Klyashtorny Recognized As A Super Lawyer

Natalie Klyashtorny has been named by *Philadelphia Magazine* as a Pennsylvania Super Lawyer Rising Star in the area of business litigation.

The objective of the Super Lawyers selection process is to create a credible, comprehensive and diverse listing of outstanding attorneys that can be used as a resource to assist attorneys and sophisticated consumers in the search for legal counsel. Only 2.5 percent of the best up-and-coming attorneys in the state are named to the Rising Stars list.

Rental Applicants Do Not Have Viable ECOA And UTPCPL Claims

A recent decision handed down by the United States District Court for the Middle District of Pennsylvania in *Portis v. River House Associates* sheds new light on what legal measures residential lease applicants in Pennsylvania may take due to racial discrimination.

In *Portis*, the federal court summarily dismissed an attempt by rental applicants to sue for racial discrimination under the Equal Credit Opportunity Act (ECOA) and Pennsylvania's Unfair Trade Practices and Consumer Protection Law (UTPCPL).

In 2005, a married African-American woman, who was relocating from out of state to central Pennsylvania, sought to lease an apartment unit at Korman Communities in Harrisburg. After touring the sample apartment units, she stated her intention to lease a studio apartment unit in the complex. She was then directed by the general manager to complete a rental application, which she immediately did.

After doing so, the general manager left the couple to run a credit history on the wife.

When the general manager returned, she indicated that the credit check showed no credit history for the wife and requested to run such a check on the husband instead. The husband complied with the general manager's request even though the wife insisted she had an established credit history.

The general manager then left the couple again to check the husband's credit. Upon her return, the general manager stated that the credit check showed no credit history for him as well. Visibly frustrated, the couple demanded that the general manager re-run the credit checks. After the couple left the property management office, the general manager claimed she had run credit checks several times for both of them but that no such history was available for either of them.

According to the general manager, all of these credit checks were performed through a company named First American Registry Inc.

Due to the alleged absence of a credit history for the couple, Korman Communities demanded that the wife pay a security deposit of a greater amount than originally represented and a non-refundable move-in fee to secure the lease. The couple refused to agree to these new terms.

One week later, the wife completed a rental application and leased an apartment unit down the road at Pennsylvania Place.

Similar to Korman Communities, Pennsylvania Place also required a credit check for rental applicants, and via First

American Registry Inc. they were able to confirm that the wife had good credit.

Soon thereafter, the couple contacted First American Registry Inc. to ascertain why their credit histories were not made available to Korman Communities. They were advised that neither the general manager nor any employee of Korman Communities requested such histories, and that the only requests for their credit were made by Pennsylvania Place.

Believing that they were subjected to racial discrimination, the couple filed suit against Korman Communities and its general manager for violations of the ECOA and UTPCPL, among other causes of action.

The general manager and Korman Communities then filed a motion to dismiss these statutory claims.

As for the ECOA claim, the defendants argued that the couple lacked a viable cause of action because leasing residential property does not constitute a credit transaction under the ECOA.

The federal court first examined both the actual text of the ECOA as well as Congress's findings and statement for the ECOA.

The ECOA provides that "[i]t shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction . . . on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract)." After reviewing this passage of the ECOA, the federal court focused its inquiry on how the terms "creditor" and "credit transaction" are defined under the ECOA. The federal court noted that, although the ECOA did not define the term "credit transaction", the terms "credit" and "creditor" are defined and "their definitions provide some insight: 'credit' denotes 'the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor;' 'creditor' refers to 'any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit.'" Since the U.S. Supreme Court and the 3rd U.S. Circuit Court of Appeals have never considered application of the ECOA in the residential lease context, the federal court thus relied upon Congress's findings and statement of the ECOA's purpose as well as the United States Court of Appeals for the 7th Circuit's ruling in *Laramore v. Ritchie Realty Management Co.* for further guidance.

According to Congress, "there is a need to insure that the various financial institutions and other firms engaged in the extensions of credit exercise their responsibility to make credit available with fairness, impartiality, and without discrimination on the basis of sex or marital status. Economic stabilization would be enhanced and competition among the various financial institutions and other firms engaged in the extension of credit would be strengthened by an absence of discrimination on the basis of sex or marital status, as well as by the informed use of credit which Congress has heretofore sought to promote.

It is the purpose of [ECOA] to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to sex or marital status." In *Laramore*, the 7th Circuit found that the ECOA does not apply to "typical" residential leases.

The federal court in *Portis*, after reviewing the allegations contained in the complaint, similarly found no reason that the lease which the couple "sought was sufficiently extraordinary to render it within the ECOA." Relying heavily upon the underlying basis set forth by the 7th Circuit in *Laramore*, the federal court in *Portis* found "sound *Laramore's* reasoning that 'the typical residential lease involves a contemporaneous exchange of consideration – the tenant pays rent to the landlord on the first of each month for the right to continue to occupy the premises for the coming month.'" The federal court concluded that, "generally speaking, residential leases are not credit transactions and landlords are not creditors under the ECOA." According to the federal court, there was no indication in the complaint that the couple sought a lease containing any extraordinary terms or conditions that could render the lease a credit transaction under the ECOA.

Rather, the federal court emphasized that the complaint repeatedly alleged that the couple merely sought to lease an apartment.

The federal court in *Portis* also found that the complaint already included a claim under the Fair Housing Act, "any application of the ECOA to the instant circumstances would be duplicative and superfluous." The federal court next addressed the viability of the couple's claim under UTPCPL.

The federal court, similar to its analysis under the ECOA, turned to the text of that statute.

The UTPCPL prohibits "'unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce.' Should such unsavory practices be employed, the UTPCPL permits certain private and public actors to bring suit.

Specifically, private actions may be filed by 'any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, as a result of the use or employment by any person of a method, act or practice declared unlawful by this act,' and the Attorney General or a District Attorney may bring an action when he or she 'has reason to believe that any person is using or is about to use any method, act or practice declared by [the UTPCPL] to be unlawful, and that proceedings would be in the public interest.'" The federal court pointed out that "the UTPCPL clearly permits private actors to bring suit only when they purchase or lease goods or services." Thus, while Pennsylvania courts have repeatedly found that the UTPCPL applies to residential leases, the question remained "whether the UTPCPL permit[ted] a person who leased property from one entity to bring suit against another entity from which the person initially attempted to lease property", since no such court has addressed such a situation.

The federal court ultimately refused to expand behind the plain meaning of the UTPCPL's text. In particular, the federal court rejected the couple's plea to liberally construe that text because, in doing so, the court would have had to basically ignore the plain language of the text. In doing so, the federal court merely confirmed that the UTPCPL only applies to consummated transactions.

Alan Nochumson

Vertical Position 100%

Nochumson Teaches "Real Estate Law From A To Z"

Alan Nochumson served as a faculty speaker at the Continuing Legal Education (CLE) seminar sponsored by the Lorman Education Services entitled "Real Estate Law From A to Z in Pennsylvania" which took place in Philadelphia, Pennsylvania.

At the seminar, Nochumson discussed how to represent sellers and buyers during the negotiation of an agreement of sale in Pennsylvania.

Vertical Position 100%

Purchaser Lacks Claim Against Title Insurer For Property's Physical Defect

In most real estate transactions taking place in Pennsylvania, title insurance is purchased in order to protect against "defects" in title that may affect the property's fair market value.

In a recent decision by the Superior Court of Pennsylvania in *Rood v. Commonwealth Land Title Insurance Company*, the appellate court clarified that physical defects with a property are not covered by title insurance.

THE CASE

In *Rood*, the homeowner purchased a property on the Main Line in the 1970s. When he purchased the property, the homeowner obtained title insurance.

Almost 25 years later, the homeowner discovered that his property contained an abandoned septic tank in the front yard. The homeowner subsequently learned that the tank was documented at the township office in a public record entitled "Record of Sanitary Drainage and Plumbing Fixtures."

The homeowner demanded reimbursement from the title insurance company for the cost of remediation on the grounds that the title insurance company never notified him of the tank's existence when he obtained title insurance. The homeowner claimed that the title insurance policy he had purchased protected him against any "defect, lien or encumbrance on the title of the estate" and the existence of the abandoned septic tank fell within this coverage. The title insurance company denied the homeowner's insurance claim.

The homeowner thereafter commenced a lawsuit against the title insurance company. When the trial court dismissed the lawsuit, the homeowner appealed the trial court's ruling to the Superior Court. The appeal centered on whether the trial court erred in refusing to interpret the term "defect" under the title insurance policy to encompass the abandoned septic tank.

On appeal, the homeowner argued that his title was rendered unmarketable because he would have to disclose the presence of the abandoned septic tank were he to sell his house under Pennsylvania's Real Estate Sellers Disclosure Law, and that such a disclosure would cause a reduction in the sale price.

THE DECISION

The Superior Court ultimately concluded that while the existence of the septic tank may cause a reduction in the fair market value of the property, the title to the property was not so affected.

Due to the dearth of cases in Pennsylvania addressing whether physical defects to a property are covered under a title insurance policy, the Superior Court relied upon a litany of decisions rendered by courts outside of Pennsylvania.

The Superior Court first discussed the Massachusetts Appeals Court's ruling in *Chicago Title Insurance Co. v. Kumar*, where that state court addressed whether the release of hazardous materials was a defect in title within the meaning of a landowner's title insurance policy. The court in *Kumar* noted the difference between the condition of the title to land and the physical state of the law. According to the court in *Kumar*, "[p]rotection as to the former is what the . . . title insurance policy coverage furnished when it provided coverage against defects in, or liens or encumbrances on, title." As such, the court in Kumar stated that title insurance protect against 'defects' as "pertaining to the record title to the premises, not its physical make up."

Notably, the court in *Kumar* also rejected the landowner's argument that title was unmarketable because of the possibility that a future lien may attach to the property due to the environmental hazard. The court in Kumar explained that "[o]ne can hold perfect title to land that is valueless; one can have marketable title to land while the land itself is unmarketable."

The Superior Court in Rood then cited *Logan v. Barretto*, a decision handed down by the New York Supreme Court, where purchasers sued multiple title insurance companies on the basis that they breached their contractual obligations by failing to disclose the existence of sanitary code violations in their title report. The state appellate court concluded that the violations were not encumbrances on the title and thus did not render title unmarketable. The court in *Logan* stressed that the government regulations provided the manner in which the property could be used and did not impair title.

The Superior Court then pointed to the Supreme Court of Washington's ruling in *Lombardo v. Pierson*, in which a homeowner brought suit against a title insurance company for failing to disclose a document uncovered during a title search conducted prior to the purchase of her farm, which alluded to potential seepage problems. The court in *Lombardo* affirmed the trial court's dismissal of the title insurance company from the lawsuit because the document did not affect title, or otherwise encumber the property.

Similar to the court decisions in Massachusetts, New York, and Washington, the Superior Court in *Rood* emphasized that title insurance does not protect against claims arising from the physical condition of the property. In doing so, the Superior Court concluded that the homeowner was confusing the economic lack of marketability, which related to physical conditions affecting the use of the property, with title marketability, which related to defects affecting legally recognized rights and incidents of ownership.

The Superior Court poignantly pointed out that "[t]here are many items which might affect the ability of an owner to sell his property, i.e., it may be located in a flood plain, it may be unsound structurally, contain lead paint or asbestos, be situated over an abandoned coal mine or septic tank, have seepage of contaminants into the property, be in violation of the health code, or be adjoining a designated Superfund site, but none has anything to do with the title to the real property."

LESSON LEARNED

Title insurance companies across the commonwealth should let out a collective sigh of relief after reading the Superior Court's ruling in *Rood*. The Superior Court refused to increase the scope of covered "defects" in the title insurance context. Rather, the Superior Court reasserted a title insurance company's role in a real estate transaction as the protector of the condition of title, not the physical condition of the property.

Alan Nochumson

Vertical Position 100%

Nochumson Outlines The "ABC's Of Landlord-Tenant Law In Philadelphia"

Alan Nochumson outlined the "ABC's of Landlord-Tenant Law in Philadelphia" as part of the People's Law School, an adult legal education program sponsored by the Philadelphia Bar Association.

During the six-week program, attendees gain a basic, non-technical knowledge of those areas of the law most likely to impact on their lives, presented in clear, easy-to-understand terms.

Vertical Position 100%

Commercial Landlord Allowed To Re-Let Leased Premises

In the commercial lease context, a landlord in Pennsylvania is not required to find a replacement tenant where the original tenant leaves the leased premises before the lease term expires. In a case like this, the landlord may allow the leased premises to remain vacant during the lease term and instead collect the rent due under the lease agreement from the vacating tenant.

A tenant who leaves the leased premises usually does so for financial reasons. As such, a landlord will most likely be unable to successfully collect rent from such a tenant. Equally important is that no commercial landlord wants any portion of its property to remain vacant because such a vacancy may detrimentally affect the fair market rental value of the property. Such a landlord will nonetheless attempt to secure a replacement tenant.

In *Trizechahn Gateway, LLC v. Titus*, the Superior Court of Pennsylvania confronted such situation, in which a landlord did attempt to mitigate its damages by finding a replacement tenant and the legal ramifications for doing so.

In the mid-1990s, Trizechahn Gateway, the owner of a commercial office building located in downtown Pittsburgh, and a now-defunct law firm, Titus & McConomy LLP, entered into a 10-year lease agreement for occupation of one and one-half floors and basement storage space in that building.

Several years later, the law firm closed its business operations and offered to work toward subletting the office space. Shortly thereafter, the law firm vacated the office space, but left behind files in the basement storage spaces. For a short period of time after leaving the building, the law firm continued making its monthly rental payments due under the lease agreement.

After the law firm ceased making the rental payments, the landlord indicated its intention to recover the portion of the storage space necessary to correct a building code violation. The landlord then utilized a portion of the recovered storage space to construct an egress from the basement of the office building for the benefit of a new tenant.

The landlord eventually re-let the office space to other tenants for a term that extended beyond the term contained in the agreement with the law firm. Due to the weaken condition of the commercial lease market, the landlord was forced to give rent abatements to the replacement tenants.

The landlord then commenced an action against the law firm and its general partners seeking the remaining amounts due under the lease agreement.

At trial, the law firm was found to have breached the lease agreement, and judgment was entered against the law firm and in favor of the landlord for the accelerated amount due under the lease, less the amount the landlord would receive under the new lease agreements.

On appeal, the law firm asserted that the landlord breached both the covenant of good faith and fair dealing and the covenant of quiet enjoyment by retaking the rented storage space to correct a building code violation and by obstructing the re-letting of the office space.

The Superior Court first addressed the law firm’s argument that the landlord breached its duty of good faith and fair dealing to the law firm, which, in turn, excused its performance under the lease agreement.

According to the law firm, the landlord first notified the law firm that the landlord needed to retake the storage space in order to correct a building code violation. The law firm contended that the landlord, prior to sending this notice, already had decided to take back the space so that it could commit the space to a new tenant for purposes of building an egress. This misrepresentation, the law firm believed, stripped the law firm of information that could have been used as leverage in buyout negotiations.

Although the Superior Court noted that every contract imposes a duty of good faith and fair dealing on the parties in the performance and the enforcement of the contract, it summarily dismissed that the landlord breached this duty.

Under the lease agreement, the landlord was entitled to enter the storage space and make any alterations to that space without terminating the lease agreement.

Keeping that lease provision in mind, the Superior Court emphasized that once the law firm defaulted on the lease agreement, the landlord was entitled to enter the storage space and make the alterations the landlord felt necessary to allow that space to be re-letted. The Superior Court thus believed that the original notice to the law firm about curing a building violation was immaterial, because even if the law firm had known about the landlord's impending plan to use the storage space to create an egress for a new tenant, the law firm would have not had any greater leverage in settlement negotiations because the landlord was entitled to alter the storage space as a matter of right.

In a footnote, the Superior Court did point out that this conclusion would have been different if "a general rule existed whereby anytime a landlord alters or interferes with a portion of a leasehold the entire lease is terminated." The Superior Court noted that such a general rule did not exist in Pennsylvania and refused to create one.

The Superior Court also found that the landlord did not obstruct the law firm from re-letting the leased premises based upon what it described as its painstaking review of the record below. The Superior Court stated that the earliest mention of the law firm taking any affirmative action to re-let the leased premises was over two years after the original default when the law firm started “the process of concluding discussions with a leasing agent.” The court found no evidence that the law firm actually presented a prospective replacement tenant that was rejected to the landlord.

Since the landlord did not breach its duty of good faith and fair dealing to the law firm, the Superior Court held the law firm was not relieved from further performance under the lease agreement.

The Superior Court next addressed whether the landlord’s alteration of the leased premises breached its quiet enjoyment to the leased premises and thus constituted an eviction from and termination of the entire lease agreement that relieved the law firm of further performance under the lease agreement.

The law firm argued that although the landlord was permitted to make alterations necessary for re-letting the leased premises, “it was permitted to do so only if the re-letting [wa]s done in a way that [wa]s not hostile to the first lease and create[d] an estate that [wa]s subordinate to and consistent with that of the original tenant.”

According to the Superior Court, after the law firm defaulted on the lease agreement and abandoned the leased premises, the landlord was entitled to take possession of the leased premises and make the alterations the landlord deemed necessary to re-let the leased premises. By abandoning the leased premises, the Superior Court stated that the tenant had no possessory interest which could be disturbed.

The Superior Court also did not believe that these alterations constituted acceptance by the landlord of the law firm’s surrender of the leased premises. In doing so, the Superior Court embraced the concept promulgated by the Pennsylvania Supreme Court between “a ‘hostile’ second lease with that of a ‘beneficial’ second lease.”

In Pennsylvania, a landlord may rent a property which has been abandoned for the benefit of the original tenant and that tenant remains liable for any deficiency in the rent. The original tenant’s duty to pay rent is only relieved when rent of an equal amount is paid under the replacement lease. As such, any deficiency in rent between these leases will be bourn out by the original tenant.

The Superior Court warned that the replacement lease only becomes “hostile” to the original lease when the landlord accepts the original tenant’s abandonment of the property. In doing so, the court clarified that the burden of proving a landlord’s acceptance of tenant’s surrender of the leased premises is on the tenant to establish, by convincing evidence, that the landlord committed an “unequivocal act” constituting acceptance of the surrender.

The law firm argued that, by granting rent abatement to the replacement tenant and extending the term of the new lease agreements beyond the term set forth in the original lease agreement, the landlord unequivocally accepted the law firm’s surrender of the leased premises.

The Superior Court found that giving rent abatement to the replacement tenant was a “commercially reasonable inducement” considering that the local commercial real estate market was in a state of decline. As a result, the law firm would be required to reimburse the landlord for the amount of this rent abatement.

The Superior Court did not believe that the landlord accepted the law firm’s surrender of the leased premises by entering into lease arrangements with the replacement tenants for a term which exceeded the original term. The court pointed out that the “Supreme Court has given a strong indication that when a landlord enters into a second lease that contains a longer term than the first lease that is in default, this fact is insufficient to establish acceptance of surrender.”

Moreover, the Superior Court stressed that, “although commercial landlords have no duty to mitigate their damages[,] [i]t would be logically inconsistent to punish a landlord by stripping him or her of the benefit of the bargain for re-letting a premises, to the benefit of the breaching lessee, by concluding acceptance of surrender has taken place simply because the landlord entered into a subsequent lease with a longer term—a transaction which is both economically efficient as a general matter and beneficial to the landlord as a specific matter.”

LESSONS LEARNED

The Superior Court in *Trizechahn Gateway* merely confirmed that while a commercial landlord may mitigate its damages, its tenant is not absolved from making the landlord whole. If the court had ruled otherwise, landlords in Pennsylvania would be less included to mitigate its damages.

Alan Nochumson

Vertical Position 100%

Klyashtorny Discusses The Scope Of Internet Defamation

Natalie Klyashtorny served as a course planner and speaker at a Continuing Legal Education (CLE) seminar on “Defamation Law and the Internet” at the Philadelphia Bar Association’s Bench-Bar Conference which took place in Atlantic City, New Jersey.

The CLE focused on the impact of United States Congress’ immunization of Internet providers through the Communications Decency Act of 1996 and its impact on traditional, common-law defamation.

Vertical Position 14%

Wife Not Responsible For Spouse’s Inaccuracies In Disclosure

In order to protect homebuyers from “seller fraud”, the Pennsylvania General Assembly enacted the Real Estate Seller Disclosure Law (RESDL). At its heart, sellers are statutorily required to make, through closing, written disclosures to homebuyers about the condition of the property.

In a recent decision handed down by the Superior Court in *Growall v. Maietta*, a wife, who jointly owned a property with her husband, was not held responsible for inaccuracies contained in such a property disclosure statement which he prepared and she blindly signed.

In *Growall*, the defendant husband and wife placed a house they owned, which was divided into three apartments, on the market. The husband completed the seller disclosure statement for himself and his wife. The wife apparently did not review the responses made in the statement prior to signing it. In the seller-disclosure statement, they marked the following questions in the negative: "Are you aware of any water leakage, accumulation or dampness within the basement, garage or crawl space?" "Do you know of any repairs or other attempts to control any water or dampness problem in the basement, garage or crawl space?", "Are you aware of any past or present water leakage in the house or other structure?"

Several months after signing the seller-disclosure statement, the husband became aware of a water-leakage problem in the basement apartment. The husband hired a plumber to fix the problem. The wife was allegedly never aware of the water problem or of the husband's attempt to fix the problem.

Soon thereafter, the husband and wife signed an agreement to sell the property to the plaintiff-purchaser. Since the seller-disclosure statement was never updated prior to the sale, the purchaser bought the property without knowing about the water problem in the basement.

Less than a year later, the water problem in the basement resurfaced and the purchaser called the husband about making him whole for the water damage to the property. Although the husband freely admitted to the previous water problem, the wife denied that she was ever informed of its existence. She explained that the house had belonged to her husband's family and she, unlike her husband, was relatively uninvolved for maintaining the house and dealing with the tenants.

After the husband and wife refused to pay for the damages caused to the property as a result of the ongoing water problem, the purchaser filed suit against them for violating the RESDL, among other things.

At arbitration, the purchaser was awarded a monetary judgment against both the husband and the wife. After an appeal by the husband and wife, at trial, the jury rendered a monetary judgment only against the husband. The purchaser then appealed the trial jury's findings to the Superior Court.

The Superior Court ultimately held that the wife's failure to disclose the water problem in the basement apartment did not violate the RESDL simply because she was not aware of any water leak in the basement until after the purchaser approached her and her husband about the situation after closing already took place.

In doing so, the Superior Court pointed out that a seller is not obligated under the RESDL to make any specific investigation or inquiry in an effort to complete the property disclosure statement. Rather, the Superior Court stated that a seller, in completing the property-disclosure statement, is only prohibited from "make any representations that the seller . . . knows or has reason to know are false, deceptive or misleading and shall not fail to disclose a known material defect."

The Superior Court did caution that, if information disclosed the property disclosure statement is subsequently rendered inaccurate prior to final settlement as a result of any act, occurrence or agreement subsequent to the delivery of the statement, then the seller is required to notify the buyer of the inaccuracy.

Keeping that in mind, the Superior Court noted that, at the time the disclosure statement was signed by the wife, the information contained in the statement was accurate and thus the purchaser's RESDL claim rested solely upon her alleged duty to notify him prior to closing of the subsequent water problem which rendered the statement inaccurate. The Superior Court, however, refused to place that burden upon the wife because she "could not disclose what she did not know."

The Superior Court rejected the purchaser's attempt to place an absolute duty on the wife to know the condition of her property by investigating the condition of the property or by disclosing her lack of knowledge.

The Superior Court cited language in the RESDL which specifically provided that a seller is not obligated to make any specific investigation or inquiry in completing the property disclosure statement, and that a seller is not liable for any error, inaccuracy or omission of which he or she had no knowledge.

The Superior Court then distinguished and called into question the line of cases relied upon by the purchaser involving innocent misrepresentations made by sellers in the real estate context.

According to the Superior Court, these cases impose a strict liability standard where the "innocent" misrepresentation centers upon "basic facts" about the property readily ascertainable by the selling party, such as zoning restrictions and boundary lines. The Superior Court did not believe that the wife's "ignorance of an isolated incident of water damage/flooding in the basement constitutes such a 'basic fact' as to trigger absolute liability."

Irrespective, the Superior Court rejected "a strict liability standard concerning innocent misrepresentations where the RESDL does not impose such an absolute duty." Indeed, the Superior Court warned that that the cited cases were decided prior to the enactment of the "RESDL and therefore, its continued viability in this area may rightly be called into question."

The Superior Court also noted how Pennsylvania courts treat "innocent" misrepresentations where the relief sought is rescission of the contract as opposed to monetary damages. In Growall, the purchaser sought out-of-pocket losses in the form of repairs, loss of rent, etc., but did not sue to rescind the contract. According to the Superior Court, since "[t]here appear[ed] to be no basis for such damages under a claim of innocent misrepresentation in Pennsylvania", the purchaser had no cause of action under the RESDL against the wife for her 'innocent' misrepresentations about the condition of the property.

The Superior Court in *Growall* gave a free pass to an individual who did not take her legal obligations under the RESDL seriously. The wife, in signing the disclosure statement, did not make any attempt to respond to the questions contained in the statement herself or even fully read the responses to the statement prepared by her husband, which responses were based solely upon his knowledge.

By essentially allowing the wife to disclaim any knowledge about the condition of the property, the Superior Court defeated the whole purpose behind the RESDL, which is to compel a seller to give a homebuyer information about the condition of the property so that homebuyer can then make an informed decision to extend an offer to purchase the property, enter into an agreement to purchase the property, and finally proceed forward with closing.

The inequitable result cast in *Growall* should encourage real estate agents and attorneys alike who represent homebuyers to require, in situations where there are multiple sellers, each seller to complete a separate disclosure statement. If the wife in Growall had been forced to complete a separate statement, she very well may have approached her husband about assisting her in responding to the questions in the statement, which, in turn, may have caused him to reveal to her the water problem plaguing the basement of the property and thus obligated her to disclose it to the purchaser prior to closing.

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Alan Nochumson

Vertical Position 100%

Nochumson Explains How To Negotiate Agreements Of Sale

Alan Nochumson was a faculty speaker at the Continuing Legal Education (CLE) seminar sponsored by the Lorman Education Services entitled *Fundamentals of Real Estate Closings in Pennsylvania* which took place in Philadelphia, Pennsylvania.

During the seminar, Nochumson provided seminar attendees with a clearer understanding on how to negotiate an agreement of sale in Pennsylvania.

Vertical Position 100%

Borrower May Be Excused From Returning Loan Proceeds Under

TILA

Many homeowners borrow money as a second mortgage so as to purchase their house, pay for home improvements, or pay off unrelated personal debt. In this highly regulated industry, such homeowners can rescind the mortgage loan even after closing and receiving the loan proceeds.

In *Johnson v. Chase Manhattan Bank*, the U.S. District Court for the Eastern District of Pennsylvania recently implied that a borrower maybe allowed to rescind a mortgage loan without even being obligated to return the loan proceeds back to the mortgage lender.

BORROWERS DEFRAUDED

The plaintiffs, a married couple, were approached by two men on behalf of an organization called the Philadelphia Home Improvement Outreach Program (PHI). These men told the plaintiffs that Pm would assist them in arranging financing to pay for improvements to their house and to oversee the completion of these home improvements. Without the plaintiffs' knowledge, these men contacted a mortgage broker from Bryn Mawr Mortgage to arrange for financing. Sometime thereafter, a loan application was submitted to Chase Manhattan Bank upon the plaintiffs' behalf.

The plaintiffs subsequently agreed to a loan from Chase, approximately half of which was to pay off two existing mortgages on their home and other existing debt, another portion of which was to be distributed to them in the form of cash, and the remainder of which was to be used for the home improvements.

At the loan closing, the plaintiffs were advised that Chase would escrow the loan proceeds intended for the home improvements and would disburse the funds upon authorization of the plaintiffs to PHI's subcontractors.

Despite the representations made to the plaintiffs prior to the closing, the nonmortgage debt was not paid off, and they did not receive the cash disbursement. Instead, these loan proceeds were directly distributed to these men at closing. Although PHI retained the services subcontractors to complete the home improvements, much of the work was not completed and what was completed was shoddy and consisted of substandard materials. As a result, the plaintiffs notified Chase that they were rescinding the loan.

When Chase refused to honor the plaintiffs’ rescission request, the plaintiffs filed a complaint against Chase for, among other things, violations of the Truth in Lending Act (TILA). In response, Chase filed a motion attempting to dismiss the complaint due to the plaintiffs’ alleged failure to assert a viable cause of action under TIIA.

TILA

In the case of any consumer credit transaction, TILA gives borrowers a temporary right to rescind a mortgage loan where the mortgaged property is being used as their principal dwelling. Under TILA, borrowers can rescind the transaction until midnight of the third business day following the consummation of the transaction or the delivery of statutorily mandated information and rescission forms, whichever is later.

The creditor must provide the borrower with notice of this right of rescission by giving two copies of the notice to each borrower who has that right and the notice must clearly and conspicuously disclose the retention or acquisition of a security interest in the borrower’s principal dwelling, the borrower’s right to rescind the transaction, how to exercise the right to rescind, with a form for that purpose, designating the address of the creditor’s place of business, the effects of rescission, and the date the rescission period expires.

If a creditor fails to deliver the notice or any of the required material disclosures, the borrower may rescind the transaction at any time up to three years following the consummation of the transaction.

The board of governors of the Federal Reserve System, which is responsible for developing model disclosure forms, has published a model notice of right to cancel form. A creditor using this model form is deemed to be in compliance with the disclosure provision of TILA.

TRIAL COURT DECISION

In Johnson, there was no dispute that the form used by Chase Manhattan Bank conformed to the model form promulgated under TILA. Rather, the plaintiffs pointed out that Chase failed to properly complete the paperwork given to the wife. Unlike the husband's notice, the line in the notice providing for the date by which the wife had to exercise her right to rescind the transaction was left blank. As such, the wife contended that the three-year, not the three-day, period to rescind the loan applied.

Relying upon the 1st U.S. Circuit Court of Appeals' recent decision in *Palmer v. Champion Mortgage*, Chase argued that its duty was only to provide an objectively reasonable notice of the deadline and that the wife's notice was sufficient to meet that standard because it twice provided information that would make the deadline clear to the average consumer.

In *Palmer*, the creditor mailed the notice to the borrower after the closing had already taken place. Although the notice identified the deadline for rescission, the borrower did not receive it until after the recession deadline had passed.

The notice contained language explaining that the rescission deadline would not pass until three days after the latest of the three triggering events, one of which was the date the borrower received the notice of her right to cancel, and a parenthetical note after listing the rescission deadline setting out an alternative manner for determining the deadline if the three triggering events did not occur at the same time.

The borrower attempted to rescind the transaction 17 months later. She argued that because the original recession deadline had passed before she received the notice, the notice was “confusing” and such defective notice extended her right to rescind to the statutory three-year period.

The 1st Circuit in *Palmer* used the standard of an “average consumer, looking at the notice objectively” to determine that the notice was not confusing and that the extended rescission right under TILA was not triggered. The court stressed that the “twice-repeated alternative deadlines would have made it crystal clear to the average consumer that the . . . deadline would not necessarily be the applicable one.”

The trial court in *Johnson* did not believe that the factual circumstances in *Palmer* were analogous but instead were fatally distinguishable. Unlike *Palmer*, the trial court noted that the notice in *Johnson* did not comply with TILA’s statutory scheme in that the notice did not contain the requisite date to rescind the transaction.

Moreover, the trial court in *Johnson* concluded that the 1st Circuit in Palmer did not address whether an alleged TILA violation could be excused, but rather whether the notice was defective because it was confusing even though there was compliance with TILA.

The trial court next tackled Chase Manhattan Bank’s assertion that the TILA claim should be dismissed because the plaintiffs did not return the principal of the mortgage loan prior to pursuing its rescission.

After reviewing the statutory language, the trial court held that borrowers are not required to tender the loan proceeds before invoking their right to rescind unless and until a court decides otherwise and modifies the statutory scheme. According to the trial court, "[c]ontrary to Chase Manhattan Banks assertion, this modification is a matter of the court's equitable discretion and does not operate automatically. Indeed, in each of the cases Chase Manhattan Bank cites, the court recognizes that it is using its authorized discretion to depart from the ordinary order as described in the statute."

The trial court emphasized that even if it were to interpret Chase's motion for dismissal as a request for conditional rescission, it would have been premature at that early stage of litigation since there was no record of the plaintiffs' inability to return the proceeds of the loan or any of the other circumstances it would be obliged to consider if making a decision on equitable grounds.

LESSONS LEARNED

The trial court's ruling in *Johnson* should send shivers down the spines of mortgage lenders throughout the commonwealth. The trial court has not foreclosed the possibility that Chase Manhattan Bank could be held financially responsible for the fraudulent activity allegedly committed by unrelated third parties. In Johnson, the trial court will be presumably forced to determine liability based upon Chase's alleged failure to properly monitor the disbursements of loan proceeds earmarked for the nonmortgage debt and the home improvements.

At the very least, *Johnson* should clearly encourage mortgage lenders to review and tighten their business practices with respect to home equity lines of credit.

Alan Nochumson

Vertical Position 100%