and policies of a person, whether through the ownership of voting securities, by contracts or otherwise'...." [53]

The tenant had entered into an agreement with a real estate and financial services firm ("A"), pursuant to which "A" agreed "to provide advisory services" related to the tenant's real estate holdings. Thereafter, the tenant asked "A" to assist the tenant in acquiring the property and "A" agreed to do so.

"In order to ensure that [tenant] paid the lowest possible price, [tenant] and ['A'] agreed to have...['A'] offer to purchase the [property] for exactly $16,280,000, the amount specified in" the ROFR lease provision. The tenant agreed to pay a $365,000 advisory fee upon the closing, if the tenant successfully purchased the property. "A" thereafter submitted a letter to the landlord which "purported to be a 'purchase offer' setting out the 'basic terms and conditions'" pursuant to which "A" or its assignees would agree to purchase the property. The tenant thereafter purported to exercise its ROFR. The landlord thereafter rejected the tenant's purchase offer.

"A" thereafter created a "script" for a tenant executive "to follow when speaking with representatives of [the landlord]." The script provided that the tenant had "learned of the purchase offer only because ['A'] had contacted [tenant] about ['A'] 'surrendering its leasehold.'" The script suggested that the tenant "'steer clear of' mentioning '[t]he meaning of control in the document' or '[t]he meaning of affiliate in the document.'" Although the tenant did not dispute that "A" had sent the script or had received the script, the tenant asserted that it had not discussed or relied upon the script.

The dispute turned "on whether ['A'] qualifies as an 'affiliate' of [tenant] for purposes of the ROFR. If "A" is an affiliate of the tenant, then the ROFR was not triggered. If "A" is not an affiliate of the tenant, then the ROFR was triggered and the landlord was required to sell the property to the tenant for the offered price. The landlord argued that "A" was an "affiliate" of the tenant because "A" was either an agent of the tenant or controlled by the tenant pursuant to "A's" contract with the tenant. The tenant asserted that it neither controlled "A," nor was "A" an agent of the tenant.

The court found that "A" was an "affiliate" of the tenant. The court explained that the ROFR and its related definitions were "plainly drafted to prevent just the sort of gamesmanship [tenant] attempted in this case." The court stated that the "obvious reason to include such a clause in [the lease] is to prevent one counterparty from making a straw-man offer and effectively holding a call option on the property at a below-market price." The court found that "A" is an affiliate of the tenant since the tenant had "the power to direct or cause the direction of the management and policies of ['A'], whether through...contracts or otherwise."

The contract between the tenant and "A" gave the tenant a "measure of control because it effectively required ['A'] to do exactly what [tenant] wanted it to do: namely, make a purchase offer for the... property. That this measure of control came through positive rather than negative reinforcement—i.e., a benefit for complying rather than a punishment for breach—is irrelevant for purposes of the lease agreement, which also includes as 'affiliates' entities 'control[led]...otherwise." The court noted that "A" "only had to submit a purchase offer for the...property in order to collect $360,000" and "A" "effectively bore no risk in the transaction whatsoever." Thus, the court held that under the language of the lease, "A" was "[the tenant's] affiliate—either by contract or, in the alternative, 'otherwise.'" Accordingly, the court dismissed the complaint.

The court further stated that even if the lease language was "initially ambiguous," the result would be the same. The court explained that the tenant's "preferred reading would...give it an unfair advantage, as it would effectively allow plaintiff to employ trickery and deceit to obtain a result for which it did not bargain in the first instance." The court stated that the "world of complex commercial transactions, like politics, may not be 'beanbag,'...- but neither is it Three-Card Monte."

AAR Allen Services v. Feil 747 Zeckendorf Blvd, **13 Civ. 3241, NYLJ 1202654899215, at *1 (SDNY, Decided May 6, 2014), Furman, J.**

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White v. Farrell, 20 N.Y.3d 487, 987 N.E.2d 244 (2013).

No Help for Jilted Sellers as Court Sticks With Precedent

In *White v. Farrell*[11], the New York Court of Appeals ruled that the measure of damages for a buyer's breach of a contract to sell real property, where the contract does not contain a liquidated damages clause as the seller's exclusive remedy,[12] is the difference between the contract price and the fair market value of the property on the date of the breach. In so ruling, the court, citing to Williston on Contracts, professed to follow the rule of decision adhered to by the "majority of jurisdictions" and what it found to be the "longstanding rule in New York" that "the four departments of the Appellate Division…have consistently endorsed," even though the court itself had "never considered the measure of damages for a buyer's breach of a contract to sell real property."

Facts:
The buyers in *White* had sued to recover a $25,000 down payment that the sellers retained after the buyers defaulted on the $1,725,000 contract of sale for a parcel of lakeside property. The sellers counterclaimed seeking actual damages of $348,450—the difference between the contract price and the $1,376,550 price for which the property was eventually sold. The sellers also sought consequential damages totaling $217,636.88 for mortgage and tax payments made after the buyers' default until the closing with the ultimate purchaser. The parties' contract did not contain a liquidated damages provision.

'Date of the Breach' Rule
In deciding cross-motions for summary judgment, the Supreme Court ruled that the buyers had breached the contract and were not entitled to recover their $25,000 down payment. However, the Supreme Court found that the fair market value of the property on the date of the breach was the same as the contract price, and, therefore, by applying the "date of the breach" rule to the sellers' damages claim, it held that the sellers had not suffered any actual damages. The Supreme Court's ruling, which also rejected the sellers' claim for consequential damages as "not valid,"[13] was unanimously affirmed by the Appellate Division without opinion.

Decision:
The Court of Appeals chose to adopt the "date of the breach" rule, which it held to be "settled law," and it declined to adopt "a new rule whereby a seller's damages for a buyer's breach of contract to sell real property is the difference between the contract price and the resale price (assuming, of course, the property is resold in an arm's-length transaction sometime before the conclusion of the lawsuit for breach of the contract)."

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[11] 20 NY3D 487 (2013).
[12] The court quoted Williston's observation that the "date of the breach" damages rule does not apply where "the vensor has elected to accept, as the exclusive remedy, liquidated damages representing the purchaser's deposit." Therefore in those areas of the State in which the prevailing practice is for real estate contracts of sale to include a liquidated damages provision, the *White* decision will now govern the determination of damages in all cases involving the buyer.'
[13] The Court of Appeals noted that the question to what extent the sellers were entitled to recover consequential damages was not a matter to be properly decided on the sellers' appeal.

The court advanced the following three reasons for adopting the "date of the breach" rule as the measure of damages for a buyer's breach of a real estate contract: first, that it "seems to be the rule everywhere"; second, that it is "consistent with the general contract principles that damages 'are properly ascertained as of the date of the breach,' and 'the injured party has a duty to mitigate.'"

Comment:
In sum, as Pigott so aptly noted, under the court majority's "date of the breach" measure of damages rule, "it is the innocent sellers and not the breaching buyers, who must bear the cost of the buyers' breach." If the rule of contract damages is to give the sellers the benefit of their bargain, a rule that inevitably leads to a finding of "no damages," when there is an admittedly blatant buyer default, can hardly be said to give victimized sellers the benefit of their bargain. So long as there are areas in New York State where liquidated damages provisions are routinely not included in the contracts of sale of real property, *White v. Farrell* is a decision that cries out for a legislative reversal.

WestlawNext

White v. Farrell

Court of Appeals of New York. March 21, 2013 20 N.Y.3d 487 964 N.Y.S.2d 467 987 N.E.2d 244 2013 N.Y. Slip Op. 01870 *(Approx. 12 pages)*

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20 N.Y.3d 487

Court of Appeals of New York.

Paula WHITE, Individually and as Executrix of the Estate of Leonard White, Respondent,

v.

Dennis FARRELL et al., Appellants.

March 21, 2013.

Synopsis

Background: Prospective purchaser of real estate filed suit against vendor to recover earnest money down payment after deal fell through, alleging fraudulent inducement, negligent misrepresentation, and unwillingness to close on declared closing date. Vendor counterclaimed for actual and consequential damages for breach of contract. Both sides moved for summary judgment. The Supreme Court, Onondaga County, Brian F. DeJoseph, J., found that purchaser breached contract, but that vendor had not suffered damages. Vendor appealed. The Supreme Court, Appellate Division, affirmed. Vendor appealed.

Holding: The Court of Appeals, Read, J., held that genuine issue of material fact as to fair market value of residential real estate at time of purchaser's breach precluded summary judgment on issue of vendor's damages.

Affirmed as modified.

Pigott, J., concurred and filed opinion in which Smith, J., joined.

West Headnotes (4)

Change View

1 **Appeal and Error** Defects, objections, and amendments

Real estate vendor's notice of appeal, challenging only so much of judgment as denied its claim for actual damages from prospective purchaser when sale of residential property fell through, precluded review of its claim that it was also entitled to consequential damages relating from the breach.

2 **Vendor and Purchaser** Damages

Pursuant to time-of-the-breach rule, a vendor's damages for a purchaser's failure to perform under a contract of sale for real property is the difference between the contract price and the fair market value of the property at the time of breach.

1 Case that cites this headnote

3 **Vendor and Purchaser** Effect of delay or default in performance by purchaser

Vendee who defaults on a real estate contract without lawful excuse cannot recover its down payment.

1 Case that cites this headnote

4 **Judgment** Sales cases in general

Genuine issue of material fact as to fair market value of residential real estate at time purchaser breached contract for its sale precluded summary judgment on issue of vendor's damages in breach of contract action.

1 Case that cites this headnote

RELATED TOPICS

Vendor and Purchaser

- Remedies of Vendor
  - Purchaser Breach of Real Estate Sales Agreement
- Effect of Delay or Default in Performance by Purchaser
  - Purchaser and Vendor Breached Contract

Appeal and Error

- Transfer of Cause
  - Notice of Appeal of Declaratory Judgment Holding Title

Attorneys and Law Firms

***468** Milford, Lynch & Shannon, Syracuse (John A. Cirando, Bradley E. Keem and Elizabeth deV. Moeller of counsel), for appellants.

Mackenzie Hughes LLP, Syracuse (W. Bradley Hunt of counsel), for respondent.

Opinion

OPINION OF THE COURT

READ, J.

***489**246** We are called upon in this appeal to decide the measure of a seller's damages for a buyer's breach of a contract to sell real property. We hold that the measure of damages is the difference, if any, between the contract price and the fair market value of the property at the time of the breach. The price obtained by the seller on a later resale of the property may well bear on damages, depending upon the circumstances. As matters stand in this case, there is conflicting evidence as to the property's fair market value when the buyer defaulted, an issue of fact, which precludes summary judgment.

I

In May 2004, defendants Dennis and Nancy Farrell decided to sell their lakeside property in Skaneateles, New York. The Farrells originally purchased this land in October 2002 and razed the existing structures—a seasonal home, guest cottages and a garage—to build themselves a new single-family, year-round residence as a second home. They resided in New Jersey at the time, but by 2004 the Farrells were considering moving to South *490 Carolina. Because of construction delays, the house in Skaneateles was not **246***469 completed until March or April 2005; a certificate of occupancy was issued on May 31, 2005, a year after the Farrells first listed the property for sale.

On June 12, 2005, the Farrells' real estate agent, Linda Roche, showed the property to plaintiff Paula White and her now-deceased husband, Leonard. That same day, the Whites signed a contract to buy the property for $1.725 million, the Farrells' asking price, and tendered a $25,000 deposit. The $1.7 million balance was to be paid in cash at a closing to be held "on or about July 10, 2005." The contract, which did not state that time was of the essence, was contingent on a satisfactory home inspection; resolution of a number of construction-related items, including one identified as "drainage finished"; and attorney approval. The Farrells executed the contract on June 13, 2005.

At the time the parties reached this agreement, a drainage system intended to divert surface water away from the house was apparently still under construction on the north side of the property, and the leach field for the raised bed septic system was soggy. On June 15, 2005, Mr. Farrell wrote Ms. Roche to advise that "[i]n response to our buyer [i.e., Mr. White] and his concerns" he was prepared to "fix or credit him to make [the] house as close to what he wants as possible." He mentioned one project that would take five or six weeks to complete, and identified the steps then being taken to correct "[t]he water between the garage and [the] house" and "[t]he water in front of the garage." Mr. Farrell added that he lived too far away to hire or monitor contractors, and so would agree to reduce the contract price by $10,000 to cover other items that Mr. White might "choose[ ] to change or modify like bench tops, locks, painting[,] new front lawn[,] etc." Ms. Roche conveyed this information to the Whites' real estate agent; retained a plumber and septic system expert to investigate and remedy water and drainage problems; and kept the Whites' real estate agent closely apprised of progress.

The house inspection was conducted on June 18, 2005. On June 22, 2005, the Whites' attorney approved the contract, subject to proof of real estate taxes being $30,000 or less, and the parties executed a contract addendum. By the addendum, the Whites removed all contingencies in exchange for the Farrells' promise to complete several enumerated tasks, including finishing the drainage system on the north and south sides of the house, and to provide the $10,000 credit. According to Mr. *491 Farrell, while "it was known" when the addendum was signed "that a portion of the property was wet and/or having drainage issues," the cause of the dampness, which he claimed was not present when he and his wife signed the property condition disclosure statement in May 2004 (see Real Property Law § 462), had yet to be figured out. The addendum did not set any time frame or deadline for completion of the work the Farrells committed to accomplish.

Two weeks later, by letter dated July 7, 2005, the Whites' attorney notified the Farrells' attorney that his clients had "elected to terminate the contract [because] upon closer inspection ... the drainage situation [might] never be rectified." He indicated they reached this conclusion after Mr. White toured the site that day with his construction consultant. The Farrells' attorney responded by letter dated July 8, 2005, essentially taking the position that the Whites were well-aware when they signed the contract that additional measures needed to be implemented to fix the septic system and deal with surface water runoff. He outlined what had been done to date, and observed that ***247***470*** Mr. Farrell considered one of the issues now raised by the Whites—the supposed necessity for a retaining wall—"nothing more than a fabricated reason to cancel the contract." He closed by saying that Mr. Farrell would be "more than willing" to meet with Mr. White on the premises to review the work completed and address his concerns, but that "[i]f [Mr. White was] unwilling to discuss the 'alleged issues' in a good faith manner, then we will have no alternative but to relist the property for sale and hold your clients responsible for the damages which might result." On July 13, 2005, the Whites' attorney responded that Mr. White had "no intentions of going forward with the contract," and was "extremely upset that the drainage problem was never disclosed, and in fact [the property condition disclosure statement] affirmatively denie[d] any drainage problem" existed.

On October 4, 2005, the Farrells' attorney sent a time-is-of-the-essence letter to the Whites' attorney, stating that Mr. Farrell had "resolved all issues" regarding required septic modifications on his property; declaring the place, time and date (Oct. 24, 2005) of closing; and enclosing the relevant closing documents. The Whites neither responded to this letter nor showed up at the closing. On July 23, 2005, they had signed a contract of purchase and sale for another piece of property on Skaneateles Lake The Whites closed on this property, for which they paid $1.7 million, on August 24, 2005.

492 On June 6, 2006, the Whites sued the Farrells to recover their $25,000 down payment, alleging fraudulent inducement, negligent misrepresentation and that the Farrells were not ready, willing and able to close as of the declared closing date in October 2005. In particular, the Whites claimed that they made the offer to purchase and tendered the earnest money in reliance on the Farrells' representation in the property condition disclosure report, attached to the contract, that there were no flooding, drainage or grading problems resulting in standing water on the property On July 31, 2006, the Farrells answered and counterclaimed for damages for breach of contract.

During discovery, the Farrells' real estate agent, Ms. Roche, was deposed by the Whites' attorney She testified that she had worked as a broker in the Skaneateles area since 1980; that she would generally be considered an expert regarding the value of properties around the lake; and that real estate appraisers and bankers looked to her when they wanted an accurate estimate of value in the Skaneateles real estate market. When asked a series of questions about fair market value, Ms. Roche opined that $1.725 million was the fair market value of the **Farrells**' property in May 2004 (when it was first listed), June 2005 (when the contract was signed), July 2005 (when the **Whites** repudiated the contract), and October 2005 (the date set for conveying title). She added that $1.725 million was also the fair market value of the **Farrells**' property in the spring and summer of 2006 "because everything still was selling at ... 1.5 to 3 million in 2006 ... We were still in a very heated market." Ms. Roche acknowledged that the only offer the **Farrells** ever received in the $1.725 million "range" was from the **Whites**. On January 11, 2007, while this lawsuit was pending, the **Farrells** accepted a purchase offer of $1,376,550 from a third party, to whom they conveyed the property on March 9, 2007.

On December 14, 2009, the **Farrells** moved for summary judgment to dismiss the **Whites**' complaint and award them damages on their counterclaim, They sought $348,450 in actual damages (the difference between the original contract ***248***471*** price of $1.725 million agreed to by the **Whites** and the eventual sale price of $1,376,550), and consequential damages of $217,636.88 (apparently, the sum of mortgage and tax payments made on the property from July 7, 2005 until the closing with the ultimate purchaser on March 9, 2007). The **Whites** opposed the **Farrells**' motion and cross-moved for summary judgment to dismiss the counterclaim and compel the **Farrells** to return the $25,000 deposit.

1 ***493*** On February 9, 2010, Supreme Court handed down a bench decision disposing of the parties' motions. The judge concluded that the **Whites** had breached the contract, and so were not entitled to return of their $25,000 down payment. He adopted as the measure of the **Farrells**' actual damages the standard stated in *Webster v. Di Trapano*, 114

A.D.2d 696, 699, 494 N.Y.S.2d 550 (3d Dept.1985)—i.e., "the difference between the contract price and the market value of the real property at the time of the breach." The judge then reasoned that, in view of Ms. Roche's deposition testimony that the property's "market value at the time of the breach was, in fact, the same as the contract price," the buyers (the **Whites**) had established that the sellers (the **Farrells**) did not suffer any actual damages on account of the buyers' breach. Additionally, he ruled that the **Farrells'** claim for consequential damages was "not valid." The **Farrells** appealed from so much of Supreme Court's subsequent order, entered on June 9, 2010, as determined that they suffered no actual damages; the **Whites** did not cross-appeal. The Appellate Division unanimously affirmed the order, insofar as appealed from, without opinion (87 A.D.3d 1309, 930 N.Y.S.2d 171 [4th Dept.2011]). We subsequently granted the **Farrells** leave to appeal (18 N.Y.3d 809, 944 N.Y.S.2d 479, 967 N.E.2d 704 [2012]).[1]

II

The **Farrells** argue that Supreme Court should have measured damages by applying a principle articulated by the Third Department in *Di Scipio v. Sullivan*, 30 A.D.3d 660, 816 N.Y.S.2d 576 (3d Dept.2006). In that case, the buyer in a real estate transaction died suddenly several days before the scheduled closing. Following the appointment of an administrator for the buyer's estate, the seller declared time to be of the essence and scheduled two closing dates. When the administrator failed to close, the seller brought an action for breach of contract. Supreme Court granted, and the Third Department affirmed, an order determining that the administrator breached the contract, which entitled the seller to retain the 10% down payment of $99,900 as damages.

The seller then sought an inquest, claiming that he had suffered further actual or consequential damages. After the ***494** inquest, Supreme Court ruled that the seller had not proven any additional damages by a preponderance of the evidence. The seller then appealed, claiming that he had shown further damages consisting of a real estate broker's commission owed and real estate taxes, mortgage interest, maintenance expenses and utilities paid. The Third Department disagreed, stating in dictum that

> ***472**249 "the measure of damages incurred as a result of a breach of a real estate contract is *either* the difference between the contract price and a subsequent lower sale price *or*, where no subsequent sale has occurred, the difference between the contract price and the market value of the real property at the time of breach. Here, [the seller] spurns the commonly accepted measure of damages and, instead, seeks recovery for the aforementioned items," which the court considered to be unrecoverable consequential damages or expenses not proximately caused by the buyer's breach (*see Di Scipio v. Sullivan*, 30 A.D.3d 677, 677–678 [816 N.Y.S.2d 578] [3d Dept.2006] [emphasis added and citations omitted]).

The **Farrells** take *Di Scipio* to mean that the measure of a seller's actual damages for a buyer's breach of a contract to sell realty is always the difference between the contract price and any later lower selling price, and ask us to adopt this as the rule of decision. The majority of jurisdictions, however, adhere to a different standard, succinctly explained in Williston on Contracts as follows:

> "Unless the vendor has elected to accept, as the exclusive remedy, liquidated damages represented by the purchaser's deposit, where the vendor sues the purchaser for breach of contract, the vendor may recover for the loss of the bargain, and *the generally accepted measure of damages is the difference between the contract price and the fair market value of the property at the time of the breach* The vendor may recover damages in the amount of the contract price reduced by the fair market value of the property, less any deposit or earnest money paid by the purchaser.... *The price obtained by the vendor on a later resale of the property may be regarded as competent evidence of its fair market value on the date of the purchaser's breach, provided that the **495 market conditions are similar and the time elapsed between the date of the breach and the date of the resale is not too great* " (13 Lord, Williston on Contracts § 66:80 [4th ed.] [emphasis added]; *see also* 14 Powell on Real Property § 81.04 [2] [b] at 81–183 [Michael Allan Wolf ed., Lexis–Nexis Matthew Bender 2000] [where the buyer breaches a contract for the sale of real property, "(t)he damage award is set by determining the difference between the contract price and the property's market value at the time of breach"]; Korngold, *Seller's Damages from a Defaulting Buyer of Realty: The Influence of the Uniform Land Transactions Act on the Courts*, 20 Nova L. Rev. 1069, 1073 [1995–1996] [collecting cases and noting that "(c)ourts typically declare that the measure of a seller's damages for a buyer's failure to

perform under a contract of sale for realty is the difference between the contract price and the market value of the property on the date of the breach"]; Calamari & Perillo's Hornbook on Contracts § 14.30 [6th ed. 2009] ["If the vendee breaches, it seems to be the rule everywhere that the vendor may recover standard contract damages: the difference between the unpaid contract price and the market value of the real property at the time of the breach"]).

We have never before considered the measure of damages for a buyer's breach of a contract to sell real property. The four departments of the Appellate Division, however, have consistently endorsed the time-of-the-breach rule, although there are certainly cases where the standard used is not stated, or it is not made clear that the resale price is simply evidence of the property's fair market value at the time of the breach.

***473**250* In *Hayden v Pinchot,* 172 App.Div. 102, 158 N.Y.S. 215 (1st Dept.1916), there was conflicting proof at trial of the property's market value at the time the buyer broke the contract of purchase and sale. The First Department affirmed the trial judge's finding as to fair market value, concluding that it was not against the weight of the evidence. In so doing, the court observed that "[t]he rule seems to be well settled that the measure of damages for the breach of a contract by the vendee is the difference between the contract price and the market value of the property at the time of the breach" (*id.* at 105, 158 N.Y.S. 215).

*496 The Second Department in *Cohen v. Kranz,* 15 A.D.2d 938, 226 N.Y.S.2d 509 (2d Dept.1962), *aff'd,* 12 N.Y.2d 242, 238 N.Y.S.2d 928, 189 N.E.2d 473 (1963) did not state the rule applied to affirm a trial judge's award of damages amounting to the difference between the contract and resale prices, less the buyer's down payment. On appeal, we addressed other issues presented by the case. With respect to the measure of damages, we observed only that the sellers "obtained an affirmative recovery on their counterclaim for breach of contract based on the loss they sustained when they sold the house to a third person for what the courts below found to be its fair market value" (*id.* at 247, 238 N.Y.S.2d 928, 189 N.E.2d 473).

The seller in *Procopis v. G.P.P. Rests.,* 43 A.D.2d 974, 352 N.Y.S.2d 230 (2d Dept.1974) sought as damages the difference between the contract price and the property's fair market value at the time of the buyer's breach, which he argued was the resale price. The judge, after a nonjury trial, agreed and awarded damages in the amount asked for. The Second Department reversed, reasoning that "although the subsequent sale [was] some evidence of the fair market value of the property at the time of the breach, standing alone it [was] insufficient proof ... upon which to predicate [sellers'] damages," especially since the terms of the resale were "substantially different ... from those contained in the contract sued upon" (*id.* at 975–976, 352 N.Y.S.2d 230).

In *Colonial Diversified v. Assured Holding Corp.,* 71 A.D.2d 1011, 420 N.Y.S.2d 419 (2d Dept.1979), the judge, after a nonjury trial, dismissed the seller's counterclaim for damages for breach of contract and directed return of the buyer's down payment. The Second Department reversed, holding that "it [was] apparent that the [buyer] was the defaulting party, and as a result [was] barred from recovering its down payment, as well as remaining liable for damages sustained by the [sellers] by virtue of its default" (*id.* at 1012, 420 N.Y.S.2d 419 [citations omitted]). The court noted that at trial the sellers presented expert testimony to show that the market value of the property at the time of the buyer's breach was $32,000, and also proved they were only able to resell the property for that amount. Accordingly, the Second Department ruled that the sellers were entitled to recover the difference between $32,000 and the contract price, less the down payment already in their possession

In addition to *Di Scipio,* the Third Department has in relatively recent years considered four other appeals in cases where the trial judge, after a nonjury trial, assessed damages for a buyer's breach of a contract to sell realty. In *Tator v. Salem,* (81 A.D.2d 727, 728, 439 N.Y.S.2d 497 [3d Dept.1981])*497 the Third Department affirmed an award of $10,000 in "direct damages," which was the difference between the original contract price and the eventual sale price. The decision is silent as to the standard applied.

***474**251* In *Webster,* the case relied upon by Supreme Court to support the bench decision and order here, the trial judge computed damages for the buyer's breach by subtracting the real property's eventual sale price from the contract price. Citing the First Department's decision in *Hayden*, the Third Department "[found] merit in [the sellers'] argument that the proper measure of damages is the difference between the contract price

and the market value of the real property at the time of breach" (*Webster*, 114 A.D.2d at 699, 494 N.Y.S.2d 550). Since the trial judge "expressly found" that the property's market value at the time of the breach was higher than the resale price, and this higher figure was supported by the evidence, the court concluded that calculation of damages using the resale price was " inappropriate," and remitted for purposes of recalculation. (*Id.*)

The Third Department in *Matzkowitz v. Prince*, 195 A.D.2d 842, 600 N.Y.S.2d 799 (3d Dept.1993), *lv. denied*, 83 N.Y.2d 751, 611 N.Y.S.2d 133, 633 N.E.2d 488 (1994) recast somewhat the rule stated in *Webster*. There, the seller contended that the trial judge had erred by calculating damages using the price for which the property was sold some 11 months after the breach. The court stated that "[o]rdinarily, '[sellers] are entitled to the difference between the price established in their contract with [buyers] and the amount ultimately received for the [real] property' *unless there is evidence that the fair market value at the time of the breach is otherwise* " (*Matzkowitz*, 195 A.D.2d at 842, 600 N.Y.S.2d 799, quoting *Binks v. Farooq*, 178 A.D.2d 999, 1001, 578 N.Y.S.2d 335 [4th Dept.1991], *lv. denied*, 80 N.Y.2d 752, 587 N.Y.S.2d 904, 600 N.E.2d 631 [1992], discussed later, and citing *Tator*, *Cohen*, and *Webster*, discussed earlier [emphasis added]). And "[w]hile ... [the buyer] offered expert testimony of market value at the time of the breach in excess of the amount ultimately received, [the sellers'] expert offered contrary opinion evidence which created a credibility issue for determination by the trial court" that the Third Department was "loath to disturb" (*id.*).

In *Ashton v. McLenithan*, 224 A.D.2d 749, 636 N.Y.S.2d 936 (3d Dept.1996), the sellers commenced an action alleging fraud and breach of contract for the sale of a parcel of land. The parties reached a settlement agreement in open court whereby the sellers agreed to sell the parcel with a newly constructed home to the buyers for $300,000. The buyers failed to perform in accordance with ***498** this agreement, and the sellers sought judgment for the agreed-upon amount. At the subsequent nonjury trial held to determine the sellers' damages "as the difference in value of the settlement amount and the actual value of the house at the time of the breach," both parties submitted expert evidence on this issue (*id.* at 749, 636 N.Y.S.2d 936). The trial judge found the value of the property to be $214,000 "based upon the assessments of value offered by both experts," and "determined damages to be the difference between the settlement price and the value at the time of the breach" (*id.* at 750–751, 636 N.Y.S.2d 936). The Appellate Division concluded there was "sufficient evidence for Supreme Court to have made its assessment within the range of values given" (*id.* at 751, 636 N.Y.S.2d 936). This property was apparently not resold while the lawsuit was pending.

The Fourth Department in *Binks*, reversing the trial court, ruled that the buyers had breached their contract to purchase the sellers' apartment complex. Stating that the sellers were "entitled to the difference between the price established in their contract with [the buyers] ***252***475** and the amount ultimately received for the property," the court awarded the sellers this amount, which was "uncontroverted," less the buyers' down payment, ordered to be released from escrow to the sellers (178 A.D.2d at 1001, 578 N.Y.S.2d 335). In support of its ruling, the Fourth Department cited our decision in *Tague Holding Corp. v. Harris*, 250 N.Y. 422, 165 N.E. 834 (1929) [the seller was awarded profits lost when the buyer defaulted on an installment contract for the purchase of land that the seller had contracted to buy from a third party], which deals with consequential damages, *Tator* and *Cohen*.

In *Tesmer Bldrs. v. Cimato*, 217 A.D.2d 953, 629 N.Y.S.2d 594 (4th Dept.1995), the trial court awarded the buyer summary judgment on its claim to recover a down payment. The Fourth Department reversed, holding that the buyer's unilateral rescission of the contract for the sale of real property constituted an anticipatory breach, entitling the sellers to retain the down payment. The court endorsed a judgment in favor of the sellers representing the difference between the contract price and the resale price, while observing that the buyer had "not controverted the claim of damages asserted by the seller" (*id.* at 954, 629 N.Y.S.2d 594).

The Fourth Department in *Ryan v. Corbett*, 52 A.D.3d 1270, 859 N.Y.S.2d 808 (4th Dept.2008) agreed with the buyer that the trial court had erred by relying on *Di Scipio* when assessing the amount of the sellers' damages caused by the buyer's breach of the parties' contract of purchase and sale. In sum, "[b]ecause there was a ***499** subsequent sale of the [sellers'] residence, the court in reliance on *Di Scipio* did not consider evidence of the market value of the property at the time of the breach, and it awarded [the sellers] the difference between the contract price and the price received upon the subsequent sale of

the property" (*id.* at 1270, 859 N.Y.S.2d 808). Instead, the Fourth Department agreed with the Third Department's decisions in *Matzkowitz* and *Webster*. But although "agree[ing] with [the seller] that the [trial judge] erred in failing to consider the testimony of her expert appraiser with respect to the fair market value at the time of the breach," the court "nevertheless conclude[d], upon [its] independent review of the record, that the expert's testimony did not establish 'that the fair market value at the time of the breach [was] otherwise[;]' i.e., it did not outweigh the evidence of value established by the subsequent sale of the property" (*id.* at 1271, 859 N.Y.S.2d 808 [citation omitted], quoting *Matzkowitz*, 195 A.D.2d at 842, 600 N.Y.S.2d 799).

III

2 We reject the **Farrells**' invitation to put aside settled law and adopt a new rule whereby a seller's damages for a buyer's breach of a contract to sell real property is the difference between the contract price and the resale price (assuming, of course, the property is resold in an arm's length transaction sometime before the conclusion of the lawsuit for breach of contract). The time-of-the-breach rule is longstanding in New York, as illustrated by the preceding Cook's tour of appellate decisions from throughout the State and as early as 1916; "seems to be the rule everywhere" in the United States (*see* Calamari & Perillo, *supra* at 495); and is consistent with the general contract principles that damages "are properly ascertained as of the date of the breach," and "the injured party has a duty to mitigate" (*see Brushton–Moira Cent. School Dist. v. Thomas Assoc.*, 91 N.Y.2d 256, 262–263, 669 N.Y.S.2d 520, 692 N.E.2d 551 [1998] [measuring damages for breach of a construction contract from the date of the breach rather than from the date of the damages trial held 13 years ***253***476** later]). This is not to say that resale price is irrelevant to the determination of damages; in fact, the resale price, in a particular case, may be very strong evidence of fair market value at the time of the breach. This is especially true where the time interval between default and resale is not too long, market conditions remain substantially similar, and the contract terms are comparable (*cf. e.g. Procopis*, discussed earlier).

3 In the view of the concurring judges, the "better rule" for calculating a seller's damages when a buyer breaches a contract ***500** to sell real property "is found in the Uniform Land Transactions Act" (ULTA) (*see* concurring op at 502). The relevant provision states that the wronged seller "may resell the real estate ... and recover any amount by which the unpaid contract price ... exceeds the resale price, less expenses avoided because of the buyer's breach" (ULTA [1975] § 2–504[a]). Initially approved by the National Conference of Commissioners on Uniform State Laws (the National Conference) in 1975 and intended to be the Uniform Commercial Code of real estate law, ULTA was something of a flop. It was never adopted by any state, and was withdrawn by the National Conference in 1990 (*see* Brown, *Whatever Happened to the Uniform Land Transactions Act?*, 20 Nova L. Rev. 1017, 1018 [1996]). Further, ULTA's measure-of-damages rule for a buyer's breach appears to have been adopted judicially by only a single intermediate appellate court some 20 years ago (*see Kuhn v. Spatial Design, Inc.*, 245 N.J.Super. 378, 585 A.2d 967 [Super.Ct.App.Div.1991] [where the buyer breaches a contract to purchase real estate, the seller may recover the difference between the contract price and the resale price and any incidental and consequential damages, less expenses avoided as a result of the breach]). This is not surprising, as the ULTA rule is not conspicuously fairer or easier to apply than the time-of-the-breach rule. And as we noted in *Maxton Bldrs. v. Lo Galbo*, 68 N.Y.2d 373, 509 N.Y.S.2d 507, 502 N.E.2d 184 (1986), where we reaffirmed a seller's right to retain the down payment when the buyer in a real estate transaction wrongly fails to perform,[2] adherence to tradition is

> "particularly apt in cases involving the legal effect of contractual relations. In fact, when contractual rights are at issue, 'where it can reasonably be assumed that settled rules are necessary and necessarily relied upon, stability and adherence to precedent are generally more important than a better or even a "correct" rule of law' " (*id.* at 381, 509 N.Y.S.2d 507, 502 N.E.2d 184, quoting ***501** *Matter of Eckart*, 39 N.Y.2d 493, 500 [384 N.Y.S.2d 429, 348 N.E.2d 905] [1976]; *see also People v. Damiano*, 87 N.Y.2d 477, 488, 489 [640 N.Y.S.2d 451, 663 N.E.2d 607] [1996, Simons, J., concurring] ["common-law decisions should stand as precedents for guidance in cases arising in the future" for substantial reasons of stability and legitimacy, subject to "reexamination if there is ***254*****477** some evidence that the policy concerns underlying them are outdated or if (existing rules) have proved unworkable"]).

IV

4 Here, the **Farrells** contend that Ms. Roche's opinion as to the value of their property on the date of the breach (which is October 24, 2005, given the facts) is not entitled to any weight; contrariwise, the **Whites** maintain that Ms. Roche's opinion is conclusive as a matter of law, which is how Supreme Court seems to have treated it. Ms. Roche's deposition testimony does not lack factual support, as the **Farrells** protest: she is an experienced broker in the Skaneateles area; she explained the factors she considered to come up with $1.725 million as the property's listing price and fair market value, including what the **Farrells** paid for the property in 2002 (she was the seller's broker at the time), the cost of the improvements they subsequently made, and the size and lake frontage of other properties selling in the $1.5 to $3 million range in 2005 and 2006 (although she did not describe or discuss the property the **Whites** actually bought for $1.7 million in August 2005). But fair market value is a question of fact, and in this case there was evidence contradicting Ms. Roche's testimony, including the property's substantially lower eventual sale price. As a result, neither party was entitled to the summary judgment both sought and the **Whites** successfully secured in Supreme Court. Notably, in the Appellate Division decisions discussed earlier the trial judges determined damages only *after* a trial or Inquest. On remittal, the judge in this case will need to consider at least the following factors relevant to damages: whether, or the degree to which, the property's resale in January 2007 for $1,376,550 reflects fair market value as of October 2005, given the lapse of time (about 14 months) and any differences in market conditions and contract terms; whether the **Farrells** made sufficient efforts to mitigate (i.e., to resell at a reasonable price after the **Whites**' default), which is relevant to any weight to be given the resale price as a measure of fair market value at the time of the ***502*** breach; and the cost to remedy the property's drainage deficiencies, which, like the cost to complete several other specified tasks and the $10,000 credit—all agreed to by the parties in the contract addendum—should be subtracted from $1.725 million (the original contract price) in order to establish the contract price to be compared to the property's fair market value in October 2005.[3]

Accordingly, the order of the Appellate Division should be modified, without costs, by remitting to Supreme Court for further proceedings in accordance with this opinion, and, as so modified, affirmed.

PIGOTT, J. (concurring).
I concur in the result reached by the majority, but I disagree with its rationale because, in my view, the majority is blurring an important distinction between the measure of damages for breach of real estate contracts and the measure of damages in other sales.

Real property is and has always been treated differently from other sales, mainly because real property, by its very nature, is unique (*see* 1–3 Warren's Weed, New York Real Property § 3.01 [1] [f]). There is no dispute here that the buyers breached the contract. The sellers should therefore recover the benefit of their bargain from the buyers. In this case, that may very well be $348,450, the difference between the contract price and the subsequent sale price, subject, of course, to any ***255***478*** evidence proffered by the buyers that the sellers failed to act with due diligence to mitigate their claimed loss. Any other measure is a fiction. To flatly suggest, as the majority does, that the measure should be "fair market value" at the time of the breach would almost always mean the actual contract price, for the simple reason that a willing seller and willing buyer had established that price at arm's length. The end result is that a seller will rarely be damaged by a purchaser's breach for any reason.

Under the majority's rule, it is the innocent sellers, and not the breaching buyers, who must bear the cost of the buyers' breach. In my view, the better rule is found in the Uniform Land Transactions Act:

> "If a buyer wrongfully rejects, or otherwise commits a material breach, or repudiates as to a substantial part of the contract ..., the seller may resell the ***503*** real estate ... and recover any amount by which the unpaid contract price ... exceeds the resale price, less expenses avoided because of the buyer's breach" (Uniform Land Transactions Act [ULTA] [1975] § 2–504[a]).[1]

Not only does this rule recognize the unique character of real estate transactions and provide some certainty for the nonbreaching seller, it also places the risk where it properly belongs, i.e. on the breaching buyer. This rule is not one-sided, affording protection to the breaching buyer should the seller be fortunate enough to resell the property at the same or

a higher price (*see* ULTA § 2–504[f] [stating that the seller will not be "accountable to the buyer for any profit made on any resale"]).

The nonbreaching sellers are entitled to the benefit of their bargain, and that benefit should not be denied by the application of a rule that fails to take that basic tenet into account. The cases cited by the majority in support of the "time-of-the-breach" rule appear to apply the rule by rote (majority op at 495–499), detached from the reality of realty by failing to consider the legal consequence of an axiom that is harmful to the nonbreaching party.

The majority ultimately supports its adoption of the "time-of-the-breach" rule—which is common in contract law and in the Uniform Commercial Code[2] where the parties are dealing in common activities or fungible goods—by relying primarily on a case involving a school district's cause of action seeking the cost of replacing or repairing defective window panels that had been installed in its building (*see Brushton–Moira Cent. School Dist. v. Thomas Assoc.,* 91 N.Y.2d 256, 669 N.Y.S.2d 520, 692 N.E.2d 551 [1998]). There, the Court, applying general, black letter law, stated that "damages for breach of contract are ordinarily ascertained as of the date of the breach" (*id.* at 261, 669 N.Y.S.2d 520, 692 N.E.2d 551 [citations omitted]).

But real property, unlike window panels, is not fungible. While there are usually extensive and active markets for fungible goods, thereby making it relatively less difficult for the seller to mitigate or cover in the event of a breach, the sale of real estate is clearly different because each parcel is unique (*see Alba v. Kaufmann,* 27 A.D.3d 816, 818, 810 N.Y.S.2d 539 [3d Dept.2006]; *EMF Gen. Contr. Corp. v. **256***479 Bisbee,* 6 A.D.3d 45, 774 N.Y.S.2d 39 [1st Dept.2004], *lv. denied,*504* 3 N.Y.3d 607, 785 N.Y.S.2d 25, 818 N.E.2d 667 [2004]). As a result, the pool of buyers is plainly smaller for real estate than goods, and when a buyer breaches a real estate purchase agreement, the seller must then commence the sale process anew, which may require a reassessment of the list price and more showings of the property to new buyers, who may or may not find the property's location, amenities or architectural style desirable. This may take a substantial amount of time and effort on the seller's part, and the seller's efforts may not readily succeed, because once the house has been on the market for a significant period of time, the market may have declined or prospective purchasers may be wary of the amount of time the house has been on the market, leading them to conclude that the property is tainted in some fashion. Meanwhile, under our holding today, the breaching buyer will walk away indifferent to the hardship caused to the seller by his conduct.

The majority agrees that "the resale price, in a particular case, may be very strong evidence of fair market value at the time of the breach," especially if "the time interval between default and resale is *not too long,* market conditions remain substantially similar, and the contract terms are comparable" (majority op at 499 [emphasis added]). There is no dispute that the general rule is that damages are measured by the fair market value at the time of the breach; the issue here is whether that measure, in cases where the property is later sold with reasonable diligence and in good faith, is adequate or even realistic. In such a circumstance, why should the nonbreaching seller suffer the consequences of the buyer's breach? If market conditions decline, shouldn't the loss be laid squarely at the feet of the breaching buyer, particularly where the seller is able to make a colorable claim at trial in that regard?

The majority also holds that the trial court in this case will need to consider, among other things, whether the sellers "made sufficient efforts to mitigate" (majority op at 501), but mitigation is irrelevant under the majority's rule since the only calculation that matters is the difference between the fair market value at the time of the breach and the contract price. Under the ULTA rule proposed by this concurrence, the seller's mitigation is very relevant, and would constitute a valid defense by a breaching purchaser on the issue of damages once the nonbreaching seller has made a prima facie case for breach of contract and entitlement to damages. Applying that rule here, there is a question of fact as to whether the sellers mitigated their damages subsequent to the buyers' breach and whether **505* the sale in March 2007 for $1,376,550 represented the fair market value of the property.

Although the majority correctly concludes that there are questions of fact, it is my view that the trial court should follow the above rule in assessing the true nature of the damages incurred by the sellers.

Chief Judge LIPPMAN and Judges GRAFFEO and RIVERA concur with Judge READ; Judge PIGOTT concurs in the result in an opinion in which Judge SMITH concurs.
Order modified, without costs, by remitting to Supreme Court, Onondaga County for further proceedings in accordance with the opinion herein, and, as so modified, affirmed.

Parallel Citations

20 N.Y.3d 487, 987 N.E.2d 244, 964 N.Y.S.2d 467, 2013 N.Y. Slip Op. 01870

Footnotes

1 We agree with the **Whites** that any question of whether, or to what extent, the **Farrells** were entitled to recover consequential damages is not properly before us (*see Clifford R. Gray, Inc. v. City School Dist. of Albany*, 277 A.D.2d 843, 846–847, 716 N.Y.S.2d 795 [3d Dept.2000]; *City of Mount Vernon v. Mount Vernon Hous. Auth.*, 235 A.D.2d 516, 516–517, 652 N.Y.S.2d 771 [2d Dept.1997]).

2 In *Maxton*, the defaulting buyer failed to persuade us to replace our traditional rule with a "modern rule" permitting recovery for part performance in excess of the seller's actual damages, with the burden on the buyer to prove the net benefit conferred (68 N.Y.2d at 379–380, 509 N.Y.S.2d 507, 502 N.E.2d 184). Because in New York it is "axiomatic [that] a 'vendee who defaults on a real estate contract without lawful excuse [ ] cannot recover the down payment' " (*see Cipriano v. Glen Cove Lodge # 1458, B.P.O.E.*, 1 N.Y.3d 53, 62, 769 N.Y.S.2d 168, 801 N.E.2d 388 [2003], quoting *Maxton*, 68 N.Y.2d at 378, 509 N.Y.S.2d 507, 502 N.E.2d 184), it may well be that, in most instances where the buyer breaches a contract to sell real estate, the seller simply retains the down payment without resorting to the expense and uncertainty of litigating actual harm.

3 Any damages awarded would, of course, be less the $25,000 down payment.

1 Although this provision also states that a buyer may also recover incidental and consequential damages, whether or not the sellers here are entitled to such damages is not before us.

2 Uniform Commercial Code § 2–725.

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No Help for Jilted Sellers as Court Sticks With Precedent

BY ADAM LEITMAN BAILEY & JOHN M. DESIDERIO

In *White v. Farrell*,[1] the New York Court of Appeals ruled that the measure of damages for a buyer's breach of a contract to sell real property, where the contract does not contain a liquidated damages clause as the seller's exclusive remedy,[2] is the difference between the contract price and the fair market value of the property on the date of the breach. In so ruling, the court, citing to Williston on Contracts, professed to follow the rule of decision adhered to by the "majority of jurisdictions" and what it found to be the "longstanding rule in New York" that "the four departments of the Appellate Division…have consistently endorsed," even though the court itself had "never considered the measure of damages for a buyer's breach of a contract to sell real property."

This article will question the basis for the court's ruling and show that the concurring opinion, which disagreed with the majority's rationale, set forth what would have been a better rule of damages in buyer default cases. It will also posit that the court's preferred rule renders the measurement of damages in such cases an almost irrelevant issue with unfair results for a seller victimized by a buyer's default.

The buyers in *White* had sued to recover a $25,000 down payment that the sellers retained after the buyers defaulted on the $1,725,000 contract of sale for a parcel of lakeside property. The sellers counterclaimed seeking actual damages of $348,450—the difference between the contract price and the $1,376,550 price for which the property was eventually sold. The sellers also sought consequential damages totaling $217,636.88 for mortgage and tax payments made after the buyers' default until the closing with the ultimate purchaser. The parties' contract did not contain a liquidated damages provision.

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'Date of the Breach' Rule

In deciding cross-motions for summary judgment, the Supreme Court ruled that the buyers had breached the contract and were not entitled to recover their $25,000 down payment. However, the Supreme Court found that the fair market value of the property on the date of the breach was the same as the contract price, and, therefore, by applying the "date of the breach" rule to the sellers' damages claim, it held that the sellers had not suffered any actual damages. The Supreme Court's ruling, which also rejected the sellers' claim for consequential damages as "not valid,"[3] was unanimously affirmed by the Appellate Division without opinion.

The Court of Appeals chose to adopt the "date of the breach" rule, which it held to be "settled law," and it declined to adopt "a new rule whereby a seller's damages for a buyer's breach of contract to sell real property is the difference between the contract price and the resale price (assuming, of course, the property is resold in an arm's-length transaction sometime before the conclusion of the lawsuit for breach of the contract)."

The court advanced the following three reasons for adopting the "date of the breach" rule as the measure of damages for a buyer's breach of a real estate contract: first, that it "seems to be the rule everywhere"; second, that it is "consistent with the general contract principles that damages 'are properly ascertained as of the date of the breach,' and 'the injured party has a duty to mitigate'" (citing *Brushton-Moira Central School District v. Thomas Associates*,[4] an earlier decision of the court, involving breach of a construction contract, in which damages were measured from the date of the breach rather than from the date of the damages trial 13 years later); and third, that "adherence to tradition" is "particularly apt in cases involving the legal effect of contractual relations." Respecting this latter point, the court elaborated by noting that, "when contractual rights are at issue," and "it can reasonably be assumed that settled rules are necessary and necessarily relied upon, stability and adherence to precedent are generally more important than a better or even a 'correct' rule of law."[5]

Nevertheless, the court observed that "resale price" will not always be irrelevant to the determination of damages. It noted that "the resale price, in a particular case, may be strong evidence of fair market value at the time of the breach." The court said that "[t]his is especially true where the time interval between default and resale is not too long, market conditions remain substantially similar, and the contract terms are comparable."

The court's adoption of the "date of the breach" measure of damages is problematical. Despite it seeming, in the court's view, to be the rule "everywhere," there was no necessity or reason of comity for the court to adopt a rule applied to sales of real property located in other States and not within New York. Likewise, the fact that the four departments of the Appellate Division had also "consistently endorsed" the rule need not have been a determining factor if the court itself deemed the policy behind the rule outdated, unworkable, or unworthy. The chief ground for adopting the rule appears, therefore, to have been the court's desire to adhere to tradition and maintain "stability" in contractual relations under "settled law."

However, the "date of the breach" measure of damages for a buyer's default does little to maintain stability in real property sales transactions. On the contrary, it facilitates, if it does not actually promote, instability in real estate transactions because the buyer need never fear incurring a large money judgment for defaulting on the contract. As Judge Eugene Pigott Jr. noted in his concurring opinion, [t]he end result [of the "date of the breach" measure of damages] is that a seller will rarely be damaged by a purchaser's breach for any reason," because the "fair market value" at the time of the breach "would almost always mean the actual contract price, for the simple reason that a willing seller and willing buyer had estab-

lished that price at arms length." To emphasize the point, Pigott stated that "[a]ny other measure [other than the difference between the contract price and the subsequent resale price] is a fiction."

Moreover, the court's reliance upon the contract measure of damages stated in cases not involving real estate, like the construction contract in *Brushton-Moira*, was misplaced. As Pigott also noted,

> [T]he majority is blurring an important distinction between the measure of damages for breach of real estate contracts and the measure of damages in other sales. Real property is and has always been treated differently from other sales, mainly because real property, by its very nature, is unique.
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> ***
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> [R]eal property, unlike window panels, is not fungible. While there are usually extensive and active markets for fungible goods, thereby making it relatively less difficult for the seller to mitigate or cover in the event of a breach, the sale of real estate is clearly different because each parcel is unique. As a result, the pool of buyers is plainly smaller for real estate than goods, and when a buyer breaches a real estate purchase agreement, the seller must then commence anew, which may require a reassessment of the list price and more showings of the property to new buyers, who may or may not find the property's location, amenities or architectural style desirable. This may take a substantial amount of time and effort on the seller's part, and the seller's efforts may not readily succeed, because once the house has been on the market for a significant period of time, the market may have declined or prospective purchasers may be wary of the amount of time the house has been on the market, leading them to conclude that the property is tainted in some fashion. Meanwhile, under [the court's] holding today, the breaching buyer will walk away indifferent to the hardship caused to the seller by his conduct.

The court's majority obviously gave short shrift to the hardship factors noted by Pigott. Except for the court's stated concern for the stability of contractual relations and adherence to precedent—without caring, as noted above, to apply "a better or even a 'correct' rule of law"—the court's preference for the "date of the breach" measure of damages is inexplicable. The court's decision assumes that buyers will either always, or more often than not, agree to pay contract prices that are above fair market value. There is no basis for such an assumption. If the contract price is negotiated at arm's length and a buyer is not duped by the seller, but performs due diligence and is advised by a knowledgeable broker and represented by counsel, there is hardly any chance that the buyer will ever agree to pay a contract price that exceeds the fair market value of the property.

Other Points

The court's other points, regarding the seller's duty to mitigate, the possible relevance of the seller's resale price in determining the fair market value at the time of the breach, and the relevance of any differing terms between the buyer's contract and that of the subsequent sale, are equally at odds with how the "date of the breach" measure of damages is likely to apply in practice.

As Pigott also noted, "mitigation is irrelevant under the majority's rule since the only calculation that matters is the difference between the fair market value at the time of the breach and the contract price." For example, if the contract price was the fair market value of the property, then, under the "date of the breach" measure of damages, any loss suffered by the seller on a subsequent resale is irrelevant, except to the extent the resale price itself may be deemed to be evidence of the fair market value on the date of breach.

Under the stated rule, any lower resale price would not be a basis for measuring the seller's damages. Therefore, it really does not matter whether the seller does or does not do anything to "mitigate" the damages incurred on the date of breach. Because, where the resale price is equal to the date-of-breach fair market value, the rule mandates a finding of no damages; and, where the resale price is lower than the buyer's contract price, the rule bars any consideration of that lower price in determining the seller's damages, and there is nothing to mitigate.

Likewise, whether or not the terms of the buyer's contract and those of any subsequent contract for the property are comparable should be irrelevant in determining a seller's damages from the buyer's default. If the terms of the two contracts are different, that fact should not affect the seller's right to recover the difference in the price realized for the property caused by the buyer's breach.

Given the hardship reasons, which Pigott summarized, that would tend to drive the seller to sell to a new buyer at a lower contract price, it is just as likely that the seller may also be compelled to make other concessions to the new buyer, to the seller's detriment, that are equally driven by the same factors caused by the original buyer's default. Therefore, any different terms that might be found in the subsequent contract should not be deemed to offset the injury suffered from the buyer's default, the subsequent delay entailed thereby, and the seller's renewed efforts to get the property sold. Indeed, different terms in the subsequent contract will probably be the further result of the default.

Conclusion

In sum, as Pigott so aptly noted, under the court majority's "date of the breach" measure of damages rule, "it is the innocent sellers and not the breaching buyers, who must bear the cost of the buyers' breach." If the rule of contract damages is to give the sellers the benefit of their bargain, a rule that inevitably leads to a finding of "no damages," when there is an admittedly blatant buyer default, can hardly be said to give victimized sellers the benefit of their bargain. So long as there are areas in New York State where liquidated damages provisions are routinely not included in the contracts of sale of real property, *White v. Farrell* is a decision that cries out for a legislative reversal.

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Endnotes:

1. 20 NY3D 487 (2013).
2. The court quoted Williston's observation that the "date of the breach" damages rule does not apply where "the vendor has elected to accept, as the exclusive remedy, liquidated damages representing the purchaser's deposit." Therefore, in those areas of the State in which the prevailing practice is for real estate contracts of sale to include a liquidated damages provision, the *White* decision may be of academic interest only. However, for any real estate transaction in which the contract of sale does not include a liquidated damages provision, the *White* decision will now govern the determination of damages in all cases involving a buyer's contract default.
3. The Court of Appeals noted that the question to what extent the sellers were entitled to recover consequential damages was not a matter to be properly decided on the sellers' appeal.
4. 91 NY2d 256 (1998).
5. See *Maxton Builders v. LoGalbo*, 68 NY2d 373 (1986).

New York Law Journal

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Realty Law Digest

Scott E. Mollen, New York Law Journal

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Contracts—Court of Appeals Held That the Measure of a Seller's Damages for a Buyer's Breach of Contract to Sell Real Property, Is "the Difference, If Any, Between the Contract Price and the Fair Market Value of the Property at the Time of the Breach"—the Price Obtained by the Seller at a Later Resale of the Property May Bear on Damages, Depending on the Circumstances—Fraudulent Inducement—Negligent Misrepresentation

The subject Court of Appeals (court) decision involved the "measure of a seller's damages for a buyer's breach of a contract to sell real property." The court held that "the measure of damages is the difference, if any, between the contract price and the fair market value [FMV] of the property at the time of the breach. The price obtained by the seller on a later resale of the property may well bear on damages, depending upon the circumstances." In the subject case, there was "conflicting evidence as to the property's [FMV] when the buyer defaulted," and therefore, an issue of fact precluded summary judgment.

In May 2004, the defendants decided to sell their property upon which they were building a new home. Due to construction delays, the new home was not completed until approximately April 2005. A certificate of occupancy (C of O) was issued on May 31, 2005, a year after the defendants first listed the property for sale.

In June 2005, the defendants' real estate agent (agent) showed the property to the plaintiff and her now-deceased husband (plaintiffs). The plaintiffs signed a contract to buy the property for $1.725 million, the defendants' asking price and tendered a $25,000 deposit. "The $1.7 million balance was to be paid...at a closing to be held 'on or about July 10, 2005.'" The contract did not make time of the essence and was contingent upon "a satisfactory home inspection; resolution of a number of construction-related items, including one identified as 'drainage finished;' and attorney approval." The defendants executed the contract on June 13, 2005.

At the time of contract, "a drainage system...was apparently still under construction..., and the leach field for the raised bed septic system was soggy." On June 15, 2005, the defendants wrote that they would fix or credit the buyer "to make [the] house as close to what he wants as possible." The defendants mentioned that one project would take five or six weeks to complete and identified certain water issues. The defendants stated that they "would agree to reduce the contract price by $10,000 to cover other items that [the plaintiffs] might 'choose[] to change or modify like bench tops, locks, painting[,] new front lawn[,] etc.'" The agent retained "a plumber and septic system expert to investigate and remedy water and drainage problems; and kept the [plaintiffs'] real estate agent closely apprised of progress."

An inspection was conducted on June 18, 2005. On June 22, 2005, the plaintiffs' attorney approved the contract, subject to proof that real estate taxes were $30,000 or less and the parties executed a contract addendum. The addendum eliminated all contingencies in exchange for the defendants' "promise to complete several enumerated tasks," including finishing the drainage system and providing the $10,000 credit. The defendants asserted that although "'it was known' when the addendum was signed 'that a portion of the property was wet and/or having drainage issues,' the cause of the dampness, which he claimed was not present when he and his wife signed the property condition disclosure statement in May 2004 (see Real Property Law §462), had yet to be figured out. The addendum did not set any time frame or deadline for completion of the work the [defendants] committed to accomplish."

Two weeks later, the plaintiffs' lawyer notified the defendants that the buyers "elected to terminate the contract [because] upon closer inspection...the drainage situation [might] never be rectified." The plaintiffs alleged that their decision followed a site inspection with a construction consultant. The defendants asserted that the plaintiffs knew when they signed the contract that additional measures were needed to fix the septic system and address surface water runoff. The defendants outlined what had been done to date and noted that they considered "one of the issues now raised by the [plaintiffs]—the supposed necessity for a retaining wall" to be "nothing more than a fabricated reason to cancel the contract."

The defendants had written that they would be "'more than willing' to meet with [the plaintiffs] on the premises to review the work completed and address his concerns, but that '[i]f [the plaintiff was] unwilling to discuss the 'alleged issues' in a good faith manner," then the defendants would "have no alternative but to relist the property for sale and hold [the plaintiffs] responsible for the damages which might result." The plaintiffs responded that they "had 'no intentions of going forward with the contract,'" and they were "'extremely upset that the drainage problem was never disclosed, and in fact [the property condition disclosure statement] affirmatively denie[d] any drainage problem' existed."

The defendants thereafter sent a time of the essence letter, stating that the defendants "had 'resolved all issues' regarding required septic modifications on his property; declaring the place, time and date (October 24, 2005) of closing; and enclosing the relevant closing documents." The plaintiffs neither responded to the letter nor showed up at the closing.

On July 23, 2005, the plaintiffs signed a contract to purchase another property. The plaintiffs closed on that property, for which they paid $1.7 million, on Aug. 24, 2005. Thereafter, the plaintiffs sued the defendants "to recover their $25,000 down payment, alleging fraudulent inducement, negligent misrepresentation and that the [defendants] were not ready, willing and able to close as of the declared closing date in October 2005." The plaintiffs claimed that they had relied "on the [defendants'] representation in the property condition disclosure report, attached to the contract, that there were no flooding, drainage or grading problems resulting in standing water on the property." The defendants answered and counterclaimed for breach of contract.

The agent asserted that $1.725 million was the fair market value of the defendants' property in May 2004 (when it was first listed), June 2005 (when the contract was signed), July 2005 (when the plaintiffs repudiated the contract), and October 2005 (the date set for conveying title). She also testified that the $1.725 million was also the fair market value of the defendants' property in the spring and summer of 2006 since "everything still was selling at...1.5 to 3 million in 2006...." The agent acknowledged that the only offer the defendants ever received in the $1.725 million range was from the plaintiffs.

In January 2007, while the subject litigation was pending, the defendants accepted an offer of $1,376,550 from a third party and conveyed the property on March 9, 2007 to such subsequent buyer.

The defendants had moved for summary judgment to dismiss the plaintiffs' complaint and award them damages on their counterclaim. The defendants sought $348,450 in actual damages and consequential damages of $217,636.88, "(apparently, the sum of mortgage and tax payments made on the property from July 7, 2005 until the closing with the ultimate purchaser on March 9, 2007)." The plaintiffs cross-moved for summary judgment to dismiss the counterclaim and compel the defendants to return the deposit.

The trial court found that the plaintiffs had breached the contract and were not entitled to their down payment. The trial court held that the damages were the difference between the contract price and the market value of the real property at the time of the breach. However, in view of the agent's testimony, the market value at the time of the breach was, in fact, the same as the contract price. Thus, the trial court held that the defendants had not suffered any actual damages based on the plaintiffs' breach.

The trial court rejected the defendants' "claim for consequential damages." The defendants appealed from the trial court's finding that they had suffered no actual damages. The plaintiffs did not cross-appeal. The Appellate Division affirmed. The court thereafter granted leave to appeal. The court agreed with the plaintiffs that "any question of whether, or to what extent, the [defendants] were entitled to recover consequential damages is not properly before [the Court]...."

The defendants argued that the trial court "should have measured damages by applying a principle articulated in *Di Scipio v. Sullivan* (30 AD3d 660 [3d Dept. 2006])."

The Third Department had stated in dictum that:

the measure of damages incurred as a result of a breach of a real estate contract is *either* the difference between the contract price and a subsequent lower sale price or, where no subsequent sale has occurred, the difference between the contract price and the market value of the real property at the time of breach. Here, [the seller] spurns the commonly accepted measure of damages and, instead, seeks recovery for the aforementioned items, which the court considered to be unrecoverable consequential damages or expenses not proximately caused by the buyer's breach.... (Emphasis in original).

The defendants reasoned that *Di Scipio* means that "the measure of a seller's actual damages for a buyer's breach of a contract to sell realty is always the difference between the contract price and any later lower selling price...." In rejecting such argument, the court explained that "[t]he majority of jurisdictions...adhere to a different standard," citing Williston on Contracts. Williston provides:

Unless the vendor has elected to accept, as the exclusive remedy, liquidated damages represented by the purchaser's deposit, where the vendor sues the purchaser for breach of contract, the vendor may recover for the loss of the bargain, and *the generally accepted measure of damages is the difference between the contract price and the fair market value of the property at the time of the breach.* The vendor may recover damages in the amount of the contract price reduced by the fair market value of the property, less any deposit or earnest money paid by the purchaser.... *The price obtained by the vendor on a later resale of the property may be regarded as competent evidence of*

its fair market value on the date of the purchaser's breach, provided that the market conditions are similar and the time elapsed between the date of the breach and the date of the resale is not too great... (Emphasis in original).

The court explained that it had "never before considered the measure of damages for a buyer's breach of a contract to sell real property." However, the four Appellate Division departments have "consistently endorsed the time-of-the-breach rule, although there are certainly cases where the standard used is not stated, or it is not made clear that the resale price is simply evidence of the property's fair market value at the time of the breach."

After reviewing several prior Appellate Division level decisions, the court rejected the defendants' "invitation to put aside settled law and adopt a new rule whereby a seller's damages for a buyer's breach of a contract to sell real property is the difference between the contract price and the resale price (assuming, of course, the property is resold in an arm's-length transaction sometime before the conclusion of the lawsuit for breach of contract). The time-of-the-breach rule is longstanding in New York...; and is consistent with the general contract principles that damages 'are properly ascertained as of the date of the breach,' and 'the injured party has a duty to mitigate'...." The court did not say that "resale price is irrelevant to the determination of damages; in fact, the resale price, in a particular case, may be very strong evidence of fair market value at the time of the breach. This is especially true where the time interval between default and resale is not too long, market conditions remain substantially similar, and the contract terms are comparable...."

Concurring judges opined that the "'better rule' for calculating a seller's damages when a buyer breaches a contract to sell real property 'is found in the Uniform Land Transactions Act' (ULTA).... The relevant provision states that the wronged seller 'may resell the real estate...and recover any amount by which the unpaid contract price...exceeds the resale price, less expenses avoided because of the buyer's breach'..." That standard was "[i]nitially approved by the National Conference of Commissioners on Uniform State Laws (the National Conference) in 1975 and intended to be the Uniform Commercial Code [UCC] of real estate law."

However, the court explained that "ULTA was something of a flop. It was never adopted by any state, and was withdrawn by the National Conference in 1990...." Moreover, "ULTA's measure-of-damages rule for a buyer's breach appears to have been adopted judicially by only a single intermediate appellate court some 20 years ago...." The court stated that such failure was "not surprising, as the ULTA rule is not conspicuously fairer or easier to apply than the time-of-the-breach rule." Citing *Maxton Bldrs. v. Lo Galbo*, (68 NY2d 373 [1986]), the court noted that "adherence to tradition is 'particularly apt in cases involving the legal effect of contractual relations.'" The court emphasized that "when contractual rights are at issue, 'where it can reasonably be assumed that settled rules are necessary and necessarily relied upon, stability and adherence to precedent are generally more important than a better or even a "correct" rule of law'...."

After reviewing record evidence, the court found that "fair market is a question of fact, and in this case there was evidence contradicting [the agent's] testimony, including the property's substantially lower eventual sale price." Thus, the court concluded that "neither party was entitled to the summary judgment...."

The court then explained that on remittal, the trial court should "consider at least the following factors relevant to damages: whether, or the degree to which, the property's resale in January 2007 for $1,376,550 reflects fair market value as of October 2005, given the lapse of time (about 14 months) and any differences in market conditions and contract terms; whether the ([defendants] made sufficient efforts to mitigate (i.e., to resell at a reasonable price after the [plaintiffs'] default), which is relevant to any weight to be given the resale price as a measure of fair market value at the time of the breach; and the cost to remedy the property's drainage deficiencies, which, like the cost to complete

several other specified tasks and the $10,000 credit—all agreed to by the parties in the contract addendum—should be subtracted from $1.725 million (the original contract price) in order to establish the contract price to be compared to the property's fair market value in October 2005." Thus, the court remitted the matter to the trial court for further proceedings in accordance with the court's opinion.

The concurring opinion agreed with the result of the majority, but disagreed with its rationale. The concurring opinion asserted that the majority was "blurring an important distinction between the measure of damages for breach of real estate contracts and the measure of damages in other sales." It reasoned that "[r]eal property is and has always been treated differently from other sales, mainly because real property, by its very nature, is unique...." The concurring opinion contended that since there was no dispute that the buyers had breached the contract and real property is unique, the sellers are entitled to "recover the benefit of their bargain from the buyers."

In this case, "that may very well be $348,550, the difference between the contract price and the subsequent sale price, subject, of course, to any evidence proffered by the buyers that the sellers failed to act with due diligence to mitigate their claimed loss. Any other measure is a fiction. To flatly suggest, as the majority does, that the measure should be 'fair market value' at the time of the breach would almost always mean the actual contract price, for the simple reason that a willing seller and willing buyer had established that price at arms' length. The end result is that a seller will rarely be damaged by a purchaser's breach for any reason."

The concurring opinion argued "[u]nder the majority's rule, it is the innocent sellers, and not the breaching buyers, who must bear the cost of the buyers' breach." The concurring opinion preferred the ULTA standard that '[i]f a buyer wrongfully rejects, or otherwise commits a material breach, or repudiates as to a substantial part of the contract..., the seller may resell the real estate...and recover any amount by which the unpaid contract price...exceeds the resale price, less expenses avoided because of the buyer's breach'...."

The concurring opinion believed that the ULTA rule recognizes the "unique character of real estate transactions and provides some certainty for the non-breaching seller," by placing "the risk where it properly belongs, i.e. on the breaching buyer." The concurring opinion asserted that such rule "is not one-sided, affording protection to the breaching buyer should the seller be fortunate enough to resell the property at the same or a higher price...."

The concurring opinion argued that "non-breaching sellers are entitled to the benefit of their bargain, and that benefit should not be denied by the application of a rule that fails to take that basic tenet into account." The concurring opinion believed that the authorities cited by the majority "in support of the 'time-of-the-breach' rule appear to apply the rule by rote..., detached from the reality of realty by failing to consider the legal consequence of an axiom that is harmful to the non-breaching party."

The concurring opinion stated that "the 'time-of-the-breach' rule—which is common in contract law and in the [UCC] where the parties are dealing in common activities or fungible goods" relies "primarily on a case involving a school district's claim seeking the cost of replacing or repairing defective window panels that had been installed in its building...." The concurring opinion further asserted that "[w]hile there are usually extensive and active markets for fungible goods, thereby making it relatively less difficult for the seller to mitigate or cover in the event of a breach, the sale of real estate is clearly different because each parcel is unique...."

The concurring opinion emphasized that "the pool of buyers is plainly smaller for real estate than goods, and when a buyer breaches a real estate purchase agreement, the seller must then commence the sale process anew, which may require a reassessment of the list price and more showings of the property to new buyers, who may or may not find the property's location, amenities or architectural style desirable. This may take a substantial amount of time and effort on the seller's part,

and the seller's efforts may not readily succeed, because once the house has been on the market for a significant period of time, the market may have declined or prospective purchasers may be wary of the amount of time the house has been on the market, leading them to conclude that the property is tainted in some fashion. Meanwhile, under our holding today, the breaching buyer will walk away indifferent to the hardship caused to the seller by his conduct."

The concurring opinion further stated that "[t]here is no dispute that the general rule is that damages are measured by the fair market value at the time of the breach; the issue here is whether that measure, in cases where the property is later sold with reasonable diligence and in good faith, is adequate or even realistic. In such a circumstance, why should the non-breaching seller suffer the consequences of the buyer's breach? If market conditions decline, shouldn't the loss be laid squarely at the feet of the breaching buyer, particularly where the seller is able to make a colorable claim at trial in that regard?"

Additionally, the concurring opinion noted that the majority opinion requires the trial court to consider, inter alia, "whether the sellers 'made sufficient efforts to mitigate.'" However, the concurring opinion asserted that "mitigation is irrelevant under the majority's rule since the only calculation that matters is the difference between the fair market value at the time of the breach and the contract price." The concurring opinion further stated that under the ULTA rule, "the seller's mitigation is very relevant, and would constitute a valid defense by a breaching purchaser on the issue of damages once the non-breaching seller has made a prima facie case for breach of contract and entitlement to damages.

Applying that rule here, there is a question of fact as to whether the sellers mitigated their damages subsequent to the buyers' breach and whether the sale in March 2007 for $1,376,550 represented the fair market value of the property." The concurring opinion concluded that although the majority properly held that there are questions of fact, the trial court should follow the ULTA rule in assessing the true nature of the damages incurred by the sellers.

Comment: In most real estate purchase/sale transactions, parties will attempt to avoid a dispute over the amount of damages by incorporating a liquid damages provision into the purchase/sale contract. Here, there was no such provision and the seller agreed to accept a $25,000 deposit on a contract price of $1,725,000, i.e., a deposit of less than 1.5 percent. Sheldon Chanales, a real estate transaction partner at Herrick, Feinstein noted that generally, sellers will only accept an extremely low deposit when they are having trouble selling their property at or near their asking price.

White v. Farrell**, No. 43, NYLJ 1202593024445, at *1 (Ct. of App., Decided March 21, 2013), Opinion by Read, J. Ch.J. Lippman and Graffeo and Rivera, JJ. concur. Pigott, J. concurs in the result in an opinion in which Smith, J. concurs.**

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1256 Hertel Ave. Associates, LLC v. Calloway, 12-1603-BK, 2014 WL 3765864 (2d Cir. Aug. 1, 2014).

Takings Clause Does Not Protect Judgment Liens

The homestead exemption was originally established to protect a debtor's principal residence from being used to satisfy a creditor's judgment up to a statutorily defined maximum value. After standing at $10,000 from 1997 to 2005, the New York Legislature modified CPLR §5206, which governs the homestead exemption, to raise the limit to $50,000. In 2010, the New York Legislature modified the exemption yet again, to bring it to its current limit of $75,000. In a case of first impression, *1256 Hertel Avenue Associates v. Calloway*, the Court was faced with the issue of whether a judgment lien against real property is protected by the Fifth Amendment's Takings Clause. The case was further complicated by the fact that the judgment lien was perfected before the amendment's effective date.

Facts:
In 2003, a lender (Hertel) secured a $4,628 judgment lien against a borrower's home and filed the judgment with the County Clerk's office. In 2008, a second lender secured a judgment lien against the same borrower in the amount of $5,973, which it also filed. At the time, the borrower's home was worth approximately $110,000, and was encumbered by a $85,000 mortgage, leaving her with $25,000 equity in her home. The following year, the borrower filed bankruptcy and moved to dismiss the judgment liens against her home, claiming the homestead exemption of $50,000 applied to make the judgment liens of $10,655 against her home worthless. In the bankruptcy proceedings, Hertel agreed that the borrower could claim homestead exemption, but argued over which version of the law applied. Hertel asserted that the amendment could only be applied to liens perfected after its effective date.

Issues:
The issue is whether the 2005 amendment to the homestead exemption applied to a judgment lien perfected before the amendment's effective date, and if so, whether the judgment lien was protected by the Fifth Amendment's Takings Clause.

Analysis:
The amendment to the homestead exemption applies to judgment liens perfected before the amendment's effective date, and does not result in a taking because a judgment lien against a debtor's real property is not a constitutionally protected property interest. The Court noted that "retroactive operation is not favored by New York courts" but that "in light of the legislative finding that that the increased exemption amount was long overdue and that the old amount was unrealistic in today's economy, it would defeat the intent of the Legislature to judicially engraft an anti-retroactivity provision." Furthermore, "§5206 does not implicate difficult and sensitive questions arising out of the takings clause because the lien was born subject to the borrower's right to avoid it and the Homestead exemption was subject to change according to varying economic conditions." As a result, the Court applied the amendment retroactively. The Court went on to define the two types of takings, physical occupations and regulatory takings (where government regulation is overreaching and essentially results in a taking of property) and concluded that there was no taking. It reasoned that the legislature did not invade or appropriate

the liens for its own use and found that the type of interference with property rights that occurred was just like any other intrusion that results when the government passes economic legislation.

Decision:
In holding that a judgment lien is not protected by the Fifth Amendment, the Court announced that a state-amended statute may have retroactive effect, even to contract-based debts that existed before its enactment, because judgment liens are not vested property rights.

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1256 Hertel Ave. Associates, LLC v. Calloway
United States Court of Appeals, Second Circuit August 1, 2014 --- F.3d ---- *(Approx. 19 pages)*

RELATED TOPICS

Bankruptcy

Deduction of Any Unavoidable Liens and Debtors State Law Homestead Exemption

2014 WL 3765864
Only the Westlaw citation is currently available.
United States Court of Appeals,
Second Circuit.

1256 HERTEL AVENUE ASSOCIATES, LLC, Claimant–Appellant,
Harold P. Bulan, Trustee,
v.
Tanya R. CALLOWAY, dba Miniature Moments Daycare, Debtor–Appellee.

Docket No. 12–1603–bk. Submitted: April 29, 2014. Decided: Aug. 1, 2014.

Synopsis

Background: Chapter 7 debtor moved to avoid, on exemption-impairment grounds, a judgment lien on her residence that creditor had perfected prior to effective date of statutory amendment that increased New York's homestead exemption from $10,000 to $50,000. Creditor objected on ground that debtor should be limited to original homestead exemption amount and that, based on this amount, there was no impairment of debtor's homestead exemption. The United States Bankruptcy Court for the Western District of New York, Bucki, Chief Judge, 423 B.R. 627, granted debtor's motion. Creditor appealed. The District Court, Skretny, Chief Judge, affirmed, and creditor again appealed

Holdings: The Court of Appeals, Wesley, Circuit Judge, held that:
1 amended homestead exemption was intended by legislature to apply to all debtors who filed for bankruptcy after the amendment's effective date, and could be utilized by debtor to avoid judgment lien, regardless of when debtor's debt to judgment creditor was incurred or reduced to judgment;
2 judgment lien creditor had interest in judgment creditor's real property, of kind protected by Due Process Clause, abrogating *In re Trudell*, 381 B.R. 441 and *In re Lattimore*, 12 B.R. 111; but
3 allowing debtor to avoid preexisting lien based on amended homestead exemption amount did not result in violation of the Takings Clause, as applied to states under the Fourteenth Amendment.

Affirmed.

West Headnotes (20)

Change View

1 **Bankruptcy** Conclusions of Law; De Novo Review
Order of district court functioning in its capacity as bankruptcy appellate court is subject to plenary review, and allows the Court of Appeals to independently review factual determinations and legal conclusions of the bankruptcy court.

2 **Bankruptcy** Conclusions of Law; De Novo Review
Bankruptcy Clear Error
On appeal, bankruptcy court's legal conclusions are evaluated de novo, and its factual findings are reviewed for clear error. Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.

3 **Homestead**
New York homestead exemption protects homeowner against seizure of his or her dwelling to satisfy money judgment, and reflects long-standing legislative decision to provide an honest debtor with fresh start and to avoid leaving debtor and his or her family homeless and on brink of financial ruin.

4 **Bankruptcy** Homestead; Residence
Bankruptcy Proceedings
Homestead
Amendment to New York homestead exemption statute, to increase amount of available exemption from $10,000 to $50,000, was intended by legislature to apply to all debtors who filed for bankruptcy after the amendment's effective date, and could be utilized by debtor to avoid judgment lien on exemption-impairment grounds, regardless of when debtor's debt to judgment creditor was incurred or reduced to judgment; intent to allow all debtors who filed for bankruptcy after amendment's effective date could be inferred from legislature's desire to have amendment apply immediately to remedy outdated exemption amount that had deprived debtors of any real exemption, from legislature's failure to carry over anti-retroactivity provision from prior version of statute, and from legislature's conduct after retroactivity issue was brought to its attention, 11 U.S.C.A. § 522(f); N.Y.McKinney's CPLR 5206.

5 **Statutes** Language and Intent; Express Provisions
Fundamental canon of statutory construction is that retroactive operation is not favored by courts and that statutes will not be given such a construction unless statutory language expressly or by necessary implication requires it.

6 **Statutes** Intent
Court, in interpreting statute, should attempt to effectuate intent of legislature

7 **Statutes** Intent
Statutes Presumptions and Inferences
Presumption against retroactivity and other principles of statutory construction are merely navigational tools to discern legislative intent.

8 **Statutes** Purpose
While maxims of statutory construction provide helpful guideposts, reach of statute ultimately becomes matter of judgment, made upon review of the legislative goal.

9 **Statutes** Language and Intent; Express Provisions
Statutes Declaratory, Clarifying, and Interpretive Statutes
When statute is unclear as to its retroactive effect, factors relevant to retroactivity analysis include: whether legislature has made a specific pronouncement about retroactive effect or conveyed a sense of urgency; whether the statute was designed to rewrite an unintended judicial interpretation; and whether the enactment itself reaffirms a legislative judgment about what the law in question should be.

10 **Constitutional Law** Avoidance of Doubt
Under canon of constitutional doubt, statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score.

11 **Constitutional Law** Avoidance of Doubt
Application of canon of constitutional doubt, which requires that statute be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score, depends upon whether statute in question is genuinely susceptible to at least two interpretations and whether there is serious likelihood that statute will be held unconstitutional absent application of the canon

12 **Constitutional Law** Enforcement
Federal Civil Procedure Lien
Judgment Nature of Lien
Judgment lien creditor had interest in judgment creditor's real property, of kind protected by Due Process Clause of the Fourteenth Amendment; abrogating *In re Trudell*, 381 B.R. 441; *In re Lattimore*, 12 B.R. 111. U.S.C.A. Const. Amend. 14.

13 **Constitutional Law** Source of Right or Interest
Federal constitutional law, and not state law, determines whether an interest rises to the level of a legitimate claim of entitlement protected by the Due Process Clause. U.S.C.A. Const.Amend. 14.

14 **Eminent Domain**
"Physical taking" of property occurs, for Fifth Amendment purposes, when there is either a condemnation or physical appropriation of property. U.S.C.A. Const. Amend. 5.

15 **Eminent Domain**
"Regulatory taking" of property occurs, for Fifth Amendment purposes, where, even absent a direct physical appropriation, governmental regulation of private property goes too far and is tantamount to a direct appropriation or ouster. U.S.C.A. Const.Amend. 5.

16 **Eminent Domain**
In deciding whether regulatory taking has occurred, courts consider economic impact of regulation on claimant and, particularly, extent to which regulation has interfered with distinct, investment-backed expectations. U.S.C.A. Const.Amend. 5.

17 **Eminent Domain**
Important in determining whether a regulatory taking has occurred is the character of the governmental action, particularly whether it amounts to physical invasion or appropriation of property, or instead merely affects property interests through some public program adjusting benefits and burdens of economic life to promote the common good. U.S.C.A. Const. Amend. 5.

18 **Eminent Domain**
Categorical taking occurs, without need for court to consider the *Penn Central* factors: (1) where regulation compels property owner to suffer a physical invasion' of his property, or (2) where regulation denies all economically beneficial or productive use of land.

19 **Eminent Domain**
Even assuming that, at time judgment creditor recorded its judgment and obtained lien in judgment debtor's homestead property, prior to amendment of New York homestead exemption to increase exemption amount from $10,000 to $50,000, debtor had some nonexempt equity in property to support judgment creditor's lien under the old $10,000 homestead exemption, mere fact that amendment had some effect on creditor's economic interests did not result in violation of the Takings Clause, as applied to states under the Fourteenth Amendment; when creditor obtained its judgment lien, inherent in the property interest that it acquired was the implied limitation that collection on the judgment might be impeded by New York's long-standing protection of judgment debtors' homesteads, protection that had changed over time to keep pace with changing conditions. U.S.C.A. Const.Amends. 5, 14; N.Y.McKinney's CPLR 5206.

20 **Eminent Domain**

Relevant question for court, when assessing a takings claim, is not whether governmental action has affected a party's interests in some way but, rather, the extent to which the challenged governmental action has upset claimant's investment-backed economic expectations by altering its rights as to a constitutionally protected property interest. U.S.C.A. Const Amend. 5.

Appeal from the March 16, 2012 order of the United States District Court for the Western District of New York (Skretny, C.J.) affirming the February 16, 2010 order of the Bankruptcy Court (Bucki, C.U.S.B.J.) holding that the 2005 amendment to N.Y. C.P.L.R. 5206, 2005 N.Y. Laws ch. 623, which increased New York's homestead exemption from $10,000 to $50,000, applied to a judgment lien obtained prior to the amendment's effective date. We AFFIRM.

Attorneys and Law Firms

Edward Y. Crossmore, The Crossmore Law Office, Ithaca, NY, for Claimant–Appellant.

Joshua D. Liston, Beys Stein Mobargha & Berland LLP, New York, NY, for Debtor–Appellee.

Before WESLEY and DRONEY, Circuit Judges, and BRICCETTI, District Judge *

Opinion

WESLEY, Circuit Judge:

*1 The New York State Legislature amended N.Y. C.P.L.R. 5206 in August 2005, increasing the state's homestead exemption from $10,000 to $50,000. *See* 2005 N.Y. Laws ch. 623. The homestead exemption entitles New York debtors to exempt their homes "from application to the satisfaction of a money judgment," *id.*, and is also available to debtors in bankruptcy proceedings, *see* N.Y. Debt. & Cred. Law § 282; 11 U.S.C. § 522(b)(3)(A). This appeal requires us to determine whether the 2005 Amendment's increased homestead exemption applies to judgment liens perfected prior to the amendment's effective date and, if so, whether application of the law to pre-enactment judgment liens violates the Takings Clause of the Fifth Amendment. We hold that the 2005 Amendment applies to debts incurred prior to the amendment's effective date and does not violate the Fifth Amendment's Takings Clause.

BACKGROUND

In July 2003, 1256 Hertel Avenue Associates, LLC ("Hertel") secured a $4,682 judgment lien against Tanya R. Calloway's ("Calloway") home in Buffalo, New York. Hertel docketed the judgment in the Erie County Clerk's office on July 11, 2003. Five years later, another creditor obtained a $5,973 judgment lien against the same property, which it docketed in December 2008. Calloway estimates the current value of her property to be $110,000. The property is encumbered by a mortgage with a remaining balance of approximately $85,000, leaving her around $25,000 in equity.

On May 12, 2009, Calloway filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. In that proceeding, Calloway moved to avoid the judgment liens against her residence pursuant to New York's homestead exemption, N.Y. C.P.L.R. 5206. The exemption protects a debtor's principal residence from being used to satisfy a creditor's judgment up to a statutorily defined maximum value. After standing at $10,000 from 1977 to 2005, *see* 1977 N.Y. Laws ch. 181, the homestead exemption limit has been modified twice in recent years: In 2005, New York's Legislature raised the limit to $50,000, 2005 N.Y. Laws ch. 623, and in 2010 the Legislature again modified the exemption, bringing it to its present form, which provides a baseline exemption of $75,000 that is adjusted upward for certain high-property-value counties, *see* 2010 N.Y. Laws ch. 568.

In the bankruptcy court, Hertel acknowledged that Calloway was entitled to claim the homestead exemption, but disputed which version of the exemption should apply: Calloway claimed the $50,000 exemption in effect when she filed for bankruptcy in 2009, while Hertel contended that the bankruptcy court should apply the lower, $10,000 exemption in effect when it perfected its judgment lien in 2003. Specifically, Hertel argued that the 2005 Amendment should be interpreted to apply only to judgment liens perfected after its effective date because retroactive interpretations are disfavored and the amendment did not explicitly provide that it should be applied to pre-existing judgment liens. Further, Hertel also argued

that were the amendment interpreted to apply to judgment liens perfected prior to its effective date, this limitation on Hertel's ability to collect on its judgment lien would constitute an unconstitutional taking of its property in violation of the Takings Clause of the Fifth Amendment to the United States Constitution.

*2 The bankruptcy court (Bucki, C.U.S.B.J.) rejected Hertel's contentions and concluded that Calloway was entitled to the $50,000 homestead exemption in effect at the time of her bankruptcy filing. *In re Calloway*, 423 B.R. 627 (Bankr.W.D.N.Y.2010). In so holding, the bankruptcy court relied on *CFCU Community Credit Union v. Hayward*, 552 F.3d 253 (2d Cir.2009), in which this Court determined that the 2005 Amendment applies retroactively even to contract-based debts that preceded its enactment. Although, unlike the creditor in *Hayward*, Hertel reduced the debt to a perfected judgment lien prior to the 2005 Amendment, the bankruptcy court concluded that this made no difference. In its view, the amendment immediately increased the exemption to $50,000 as to all creditors and all obligations, regardless of whether the creditor had reduced the debt to judgment prior to its enactment. *In re Calloway*, 423 B.R. at 629. As to Hertel's Takings Clause challenge, the bankruptcy court concluded that there had been no taking of Hertel's property because, under New York law, judgment liens are not vested property interests. *Id.* at 629–30 (citing *Watson v. N.Y. Cent. R.R. Co.*, 47 N.Y. 157 (1872)). The district court (Skretny, C.J.) affirmed on substantially the same grounds, adding that even were a judgment lien a property interest protected by the Takings Clause, the 2005 Amendment's effect on Hertel's lien did not constitute a taking. *1256 Hertel Ave. Assocs., LLC v. Calloway*, No. 10–CV–250S, slip op. at 8–9 (W.D.N.Y. Mar. 16, 2012).

1 2 On appeal to this Court, Hertel reiterates its arguments that (1) the 2005 Amendment should be interpreted to apply only to judgment liens perfected after its enactment; and (2) if the 2005 Amendment does apply to pre-enactment judgmenent liens, the result is an unconstitutional taking of its property in violation of the Fifth Amendment. For the reasons set forth below, we affirm the order of the district court.[1]

DISCUSSION[2]

3 New York has provided a homestead exemption for more than 150 years. *See* 1850 N.Y. Laws ch. 260. The exemption "protect[s] a homeowner against seizure of his or her dwelling to satisfy a money judgment," *Gen. Elec. Capital Bus. Asset Funding Corp. v. Hakakian*, 300 A.D.2d 486, 487, 751 N.Y.S.2d 570 (2d Dep't 2002), and reflects a long-standing legislative decision to "provide an honest debtor with a fresh start" and avoid "leaving the debtor and his family homeless and on the brink of financial ruin," *Westinghouse Credit Corp. v. Cent. Trust Co. Rochester, N.Y.*, (In re *Leonardo*), 11 B.R. 453,455 (Bankr.W.D.N.Y.1981); *accord Robinson v. Wiley*, 15 N.Y. 489, 494 (1857) (opinion of Johnson, J.).

Consistent with the statute's purpose, New York's Legislature has amended the homestead exemption from time to time to ensure that its protections keep pace with homeowners' changing needs. The exemption was amended in 1977, for example, to protect "condominium apartments," 1977 N.Y. Laws ch. 181, and again in 1980 to add "mobile home[s]" to the list of protectable homesteads, 1980 N.Y. Laws ch. 717. To account for rising home values, the Legislature has also periodically increased the exemption limit—from $1,000 to $2,000 in 1969; to $10,000 in 1977; to $50,000 in 2005; and to $75,000 (with upward adjustments for high-property-value counties) in 2010.[3] *See* 1969 N.Y. Laws ch. 961;1977 N.Y. Laws ch. 181; 2005 N.Y. Laws ch. 623; 2010 N.Y. Laws ch. 568.

*3 At issue in this case is the 2005 Amendment, which increased the homestead exemption limit from $10,000 to $50,000 and provided as follows:

> Exemption of homestead. Property of one of the following types, not exceeding fifty thousand dollars in value above liens and encumbrances, owned and occupied as a principal residence, is exempt from application to the satisfaction of a money judgment, unless the judgment was recovered wholly for the purchase price thereof:
>
> 1. a lot of land with a dwelling thereon,
>
> 2. shares of stock in a cooperative apartment corporation,
>
> 3. units of a condominium apartment, or
>
> 4. a mobile home.

2005 N.Y. Laws ch. 623, § 1. Although the 2005 Amendment included language directing that "[t]his act shall take effect immediately," 2005 N.Y. Laws ch. 623, § 2, the amendment did not specify whether its immediate effect was to protect a debtor's homestead from all obligations, even those incurred before the amendment was passed, or only obligations postdating its enactment.

This Court has once before addressed the 2005 Amendment's interaction with pre-existing obligations, in *CFCU Community Credit Union v. Hayward*, 552 F.3d 253 (2d Cir.2009). In that case, CFCU held a $11,291 claim against the debtor based on a car loan secured by an automobile valued at only $7,185, which left CFCU a general unsecured creditor for the remaining $4,106. *Hayward*, 552 F.3d at 257. CFCU argued that because the homestead exemption in effect at the time of the 2003 car loan provided only $10,000 of protection, the debtor was entitled only to that exemption and not the higher $50,000 exemption set forth in the 2005 Amendment. *Id.*

Following an analysis of the 2005 Amendment's legislative history, the *Hayward* Court concluded that "a New York debtor's ability to invoke the increased homestead exemption is determined not by the date the debtor's unsecured contract debt was incurred, but rather, by the date upon which the debtor files his or her bankruptcy petition." *Id.* at 265. Noting that retroactive interpretations are generally disfavored, the Court nonetheless applied the increased exemption to an existing obligation because the clear purpose of the legislation was to provide immediate relief to homeowners and because the Legislature had evinced its intent that the statute apply to pre-enactment liens by choosing not to carry over into the 2005 Amendment language from the prior homestead exemption that had specifically included an anti-retroactivity provision:

> In light of the legislative finding that the increased exemption amount was long overdue and that the old amount was unrealistic in today's economy, it would defeat the intent of the Legislature to judicially engraft an anti-retroactivity provision (similar to that found in the 1977 Amendment) onto the statute where none exists ... If the Legislature intended the Amendment to be prospective only ... it could easily have carried over the language from the 1977 Amendment.

*4 *Id.* at 265

A. Whether the 2005 Amendment Applies to Pre-enactment Judgment Liens

4 Although *Hayward* clarified that the 2005 Amendment's increased homestead exemption applies even to contract-based debts that predate the amendment, the Court did not address whether the amendment applies where, prior to the amendment's enactment, a creditor has reduced a debt to judgment and perfected a judgment lien on the debtor's residential property. Because CFCU had not reduced the debt to a judgment, the *Hayward* Court had no reason to reach the issue. *See id.* at 262 n. 9, 264–65 n. 12.

This case places the issue squarely before us. Hertel obtained a judgment against Calloway and secured a judgment lien against her home in July 2003, when the homestead exemption limit still stood at $10,000. We must therefore determine whether, when Calloway filed for bankruptcy on May 12, 2009, she was entitled to the full $50,000 homestead protection of the 2005 Amendment even as to a debt reduced to judgment prior to the statute's enactment. Hertel argues that the statute should be interpreted not to apply to judgment liens obtained prior to the 2005 Amendment (1) because interpretations that retroactively affect vested interests are generally disfavored; and (2) to avoid the constitutional question of whether the legislation's effect on pre-existing judgment liens constitutes an unconstitutional taking of its property in violation of the Fifth Amendment.

5 6 7 8 9 "It is a fundamental canon of statutory construction that retroactive operation is not favored by courts and statutes will not be given such construction unless the language expressly or by necessary implication requires it."[4] *Majewski v. Broadalbin–Perth Cent. Sch. Dist.*, 91 N.Y.2d 577, 584, 673 N.Y.S.2d 966, 696 N.E.2d 978 (1998). However, it is also "fundamental that a court, in interpreting a statute, should attempt to effectuate the intent of the Legislature." *Id.* at 583, 673 N.Y.S.2d 966, 696 N.E.2d 978 (internal quotation marks omitted). The presumption against retroactivity and other principles of construction "are merely navigational tools to discern legislative intent." *Id.* at 584, 673 N.Y.S.2d 966, 696 N.E.2d 978. "[M]axims of statutory construction provide helpful guideposts, [but] the reach of [a] statute ultimately becomes a matter of judgment

made upon review of the legislative goal." *Duell v. Condon,* 84 N.Y.2d 773, 783, 622 N.Y.S.2d 891, 647 N.E.2d 96 (1995). Where a statute is unclear as to its retroactive effect, factors relevant to the retroactivity analysis include "whether the Legislature has made a specific pronouncement about retroactive effect or conveyed a sense of urgency; whether the statute was designed to rewrite an unintended judicial interpretation; and whether the enactment itself reaffirms a legislative judgment about what the law in question should be." *In re Gleason (Michael Vee, Ltd.),* 96 N.Y.2d 117,122 (2001).

Although the Legislature made no specific pronouncement as to the 2005 Amendment's effect on pre-enactment debts, the statute's legislative history reflects a clear sense of urgency that the homestead exemption limit be immediately adjusted to bring it in line with modern home values. The memoranda submitted by the 2005 Amendment's sponsors in the Senate and Assembly noted that the $10,000 exemption limit had not been updated since 1977 and was "not at all realistic in today's economy." N.Y. Spons. Memo., 2005 S.B. S4582; N.Y. Spons. Memo., 2005 A.B. A8479. The memoranda further explained that "hav[ing] the figure so low is tantamount to having no exemption at all" and proposed a $50,000 exemption as "a much more realistic figure." *Id.*

*5 To provide immediate relief to debtors whose homesteads were underprotected by the outdated exemption limit, the 2005 Amendment explicitly provided that "[t]his act shall take effect immediately." 2005 N.Y. Laws ch. 623, § 2. The statute's directive that it take effect immediately is not itself enough to require retroactive application, but it does evince a sense of urgency on the part of the Legislature that the benefit of the increased homestead exemption be available to debtors as soon as possible. *See Majewski,* 91 N.Y.2d at 583, 673 N.Y.S.2d 966, 696 N.E.2d 976. The 2005 Amendment's specification that it take effect "immediately" is particularly striking given that the effective date of statute it replaced, the 1977 Amendment, had been intentionally crafted to avoid any effect on pre-enactment debts. Section 2 of the 1977 Amendment provided that "[t]his act shall take effect ninety days after it shall have become a law, *but shall not affect the application of property to the satisfaction of a money judgment for a debt contracted before it takes effect.*" 1977 N.Y. Laws ch. 181, § 2 (emphasis added). The Legislature chose not to carry over the anti-retroactivity provision of the 1977 Amendment to the 2005 Amendment and instead replaced it with an instruction that the statute have immediate effect.

Hayward relied on these indicia of legislative purpose to conclude that a debtor may invoke the 2005 Amendment's increased homestead exemption even as to pre-enactment unsecured contract-based debts. Nothing in the legislative history suggests that the Legislature intended a different rule to apply where the creditor has reduced the debt to a judgment and obtained a judgment lien. In fact, the statute's legislative history post-*Hayward* further evinces the Legislature's intent to apply the 2005 Amendment to pre-enactment judgment liens. As noted above, in 2010 the Legislature increased the homestead exemption limit to $75,000 (or higher for certain high-property-value counties). 2010 N.Y. Law ch. 568. The 2010 Amendment provided that "[t]his act shall take effect on the thirtieth day [Jan. 21, 2011] after it shall become a law and shall apply to the *satisfaction* of judgments on or after such date." § 7 (emphasis added). By expressly stating the amendment would apply to the satisfaction of judgments on or after its effective date, the Legislature made clear that the increased exemption limits would apply to *judgments* obtained *prior* to the effective date, since a party necessarily must have a judgment before seeking to satisfy it.

The fact that the Legislature, presumably aware of *Hayward* and alerted to the retroactivity question, *Arbegast v. Bd. of Educ. of S. New Berlin Cent. Sch.*, 65 N.Y.2d 161, 169, 490 N.Y.S.2d 751, 480 N.E.2d 365 (1985), resolved any lingering ambiguity as to the homestead exemption's retroactive effect by expressly applying the 2010 Amendment to pre-enactment judgments supports our conclusion that the 2005 Amendment is best read as making the increased homestead exemption available to all debtors who file for bankruptcy after the statute's effective date, regardless of the date on which the debt was incurred or reduced to judgment or the date on which any judgment lien was perfected.

10 11 *6 Anticipating our reaffirmation of *Hayward,* Hertel argues that even if the 2005 Amendment is most naturally read to apply to pre-enactment obligations, the canon of constitutional doubt requires the Court to adopt a different interpretation as to judgment lien debts to avoid the question of whether the 2005 Amendment has effected a taking of its property in violation of the Fifth Amendment. Under the federal and New York State canons of constitutional doubt,[5] "[a] statute must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score." *Tauza*

v. Susquehana Coal Co., 220 N.Y. 259, 267, 115 N.E. 915 (1917) (Cardozo, J.), *and Almendarez–Torres v. United States*, 523 U.S. 224, 237, 118 S.Ct. 1219, 140 L.Ed.2d 350 (1998) (both quoting *United States v. Jin Fuey Moy*, 241 U.S. 394, 401, 36 S.Ct. 658, 60 L.Ed. 1061 (1916) (Holmes, J.)); *accord In re Jacob*, 86 N.Y.2d 651, 667, 636 N.Y.S.2d 716, 660 N.E.2d 397 (1995); *see also* N.Y. Stat. Law § 150. The constitutional-doubt canon is justified partly by a presumption that legislatures are cognizant and respectful of constitutional limitations and partly by a judicial policy of minimizing confrontations between the legislative and judicial branches. *See Almendarez–Torres*, 523 U.S. at 238. Application of the canon requires that the statute in question be genuinely susceptible to at least two interpretations and that there be a serious likelihood that the statute will be held unconstitutional absent application of the canon.

These conditions are not met in this case. Even assuming that the 2005 Amendment is susceptible to two plausible interpretations, there is no serious likelihood that interpreting the statute to apply to Hertel's pre-enactment judgment lien will result in the statute being held unconstitutional. For the reasons discussed above, the statute is best interpreted as applying the increased exemption limit even to pre-enactment judgment liens, and, although that interpretation requires the Court to address a constitutional question, the Takings Clause issue that Hertel raises does not lead us to doubt the statute's constitutionality.

B. Takings Clause

Hertel argues that if the 2005 Amendment is read to apply to its pre-enactment judgment lien, the statute effects an unconstitutional taking of its judgment lien in violation of the Fifth Amendment. The Takings Clause provides that no "private property [shall] be taken for public use, without just compensation." U.S. Const. amend. V. The clause applies to the states through the Fourteenth Amendment. *Kelo v. City of New London, Conn.*, 545 U.S. 469, 472 n. 1, 125 S.Ct. 2655, 162 L.Ed.2d 439 (2005).

1. Whether a Judgment Lien is a Protected Property Interest

12 Before addressing Hertel's Takings Clause challenge, we must first address the threshold question of whether Hertel even held a protected property interest in its judgment lien. If Hertel held no property interest, the 2005 Amendment can have taken none from it.

This Court has never previously addressed whether a judgment lien against a judgment debtor's real property constitutes a property interest protected by the Fifth Amendment. The bankruptcy court below, following the decisions of other bankruptcy courts in this Circuit, concluded that under New York law a judgment lien against a debtor's real property is not a constitutionally protected property interest. *See In re Calloway*, 423 B.R. 627, 629–30 (Bankr.W.D.N.Y.2010).

*7 In an 1872 decision, *Watson v. New York Central Railroad Co.*, 47 N.Y. 157 (1872), the New York Court of Appeals addressed whether a judgment lienholder was entitled to be a party to, and receive compensation from, a property seizure initiated by a railroad company pursuant to a state statute delegating to the railroad limited eminent domain power to secure its right-of-way should it be unable to obtain the land it required by private contract. The Court of Appeals understood the statute to give a right to compensation only to property holders and reasoned that because a lienholder's rights are created by statute, the lienholder holds no property interest in the land underlying the lien, and its statutory rights can be superseded at will by the Legislature. *Id.* at 162. *Watson* is an old case, but its holding has never been repudiated by New York's Court of Appeals. Finding no more recent decision to the contrary, a number of bankruptcy courts in this Circuit have relied on *Watson* in recent years to reject Takings Clause challenges to the homestead exemption on the ground that New York law does not recognize judgment liens as protected property interests. *See In re Calloway*, 423 B.R. at 629–30; *see also In re Trudell*, 381 B.R. 441, 442–44 (Bankr.W.D.N.Y.2008); *Lattimore v. Walt's Tree Serv., Inc.* (In re *Lattimore*), 12 B.R. 111 (Bankr.W.D.N.Y.1981).

13 The crucial question in this case, however, is not whether Hertel's judgment lien is categorized as a property interest by New York law, but whether it constitutes a property interest for purposes of the Fifth and Fourteenth Amendments. "That determination, despite its state-law underpinnings, is ultimately one of federal constitutional law. Although the underlying substantive interest is created by an independent source such as state law, *federal constitutional law* determines whether that interest rises to the level of a legitimate claim of entitlement protected by the Due Process Clause." *Town of Castle Rock, Colo. v. Gonzales*, 545 U.S. 748, 756–57, 125 S.Ct. 2796, 162 L.Ed.2d 658 (2005) (internal

quotation marks omitted). Accordingly, we look first to state law to define the contours of the purported property interest, and then to federal constitutional law to determine whether that interest merits constitutional protection as a property interest.

Under New York law, after a plaintiff has won a judgment against a defendant, obtaining a judgment lien against his real property is simple. The judgment creditor need only file the judgment with the county clerk of the county where the property is located.[6] N.Y. C.P.L.R. § 5018(a). The lien secures the judgment creditor's ability to collect the judgment, by forced sale of the property if need be, N.Y. C.P.L.R. § 5236, by ensuring that, apart from a few statutory exceptions, no transfer by the judgment debtor of any interest in the liened property is effective against the judgment creditor. N.Y. C.P.L.R. § 5203.

In *Ford Motor Credit Co. v. NYC Police Department* this Court held that a lienholder with a security interest in a motor vehicle seized by the New York City Police Department possesses a constitutionally protected property interest in the seized vehicle and may not be excluded from participation in the civil forfeiture process. 503 F.3d 186, 190–92 (2d Cir.2007). The Court relied in part on *Armstrong v. United States*, in which the Supreme Court similarly concluded that a mechanic's lien obtained pursuant to Maine law constituted a constitutionally protected property interest. 364 U.S. 40, 44–45, 80 S.Ct. 1563, 4 L.Ed.2d 1554 (1960). Like the mechanic's lien at issue in *Armstrong*, a judgment lien entitles the lienholder to force a sale of the liened property and to obtain payment in priority over other creditors. *See* N.Y. C.P.L.R. § 5236(a); *see also* N.Y. C.P.L.R. § 5235 prac. cmt. C5235:1 (McKinney 2014) (explaining that N.Y. C.P.L.R. § 5236(a) "ordinarily bars sale of the realty on execution if the judgment is not ... a lien"). And like other common property interests, a judgment lien can be freely bought, sold, and assigned. There is no reason that a judgment lien should not be entitled to similar protection. The legal rights of a judgment lienholder are obviously far fewer than those of an owner in fee simple, but a judgment lien, like other security interests, "is indisputably a property interest protected by the Fourteenth Amendment." *Ford Motor Credit Co.*, 503 F.3d at 191.

2. Regulatory Taking Analysis

14 15 **8* The Supreme Court has recognized two branches of Takings Clause cases: physical takings and regulatory takings.[7] *See Tahoe–Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 322, 122 S.Ct. 1465, 152 L.Ed.2d 517 (2002). A physical taking occurs when there is either a condemnation or a physical appropriation of property. *Id.* A regulatory taking, by contrast, occurs where even absent a direct physical appropriation, governmental regulation of private property "goes too far" and is "tantamount to a direct appropriation or ouster." *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528,537 (2005) (quoting *Pa. Coal Co. v. Mahon*, 260 U.S. 393,415 (1922) (Holmes, J.)). Because application of the 2005 Amendment to pre-existing liens "does not present the 'classi[c] taking' in which the government directly appropriates private property for its own use," *E. Enters. v. Apfel*, 524 U.S. 498, 522, 118 S.Ct. 2131, 141 L.Ed.2d 451 (1998) (alteration in original), any taking in this case would be regulatory in nature.

16 17 The Supreme Court has "generally eschewed any set formula" for identifying regulatory takings, instead "preferring to engage in essentially ad hoc, factual inquiries" to determine in each case whether the challenged property restriction rises to the level of a taking. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992) (alterations omitted) (internal quotation marks omitted). Paramount to the inquiry are the familiar factors set forth in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978). "Primary among those factors are '[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations.' " *Lingle*, 544 U.S. at 538–39 (alteration in original) (quoting *Penn Central*, 438 U.S. at 124). Also telling, is the "character of the governmental action," particularly "whether it amounts to a physical invasion" or appropriation of property or instead merely affects property interests through "some public program adjusting the benefits and burdens of economic life to promote the common good." *Id.* at 539 (internal quotation marks omitted).

18 Although these factors govern most regulatory takings challenges, the Supreme Court has also identified two types of regulatory action that are treated as per se takings for Fifth Amendment purposes and therefore require no case-specific weighing of the *Penn Central* factors. A categorical taking occurs (1) where a regulation "compel[s] the property owner to suffer a physical 'invasion' of his property"; or (2) "where regulation denies all economically beneficial or productive use of land." *Lucas*, 505 U.S. at 1015.

19 Hertel argues that this case falls into the second of these two per se takings categories. It reasons that the 2005 Amendment has deprived it of all economic use of its judgment lien against Calloway and that the Court should simply find a per se taking under *Lucas* and forgo a detailed analysis of the *Penn Central* factors. In the alternative, Hertel argues that even were we to apply *Penn Central*, those factors would weigh in favor of its takings claim.

*9 The cases in which the Supreme Court has applied *Lucas*'s total takings rule have involved real property, and it is unclear whether that case's per se rule should be applied to purported takings of other types of property, such as intellectual property, personal property, or a security interest like that at issue here. The *Lucas* Court repeatedly referred to regulation that deprives "*land*" (not "property") of all economically beneficial use,[8] and subsequent decisions of the circuit courts have not reached a clear consensus on how broadly to apply *Lucas*'s per se rule. *See A & D Auto Sales, Inc. v. United States*, 748 F.3d 1142,1151–52 (Fed.Cir.2014) (noting the question and collecting cases). The parties have not briefed the issue, however, and its resolution is unnecessary to our decision because there has been no taking under either standard. Because Hertel's takings claim fails for similar reasons under both tests, *Lucas* and the *Penn Central* factors can be addressed together.

First, the nature of the challenged governmental action in this case is not that of a regulatory taking. The government has not physically invaded or appropriated Hertel's judgment lien for its own use; it has merely adjusted its long-standing statutory protection of debtors' homesteads to account for modern home values. Legislative tinkering of this sort inevitably creates individual winners and losers, for one man's defense is another's obstacle. But "it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another." *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 223, 106 S.Ct. 1018, 89 L.Ed.2d 166 (1986). The 2005 Amendment's interference with judgment lienholders' property rights is of the sort that inevitably follows when the Legislature adjusts the benefits and burdens of economic life to promote the common good.

Second, the economic impact of the 2005 Amendment and its effects on Hertel's investment-backed expectations establish that no taking occurred here. Hertel obtained a judgment lien on Calloway's property in 2003. At the time of the bankruptcy court proceeding, the property was valued at approximately $110,000, but was encumbered by a mortgage with a remaining balance of approximately $85,000, leaving Calloway around $25,000 in home equity. If the 2005 Amendment had never been enacted and the homestead exemption limit had been left at $10,000, a portion of Calloway's home equity would now be available to satisfy Hertel's judgment against her. However, because the 2005 Amendment raised the homestead exemption limit to $50,000, Calloway's equity in her home is completely shielded.[9] Hertel reasons as follows: But for the 2005 Amendment, Calloway's home equity would be available to satisfy the judgment; a comparison of Hertel's economic position before and after the statute's effective date shows a change for the worse; therefore Hertel's property has been taken in violation of the Fifth Amendment.

*10 Hertel's reasoning, however, rests on the factually unsupported assumption that its judgment lien had value before the passage of the 2005 Amendment. The record contains no evidence as to Calloway's equity in her home on August 29, 2005, the day before the amendment took effect. If on that date she held $10,000 or less in home equity, Hertel's judgment lien would have been worthless, since Calloway could have protected all of her home equity under the then-applicable $10,000 exemption. Hertel therefore has not shown the 2005 Amendment, in fact, affected its economic interests.

20 In any event, however, even assuming the 2005 Amendment did have some effect on Hertel's economic interests, that alone is not enough to support its claim. In assessing a takings claim, the relevant question is not whether governmental action has affected a party's interests in some way but, rather, the extent to which the challenged governmental action has upset the claimant's investment-backed economic expectations by altering its rights as to a constitutionally protected property interest.

To argue that the 2005 Amendment impermissibly affected its property interest, Hertel relies primarily on *United States v. Security Industrial Bank*, 459 U.S. 70, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982). That case considered the retroactive application of lien-avoidance provisions contained in the then newly enacted Bankruptcy Reform Act of 1978, 92 Stat.

2549 (1978). Federal bankruptcy law had remained largely unchanged since the Depression-era Chandler Act, ch. 575, 52 Stat. 840 (1938), and, by the 1970s, Congress recognized the need for major reform. Consumer bankruptcies had come to account for nearly ninety percent of all bankruptcy cases, 123 Cong. Rec. 35444 (1977) (statement of Rep. Rodino), but the federal bankruptcy laws had not been readjusted since 1938 and were aimed primarily at business bankruptcies. H.R. Rep. No. 95–595 at 3–5 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5965–66. The Bankruptcy Reform Act of 1978 radically readjusted U.S. bankruptcy law by "redesign[ing] traditional bankruptcy protections to make them more effective for non-business debtors." 123 Cong. Rec. 35444 (1977) (statement of Rep. Rodino).

One particular concern of the Act was creditors' increasing use of liens on personal property. The traditional right under state law to exempt certain property from the bankruptcy estate did not protect debtors from creditors who had forced them into contracts waiving the exemptions or who held security interests in their household goods, apparel, and similar personal property. *See* H.R. Doc. No. 93–137, at 169–74 (1973);123 Cong. Rec. 35446 (1977) (statement of Rep. Edwards). Congress addressed these problems with the Bankruptcy Reform Act of 1978, which, among other things, made waivers of exemptions unenforceable and included a lien-avoidance provision entitling individual debtors to avoid judicial liens and nonpossessory, nonpurchase-money liens on certain types of property. Faced with the question whether Congress's dramatic alteration of bankruptcy law to permit debtors for the first time to avoid even secured debts should apply retroactively to existing liens, the Supreme Court in *Security Industrial Bank* noted "substantial doubt whether the retroactive destruction of the appellees' liens ... [would] comport[ ] with the Fifth Amendment," 459 U.S. at 78, and ultimately concluded that Congress must not have intended § 522(f) to apply to existing liens.

***11** Unlike the newly crafted lien-avoidance provision at issue in *Security Industrial Bank*, however, New York's homestead exemption is of a much earlier vintage—from a time if not quite immemorial, then at least nearly so. Hertel obtained its judgment lien against a backdrop of New York law that has continuously provided a homestead exemption for more than 150 years. Dating from 1850, New York's homestead exemption has now become a "background principle[ ] of the State's law of property," *Lucas*, 505 U.S. at 1029, that serves both to define the scope of a judgment lienholder's property interest and its reasonable investment-backed expectations.[10] So pedigreed a principle of state law "inhere[s] in the title itself," and the property owner can claim no taking when he feels the effects of that restriction, for the implied limitation has been there all along. *Lucas*, 505 U.S. at 1029.

When Hertel obtained its judgment lien in 2003, inherent in the property interest was the implied limitation that collection on the judgment might be impeded by New York's long-standing protection of judgment debtors' homesteads. Like New York's other exemption laws, the homestead exemption has changed to keep pace with the times. The exemption for "[a]ll spinningwheels-wheels [and] weaving-looms" has come to encompass instead "one sewing machine with its appurtenances." The exemption for "[t]he family bible, family pictures and school books" now includes all "religious texts" and caps the exemption for other books at $500 instead of $50. And the homestead exemption has been expanded to include condominiums, has become available to women, and now has been updated to provide an exemption limit commensurate with ever-increasing home values. *Compare* 2 Revised Statutes of New York, pt. III, ch. VI, tit. 5, art. 2, § 22 (1st ed. 1829), *and* 1850 N.Y. Laws ch. 260, *with* N.Y. C.P.L.R. 5205, *and* N.Y. C.P.L.R. 5206.

Inherent in Hertel's judgment lien was the implied limitation of a homestead exemption that predictably and necessarily must be adjusted from time to time to account for the changing values of the homes it protects. This limitation having been part of Hertel's judgment lien from the start, the 2005 Amendment neither effected a total taking of Hertel's property nor upset its reasonable investment-backed expectations. Thus, we conclude that the 2005 Amendment's application to pre-enactment judgment liens does not violate the Takings Clause of the Fifth Amendment.

CONCLUSION

In sum, we hold (1) that the 2005 Amendment applies to all creditors and all obligations, including pre-existing obligations, regardless of whether the debt was reduced to a judgment lien prior to the statute's enactment; and (2) that retroactive application of the exemption does not constitute an uncompensated taking of pre-enactment judgment liens in violation of the Takings Clause. Accordingly, the judgment of the district court is AFFIRMED.

Footnotes

* The Honorable Vincent L. Briccetti, of the United States District Court for the Southern District of New York, sitting by designation.

1 In light of this case's significance, we appointed Joshua D. Liston as pro bono counsel to represent Calloway's interest in the appeal. We thank counsel for his efforts.

2 "An order of a district court functioning in its capacity as an appellate court in a bankruptcy case is subject to plenary review." *Momentum Mfg. Corp. v. Emp. Creditors Comm.* (In re *Momentum Mfg. Corp.*), 25 F.3d 1132, 1136 (2d Cir.1994). This Court "independently review[s] the factual determinations and legal conclusions of the bankruptcy court." *Id.* (internal quotation marks omitted). Its legal conclusions are evaluated de novo, and its factual findings are reviewed for clear error. *Id.* The issues Hertel raises in this appeal are pure questions of law subject to this Court's de novo review.

3 On January 31, 2013, New York State Senator Kevin S. Parker introduced a bill that would increase the exemption yet again, from $150,000 to $250,000 in ten high-property-value counties. S. 3198, 236th Leg. (N.Y.2013). The bill was referred to the Senate Judiciary Committee on January 8, 2014.

4 A statute can be retroactive in two ways, both of which courts have traditionally disfavored because they impair an individual's ability to plan his conduct with reasonable certainty of its legal consequences. First, and most obviously, a statute is said to be retroactive if it is directed at past events and gives pre-enactment conduct a different effect from that it would have had before the passage of the statute. Second, a statute is also said to be retroactive if, although it is not directed at conduct that occurred prior to its enactment, it diminishes rights or increases obligations established prior to the legislation's effective date. *See* N.Y. Stat. Law § 51 (defining a retroactive statute as one that "takes away or impairs vested rights" or "looks backward affecting acts occurring or rights accruing before it came into force"); *see generally Landgraf v. USI Film Prods.*, 511 U.S. 244, 263–80 (1994). As interpreted by the bankruptcy and district courts, the 2005 Amendment would be retroactive in this second sense because, although it applies to the satisfaction of judgments only after its effective date, it affects judgment liens perfected prior to its enactment.

5 In the absence of a final decision by a state's highest court as to the proper interpretation of a state statute, a federal court must determine how the state's highest court would decide the issue if presented with it. 19 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 4507 (2d ed.1996). This Court has not previously addressed whether that predictive inquiry should be guided primarily by federal or state interpretive principles, in this case, the federal or New York State constitutional avoidance canon. The *Erie* doctrine would seem to require federal courts to interpret a state's law just as would the courts of that state in order to ensure consistent outcomes in federal and state courts. *See generally* Abbe R. Gluck, *Intersystemic Statutory Interpretation: Methodology as "Law" and the* Erie *Doctrine*, 120 Yale L.J. 1898 (2011). And in past cases we have naturally relied on state courts' statutory construction case law. *See, e.g., Beason v. United Techs. Corp.*, 337 F.3d 271, 275 (2d Cir.2003) (relying on Connecticut precedent on statutory construction to interpret Connecticut statute). Other of our decisions, however, suggest that federal and state courts apply distinct interpretive methodologies by virtue of a "broader interpretive power" that state courts exercise in interpreting state law and that those approaches could sometimes result in different interpretations of identical statutory language in state versus federal courts. *See, e.g., Sealed v. Sealed*, 332 F.3d 51, 59 (2d Cir.2003). We note this issue but need not resolve it, because both New York and the federal courts recognize the constitutional avoidance canon, and, whichever governs, the result is the same.

The process is simpler still if the judgment is rendered by a supreme or county

6 court and the debtor's property is located in the county where the judgment is entered. A judgment entered in a supreme or county court *automatically* becomes a judgment lien against the debtor's local real property. *See* N.Y. C.P.L.R. § 5018(a); David D. Siegel, *New York Practice* § 517 (5th ed.2011).

7 Citing the Supreme Court's observation in *United States v. Security Industrial Bank*, 459 U.S. 70, 75–76, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982) that the traditional regulatory takings framework employed in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978), fits awkwardly with governmental regulations, like this one, that affect a party's entire property interest rather than "some but not all of the 'bundle or rights,' " Hertel urges recognition of a new branch of Takings Clause doctrine to assess the destruction of liens. This we decline to do. In only two cases has the Supreme Court held that the government's destruction of a lien constituted a taking, *see Armstrong v. United States*, 364 U.S. 40, 80 S.Ct. 1563, 4 L.Ed.2d 1554 (1960); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935), both of which predated *Penn Central Transportation*, the Supreme Court's seminal case on regulatory takings. *Penn Central Transportation*, however, cited *Armstrong* as an example of a case in which a regulatory taking occurred given the government's frustration of property-holders' investment-backed expectations, *see* 438 U.S. at 127, one of the principal considerations when considering whether a regulatory taking occurred. Thus, it is far from clear that the Supreme Court would analyze the government's destruction of liens using a framework other than the regulatory takings frameworks set forth in *Penn Central Transportation* and *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992), both of which we address herein.

8 The *Lucas* Court also specifically distinguished regulation of land from regulation of personal property, which, it explained, might even face regulation that would render it economically worthless "by reason of the State's traditionally high degree of control over commercial dealings." *Lucas*, 505 U.S. at 1027–28.

9 11 U.S.C. § 522(f) allows a debtor to avoid a judgment lien in bankruptcy to the extent that the lien impairs an exemption to which the debtor would be entitled in the absence of the lien. Because the $25,000 equity that Calloway holds in her home is less than the $50,000 homestead exemption, subjecting the property to a judicial lien of any amount would impair the value of that exemption. *See* 11 U.S.C. § 522(f)(2)(A). Section 522(f) thus entitles Calloway to completely avoid the lien and prevents any portion of the lien from passing through the bankruptcy and remaining on her property.

10 Neither *Lucas* nor subsequent decisions have clarified how long a legislative enactment must remain in force before it becomes a "background principle" of property law that is sufficiently embedded in a state's legal tradition that it defines property holders' rights and investment-backed expectations. A background principle cannot be a "newly legislated" one, but it is unclear just how old is old enough. *Lucas*, 505 U.S. at 1028–29; *accord Palazzolo v. Rhode Island*, 533 U.S. 606, 630, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001). Although we do not here attempt to delineate a precise division between "background" and "foreground" laws, after more than 150 years, New York's homestead exemption qualifies as part of "those common, shared understandings of permissible limitations derived from a State's legal tradition." *Palazzolo*, 533 U.S. 606, 630, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001); *accord Tahoe–Sierra*, 535 U.S. at 352–53 (Rehnquist, C.J., dissenting) (relying on New York City's enactment of a comprehensive zoning ordinance in 1916 and the existence of zoning regulations in colonial Boston to conclude that zoning law is an implied limitation on real property and part of an owner's investment-backed expectations).

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Independence Bank v. Valentine, 113 A.D.3d 62, 976 N.Y.S.2d 504 (2013).

Conference Mandate Only Applies to Limited Residential Loans

It has now become a common situation where a corporation or an LLC seeks to obtain a loan for some business purpose and the principal of the entity is forced to give a personal guaranty. Usually, the principal's only real property asset available as collateral is their primary residence. In the case of *Independence Bank v. Valentine,* the borrower in such a situation defaulted and sought the protection of NY CPLR §3408, which mandates that a settlement conference must be held in any residential foreclosure action involving a home loan. RPAPL Article 13 defines a home loan as one where the borrower is a natural person who incurs a debt primarily for personal, family or household purposes and is secured by the borrower's primary residence.

Facts:
A commercial lender brought an action to foreclose a mortgage on the primary residence of a commercial borrower's corporate president. The corporate president had sought the loan in order to finance the purchase of equipment and machinery as well as other start-up, closing and construction costs involved in opening a "Quiznos Sub." In order to obtain the loan, she executed personal guaranty and provided a mortgage on her primary residence as security. When the borrower failed to honor her personal guaranty, the lender commenced this action.

Issue:
The issue is whether CPLR §3408 governs commercial mortgages involving residential property.

Analysis:
CPLR §3408 does not govern in commercial mortgage foreclosure actions involving residential property. Though CPLR §3408 is applicable to many residential foreclosure actions, it does not apply to every residential foreclosure action. The Court limited CPLR 3408 to "residential foreclosure actions involving home loans as the term "home loan" is defined in RPAPL 1304." RPAPL 1304 defines home loans as those in which the debt incurred is primarily for personal, family or household purposes. Here, the borrower listed on the loan term agreement and the note, and the entity that was recognized in the guaranty was the corporation, not a natural person. The Appellate Division, Second Department noted that the debt incurred was the $230,000 loan given to the corporation. It found, "the Supreme Court correctly determined that since the purpose of the loan was to purchase machinery and equipment, ant to fund other various start-up, closing and construction costs associated with fashioning a "Quizno's Sub" store, it was clearly not primarily incurred for personal family or other household purposes."

Decision:
Though the Second Department expressed its sympathy for the borrower's situation, it nevertheless held that the conference mandate does not apply to all foreclosures of residential property. Specifically, CPLR §3408's conference does not apply in foreclosure actions involving commercial mortgages, as those are not the types of borrowers intended to be protected by the settlement conference mandate.

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Independence Bank v. Valentine
Supreme Court, Appellate Division, Second Department, New York November 27, 2013 113 A.D.3d 62 976 N.Y.S.2d 504 2013 N.Y. Slip Op. 07937 (Appellate Division)

RELATED TOPICS

Foreclosure by Action

Foreclosure Suit of Note and Mortgage and Evidence of Default

General Rules of Construction of Statutes of Doubtful Meaning

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113 A.D.3d 62

Supreme Court, Appellate Division, Second Department, New York.

INDEPENDENCE BANK, respondent,

v.

Roselyn VALENTINE, appellant, et al., defendants.

Nov. 27, 2013.

Synopsis

Background: Commercial lender brought action for foreclosure of mortgage on primary residence of commercial borrower's corporate president, which mortgage collateralized president's personal guaranty of commercial loan. The Supreme Court, Queens County, Allan B. Weiss, J., granted summary judgment to lender and entered order of reference. President appealed.

Holding: The Supreme Court, Appellate Division, Cohen, J., held that civil practice rule requiring a settlement conference, in an action to foreclosure a mortgage on a primary residence, was not applicable.

Affirmed

West Headnotes (5)

Change View

1 **Mortgages** Weight and Sufficiency of Evidence
Mortgages Production of bond, note, or other obligation secured
Entitlement to a judgment of mortgage foreclosure is established, as a matter of law, where the plaintiff produces the mortgage, the unpaid note, and evidence of the default.

2 Cases that cite this headnote

2 **Mortgages** Conditions precedent
Civil practice rule requiring a settlement conference, in an action to foreclosure a mortgage on a primary residence, did not apply in commercial lender's action for foreclosure of mortgage on primary residence of commercial borrower's corporate president, which mortgage collateralized president's personal guaranty; civil practice rule was limited to residential foreclosure actions involving "home loans" as defined by statute, as so defined home loans were those which were made to a natural person and in which the debt incurred was primarily for personal, family, or household purposes, and lender's loan was made to a corporation rather than a natural person, and purpose of loan was to purchase machinery and equipment, and to fund other various start-up, closing, and construction costs, associated with fashioning a restaurant. McKinney's RPAPL § 1304; McKinney's CPLR 3408(5)(a)(ii, iii).

4 Cases that cite this headnote

3 **Statutes** Language
Statutes Plain Language; Plain, Ordinary, or Common Meaning
In determining the reach of a statute, the starting point is the language itself, giving effect to the plain meaning thereof.

4 **Statutes** Plain language; plain, ordinary, common, or literal meaning
Where the statutory language is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used.

5 **Statutes** Intent

A court, in interpreting a statute, should attempt to effectuate the intent of the Legislature.

Attorneys and Law Firms

**505* Ann C. Northern, Brooklyn, N.Y., for appellant.

Pinks Arbeit & Nemeth, Hauppauge, N.Y. (Robert S. Arbeit of counsel), for respondent.

MARK C. DILLON, J.P., DANIEL D. ANGIOLILLO, THOMAS A. DICKERSON, and JEFFREY A. COHEN, JJ.

Opinion

COHEN, J.

Since 2008, New York homeowners finding themselves in the devastating position of defending a mortgage foreclosure action involving their primary residence have been afforded certain protections enacted by the New York State Legislature (*see* L. 2008, ch. 472; *Wells Fargo Bank, N.A. v. Meyers*, 108 A.D.3d 9, 966 N.Y.S.2d 108; *see also* Hon. Mark C. Dillon, *The Newly–Enacted CPLR 3408 for Easing the Mortgage Foreclosure Crisis: Very Good Steps, but not Legislatively Perfect*, 30 Pace L. Rev. 855, 855–856 [2010]). Shortly after the passage of the Subprime Residential Loan and Foreclosure Laws, and in a further effort to mitigate the mortgage foreclosure crisis, the Legislature amended a number of the enacted statutes, primarily to allow more homeowners at risk of foreclosure to benefit from the consumer protection laws and opportunities to prevent foreclosure (*see* L. 2009, ch. 507). On this appeal, we are asked to determine whether the current version of one of these statutes, CPLR 3408, mandates that a settlement conference be conducted in an action to foreclosure a mortgage on a primary residence where the mortgage collateralizes a personal guaranty of a commercial loan to a corporation. While CPLR 3408 reflects a clear legislative intent to aid homeowners threatened with foreclosure, we hold that its protective ambit does not extend to the facts at bar, and thus no settlement conference was required in this case.

On December 18, 2006, the plaintiff, Independence Bank, entered into a commercial term loan agreement with Roz–Valt Corp., a New York corporation (hereinafter Roz–Valt), in the principal sum of $230,000. The loan was memorialized by a promissory note duly executed by the defendant Roselyn Valentine, as Roz–Valt's president. As delineated in the term loan agreement, the primary purpose of the loan was to purchase machinery and equipment, and to fund other various start-up, closing, and construction costs associated with fashioning a "Quizno's Sub" shop in leasehold premises located in Brooklyn. Valentine executed a personal guaranty for the loan, and, as collateral security for her obligation under the guaranty, executed and delivered a mortgage to the plaintiff in the amount of $230,000, giving the plaintiff a subordinate lien on her primary residence located in Queens.

Following Roz–Valt's default on the loan, and Valentine's failure to honor her personal guaranty, the plaintiff commenced the instant action to foreclose the mortgage. Valentine answered the complaint, denying its material allegations, and asserting four affirmative defenses, including, as her fourth affirmative defense, that she was entitled to a mandatory settlement conference pursuant to CPLR 3408, "for the subject premises [are] a one to four family residence and the defendant is a resident of the property."

By notice dated October 31, 2011, the plaintiff moved, inter alia, for summary judgment on the complaint insofar as asserted against Valentine and for an order of reference. Valentine opposed the motion, contending that she was entitled to a mandatory settlement conference pursuant **506* to CPLR 3408. The Supreme Court granted the motion.

1 Entitlement to a judgment of foreclosure is established, as a matter of law, where the plaintiff produces the mortgage, the unpaid note, and evidence of the default (*see Emigrant Mtge. Co., Inc. v. Beckerman*, 105 A.D.3d 895, 964 N.Y.S.2d 548; *Solomon v. Burden*, 104 A.D.3d 839, 961 N.Y.S.2d 535; *Baron Assoc., LLC v. Garcia Group Enters., Inc.*, 96 A.D.3d 793, 793, 946 N.Y.S.2d 611). Here, the plaintiff established its prima facie entitlement to judgment as a matter of law by submitting the mortgage and the underlying unpaid note,

both of which were executed by Valentine in her capacity as Roz–Valt's president, the personal guaranty by Valentine, and evidence that Roz–Valt and Valentine were in default (*see Baron Assoc., LLC v. Garcia Group Enters., Inc.*, 96 A.D.3d at 793, 946 N.Y.S.2d 611).

Notably, Valentine did not dispute the validity of any of the agreements, nor did she deny that Roz–Valt defaulted on the loan and that she defaulted on her personal guaranty. Valentine did not allege or produce evidence in admissible form sufficient to raise a triable issue of fact as to a bona fide defense such as waiver, estoppel, bad faith, fraud, or oppressive or unconscionable conduct on the part of the plaintiff (*see Nassau Trust Co. v. Montrose Concrete Prods. Corp.*, 56 N.Y.2d 175, 183, 451 N.Y.S.2d 663, 436 N.E.2d 1265; *Solomon v. Burden*, 104 A.D.3d at 839, 961 N.Y.S.2d 535). Valentine's sole argument in opposition to the plaintiff's prima facie showing was that she was improperly denied the opportunity to participate in a settlement conference pursuant to CPLR 3408.

2 CPLR 3408 mandates foreclosure settlement conferences in specified circumstances. While the statute originally applied only to foreclosure actions involving high-cost home loans or subprime or nontraditional home loans (*see* former CPLR 3408[a]), the Legislature amended the statute in November 2009 (*see* L. 2009, ch. 507, § 9) to broaden its applicability (*see Wells Fargo Bank, N.A. v. Meyers*, 108 A.D.3d at 17–18, 966 N.Y.S.2d 108). The current version of the statute applies to "any residential foreclosure action involving a home loan as such term is defined in section thirteen hundred four of the real property actions and proceedings law, in which the defendant is a resident of the property subject to foreclosure" (CPLR 3408 [a]). Real Property Actions and Proceedings Law § 1304 defines a qualifying "home loan" as one in which, inter alia, the borrower is a natural person; the borrower incurs the debt "primarily for personal, family or household purposes"; and the loan is secured by a mortgage on real property in this state "used or occupied, or intended to be used or occupied wholly or partly, as the home or residence of one or more persons and which is or will be occupied by the borrower as the borrower's principal dwelling" (RPAPL 1304 [5][a][i]-[iv]).

Valentine urges this Court to interpret these statutes as being applicable to the instant matter since she is a natural person and the mortgaged premises are occupied by her as her primary residence. While we agree with Valentine's contention that the Legislature, in enacting these statutes, sought to assist homeowners at risk of foreclosure, we nonetheless find Valentine's interpretation of the relevant statutes unpersuasive.

3 4 5 In determining the reach of CPLR 3408, the " 'starting point' is 'the language itself, giving effect to the plain meaning thereof' " ***507** (*Commonwealth of the N. Mariana Is. v. Canadian Imperial Bank of Commerce*, 21 N.Y.3d 55, 60, 967 N.Y.S.2d 876, 990 N.E.2d 114, quoting *Majewski v. Broadalbin–Perth Cent. School Dist.*, 91 N.Y.2d 577, 583, 673 N.Y.S.2d 966, 696 N.E.2d 978). " '[W]here the statutory language is clear and unambiguous, the court should construe it so as to give effect to the plain meaning of the words used' " (*Commonwealth of the N. Mariana Is. v. Canadian Imperial Bank of Commerce*, 21 N.Y.3d at 60, 967 N.Y.S.2d 876, 990 N.E.2d 114, quoting *Patrolmen's Benevolent Assn. of City of N.Y. v. City of New York*, 41 N.Y.2d 205, 208, 391 N.Y.S.2d 544, 359 N.E.2d 1338, citing *Bender v. Jamaica Hosp.*, 40 N.Y.2d 560, 388 N.Y.S.2d 269, 356 N.E.2d 1228). "Moreover, '[i]t is fundamental that a court, in interpreting a statute, should attempt to effectuate the intent of the Legislature' " (*Commonwealth of N. Mariana Is. v. Canadian Imperial Bank of Commerce*, 21 N.Y.3d at 60, 967 N.Y.S.2d 876, 990 N.E.2d 114, quoting *Majewski v. Broadalbin–Perth Cent. School Dist.*, 91 N.Y.2d at 582, 673 N.Y.S.2d 966, 696 N.E.2d 978, citing *Patrolmen's Benevolent Assn. of City of N.Y. v. City of New York*, 41 N.Y.2d at 208, 391 N.Y.S.2d 544, 359 N.E.2d 1338).

CPLR 3408 is certainly applicable to many residential foreclosure actions. However, CPLR 3408 does not apply to every residential foreclosure action. Indeed, CPLR 3408 is limited to residential foreclosure actions involving home loans as the term "home loan" is defined by RPAPL 1304. As so defined, home loans are those which are made to a natural person and in which the debt incurred is primarily for personal, family, or household purposes (*see* RPAPL 1304[5][a][ii], [iii]).

The borrower, as defined under the instant term loan agreement and the note, and the entity that is recognized in the guaranty, was Roz–Valt. Accordingly, the borrower of the sum evidenced by the note was Roz–Valt, not Valentine. The borrower, Roz–Valt, was not a natural person (*see* RPAPL 1304[5][a][ii]).

Further, the debt incurred was the $230,000 loan given to Roz–Valt. The Supreme Court correctly determined that since the purpose of the loan was to purchase machinery and equipment, and to fund other various start-up, closing, and construction costs associated with fashioning a "Quizno's Sub" store, it was clearly not primarily incurred for personal, family, or household purposes (*see* RPAPL 1304[5][a][ii]; *see also Horizons Invs. Corp. v. Brecevich*, 104 A.D.3d 475, 961 N.Y.S.2d 112; *Pritchard v. Curtis*, 101 A.D.3d 1502, 1503–1504 n. 1, 957 N.Y.S.2d 440; *Ukranian Natl. Fed. Credit Union v. Belko*, 40 Misc.3d 505, 969 N.Y.S.2d 728 [Sup. Ct., Westchester County]; *Eastern Sav. Bank, FSB v. Aguirre*, 30 Misc.3d 1230[A], 2011 N.Y. Slip Op. 50285[U] [Sup. Ct., Queens County]).

While it is unfortunate that here, a primary residence may be lost in foreclosure, not everyone under every circumstance is entitled to reap the protections afforded to victims of the mortgage crisis by the New York Legislature pursuant to CPLR 3408. Under these facts, Valentine does not fall within the protections afforded to homeowners under CPLR 3408. Here, the plaintiff made a loan to Roz–Valt, a corporation, not Valentine, a natural person. Valentine simply acted as the guarantor of Roz–Valt's loan. Valentine used her own primary residence in Queens to secure her obligations as guarantor of the mortgage. Therefore, Valentine acted only as the guarantor of this loan, not a borrower, in using her own home as collateral security. This mortgage was not given to secure or collateralize the note, but rather, Valentine gave the plaintiff a subordinate lien on her ***508** primary residence as Roz–Volt's guarantor.

Accordingly, since a mortgagor is only entitled to a mandatory settlement conference under CPLR 3408 for a home loan that falls under the definition outlined in RPAPL 1304(5) (*see Wells Fargo Bank, N.A. v. Meyers*, 108 A.D.3d at 18, 966 N.Y.S.2d 108; *Aurora Loan Serv., LLC v. Weisblum*, 85 A.D.3d 95, 104–105, 923 N.Y.S.2d 609), and the loan here does not fall within the ambit of that statute, the Supreme Court properly rejected Valentine's argument and granted those branches of the plaintiff's motion which were for summary judgment on the complaint insofar as asserted against Valentine and for an order of reference.

The order is affirmed insofar as appealed from.

ORDERED that the order is affirmed insofar as appealed from, with costs.

Parallel Citations

113 A.D.3d 62, 976 N.Y.S.2d 504, 2013 N.Y. Slip Op. 07937

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40-50 Brighton First Rd. Apartments Corp. v. Kosolapov, 39 Misc. 3d 27, 964 N.Y.S.2d 396 (App. Term 2013).

The Business Judgment Rule

In 1990, the New York Court of Appeals announced that New York courts would apply the business judgment rule, first developed in the context of business corporate law, in cases challenging the decisions and actions of the governing boards of cooperative apartment corporations and condominium associations.[14] Since then, the Court has explained that the business judgment rule was intended to insulate from court review the myriad of decisions and actions that co-op and condo boards must make in good faith on a daily basis to govern and operate their buildings in the interest of their shareholders and unit owners and for the good of their buildings generally.[15] Over the years, New York courts have given great deference to board decision-making, and they have routinely dismissed hundreds, if not thousands, of cases brought by disgruntled shareholders and unit owners who have disagreed with or been adversely affected by board decisions. Nevertheless, the Court of Appeals has also made clear that the business judgment rule was never intended to be a vehicle for courts to give "rubber stamp" approval for board action that is done without authority, in bad faith, or that discriminates between classes of shareholders or unit owners or singles out individual shareholders or unit owners for disparate treatment. *40-50 Brighton First Rd. Apartments Corp. v. Kosolapov and Goldstone v. Gracie Terrace Apartment Corporation* are examples of the New York courts' increasing willingness ignore the business judgment rule and look into the facts of the case. Though the Court in that case gave greater scrutiny to the allegation of unauthorized board action and delved deeply into the facts, it nevertheless ruled in the board's favor.

Facts:
The board of directors of a residential cooperative corporation (the board) imposed a special assessment to pay for the completion of Local Law 11 facade repairs. The board provided tenants with an assessment letter in which it stated the importance of completing the façade repairs so as to be in compliance with local law. It also estimated the cost of the work and weighed the options of getting a mortgage to finance the repairs against imposing a special assessment. It ultimately decided not to obtain a mortgage because it would result in increasing maintenance charges, which the special assessment was proposed to avoid. The shareholders challenged the assessment because they thought that the board failed to show that the assessment was needed. More importantly, they claimed that the board lied to them and said that the assessment was imposed in order to finance the facade repairs, when it was really imposed to balance a budget deficit. In response, the corporation brought a non-payment proceeding against the resisting shareholders. The shareholders countered that the board action was not authorized by the bylaws or by the proprietary leases, and therefore, that the board's action was done in bad faith and should not be protected by the business judgment rule.

Issue:

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[14]Levandusky v. One Fifth Ave. Apartment Corp., 75 N.Y.2d 530, 553 N.E.2d 1317 (1990).
[15] 40 W. 67th St. Corp. v. Pullman, 100 N.Y.2d 147, 790 N.E.2d 1174 (2003).

The issue is whether the decision of the cooperative corporation to impose a special assessment is shielded by the business judgment rule.

Analysis:
The Court ruled in the Board's favor and decided that the decision to impose a special assessment was protected by the business judgment rule. The common-law business judgment rule requires courts to defer to good faith decisions made by boards of directors in business settings. The rule is applicable to cooperative corporations as long as the board acts for the purposes of the cooperative, within the scope of its powers and in good faith. This means that the board's action must be consistent with the powers authorized by the bylaws and proprietary leases and that there is a reasonable relationship between the Board's action and the welfare of the cooperative. Here, the tenants, attempted to show fraud by the Board by claiming that the Board's representations were not true because the assessment charges were not spent on the facade repairs. However, the Court ruled in the Board's favor reasoning that the broad financial management authority granted to the Board in the bylaws and proprietary lease clearly includes the determinations made by the Board, and there is no claim that any part of the funds collected from the special assessment were used for any reason other than the furtherance of the cooperative's legitimate interests.

Decision:
The business judgment rule does not give boards a free pass to act in disregard of their governing documents and by-laws or otherwise in disregard of the law. The business judgment rule will still be applied where board decision-making is challenged, but a board is able to meet its prima facie burden to show that it acted in good faith and in furtherance of the cooperative's best interest.

However, in cases where the record shows that a board has either clearly exceeded the authority granted in its by-laws or otherwise cannot offer an explanation for a particular decision it has made, New York courts will not hesitate to find the business judgment rule inapplicable to such board action. Likewise, where the record presents triable issues of fact concerning whether the board acted outside the scope of its authority and/or whether the actions of the shareholder or unit owner justifiably triggered the complained of board action, the courts will deny summary judgment and direct that a trial be held to determine whether or not the business judgment rule should apply to the board's action.

Goldstone v. Gracie Terrace Apartment Corporation, 110 AD3d 101, 970 NYS2d 783 (1st Dept. 2013).

Facts:
A cooperative shareholder suffered extensive property damage from an overflowed water tank above her apartment. The board gutted the shareholder's apartment to clear it of toxic mold and adopted a plan of renovation and repair that necessitated a 50-square-foot reduction in the shareholder's interior apartment space. The board brought a motion for an injunction granting it access to the apartment to perform the work. That injunction was granted over the shareholder's opposition. The shareholder then brought the present suit seeking damages for the board's breach of her proprietary lease. She argued that the board's plan would decrease the size of the interior of the apartment in violation of her rights under the proprietary lease. Specifically, by placing

the insulation on the apartment's interior, the board's alteration would reduce the size of the interior and alter the apartment's configuration because it would cause the loss of 2 ½ inches along every wall where the insulation was placed, for a total loss of 50 square feet. The shareholder stated that this alteration would reduce the hallway to a width smaller than that required by the Building Code, and that to maintain a hallway of the necessary width, the adjoining room would have to decrease in size, and its interior partitions reconfigured, or new interior partitions installed, with new doors. These changes in turn require alterations or adjustments or replacements of the shareholder's storage and display units and her custom-designed kitchen counter-tops and built ins. She also sought equitable relief to compel the board to follow the renovation plan of her engineer, which avoided any reduction of square footage in her interior apartment space. The board refused to adopt that plan, contending that her engineer's plan would require the co-op to demolish and rebuild exterior walls, and entailed substantial extra expenses that the board was under a fiduciary duty to avoid imposing on other shareholders.

Issue:
The issue is whether the cooperative board breached the proprietary lease, and if so, whether the business judgment rule protects a cooperative board from liability for breach of contract.

Analysis:
The Court held that the board had breached the proprietary lease, that the business judgment rule does not shield cooperatives from liability for breaches of contract, and that the shareholder was entitled to compensable damages for the breach. It stated, "While we recognize that the anticipated diminution in square footage alone constitutes an injury, the injury is de minimus insofar as the claim for irreparable harm is made." The Court continued, "Nevertheless, an alteration to residential quarters may be so minor that even though the tenant may be entitled to some form of compensation, a finding of irreparable harm is not warranted." It found that the shareholder in the instant action failed to make a clear showing that the possible square footage reduction, a small fraction of the total footprint of the apartment, was more than de minimus. Lastly, it contended, "This conclusion, however, does not preclude compensation by other means," as any costs incurred in making alterations to built-in cabinetry or replacing structural items or components of the apartment or in addressing any other difficulties that were engendered by any necessary adjustments were largely compensable in money damages. The court also held on a balancing of the equities, that the board's adoption of the plan of its architect was justified, because the claimed impact on her apartment was far outweighed by the expense to the co-op of demolishing and rebuilding exterior walls.

Decision:
The business judgment rule does not shield cooperatives from liability for breaches of contract. The court noted that, under the circumstances presented, "[a] breach of a tenant's proprietary lease by the cooperative's board of directors may be the best of the options open to the board, but that does not protect it from liability for that breach."

WestlawNext

40-50 Brighton First Road Apartments Corp. v. Kosolapov
Supreme Court, Appellate Term, New York , Second Department, 2nd, 11th and 13th Judicial Districts March 20, 2013 39 Misc.3d 27 984 N.Y.S.2d 3099 (Approx. 5 RELATED TOPICS

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39 Misc.3d 27
Supreme Court, Appellate Term, New York.
Second Department,
2nd, 11th and 13th Judicial Districts.

Landlord and Tenant
Cooperative Apartments
Members of Housing Cooperative Corporation Board of Directors

40–50 BRIGHTON FIRST ROAD APARTMENTS CORP.,
Respondent,
v.
Eugene **KOSOLAPOV**, Rodolf **Kosolapov** and Serafima **Kosolapov**,
Appellants.

March 20, 2013.

Synopsis

Background: Residential cooperative corporation commenced nonpayment summary proceedings against tenants for failure to pay special assessment to finance completion of facade repairs pursuant to local law. Following consolidation, the Civil Court, City of New York, Kings County, Maria Milin, J., granted corporation summary judgment on three of tenants' affirmative defenses. Tenants appealed.

Holding: The Supreme Court, Appellate Term, held that business judgment rule precluded review of board of directors' good faith decision.

Affirmed.

West Headnotes (5)

Change View

1 **Common Interest Communities** Governing board; members, directors, and officers; committees
The standard of review applied to the actions of a residential cooperative corporation, the common-law "business judgment rule," requires courts to defer to good faith decisions made by boards of directors in business settings.

2 **Common Interest Communities** Governing board; members, directors, and officers; committees
The business judgment rule applies to preclude judicial review of actions of the board of directors of a residential cooperative corporation so long as the board acts for the purposes of the cooperative, within the scope of its authority and in good faith, that is, consistent with the powers authorized by the bylaws and proprietary leases, where there is a legitimate relationship between the board's action and the welfare of the cooperative and where there is no evidence of bad faith, arbitrariness, favoritism, discrimination, or malice on the cooperative's part.

3 **Common Interest Communities** Governing board; members, directors, and officers; committees
In determining application of the business judgment rule to actions of the board of directors of a residential cooperative corporation, it must **first** be determined whether the cooperative's action was authorized, made in good faith, and in furtherance of the cooperative's legitimate interests, and then whether the tenants raised a triable issue of fact with respect to fraud, self-dealing, or other misconduct by the cooperative which would trigger further judicial scrutiny.

4 **Common Interest Communities** Governing board; members, directors, and officers; committees

Conclusory and speculative allegations of bad faith, self-dealing, and other wrongdoing will not suffice to raise a triable issue of fact in determining application of the business judgment rule to actions of the board of directors of a residential cooperative corporation.

5 **Common Interest Communities** Governing board; members, directors, and officers; committees
Common Interest Communities Power and duty to assess or levy; validity
Board of directors for residential cooperative corporation exercised honest judgment in imposing special assessment to finance completion of facade repairs for cooperative, thus precluding review of board's decision under business judgment rule, regardless of tenants' claims as to wisdom of board's decision, since decision to impose special assessment was within broad financial management authority granted to board in bylaws and proprietary leases, decision was made in good faith, and assessments were only used to further cooperative's legitimate interests.

Attorneys and Law Firms

***397** Adam Leitman Bailey, P.C., New York City (Jeffrey R. Metz and Donald B. Mitchell of counsel), for respondent.

Arthur Morrison, Hawthorne, and William V. Rapp, Scarborough, for appellants.

PRESENT: PESCE, P.J., WESTON and RIOS, JJ.

Opinion

Appeal from an order of the Civil Court of the City of New York, Kings County (Maria Milin, J.), entered May 23, 2011. The order, insofar as appealed from as limited by the brief, granted landlord's motion for summary judgment to the extent of dismissing tenants' second, third and fourth affirmative defenses.

***28** ORDERED that the order, insofar as appealed from, is affirmed, without costs.

In October 2010, landlord, a residential cooperative corporation, imposed a special assessment on the proprietary lessees/shareholders to finance the completion of Local Law 11 facade repairs. A number of the tenants, including those named in the instant proceeding (tenants), resisted the assessment, and landlord commenced 56 nonpayment summary proceedings, 47 of which were consolidated in the Civil Court for certain purposes, including for motion practice.[1] In their answer, as their second, third and fourth affirmative defenses, tenants asserted that landlord had not established the need for the assessment; that the board of directors (the ***398** Board) had fraudulently misrepresented that the assessment was for purposes of Local Law 11 facade maintenance when, in fact, the assessment was imposed to balance a budgetary shortfall for the 2010 fiscal year, an action taken without authority in the bylaws or proprietary leases; and that the Board's actions, taken in bad faith, are not insulated by the business judgment rule. By order dated May 23, 2011, the Civil Court, among other things, granted landlord's motion for summary judgment to the extent of dismissing tenants' second, third and fourth affirmative defenses on the ground that the business judgment rule precluded judicial review of the Board's actions.

1 2 3 4 The standard of review applied to the actions of a residential cooperative corporation, the common-law business judgment ***29** rule, requires courts to "defer to good faith decisions made by boards of directors in business settings" (*40 W. 67th St. v. Pullman,* 100 N.Y.2d 147, 153, 760 N.Y.S.2d 745, 790 N.E.2d 1174 [2003]). The rule applies "(s)o long as the board acts for the purposes of the cooperative, within the scope of its authority and in good faith" (*Matter of Levandusky v. One Fifth Ave., Apt. **Corp.***, 75 N.Y.2d 530, 538, 554 N.Y.S.2d 807, 553 N.E.2d 1317 [1990]), that is, consistent with the powers authorized by the bylaws and proprietary leases, where there is "a legitimate relationship between the Board's action and the welfare of the cooperative" (*Pullman,* 100 N.Y.2d at 156, 760 N.Y.S.2d 745, 790 N.E.2d 1174), and where there is no evidence of "bad faith, arbitrariness, favoritism, discrimination or malice on the cooperative's part" (*id.* at 157, 760 N.Y.S.2d 745, 790 N.E.2d 1174). Accordingly, it must **first** be determined whether the cooperative's action "was authorized, made in good faith, and in furtherance of the

[cooperative's] legitimate interests," and then whether the tenants "raise[d] a triable issue of fact with respect to fraud, self-dealing, or other misconduct by the [cooperative] which would trigger further judicial scrutiny" (*Walden Woods Homeowners' Assn. v. Friedman*, 36 A.D.3d 691, 692, 828 N.Y.S.2d 188 [2007]; *see also Oakwood on the Sound, Inc. v. David*, 63 A.D.3d 893, 894, 883 N.Y.S.2d 54 [2009]; *Levine v. Greene*, 57 A.D.3d 627, 628, 871 N.Y.S.2d 187 [2008]; *Martino v. Board of Mgrs. of Heron Pointe on Beach Condominium*, 6 A.D.3d 505, 506, 774 N.Y.S.2d 422 [2004]; *Gillman v. Pebble Cove Home Owners Assn.*, 154 A.D.2d 508, 508–509, 546 N.Y.S.2d 134 [1989]). " '[C]onclusory and speculative allegations of bad faith, self-dealing, and other wrongdoing' " will not suffice to raise a triable issue of fact (*Molander v. Pepperidge Lake Homeowners Assn.*, 82 A.D.3d 1180, 1183, 920 N.Y.S.2d 201 [2011], quoting *Bay Crest Assn., Inc. v. Paar*, 72 A.D.3d 713, 714, 898 N.Y.S.2d 857 [2010]).

5 In its assessment letter of October 26, 2010 to all of the shareholders, the Board reviewed the expenses associated with prior compliance with Local Law 11, the proceedings at a February 2010 shareholders meeting when the Board had announced that the completion of the new cycle of work might require an $800,000 special assessment, the Board's subsequent consideration of mortgage financing to fund the completion of the facade work rather than imposing an assessment, and the basis for the Board's determination to reject the proposed mortgage when its terms included raising the maintenance charges, which the special assessment was intended to avoid.

Tenants claim that certain of these representations were false because no part of the assessment charges received was spent on the facade repairs, that the basis of the Board's rejection of the mortgage alternative ***399*** was unreasonable and contrary to the ***30*** cooperative's best interests, that the facade work was premature, and that the special assessment was a pretext to balance the corporation's operating budget. However, the broad financial management authority granted to the Board in the bylaws and proprietary leases clearly includes the determinations made by the Board, and there is no claim that any part of the funds collected from the special assessment were used for any purpose other than the furtherance of the cooperative's legitimate interests. Whatever tenants' claims as to the wisdom of the Board's decisions, they are clearly authorized by the bylaws and proprietary leases. Even if, as tenants claim, the assessment served only to cure a budgetary shortfall or a depletion of the cooperative's capital reserves as a result of ongoing facade work expenses throughout 2010, the assessment represents merely an indirect financing of the facade repairs. Absent proof sufficient to establish a triable issue of fraud, self-dealing, unconscionability, or other action "taken without notice or consideration of the relevant facts" (*Matter of Levandusky*, 75 N.Y.2d at 540, 554 N.Y.S.2d 807, 553 N.E.2d 1317), the Board's decisions are insulated from judicial scrutiny by the business judgment rule. Thus, tenants failed to "overcome the presumption that the directors exercised their honest judgment to promote the lawful and legitimate interests of the corporation" (*Horwitz v. 1025 Fifth Ave., Inc.*, 7 A.D.3d 461, 462, 777 N.Y.S.2d 482 [2004]).

Accordingly, the order, insofar as appealed from, is affirmed.

Parallel Citations

39 Misc.3d 27, 964 N.Y.S.2d 396, 2013 N.Y. Slip Op. 23099

Footnotes

1 As the proceedings were not consolidated for all purposes, and as a notice of appeal was filed only in the **Kosolapov** proceeding, we treat the order as having been appealed only by the respondents in the **Kosolapov** proceeding.

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Goldstone v. Gracie Terrace Apartment Corp.
Supreme Court, Appellate Division, First Department, New York August 27, 2013 110 A D 3d 101 970 N Y S 2d 783 2013 N Y Slip Op 05725 (Approx. 5 pages)

Original Image of 110 A D 3d 101 (PDF)
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110 A.D.3d 101
Supreme Court, Appellate Division, First Department, New York.

Maro A. GOLDSTONE, Plaintiff–Appellant,
Thomas R. Newman, Plaintiff,
v.
GRACIE TERRACE APARTMENT CORPORATION, Defendant–Respondent.

Aug. 27, 2013.

Synopsis

Background: Cooperative shareholder of apartment brought action against cooperative corporation, challenging corporation's plan for the renovation of her apartment and seeking to prevent the work from proceeding. The Supreme Court, New York County, Debra A. James, J., denied shareholder's motion for a preliminary injunction prohibiting corporation from proceeding with the renovation plan. Shareholder appealed.

Holdings: The Supreme Court, Appellate Division, Saxe, J., held that:
1 shareholder failed to make a clear showing of irreparable harm in absence of injunction, and
2 balance of equities did not weigh in favor of preliminary injunction.

Affirmed

West Headnotes (4)

Change View

1 **Injunction** Grounds in general; multiple factors
Injunctive relief may only be awarded if the movant makes a clear showing of a probability of success on the merits, a danger of irreparable injury in the absence of an injunction, and that the balancing of the equities weighs in its favor

2 **Common Interest Communities** Governing board; members, directors, and officers; committees
The business judgment rule does not shield cooperatives from liability for breaches of contract; a breach of a tenant's proprietary lease by the cooperative's board of directors may be the best of the options open to the board, but that does not protect it from liability for that breach.

3 **Injunction** Common interest communities
Cooperative shareholder failed to make a clear showing of irreparable harm in absence of preliminary injunction prohibiting cooperative corporation from proceeding with its plan for the renovation of her apartment; any costs incurred in making alterations to built-in cabinetry or replacing structural items or components of the apartment or in addressing any other difficulties that were engendered by any necessary adjustments were largely compensable in money damages, and shareholder failed to make a clear showing that the possible square footage reduction, a small fraction of the total footprint of the apartment, was more than de minimis.

4 **Injunction** Common interest communities
Balance of equities did not weigh in favor of preliminary injunction prohibiting cooperative corporation from proceeding with its plan for the renovation of

SELECTED TOPICS

Injunction
Grounds and Proceedings to Procure Temporary Mandatory Injunction

Landlord and Tenant
Cooperative Apartments
Members of Housing Cooperative Corporation Board of Directors

Secondary Sources

§ 17:9.Three-part test—Irreparable injury

3 N Y Prac , Com Litig in New York State Courts § 17:9 (3d ed)

There is a great deal of case law on the topic of irreparable harm However, familiarity with the law alone is not sufficient Whether a party will be irreparably harmed if an injunction is granted is

Litigating Disputes Between Common Interest Communities and Owners or Shareholders

137 Am Jur Proof of Facts 3d 409 (Originally published in 2013)

Common interest communities provide a great many benefits to the shareholders or owners who reside there Single family homeowners in a development often find that a homeowners' association can provide

§ 94.In a proceeding relating to real property

67A N Y Jur 2d Injunctions § 94

Loss of the possession or use of real property may be regarded as an irreparable injury justifying the issuance of a preliminary injunction Accordingly, under appropriate circumstances, a preliminary

See More Secondary Sources

Briefs

Brief of Plaintiff-respondent Destiny USA Holdings, LLC

2009 WL 8718652
DESTINY USA HOLDINGS, LLC, Plaintiff-Respondent, v CITIGROUP GLOBAL MARKETS REALTY CORP , Defendant-Appellant
Supreme Court, Appellate Division, Fourth Department, New York
September 15, 2009

Plaintiff-respondent Destiny USA Holdings, LLC ("Plaintiff" or "Destiny USA") respectfully submits this brief in response to the brief ("App Br ") of defendant-appellant Citigroup Global Markets Realt

Brief for Defendants-Appellants

2002 WL 32173827
40 WEST 67TH STREET, Plaintiff-Respondent, v David PULLMAN, ""John Doe" and ""Jane Doe", Defendants-Appellants
Court of Appeals of New York
December 23, 2002

This Court has jurisdiction to entertain the appeal, and to review the questions raised, by virtue of CPLR 5601(a) in that (1) the action originated in Supreme Court, and (2) the order of the Appellate

Brief of Appellees Paul Mallonee, C. H. Newhouse, Winnie Bucklin, The Shareholder Members' Protective Committee.

cooperative shareholder's apartment; although shareholder proposed an alternative method of performing the work on the exterior, she failed to respond to corporation's assertion that her method would entail substantial extra expenses that corporation was under a fiduciary duty to avoid imposing on the other cooperative shareholders, and the claimed impact to shareholder of the planned modifications to the apartment, most of which would be compensable based on shareholder's breach of contract theory, was far outweighed by the expense to the cooperative of demolishing and rebuilding exterior walls, especially when those walls had already been repaired and treated for waterproofing.

Attorneys and Law Firms

***784** Duane Morris LLP, New York (Thomas R. Newman of counsel), and Ressler & Ressler, New York (Bruce Ressler of counsel), for appellant.

Tarter, Krinsky & Drogin LLP, New York (Andrew N. Krinsky and David J. Pfeffer of counsel), for respondent.

RICHARD T. ANDRIAS, J.P., DAVID B. SAXE, LELAND G. DeGRASSE, PAUL G. FEINMAN, JJ.

Opinion

SAXE, J.

***102** A cooperative shareholder suffered extensive property damage to her apartment when the 10,000–gallon water tank above her unit overflowed, causing flooding in her apartment and, thereafter, accumulations of toxic mold. The plan of renovation and repair proposed by the cooperative's board of directors would necessitate a 50–square–foot reduction in space of the apartment's more than 1,400 square feet. The shareholder objected to the proposal, claiming it violated the terms of the proprietary lease, and sought a preliminary injunction prohibiting the board from proceeding with its planned work. The motion court denied the application, and this appeal ensued.

Plaintiff Maro A. Goldstone has been a proprietary lessee of Penthouse B in defendant's co-op building at 605 East 82nd ***103** Street since 1972, when she and her former husband purchased the apartment. Plaintiff Thomas R. Newman is Ms. Goldstone's second husband and an occupant of the apartment. After the water tank overflowed and flooded plaintiffs' apartment in August 2003, and toxic mold was subsequently discovered, defendant cooperative corporation had a contractor gut the apartment's interior down to the cement, floors, ceilings and walls. Since then, the apartment has remained in uninhabitable condition.

Plaintiffs commenced this action in 2007, seeking damages and equitable relief based on causes of action for breach of contract, breach of the warranty of habitability, constructive and actual eviction, and a variety of torts. In 2010, this court declared that plaintiffs were entitled to a 100% abatement of maintenance from the date the water damage began until the apartment was restored to habitable condition (73 A.D.3d 506, 905 N.Y.S.2d 130 [1st Dept. 2010]), and in 2011 the motion court granted plaintiffs summary judgment on their claims for breach of the warranty of habitability and breach of the lease obligation to make repairs.

In a motion made just before the present motion, defendant sought an injunction granting it access to the apartment to perform work. That motion was granted over plaintiffs' opposition, in which they made some of the same arguments raised in the present motion.

Plaintiff Goldstone then brought the motion under consideration here, challenging defendant's plan for the renovation of their apartment and seeking to prevent the work from proceeding. Plaintiff asserted that she and her husband gave defendant plans prepared by their architects in 2008 providing for a redesign of the exterior walls of the apartment to prevent water infiltration, and also provided bids from four qualified waterproofing contractors. However, rather than responding to that proposal, defendant had another engineer prepare plans providing for waterproofing and facade repair work for the building,

1947 WL 44034
Fahey v. Mallonee
Supreme Court of the United States
April 21, 1947

Note: Table of Contents page numbers missing in original document This litigation was commenced by the plaintiffs, The Shareholder Members' Protective Committee [R. 1-17] suing for and on behalf of som

See More Briefs

Trial Court Documents

Boland v. 70-80 Gibson Blvd. Owners, Inc.

2009 WL 5172478
Boland v. 70-80 Gibson Blvd. Owners, Inc.
Supreme Court of New York, Nassau County
December 15, 2009

[This opinion is uncorrected and not selected for official publication.] The following papers have been read on this motion: Papers Numbered (#1) Defendants' Motion for Summary Judgment 1 (#2) Plaintif

Riccelli Enterprises, Inc. v. State

2012 WL 1802558
Riccelli Enterprises, Inc. v. State
Supreme Court, New York, New York County
April 30, 2012

[This opinion is uncorrected and not selected for official publication.] New York State law requires that employers maintain Workers' Compensation insurance for their employees. Petitioners/plaintiffs

Raimondi v. Board of Managers of Olympic Tower Condominium

2007 WL 4176973
Raimondi v. Board of Managers of Olympic Tower Condominium
Supreme Court, New York, New York County
November 09, 2007

[This opinion is uncorrected and not selected for official publication.] [illegible] read on this motion to/for _. Cross-Motion: ☐ Yes ☐ No. Upon the foregoing papers, it is ordered that this motion Reci

See More Trial Court Documents

including the renovation of plaintiffs' apartment, that defendant asserted avoided the prohibitively expensive need to demolish all the exterior walls.

Plaintiff argued that defendant's plan would decrease the size of the interior of ***785** the apartment, in violation of her rights under the proprietary lease. Specifically, plaintiff asserted that by placing insulation on the apartment's interior, defendant's alterations would decrease the size of the interior and alter the ***104** apartment's configuration, because it would cause the loss of 2 ½ inches along every wall where the insulation was placed, which plaintiffs' expert calculated as a total loss of 50 square feet. Plaintiff stated that this alteration would reduce the hallway to a width smaller than that required by the Building Code, and that to maintain a hallway of the necessary width, the adjoining room would have to be decreased in size, and its interior partitions reconfigured, or new interior partitions installed, with new doors. These changes would, in turn, require alterations or adjustments or replacements of plaintiffs' storage and display units and their custom-designed kitchen countertops and built-ins.

Plaintiff relied on the foregoing assertions to contend that the reduction in the size and dimensions and the reconfiguration of the partition in the living space would violate the terms of the proprietary lease, which defines "the apartment" as "the rooms in the building *as partitioned on the date of the execution of this lease* ... together with their appurtenances and fixtures and any closets, terraces, balconies, roof, or portion thereof outside of said partitioned rooms, which are allocated exclusively to the occupant of the apartment" (emphasis added).

In opposition to plaintiff's motion, defendant did not dispute the opinions of plaintiffs' architects. Rather, it argued that (1) plaintiff could not show a likelihood of success on the merits because the board's decision as to how to make repairs was shielded by the business judgment rule, (2) plaintiff could not show irreparable harm because the reduction in space is de minimis (50 square feet in a more than 1,400–square–foot apartment) and could be compensated by a reduction in the maintenance charges if appropriate, and (3) the equities are balanced in defendant's favor because plaintiff's proposal would require the excessive alternative of demolishing the exterior walls, which would cause undue expense to all the shareholders, to whom the co-op owed a fiduciary duty.

The motion court denied plaintiff's motion to enjoin defendant from performing the contemplated repair work on the interior walls of the apartment, characterizing the resulting diminution in the square footage of the apartment as de minimis and observing that the claimed injury would be compensable by money damages. We affirm.

1 Injunctive relief may only be awarded if the movant makes a clear showing of a probability of success on the merits, a danger of irreparable injury in the absence of an injunction, and that ***105** the balancing of the equities weighs in its favor (*Nobu Next Door, LLC v Fine Arts Hous., Inc.*, 4 N.Y.3d 839, 840, 800 N.Y.S.2d 48, 833 N.E.2d 191 [2005]).

2 Initially, we agree with plaintiff that her showing established the probable success on the merits of her claim that the repairs will constitute a breach of the proprietary lease, because defendant does not dispute the assertion by plaintiffs' expert that the plan will create a diminution of apartment space and necessitate some reconfiguration and alterations (*see Gracie Terrace Apt. Corp. v. Goldstone*, 103 A.D.2d 699, 477 N.Y.S.2d 647 [1st Dept. 1984], *appeal dismissed* 63 N.Y.2d 952 [1984]). Defendant's reliance on the business judgment rule (*Matter of Levandusky v One Fifth Ave. Apt. Corp.*, 75 N.Y.2d 530, 554 N.Y.S.2d 807, 553 N.E.2d 1317 [1990]) is misplaced. The rule does not shield cooperatives from liability for ***786** breaches of contract (*see Whalen v. 50 Sutton Place S. Owners*, 276 A.D.2d 356, 357, 714 N.Y.S.2d 269 [1st Dept. 2000]). "[W]hile it may be good business judgment to walk away from a contract, this is no defense to a breach of contract claim" (*Dinicu v. Groff Studios Corp* , 257 A.D.2d 218, 222–223, 690 N.Y.S.2d 220 [1st Dept. 1999]). A breach of a tenant's proprietary lease by the cooperative's board of directors may be the best of the options open to the board, but that does not protect it from liability for that breach.

3 Nevertheless, we do not believe that plaintiff has made a clear showing of irreparable harm, or that the balance of the equities is in her favor. To establish irreparable harm, plaintiff relies not only on the loss of square footage, but also on the claim that the apartment will have to be reconfigured, which involves the moving of partitions and doors and will necessitate adjustments or replacements of many features of the apartment, such as built-in cabinetry. Initially, we find that any costs incurred in making alterations to built-in

cabinetry or replacing structural items or components of the apartment or in addressing any other difficulties that are engendered by any necessary adjustments are largely compensable in money damages.

Beyond that, while we recognize that the anticipated diminution of square footage alone constitutes an injury, we agree with the motion court that in itself the injury is de minimis insofar as a claim of irreparable harm is made. We do not rely for this conclusion on *Eastside Exhibition Corp v 210 E 86th St. Corp*, 18 N.Y 3d 617, 942 N.Y.S.2d 19, 965 N.E.2d 246 [2012], *cert. denied* —— U.S. ——, 133 S.Ct. 654, 184 L.Ed.2d 461 [2012], since that case concerned a landlord's alteration of leased commercial space, which raises different concerns from those raised by an alteration that reduces a residential tenant's leased space (*see Broadway 500 W. Monroe Mezz II LLC v. Transwestern* ***106** *Mezzanine Realty Partners II, LLC*, 80 A.D.3d 483, 915 N.Y.S 2d 248 [1st Dept. 2011]; *Lombard v Station Sq Inn Apts. Corp*, 94 A.D.3d 717, 721, 942 N.Y.S.2d 116 [2d Dept. 2012]). Nevertheless, an alteration to residential quarters may be so minor that even though the tenant may be entitled to some form of compensation, a finding of irreparable harm is not warranted. Cases in which interference was sufficient to justify either injunctive relief or orders preventing the work from proceeding (*see e.g. Forest Close Assn, Inc v Richards*, 45 A.D.3d 527, 529, 845 N.Y.S 2d 418 [2d Dept. 2007]; *Matter of Lite View, LLC v New York State Div. of Hous. & Community Renewal*, 97 A.D.3d 105, 945 N.Y.S.2d 49 [1st Dept. 2012]) do not preclude the possibility that interference in other circumstances may be so minimal as to fail to justify injunctive relief. Plaintiff failed to make a clear showing that the possible square footage reduction, a small fraction of the total footprint of the apartment, was more than de minimis. This conclusion, however, does not preclude compensation by other means.

4 Moreover, the balance of the equities does not weigh in plaintiff's favor. Although plaintiff proposed an alternative method of performing the work on the exterior, she failed to respond to defendant's assertion that this method would entail substantial extra expenses that defendant was under a fiduciary duty to avoid imposing on the other cooperative shareholders (*see Bryan v West 81 St. Owners Corp*, 186 A.D.2d 514, 589 N.Y.S.2d 323 [1st Dept. 1992]). The claimed impact to plaintiff of the planned modifications to her apartment, most of which will be compensable based on plaintiffs' breach of contract theory, is far outweighed ***787** by the expense to the co-op of demolishing and rebuilding exterior walls, especially when those walls have already been repaired and treated for waterproofing.

Plaintiff improperly raised her argument that defendant accorded her disparate treatment for the first time in her reply papers before the motion court (*see Caribbean Direct, Inc. v Dubset LLC*, 100 A.D.3d 510, 511, 954 N.Y.S.2d 66 [1st Dept. 2012]). In any event, no such claim was made out in the record before us.

Accordingly, the order of the Supreme Court, New York County (Debra A. James, J.), entered October 9, 2012, which denied plaintiff's motion for a preliminary injunction, should be affirmed, without costs.

Order, Supreme Court, New York County (Debra A. James, J.), entered October 9, 2012, affirmed, without costs.

All concur.

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Business Judgment Rule: No Free Pass to Board Action

BY ADAM LEITMAN BAILEY AND JOHN M. DESIDERIO

The past 12 months has been the year unit owner's and shareholders have found cooperative and condominium board of director's kryptonite at the appellate courts. For years, the courts of New York have been rubber stamping board decisions under the shield of the business judgment rule. Whether it be the persuasive facts in this year's crop of cooperative and condominium cases or a change in policy, the appellate courts have been enforcing the corporate documents and determining whether boards have been acting in good faith and with the proper authority and piercing the shield of the business judgment rule.

History of Deference

Twenty-four years ago, in *Levandusky v. One Fifth Avenue Apartment Corp.*,1 the New York Court of Appeals announced that, henceforth, New York courts would apply the business judgment rule, first developed in the context of business corporate law, in cases challenging the decisions and actions of the governing boards of cooperative apartment corporations and condominium associations.

As enunciated in Levandusky, and as the court further explained in 40 West 67th Street v. Pullman,2 the business judgment rule was intended to insulate from court review the myriad of decisions and actions that co-op and condo boards must make in good faith on a daily basis to govern and operate their buildings in the interest of their shareholders and unit owners and for the good of their buildings generally.

Over the years, in applying the business judgment rule, courts have given great deference to board decision-making, and they have routinely dismissed hundreds, if not thousands, of cases brought by disgruntled shareholders and unit owners who have disagreed with or been affected adversely by board decisions. Nevertheless, as the Court of Appeals also made clear in Levandusky and Pullman, the business judgment rule was never intended to be a vehicle for courts to give "rubber stamp" approval for board action that is done without authority, in bad faith, or that discriminates between classes of shareholders or unit owners or singles out individual shareholders or unit owners for disparate treatment.

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It is interesting to note, therefore, that, despite the history of courts affording great deference to board governance, several recent decisions have shown that New York courts appear increasingly willing to give greater scrutiny to cases alleging unauthorized board action, and, in doing so, they are making it clear that the business judgment rule does not give boards a free pass to act in disregard of their governing documents and by-laws or otherwise in disregard of the law.

To be sure, the business judgment rule will still be applied, as Levandusky and Pullman directed, where board decision-making is challenged, but a board is able to meet its prima facie burden to show that it acted in good faith within the scope of authority given in its by-laws, to further the interests of its co-op or condo, and the shareholder or unit owner challenging the board's action is unable to raise a triable issue of fact concerning the board's action.

Rule Upheld

Such was the result in *257 Central Park West v. Abraham*,3 where the record showed that the shareholder's parking license was terminated based on his demonstrated delinquency in timely paying his monthly parking fees, and the shareholder made no persuasive showing that the co-op board had acted beyond its scope of authority, and even "expressly disavowed any claim that the board improperly 'singled [him] out."

Similarly, in 40-50 *Brighton First Road Apartments v. Kosolapov*,4 where a group of shareholders challenged a special assessment imposed by a residential co-op, the court granted summary judgment to the co-op finding that "the broad financial management authority granted to the Board in the bylaws and proprietary lease clearly includes determinations made by the Board, and there is no claim that any part of the funds collected from the special assessment were used for any purpose other than the furtherance of the co-operative's legitimate interests."

Rule Held Inapplicable

However, in cases where the record shows that a board has either clearly exceeded the authority granted in its by-laws or otherwise cannot offer an explanation for a particular decision it has made, New York courts will not hesitate to find the business judgment rule inapplicable to such board action. Likewise, where the record presents triable issues of fact concerning whether the board acted outside the scope of its authority and/or whether the actions of the shareholder or unit owner justifiably triggered the complained of board action, the courts will deny summary judgment and direct that a trial be held to determine whether or not the business judgment rule should apply to the board's action. Several recent cases are illustrative of these trends.

In *Razzano v. Woodstock Owners*,5 the First Department held that the sublet policy of a co-operative corporation violated Business Corporation Law (BCL) §501(c) because the policy allowed shareholders who purchased their shares before October 2002 to sublet, but prohibited shareholders from subletting who purchased their shares after that date. The court further held that because the sublet policy violated (BCL) §501(c), the board's policy was not protected by the business judgment rule.

In *Goldstone v. Gracie Terrace Apartment Corp.*,6 a shareholder suffered extensive property damage from an overflowed water tank above her apartment. The board gutted the shareholder's apartment to clear it of toxic mold and adopted a plan of renovation and repair that necessitated a 50-square-foot reduction in the shareholder's interior apartment space. The board refused to adopt the renovation plan of the shareholder's engineer, which avoided any reduction of square footage in her interior apartment space, contending that her engineer's plan would require the co-op to demolish and rebuild exterior walls, and entailed substantial extra expenses that the board