt.

Foreclosure by advertisement: Foreclosure permitted without court order.

Form 1099-S: IRS tax form filed for real estate sales.

Four unities: The elements a conveyance must contain to create a joint tenancy: time, title, interest, and possession.

Freehold: Estate in land held for an indefinite period of time.

Fructus industriales: Emblements arising from a possessor's efforts.

Fructus naturales: Emblements naturally growing on the land.

General warranty deed: Deed with the common law covenants.

Gift: Transfer of personalty without consideration.

Gift causa mortis: Gift made in contemplation of donor's imminent death.

Grantee: Transferee.

Grantor: Transferor.

Grantor-grantee index: Method of recording titles to realty by transferor and transferee names.

Gross lease: Lease in which the tenant is liable for rent plus utilities.

Ground water: Underground or percolating water.

Hold-over doctrine: Right of landlord against tenant who remains in unlawful possession after the termination of a lawful lease.

Homeowners' association: Another name for the condominium association.

Horizontal privity: Original parties to a covenant must share a common interest.

HUD-1 Uniform Settlement Statement: Government form generally used for all real estate settlements and mandated for those backed by government loans.

Implied easement: Easement that arises by actual use of adjacent property without consent.

Indefeasibly vested remainder: Future interest that cannot be lost.

Indemnification: Agreement to be financially responsible if another is held legally liable.

Innkeeper: One who offers public accommodation.

Installment sale: Sale in which the purchase price is paid over a number of years.

Insurable title: Less clear than marketable title but one that can be insured against claims.

Intangible property: Personal property that represents something of value.

Inter vivos gift: Gift that is transferred during the life of both donor and donee.

Invitee: Person who lawfully enters land for his or her own benefit.

Joint tenancy: Multiple ownership of property with an undivided interest and a right of survivorship.

Judicial foreclosure: Foreclosure sale authorized by a court.

Landlord: Person who grants the use of property through a lease.

Landlord-tenant law: Law concerned with leaseholds.

Land use: Right of access to land permitted to persons who are not owners/ possessors of the land.

Lease: Contract for the right to possess property, creating a leasehold.

Leasehold: Possessory estate in property.

Lessee: Tenant.

Lessor: Landlord.

License: Permission to enter property for a specific act or series of acts. Allows use of a copyrighted work.

Licensee: Person who can enter land subject to a license.

Lien: Claim on property to satisfy a debt.

Life estate: Freehold held for the term of a person's life.

Life estate pur autre vie: Life estate held for the life of a person other than the titleholder.

Life tenant: Person who holds title to a life estate.

Listing agreement: Real estate broker's contract.

Marketable title: Title without any encumbrances.

Measuring life: Person whose life determines duration of the life estate.

Mechanic's lien: Lien automatically given to anyone who performs work on property.

Merger: Where dominant and servient tenement titles are owned by the same person.

Metes and bounds description: Method of describing land by following a course around the boundaries.

Mitigation of damages: Duty of non-breaching party to lessen the money owed by the breaching party.

Mortgage: Security interest to guarantee repayment of a loan.

Mortgagee: Creditor who receives a mortgage.

Mortgage insurance: Insurance to protect against a default on a mortgage loan.

Mortgagor: Debtor who gives a mortgage.

Natural flow theory: Owner may use water from watercourses in a manner that does not affect quality or quantity of the water.

Net rent lease: Landlord remains responsible for utilities.

Note: Underlying debt used to create a mortgage.

Notice: Recording statute giving priority to bona fide purchaser with no notice of other claim.

Notice to attorn: Notice to tenants of a change in ownership of the property.

Nuisance: Interference with the use and enjoyment of real property.

Offer: Proposal to enter into a contract.

Offeree: Person to whom an offer is made.

Offeror: Person who makes an offer.

Open listing: Owner engages several brokers to sell the property, and the commission only goes to the one who consummates the sale.

Ouster: Court-ordered termination of a co-tenant's rights because of failure to meet an obligation.

Partial eviction: Act that interferes with a tenant's possession of a portion of the leased property.

Partition: Court-ordered division of property among tenants.

Patent: Exclusive use of an invention.

Payoff amount: Outstanding amount owed by seller to be paid off by the buyer.

Percentage breakpoint: Type of commercial lease in which the landlord receives a portion of the tenant's gross sales or profits above a set amount.

Percentage rent: Rent based on a percentage of commercial tenant's gross sales.

Percolating water: Ground water.

Periodic tenancy: Tenancy for successive specific periods of time.

Permissive waste: Decrease in value of land due to failure to maintain the property.

Personal property: All property not classified as real property.

Personalty: Personal property.

Plat book: Record maintained at county recorder's office that describes parcels of land.

Plat description: Method of describing property based on a survey.

Pledge: Bailment of property for money.

Possibility of reverter: Automatic reversion of title to grantor in a fee simple determinable.

Premises: Leased realty.

Prime rate: Interest rate banks charge to their best customers.

Principal meridian: Artificial line used to describe rectangular divisions of land; runs north-south.

Prior appropriations doctrine: Water rights determined by historical use.

Private nuisance: Interference with an individual's right of enjoyment of his or her own land.

Promissory note: Evidence of indebtedness.

Proration: Division of rent between the buyer and the seller.

Public nuisance: Interference with the health or safety of the community.

Punch list: Itemized list of remaining problems in newly constructed premises.

Quiet title: Action to have a court decide ownership of property.

Quitclaim deed: Deed in which no covenants are given.

Race: First to record has priority.

Race-notice: To acquire priority, the person must be the first to record without notice of any prior claim.

Radius clause: Provision prohibiting a commercial percentage rent tenant from operating a similar business within a specific geographic area.

Real covenant: Covenant that touches and concerns the land and "runs with the land."

Real Estate Settlement Procedure Act: Federal statute governing real estate closings for all federally guaranteed mortgage loans.

Real property: Land and anything permanently affixed to the land, including vegetation and mineral resources.

Realty: Real property.

Reasonable use: Ordinary and foreseeable use.

Reasonable use doctrine: Permits landowner all reasonable use of the property.

Recording act: Statute that establishes the method of acquiring priority with respect to claims against property.

Rectangular survey description: Description of land created by intersection of base and principal meridian lines.

Redemption: Ability of a defaulting mortgagor to reacquire the property.

Redemption in equity: Mortgages may redeem the property at any time prior to the foreclosure sale by satisfying the debt.

Release: Document that relinquishes legal rights.

Remainderman: Person who ultimately receives a fee interest after intervening estates.

Rent: Fee for use of a property.

Rent escalation clause: Lease provision providing for rent increases over the term of the lease.

Retaliatory eviction: Unlawful eviction of a tenant for asserting legal rights.

Right of entry: Landlord may gain access to premises in the event of a breach of the lease by tenant.

Right of re-entry: Ability of a grantor to regain title to a fee simple subject to a condition subsequent.

Right of survivorship: The right of a joint tenant to succeed to title to property after the death of another joint tenant.

Riparian doctrine: Landowner has unfettered use of watercourse.

Royalty: Fee for use of a copyright, patent, or mark.

Rule Against Perpetuities: All interests must vest, if at all, within 21 years after the death of the lives in being on the date of the initial conveyance.

Salvage doctrines: Statutes enacted to prevent conveyances being found invalid by violating the Rule Against Perpetuities.

Secured investment: Debt with property the bondholder can attach.

Securitization of receivables: Structured finance transaction.

Security deposit: Money given by a tenant to the landlord to be held in a trust account in case of the tenant's default.

Service mark: Trademark that designates a service.

Servient tenement: Property subject to an easement holder's rights.

Settlement: Another name for the closing.

Settlement statement: HUD-1 Statement.

Share: Intangible that represents ownership in a corporation.

Special warranty deed: Deed that only covenants against specific acts of the grantor.

Specific performance: Equitable remedy in which the breaching party is required to perform the contract.

Statutory redemption: Ability to redeem property after a foreclosure sale.

Stock: Another name for a share.

Strict liability: Being held legally responsible for one's actions regardless of any care taken.

Structured finance transaction: Selling shares of mortgages to investors.

Subjacent support: Anyone who occupies the area beneath the property must support the surface and buildings on the property.

Subject to the mortgage: Transferor remains principally liable on the debt and the property can be attached if the transferor defaults.

Sublease: A transfer of a portion of the tenant's rights under a lease.

Sub-prime mortgage: Mortgage loan to a borrower who is a poor credit risk.

Surface rights: Rights to use the land.

Surface water: Water that accumulates on the land.

Survey: Creating a description of a parcel of land.

Tangible property: Personalty that can be touched and moved, and whose value is intrinsic.

Tenancy by the entirety: Joint tenancy for married couples.

Tenancy in common: Multiple ownership of property with transferable interests and no right of survivorship.

Tenancy in partnership: Multiple ownership of property for business partners.

Tenancy in severalty: Title held by only one person.

Tenancy at sufferance: Tenancy resulting when the tenant remains in unlawful possession of the premises.

Tenancy at will: Tenancy created by agreement of the parties with no specific term.

Tenancy for years: Tenancy for a specific number of years.

Tenant: Lessee.

Testamentary gift: Gift made at death by a will.

Time is of the essence: All obligations in a contract must be fulfilled on the dates and times specified or the contract is deemed breached.

Title: Interest in property.

Title insurance: Insurance to protect against a defect in title.

Title search: Making sure the title to property is clear and capable of being transferred.

Touch and concern the land: Requirement to create a real covenant that restricts or requires certain actions.

Tract index: Title recorded by description of the property.

Trademark: Exclusive right to use a name, symbol, or words that designate a product or service.

Trespasser: Person who unlawfully enters onto another's property.

Usual covenants: Common law covenants without the covenant for further assurances.

Variance: Government permission to use property in a manner inconsistent with zoning regulations.

Vendor and Purchaser Risk Act: Statute that passes risk only after the buyer takes possession of the property.

Vertical privity: Necessary relationship from transferor to transferee to create and enforce a real covenant.

Vested remainder subject to complete divestment: Future interest that may be lost due to the happening of a specified event.

Vested remainder subject to a condition subsequent: Future interest that can be lost.

Vested remainder subject to open: Future interest in a class to which members may be added.

Vesting: Having legally enforceable rights.

Voluntary waste: Waste occasioned by deliberate action.

Warranty: Guaranty.

Warranty of habitability: Guaranty that the premises are livable according to local standards.

Waste: Action that lessens the value of the land.

Watercourse: Water on the land coming from rivers, streams, and lakes.

Zoning board: Governmental agency that enforces zoning regulations.

Zoning regulations: Laws designed to limit use of property for governmental geographic design purposes.

Index