Attorneys Must Be Wary Of Fraudulent Conveyance

Attorneys who represent “deadbeat” clients may be unwittingly placing themselves in harm’s way. In a recent federal court decision in Maryland, an attorney found she was personally liable to a lender after arranging two transfers of real estate for her clients.

In *Business Loan Express, LLC v. Pak*, while a confession of a judgment action was pending against the guarantors of a defaulted loan, the defendant – the guarantors’ child and attorney – formed a limited liability corporation transferring the guarantors’ home and an investment property to the corporation. The corporation subsequently sold the home and transferred $200,000 of the sales proceeds to the attorney’s uncle in South Korea as payment for an alleged debt due by her parents. The lender later obtained a $1.1 million judgment against the guarantors. After discovering the transfers of real estate during execution of the judgment, the lender sought to recover the full amount of the judgment from the attorney under Maryland’s fraudulent conveyance of statute.

Citing “unmistakable” badges of fraud in the two transactions, the federal court concluded that the lender was entitled to money damages from the attorney. Although the guarantors claimed they received consideration for the sale, the court pointed out that the attorney failed to present any evidence of a debt owed by her parents to her uncle.

The court also noted the “the only reasonable inference that can be drawn from the objective circumstantial evidence is that she and her parents . . . act[ed] with fraudulent intent.”

Based upon the finding the attorney used her professional skills to effectuate the transactions for her parents, the court ordered her to pay $200,000 – the exact amount her parents transferred to the overseas relative – to the judgment creditor. The court limited the damages to that amount because there was no evidence the attorney helped her parents conceal or convey any other asset that would have been available to satisfy the judgment.

FRAUDULANT CONVEYANCE

While no Pennsylvania court has found an attorney liable for the debts of his clients, a recent Pennsylvania Superior Court decision may provide insight on whether this may change in the future. In *Presbyterian Medical Center v. Budd*, the Superior Court refused to recognize a cause of action under the Pennsylvania Fraudulent Transfer Act against a woman who allegedly made fraudulent transfers as her mother’s attorney-in-fact. The defendant’s mother was a resident of the hospital at the time of her death. Prior to her death, the hospital sought to collect the mother’s outstanding medical bills. The defendant then advised the hospital that her mother’s resources were exhausted.

She then promised that she would file an application for medical assistance with the Commonwealth on her mother’s behalf to pay for her medical bills. Knowing that her mother would not qualify for medical assistance because her resources exceeded the Commonwealth’s maximum resource limit, she allegedly promised to spend down her mother’s resources on medical expenses until her resources were depleted below the statutory limit. In exchange for this oral promise, the hospital refrained from attempting to bring her mother’s account current.

Despite her promise, the defendant did not spend down her mother’s resources on medical expenses, but instead used her power of attorney to transfer over her mother’s assets to herself. After the Commonwealth rejected the mother’s application because her assets exceeded the threshold limit, the Commonwealth and the hospital reached a settlement agreement for less than the amount owed by her mother. The hospital then filed an action against the defendant under the PFTA claiming that the transferred assets could have been used to pay the hospital, her mother's creditor.

The trial court sustained the preliminary objections filed by the defendant on grounds that the PFTA does not apply to her as attorney-in-fact. Upholding the trial court's ruling, the Superior Court, pointing to the statutory language of the PFTA, concluded that the statute only protects creditors against fraudulent transfers made by "debtors." The court rejected the hospital's argument contending that the defendant's status as attorney-in-fact qualifies her as a "debtor", making her liable to the hospital for the allegedly fraudulent transfers. The court stressed that this Commonwealth has never recognized a PFTA claim targeting the attorney-in-fact of a debtor and refused to extend the PFTA beyond the plain language of the statute.

The *Budd* decision illustrated the fundamental difference between the PFTA and Maryland's fraudulent conveyance statute. Unlike the Maryland's fraudulent conveyance statute, the Pennsylvania version does not contain language providing that the stature applies to "every conveyance and every obligation incurred . . . with actual intent" to defraud creditors.

Since an attorney-in-fact who was benefiting from the transactions was not held liable under the PFTA because she was not the "debtor", an attorney who was charging a reasonable amount for his services should be equally protected from liability. However, if the attorney was charging the client to pay, a "bonus" for his legal services a court may conclude that the attorney may be liable to the creditor for the portion of the legal fees that were not honestly earned.

The Superior Court in *Budd*, however, left open the possibility that a representative of a debtor may be liable under the PFTA without limitation. The Superior Court was intrigued by an Ohio appellate decision, which found an attorney-in-fact liable under similar circumstances. The Superior Court was, however, disappointed that the Ohio court did "not explain the particulars of its finding that the attorney-in-fact of a debtor qualified as a 'debtor'". The Superior Court refused to similarly extend liability in Budd after concluding that the hospital had not pled sufficient facts to establish a convincing link under the Pennsylvania law.

ATTORNEY'S LIABILITY

While a creditor may not have a claim against an attorney under the PFTA, the attorney may still be liable under the common law tort of creditor fraud. In *Morganroth & Morganroth v. Norri McLaughlin &Marcus, P.C.*, the 3rd U.S. Circuit Court of Appeals, predicting New Jersey law, held that a plaintiff states a claim for creditor fraud under New Jersey law by alleging that an attorney has knowingly and intentionally participated in a client's unlawful conduct to hinder, delay or fraudulently obstruct the enforcement of a judgment.

In *Morganroth*, while the New Jersey law firm was representing its client in a $6 million lawsuit for unpaid legal fees against an out-of-state law firm, the New Jersey firm helped the client transfer his interest in a 430-acre farm to one of his corporations for a nominal sum. The transfer was ultimately set aside, and a judgment for the unpaid legal fees was entered in the underlying case. Undeterred, the New Jersey law firm then allegedly arranged to have stock owned by its client send to a U.S. Marshall's office to facilitate an execution on a judgment owned by the client's brother, thereby becoming unavailable to satisfy the other judgment. The firm also allegedly drew up a fictitious lease, which leased back to the client, as his children's guardian, the interest just conveyed in the farm and then had the lease recorded by misrepresenting the facts to the county recorder.

Although the out-of-state firm conceded that they had not stated a claim for common law fraud because the complain did not contain any allegations of reliance on any misstatements actually made, they “assert[ed] they [we]re not required to allege reliance upon misstatements … to make out a cause of action for creditor fraud because New Jersey case law provides a cause of action against a judgment debtor who fraudulently obstructs enforcement of a judgment.”

Returning the case back to the district court for trial, the 3rd Circuit held that, assuming the allegations of the complaint were true, the New Jersey law firm’s actions “went beyond the bounds of permissible advocacy,” thus becoming an active participant in a scheme to obstruct execution of the underlying judgment.

Although no Pennsylvania court has ever recognized the tort of creditor fraud, the United States District Court for the Eastern District of Pennsylvania in *Corporate Aviation Concepts, Inc. v. General Electric Capital Corp.* recently discussed the tort in *dicta*. The district court stated that, even assuming if the Pennsylvania Supreme Court recognized this tort, the plaintiff failed to state a legally sufficient claim for creditor fraud.

Although the plaintiff alleged an outstanding debt owed by the defendant, the court pointed out that the debt was in the form of an unpaid obligation and now a money judgment. Since the plaintiff did not assert that it had obtained a judgment for this amount, or that the defendant intentionally obstructed the enforcement of any such judgment or liens, the district court found that the plaintiff had not established a prima facie case for creditor fraud.

A recent 3rd Circuit bankruptcy court decision clarified the narrowness of an attorney’s duty to non-clients. The *In re Yacuk* court found a New Jersey attorney, acting in his capacity as an attorney for a client, did not owe a duty under

New Jersey law to a bank where the client was a guarantor.

The attorney prepared documents conveying the marital residence of his clients to their son. Without the attorney's knowledge, the back sent a letter to the husband informing him of a default on a loan that he had guaranteed. When the attorney prepared the documents, he asked the husband whether there were any judgments, liens or claims against the husband and he was told there were none. The attorney did not ask if the husband was a borrower or guarantor to any outstanding loans.

The 3rd Circuit found that the attorney did not have an independent duty to the bank. The court stated that the attorney did not affirmatively or implicitly take any action on behalf of the bank or make any representation to the bank or its attorneys, which he would expect that the bank would rely upon to its detriment.

At the time of the conveyance, the court reasoned that the attorney had no reason to foresee that the bank would be adversely affected. The court pointed out that nothing in the record indicated that the attorney made any representation or omission to the bank that would have prevented the bank from discovering the fraudulent conveyance.

Even if Pennsylvania ultimately decides to recognize the "creditor fraud" theory of recovery, an attorney would probably only be liable if the attorney actively schemed with the client for the purpose of obstructing execution of a judgment already entered onto the books.

LESSONS LEARNED

Although the overall effect of the Maryland district court decision in *Pak* will most likely be viewed as a blip on the radar screen given the limited scope of the PFTA, Pennsylvania attorneys who help their clients obstruct collection efforts on a judgment may nonetheless be held accountable for the consequences of their actions under the tort of creditor fraud if Pennsylvania courts follow New Jersey's lead. Any attorney who fails to recognize the difference between zealous advocacy and unethical practice of law could thus find himself personally on the receiving end of a lawsuit.

Alan Nochumson

Attention Shoppers: Politicking In Aisle One?

With Election Day fast approaching, political campaigns are increasing their efforts to distribute leaflets to potential voters. Since many people want to avoid spending their time brushing aside aggressive campaign workers, mall owners often restrict pamphleteering activities on mall premises.

Although the Federal Constitution may not protect freedom of speech rights in privately owned malls, some states have extended freedom of speech protections under their respective state constitutions. The states extending such protection have done so under the "public function" doctrine. Under this doctrine, the court determines whether the shopping mall is the functional equivalent of a downtown business district. If so, then the court may find the state-action requirement satisfied and the political speech protected under the state constitution.

MALL OWNERS

In the seminal case of *Western Pennsylvania Socialist Workers 1982 Campaign v. Connecticut General Life Insurance Company*, the Pennsylvania Supreme Court considered whether under the Pennsylvania Constitution a mall owner could prohibit an individual from soliciting signatures to qualify a candidate for an election ballot. The mall had a strict policy against any political solicitation.

The court first rejected the contention that the shopping mall was a public forum. The court concluded that the shopping mall simply was not the legal equivalent of a town. In reaching its conclusion, the court pointed out that although a shopping mall may duplicate some of the commercial functions of a town, it does not provide housing or public services such as roads, education or transportation.

Notably, the court's decision did not entirely close the door on future challenges to mall regulations against political solicitations. Indeed, the court noted that constitutional restraints may apply to malls if a symbiotic relationship or sufficient nexus is proven to exist between the mall and government. In this specific case, however, the pamphleteers failed to establish the existence of such a relationship or nexus. The court, accordingly, concluded the free speech protections contained in the Pennsylvania Constitution were inapplicable.

Unlike *Western Pennsylvania*, the Colorado Supreme Court in *Block v. Westminster Mall Company* found the existence of state action based on the symbiotic relationship between the mall owner and several governmental entities. In *Block*, the court concluded the following constituted governmental involvement in the operation of the mall: $2 million worth of improvements by the city government to adjacent streets and drainage systems, placement of a police substation in the mall, presence of recruiters for the armed services; and voter registration drives by the county government.

Thus, if the individual attempting to gain access to the mall can establish a symbiotic relationship or a sufficient nexus between the mall and the government, a Pennsylvania court may very well limit the mall owner’s discretion in restricting the right of persons to hand out fliers and solicit signatures in support of a candidate’s nomination for public office on mall premises.

NEW JERSEY REGULATIONS

Although no Pennsylvania court has placed constitutional limits on privately owned malls, mall owners in New Jersey are not quite so fortunate. In *New Jersey Coalition Against War in the Middle East v. J.M.B. Realty Corporation*, the New Jersey Supreme Court held its state constitution protected free speech activities in privately owned shopping malls. In so holding, the court focused its inquiry on the following factors: the normal uses of property, the extent of the invitation and the purpose of the free speech in relation to the property’s use.

Applying the factors to the case at hand, the court concluded the mall owners’ attempts to restrict free speech on the mall premises were subject to the protections imposed by the state constitution. The court observed that the mall owners had effectively transformed their malls into a mirror-image of a downtown business district. The court noted, “[W]ithin and without the enclosures are not only stores of every kind and size, but large open spaces available to the public and suitable for numerous uses. There is space to roam, to sit down and to talk.”

Moreover, the court pointed out that each of the malls permitted and encouraged non-retail, non-commercial activities on the premises. The mall owners, for example, authorized issue-oriented speech at community desks and booths as well as voter registration drives and – in one mall – leased space to a governmental entity. The court also found that leafleting, the free speech activity at issue, was compatible with the use of the mall, highlighting the fact that such political activity has been associated with downtown streets for centuries.

The overall effect of the court’s decision in *New Jersey Coalition*, however, may be limited to large shopping malls. In *New Jersey Coalition*, the New Jersey Supreme Court explicitly refused to extend the scope of its holding beyond regional shopping centers, which attract large groups of people.

In California, for example, although the courts have found constitutional free-speech protections present in large shopping malls, they have consistently refused to recognize a free speech right to those seeking to engage in expressive activities on private sidewalks or on private parking lots in stand alone markets. In *Albertson’s v. Young*, a California appellate court reasoned that a supermarket and its private surroundings could not be equated with a public forum because there were no enclosed walkways, plazas, courtyards, picnic areas, gardens or other areas that might invite the public to congregate. Instead, the California court highlighted the fact that individuals came to the supermarket for the single purpose of buying groceries.

Based on the California cases, New Jersey courts may not protect free speech rights in smaller privately owned commercial establishments that do not assume the characteristics commonly associated with a town center. The more a mall becomes identified as part of the town center, however, the greater difficulty the mall owner likely will confront in enforcing limitations on speech.

PERMISSIBLE MALL REGULATIONS

Even if states protect free speech in privately owned malls, mall owners may still place content-neutral reasonable time, place and manner restrictions on free speech activities. Indeed, most shopping malls contain written rules and regulations prescribing the activities and conduct allowed on the mall premises.

In New Jersey, for example, the reasonableness of such regulations is judged on a sliding scale. The more a property owner opens up the property for use by the general public, the more the property owner's rights become trumped by state constitutional rights of others. In striking the balance, New Jersey courts consider the nature of the affected constitutional right, the extent to which the mall's restriction intrudes upon it, and the mall owner's need for the restriction. The more important the constitutional right sought to be exercised, the greater the burden upon the mall owner to justify interfering with that right. The means chosen by the mall owner should be designed to achieve the mall's legitimate purpose, but preserving the expressive rights of the pamphleteers.

Courts generally allow mall owners a reasonable period of time to investigate and determine whether to permit free speech activities in the mall. The courts understand that mall owners are entitled to know who, what, where, when, how and why the free speech activity will be conducted on the mall premises. In a recent decision, a California appellate court stated that "[t]he amount of time reasonably necessary to evaluate each application will vary with such circumstances as the nature of the activity, the number of persons involved, the subject or issue involved, the reputation of the person or entity involved for conducting the activities in a safe and orderly manner, and the past experience of the mall owner with the person or entity, if any." Mall owners, however, should not prolong the approval process unnecessarily.

Mall regulations restricting the time and place of the political activity also have come under court scrutiny. Since there is no constitutional right requiring mall owners to grant access to the entire shopping mall to those seeking to communicate with mall patrons, courts generally look at whether the pamphleteers were given the opportunity to communicate with a substantial portion of the patrons. Limiting political activities to the mall’s food court, for example, may be considered constitutionally permissible because the mall owner could reasonably argue that a substantial portion of the patrons congregate at that location.

Courts also have reviewed the constitutionality of mall regulations conferring discretion upon mall owners to condition access of the mall premises upon the purchase of special insurance protecting against possible loss or injury caused by their activities. In *Green Party of New Jersey v. Hartz Montain Industries Inc.*, for example, members of the Green Party sought ballot signatures on its nominating petition for its gubernatorial candidate. The Green Party intended to use fliers while collecting signatures at the shopping mall. The mall regulations required the Green Party, as a non-profit organization, to obtain a $1 million insurance policy. The Green Party challenged the constitutionality of this requirement.

The New Jersey Supreme Court determined the mall owner failed to provide objective reasons for refusing access to the mall premises absent the insurance. The court highlighted the absence of any showing the political activity actually imposed an economic burden on the mall such that the Green Party should be required to pay a fairly allocated fee objectively related to the risk it might create.

LESSONS LEARNED

As more people move to the suburbs, shopping malls have become a primary place to meet large groups of people face to face. Not surprisingly, the malls are becoming new grounds for “grass-roots” politics. The ability of a mall owner to protect patrons from annoyance and harassment may sometimes be forced to yield in face of constitutional considerations. Unlike New Jersey and other states recognizing free speech rights in privately owned shopping malls, Pennsylvania mall owners presently have the ability to limit political activities on mall premises.

Alan Nochumson

Methods For Collecting Unpaid Condominium Fees

Condominium ownership appeals to individuals who do not want to deal with the hassle of, among other things, landscaping, replacing an outdated roof or shoveling snow from the driveway during the winter. In order to enjoy this easier way of life, condominium unit owners pool their resources together by paying for the cost of maintaining and repairing the common areas of the condominium building. These payments are commonly referred to as “assessments.”

Problems arise when one of the condominium unit owners in the building fails to pay his assessments. By losing any part of this revenue stream, general maintenance or repairs to the building may be delayed, or, worse, the other unit owners may be forced to pay higher assessments to compensate for the lost revenue. “Paying” unit owners, however, are not without recourse. In *Gateway Towers Condominium Association v. Krohn*, the Pennsylvania Superior Court examined the methods for collecting unpaid assessments.

CONTRACTUAL OBLIGATION

At the time of closing, when an individual purchases a condominium unit, he assents to the terms and conditions contained in the condominium documents. The condominium documents generally include the condominium declaration, which created the condominium arrangement in the first place, the condominium bylaws and the condominium rules and regulations. Each condominium unit owner is a member of the condominium association. The condominium unit owners, as members of the condominium association, elect an executive board which, among other things, is in charge of collecting the condominium assessments, either voluntarily or by legal means.

ENFORCING COLLECTION

The condominium association has two avenues of relief under Pennsylvania law to collect assessments from delinquent condominium unit owners. If condominium unit owners refuse to pay for the condominium assessments charged by the condominium association, then the condominium association can file a breach of contract action against the unit owner under the condominium documents. Generally, the documents require the condominium unit owner to reimburse the condominium association for the attorneys’ fees and costs to collect the unpaid assessments. Under a breach of contract theory, however, the condominium association sues the unit owner personally and does not directly attack the unit owner’s interest in the unit itself.

On the other hand, the condominium association has the right under the Uniform Condominium Act, 68 Pa. C.S.A. Section 3301, to foreclose on the unit owner’s lien in a mortgage foreclosure action. Section 3315 of the Uniform Condominium Act provides that so long as the condominium association records the condominium declaration, the association has an unavoidable statutory lien for the unpaid condominium assessments. The purpose of the lien created by Section 3315 is to secure payment of the past due condominium assessments.

The condominium association’s lien may be foreclosed under Section 3315 in a like manner as a mortgage on any piece of real estate. Similar to the attorneys’ fee provision contained in the condominium documents, Section 3315 specifically provides the condominium association with the right to reimbursement for attorneys’ fees and costs incurred in the foreclosure action.

METHOD OF COLLECTION

In *Gateway Towers*, the condominium unit owner failed to pay the monthly condominium fees assessed to his unit over the course of several months. The condominium association then filed a mortgage foreclosure complaint under Section 3315. Since there was no dispute that the unit owner failed to pay the condominium assessments, and because the unit owner did not contest the amount of the assessments, the trial court granted the condominium association’s motion for summary judgment. The unit owner then filed an appeal to the Pennsylvania Superior Court.

As part of his appeal, the unit owner argued the parties had contractually agreed that arrearages in condominium assessments could only be resolved by a lawsuit of assumpsit, which by implication, precluded commencement of the mortgage foreclosure proceedings. The unit owner stated that, under the provisions of the condominium bylaws, the condominium association could only seek to recover his unpaid balance by way of a breach of contract action and had no lawful basis on which to commence a mortgage foreclosure action. He further argued that the Uniform Condominium Act did not invalidate contrary provisions of the condominium bylaws.

The Superior Court concluded that the unit owner’s argument was inconsistent with controlling statutory authority. Agreeing with the lower court, the Superior Court found the section of the condominium bylaws upon which the unit owner relied was permissive rather than mandatory. The Superior Court further found that the condominium bylaws did not, by any express term, restrict the form of action the condominium association could use.

The Superior Court then noted that, although Section 3315 cannot be read to invalidate existing provisions of the condominium bylaws or supplant existing remedies, it does provide an additional remedy upon which the condominium association in this case could properly rely. As the Superior Court recognized, nothing in the language of the condominium bylaws restricted the form of relief the condominium association could employ to recover unpaid assessments. Because no restrictions appeared in the condominium bylaws, the Superior Court reasoned the bylaws posed no impediment to the use of the additional remedy prescribed under the Uniform Condominium Act.

In so finding, the Superior Court ultimately concluded the provision of the condominium bylaws allowing the association to bring a breach of contract action to recover unpaid assessments did not preclude the association from commencing a mortgage foreclosure proceeding. In other words, although the condominium association has the right to proceed against the unit owner through a breach of contract action, the condominium association lawfully could also exercise its statutory right to foreclose on the lien provided by the Uniform Condominium Act.

VIGILANCE IS THE KEY

The statutory lien created by the Uniform Condominium Act theoretically remains on the condominium unit until the unit is sold. By failing to pay assessments, though, the unit owner could actually make the condominium unit unmarketable. To illustrate, if the unit owner originally purchased the condominium unit for $100,000 with 100 percent financing and the unit appreciated in value to $110,000, the unit owner could not allow a lien against the unit to accrue in an amount exceeding the difference in the original purchase price and the current value of the unit. Logically, the unit owner would not sell the condominium unit if the original purchase price plus the lien exceeded the current value of the unit, because the unit owner would lose money on the sale.

Whatever the unit owner decides, the condominium association must nevertheless remain vigilant in protecting its rights under Section 3315 or it will lose the statutory lien. As a threshold matter, the lien is extinguished unless the mortgage foreclosure proceedings are instituted within three years after the assessment becomes payable. Three years is not a long time when you consider that most condominium associations and their executive boards consist of volunteers who either do not have the time, interest or fortitude to confront deadbeat neighbors.

Even if the condominium association commences a mortgage foreclosure action within the prescribed time, it may nonetheless lose its statutory lien after all. Section 3315 specifically provides that the first mortgage and governmental assessments and charges encumbering the condominium unit have priority over the lien. If the condominium unit is sold at a judicial sale, the condominium association is only guaranteed to recover the six months of assessments due immediately preceding institution of the mortgage foreclosure action. After the unit is sold by the sheriff, the condominium association is entitled to more than six months of assessment only if the sale price is in excess of the cumulative amount of the first mortgage, the governmental assessments and charges and the six months of the condominium fees. Any unpaid condominium assessments would otherwise be lost.

LESSONS LEARNED

In *Gateway Towers*, the Pennsylvania Superior Court recognized two separate and independent avenues of relief available to a condominium association when one of its condominium unit owners fails to uphold their end of the bargain. Either way, the condominium association must remain vigilant in this pursuit of the unpaid condominium assessments or effectively lose its ability to collect the unpaid amount.

As a result, the condominium association should, at all costs, promptly address a condominium unit owner's failure to pay assessments. Otherwise, the longer the condominium association waits to exercise its rights under Pennsylvania law, the less likely the association will be able to collect the unpaid assessments.

Alan Nochumson

Vertical Position 100%

Landlord Makes Itself An

Offer It Can’t Refuse

Leases frequently contain provisions granting the tenant the first right to purchase the leased premises in the event the landlord desires to sell. A right of first refusal should be distinguished from a true option to purchase. In the case of an option to purchase in the landlord-tenant context, the tenant has the right to purchase the leased premises at a set price during all or a part of the lease. In comparison, a first refusal clause requires the landlord, when he wishes to sell the leased premises, to offer the premises first to the tenant at the same price offered by the potential purchaser.

A “sale” must occur in order for the first refusal clause to come into play. In a case of first impression, the Pennsylvania Superior Court in *Lehn’s Court Management LLC v. My Mouna Inc.* recently examined whether a transfer of real property from a corporate landlord to its sole shareholder amounted to a “sale,” thus triggering a tenant’s right of first refusal.

Several years ago, Lehn’s Court Management entered into a lease agreement containing a first refusal clause. The clause specifically provided that if the landlord, My Mouna Inc. and Chicken George’s Palace Inc., received or made an offer to sell the leased premises, they needed to give Lehn’s the opportunity to match the proposed offer. On the same day that the lease was executed, the parties also signed a memorandum of the right of first refusal, which reiterated the terms of the first refusal clause contained in the lease.

When George Moussa, the sole shareholder of both corporate landlords, transferred title of the leased premises to himself for $60,000 without giving Lehn’s the opportunity to purchase the premises for itself, Lehn’s filed suit alleging that the transfer was in derogation of its right of first refusal.

The lower court subsequently dismissed the complaint, finding that the transfer from the corporate entities to its sole shareholder did not constitute a “sale” within the contemplation of the first refusal clause contained in the lease. The trial court’s decision was then appealed to the Superior Court.

The court analyzed the policy reasoning behind first refusal clauses in the landlord-tenant context. From the outset, the court noted that “[i]t is a valuable right that the tenant holds and is the result of a bargained-for exchange.” The court explained that while the tenant cannot be forced to purchase the leased premises by agreeing to such a clause, the clause gives the tenant the first chance to purchase the premises before the landlord sells the premises to a third party.

The court also examined how Pennsylvania appellate courts have historically dealt with similar issues regarding transfers in the face of first refusal clauses. The court first discussed the Pennsylvania Superior Court’s ruling in *Mericle v. Wolf*. In *Mericle*, the Superior Court held that a gratuitous transfer of real property to a hospital did not trigger a tenant’s right of first refusal. The Superior Court, applying general contract principles, found that the clause was intended to give the tenant the right of first refusal if the property was sold. Since the transfer was by way of a gift instead, the Superior Court reasoned that the right of first refusal never came into play. In so holding, the Superior Court rejected the tenant’s argument that the underlying purpose of the first refusal clause was for the protection and continuation of his business, and the transfer of the property, whether by gift or sale, defeated that purpose.

The *Lehn’s* court then compared the Superior Court’s decision in *Mericle* to the Pennsylvania Supreme Court’s holding in *Warden v. Taylor*. In *Warden*, a landowner gifted farmland to her grandson in spite of the existence of the first refusal clause. However, unlike *Mericle*, the Supreme Court in *Ward* concluded that the transfer was improper because the first refusal clause in *Ward* was triggered by conveyance alone, which occurred when the land was transferred from the landowner to her grandson.

The Superior Court nevertheless found that the facts and circumstances in *Lehn's* differed from *Mericle* and *Warden* in three respects. First, the transfer was in name only because the sole shareholder remained in control of the property despite the change in ownership. Second, the transfer was not by way of gift but rather for a substantial amount of money. Third, the first refusal clause was contingent on the landlord receiving or making an offer.

The Supreme Court then reviewed how other jurisdictions have handled similar disputes. It first examined state court decisions in Colorado, Rhode Island and New Jersey, which found that a "sale" did not occur. In *Kroehnke v. Zimmerman*, the Colorado Supreme Court was faced with a transfer of property from an individual to his solely owned corporation. The court noted that while consideration was given for the transfer of title, there was "nothing in the record to suggest arm's-length dealing between an owner willing (but not forced) to sell and a buyer willing (but not forced) to buy, which customarily characterizes a sale in the open market." As a result, the court concluded that there was no "sale" between the individual and his corporation.

The Rhode Island Supreme Court in *Bellieveau v. O'Coin* also held that the transfer of land from an owner to her solely owned corporation did not constitute a sale. The court first pointed out that the transfer occurred solely for tax-avoidance reasons, thus indicating that the transaction was nothing like the type of arm's-length transactions found in the marketplace. The court then emphasized that the new landlord was not a stranger to the tenant because the transfer of ownership was in name only.

In *Sand v. London & Co.*, the New Jersey Superior Court dealt with a contested transfer of property that occurred between corporations with both corporations having identical stockholders. The court concluded that no sale occurred because the original owners remained in a position to control and dispose of the property.

After reviewing the cases previously cited, the Lehn's court then examined the persuasive effect of the Utah Supreme Court's rationale in *Prince v. Elm Investment Co.* In *Prince*, the landlord entered into a partnership agreement with another company to "acquire, improve, lease and manage" the property, with the landlord retaining 51 percent ownership in the property and the other company holding the remaining 49 percent. The partnership agreement also provided that all decisions and actions of the partnership required unanimous consent of the partners. The Prince court, guided by the three state cases previously discussed, found that, for purposes of a right for first refusal, a "sale" occurs upon the transfer (a) for value, (b) of a significant interest in the subject property, (c) to a stranger to the lease, (d) who thereby gains substantial control over the leased property.

Applying those factors to the case in hand, the *Prince* court found that since the landlord transferred its property interest to an entity unknown to the tenant, and since this stranger could control the lease via the veto power contained in the partnership agreement, a sale occurred because the tenant was, in effect, under new management.

The *Lehn's* court believed that the Utah Supreme Court's definition of "sale" protected the interests of the holder of the right of first refusal and comported with the intent of the leasing parties. The Superior Court pointed out that this type of clause is intended to safeguard a tenant's relationship with the landlord. The court reasoned that if the landlord was going to sell to a third party that the tenant did not care for, the tenant was given the ability to purchase the premises by way of the first refusal clause.

The Pennsylvania Superior Court then applied the *Prince* test to the situation at hand. It found that the first two elements of the test were easily met. First, the transfer was for $60,000, and thus “for value.” Second, the corporate landlords did transfer a significant property interest by giving its title in the property to its sole shareholder. The Superior Court nevertheless found that the last two elements of the test were not met because the new landlord, the sole shareholder, was not a stranger to the tenant. The court concluded that the transfer did not change the tenant’s position because the transfer was a change in name and legal entity only and not actual control. The court thus held that a sale did not, in fact, occur.

The Superior Court’s recent decision has established rules of engagement for a landlord who wants to transfer his property when a first refusal clause is in play. If the landlord merely transfers the property from himself to another entity he controls, or vice versa, based on the Superior Court’s holding, the first refusal clause should have no legal effect on the transfer. The Colorado, Rhode Island and New Jersey cases cited by the Superior Court in its decision support this conclusion.

If, however, the landlord wants to change the ownership structure such that new parties take “substantial control” of the burdened property, then the landlord should give the tenant the right to purchase the property before finalizing the deal. This result merely flows from the Superior Court’s reliance on *Prince*. In *Lehn’s*, the Superior Court stressed that unlike *Prince*, “there was no stranger who gained substantial control over the property.” In the context of first refusal clauses, strangers do not make good bedfellows.

Alan Nochumson

Property Owners Need To Seek Intervention In Zoning Battles

Since the 1990s, the region has received an "extreme makeover" as planned communities, retail complexes and restaurants have taken root in previously underdeveloped areas of the region. Since the use and occupancy of buildings, structures and land in the region are strictly restricted and regulated by Pennsylvania's municipalities planning code and other applicable zoning regulations, variance relief is typically required in order for development to occur.

Neighborhood opposition can prolong the zoning approval process. Even if the zoning hearing board grants the variance, affected neighbors have the right to appeal the board's decision to the court of common pleas. In a recent decision, the Commonwealth Court in *Nahas v. Zoning Hearing Board of Schuylkill* issued a strict warning to remind developers not to sit back idly while the appeal is being fought at the trial court level.

VARIANCE GRANTED

In *Nahas*, Anna and Robert Yeager filed an application for a zoning variance under the municipalities planning code with the zoning hearing board of Schuylkill County to operate a car restoration business out of their garage on property located in a residential zoning district. The zoning hearing board granted the variance after concluding that the property owners would suffer unnecessary hardship under the strict application of the ordinance due to the unique physical conditions particular to their property.

TRIAL COURT REVERSES RULING

After the zoning hearing board's decision was handed down, two of the Yeagers' neighbors, Joseph and Olga Nahas, decided to challenge the decision by filing an appeal with the Court of Common Pleas of Schuylkill County. Since the Nahases were only required under Pennsylvania law to sue the zoning hearing board and not the Yeagers, the Yeagers were not a party to the land use appeal. Even though the zoning variance was at stake, the Yeagers chose not to participate in the trial court proceedings.

The trial court eventually reversed the zoning hearing board's determination and held that there was no unnecessary hardship by the denial of the zoning variance. The Yeagers then filed an appeal of the trial court's ruling with the Pennsylvania Commonwealth Court.

The Nahases then filed a motion to quash the appeal, arguing that the Yeagers lacked standing to appeal the trial court's ruling because the Yeagers had failed to intervene in the trial court proceeding and thus were not a party to the land use appeal filed by the Nahases.

RIGHT TO INTERVENE

A party generally intervenes in a case by petitioning the court for leave to intervene pursuant to the Pennsylvania Rules of Civil Procedure. The municipalities planning code, however, makes it relatively easy for a property owner to intervene in land use appeals. Section 11004-A of the code provides that "[w]ithin 30 days… following the filing of a land use appeal, if the appeal is from a board or agency of a municipality, the…. owner or tenant of the property directly involved in the action appealed from may intervene as of course."

By permitting intervention as of right in land use appeals, the municipalities planning code, in effect, creates a presumption that the property owner or tenant meets the requirements to intervene which are set forth under Pennsylvania Rules of Civil Procedure.

LACK OF STANDING

The Commonwealth Court granted the Nahases' motion to quash the Yeagers' appeal, finding that the Yeagers lacked standing to appeal the trial's court decision because the Yeagers had failed to intervene in the trial court proceeding. The Commonwealth Court noted that a property owner whose property is directly involved in a zoning appeal is not granted automatic party status in an appeal from the decision of the zoning hearing board despite the fact that both may have participated as parties before the board. The Commonwealth Court caustically stressed that if the property owner wishes to appeal the trial court's ruling, the property owner must intervene as a party at the trial court level.

The Commonwealth Court found that the Yeagers' failure to intervene was fatal to their appeal of the trial court's adverse ruling. In *Nahas*, the court focused on the Yeagers' decision not to intervene under Section 11004-A. While a property owner or tenant has the right to intervene under Section 11004-A so long as notice of intervention is filed within 30 days of the land use appeal, the property owner or tenant is not prevented from intervening in the appeal after the 30 day period expires.

Pennsylvania courts have consistently held that the property owner or tenant can intervene pursuant to the Pennsylvania Rules of Civil Procedure even if he misses the 30-day deadline.

If the property owner or tenant decides to intervene pursuant to the Pennsylvania Rules of Civil Procedure instead of under Section 11004-A, he must file a petition for leave to intervene with the trial court. The trial court then, upon the filing of the petition and after a hearing on the merits, has the discretion to either grant or deny the petition.

While the trial court has the discretion to deny a petition to intervene filed pursuant to the Pennsylvania Rules of Civil Procedure, such petitions are generally granted simply because an owner or tenant of property involved in zoning litigation obviously has the requisite interest and status to become an intervener. For example, in *Epting v. Marion Township Zoning Hearing Board*, the Commonwealth Court found that the trial court did not abuse its discretion by allowing intervention in a land use appeal four months after the appeal was filed. In *Epting,* the Commonwealth Court concluded that the petition to intervene was filed two months before the scheduled hearing date and the delay did not prejudice the appeal.

Similarly, the Commonwealth Court in *Grove v. Zoning Hearing Board of Thornbury Township* found that the trial court did not abuse its discretion by allowing the property owner to intervene after the prescribed 30-day period has already elapsed. In *Grove,* the Commonwealth Court stated that the adjoining property owners, who appealed the zoning board’s decision, were not prejudiced by the petition to intervene, which was filed more than 30 days after the appeal was filed but before the case was listed for argument.

Even though Pennsylvania courts readily allow the property owner or tenant to intervene in the land use appeal, he must actually intervene in the appeal under Section 11004-A or pursuant to the Pennsylvania Rules of Civil Procedure. For example, in *Brendel v. Zoning Enforcement Officer of Borough of Ridgway,* the Commonwealth Court reiterated that mere participation in a matter before the trial court does not accord the participant party status and, thus, standing to appeal. In *Brendel,* the court found that the Borough of Ridgway lacked standing to appeal the decision of the trial court even though the Borough of Ridgway submitted briefs and presented testimony at trial. The court noted that the Borough did not file notice of intervention or indicate to the trial court that it was attempting to intervene pursuant to the Pennsylvania Rules of Civil Procedure.

LESSON LEARNED FROM *NAHAS*

Property owners should take solace from the Commonwealth's Court decision in *Nahas* because it merely reacquainted them with well-established precedent. As a result, they have no choice but to remain actively involved at the trial court level, even if they have received zoning approval from the zoning board. If they fail to do so and count their chickens before they hatch, they could find themselves being barred from appealing an unfavorable trial court ruling, a virtual death sentence for the development project.

Alan Nochumson

Are Commercial Real Estate Landlords Warranted In Seeking Confessions From Defaulting Tenants?

With the economy in the tank, commercial retailers are struggling to keep their cash registers ringing. Awash in red ink, some are even failing to make their lease payments. This puts many commercial landlords in the unenviable position of dealing with defaulting tenants. However, Pennsylvania landlords may be envied by their colleagues across the country for one particular ace in the hole that gives them the upper hand in dealing with defaulting tenants: a contractual provision contained in leases commonly known as a warrant of attorney.

Generally, a warrant of attorney allows the landlord to obtain a money judgment or a judgment for possession against the defaulting tenant without giving that tenant the opportunity to object prior to the entry of judgment. This contractual provision is thus a quicker, easier and less costly way of obtaining judgment against the defaulting tenant than pursing claims through full-blown litigation.

On its face, it would seem that the whole process of obtaining judgments by confession would violate the tenant’s due process rights. In the landmark case of *D.H. Overmyer Co. v. Frick Co.*, the U.S. Supreme Court held that such provisions are not per se unconstitutional.

Pennsylvania courts have consistently concluded that the entry of judgment does not violate a debtor’s due process rights so long as there are procedural safeguards protecting the debtor from a potentially overreaching creditor. These procedural safeguards are set forth in the Pennsylvania Rules of Civil Procedure. Pa. R.C.P. 2950 *et seq*.

THE WARRANT OF ATTORNEY

Because the tenant’s due process rights are significantly affected by this powerful contractual provision, courts strictly construe the language of the warrant and the landlord’s obligations under the lease. Generally, most warrants require the landlord, as a condition precedent to obtaining judgment, to provide written notice to the tenant of any default committed by the tenant under the lease. The landlord should provide sufficient detail in the notice so that the tenant can understand and cure the default. As a precautionary matter, the landlord should also follow the notice requirements of the Landlord and Tenant Act of 1951, 68 P.S. Section 250.101 *et seq*. By satisfying all of the contractual and statutory requirements, the landlord eliminates certain technical defenses the tenant could raise in attacking the validity of the judgment.

Most warrants also contain language allowing the landlord to collect an attorney’s commission from the tenant. Courts are unwilling to award an attorney’s commission unless it can be clearly derived from the warrant itself. For example, a landlord may not recover “reasonable” attorneys fees. Instead, a recoverable commission would be of a specific amount (i.e., $1,000) or of a specific percentage of the amount of money sought under the lease (i.e., 10 percent). The landlord, however, does not have carte blanche to collect an “unreasonable” amount of attorneys fees.

The Pennsylvania rules of Civil Procedure set forth the requirements in filing a complaint in confession of judgment for money. The complaint must contain the following allegations:

1. The name and last known addresses of the tenant;

2. An averment that judgment is not being entered by confession against a natural person in connection with a consumer credit transaction;
3. A statement of any assignment of the lease;
4. Either that judgment has not been on the lease in any jurisdiction or, if it has been entered, an identification of the proceeding;
5. If the judgment may be entered only after a default or the occurrence of a condition precedent, an averment of the default or of the occurrence of the condition precedent;
6. An itemized computation of the amount due, based on matters outside the lease, if necessary, which may include interest and attorney fees authorized by the lease;
7. A demand for judgment authorized by the warrant; and
8. If the lease is more than 20 years old, an application for a court order granting leave to enter judgment after notice.

Additionally, the landlord must file the following documents along with the complaint:

1. A copy of the lease showing the tenant’s signature;
2. An affidavit that the judgment is not being entered by confession against a natural person in connection with a consumer credit transaction;
3. A certificate of residence of the tenant and of the landlord;
4. An affidavit certifying that the yearly income of the tenant is in excess of $10,000 a year;
5. An averment of default;
6. An affidavit verifying the facts of the complaint;
7. An affidavit that the transaction upon which judgment is being entered is a business transaction;
8. An affidavit that the tenant is not in the military service of the United States, nor in any state or

territory thereof, or its allies as defined in the Soldiers’ and Sailors’ Civil Relief Act of 1940 and amendments thereto;
9. An affidavit that the transaction upon which judgment is being entered does not arise from a retail installment sale, contract or account; and
10. A praecipe for confession of judgment in the same form prescribed by the Pennsylvania Rules of Civil Procedure.

To obtain a judgment in confession for possession, the landlord must file a complaint in substantially the same form as prescribed by the Pennsylvania Rules of Civil Procedure concerning confession of judgments for money. The complaint must also contain:

1. An averment that the judgment is not being entered against a natural person in connection with a residential lease;
2. A description of the property; and
3. A demand for judgment in ejectment.

A warrant of attorney may authorize the landlord to obtain a money judgment and a judgment for possession concurrently, but the landlord is prohibited from obtaining a money judgment for the accelerated amount due under the lease and a judgment for possession. If the landlord was otherwise allowed to do so, the landlord would be receiving a windfall by collecting the accelerated amount due under the entire lease term and, at the same time, leasing the premises to another tenant and collect rents from that tenant as well.

ENTRY AND EXECUTION OF THE JUDGMENT

Upon filing the complaint, the prothonotary enters judgment in conformity with the praecipe for confession of judgment submitted by the landlord. After entry of judgment, the landlord is obligated to provide the tenant with written notice of the judgment. The notice requirements differ for the landlord depending on the time in which the landlord attempts to execute upon the judgment. If the landlord decides to immediately attempt to execute upon the judgment, it must personally serve the tenant with the following documents:

1. Written notice that judgment had been entered against the tenant in a form prescribed by the Pennsylvania Rules of Civil Procedure; and
2. A petition to strike the judgment and request for prompt hearing in a form prescribed by the Pennsylvania Rules of Civil Procedure.

This notice must be served along with the writ of execution. The tenant then may file with the sheriff a petition to strike the judgment. The petition is limited to whether the tenant voluntarily, intelligently and knowingly waived its right to notice and a hearing prior to the entry of judgment.

If the tenant files the petition, a court must hear the petition within three business days. At the hearing, the landlord has the burden of proving by a preponderance of the evidence that the tenant voluntarily, intelligently and knowingly waived its right to notice and a hearing prior to the entry of judgment. If the landlord fails to make this showing, the court must enter an order vacating the writ of execution and striking the judgment.

Clearly, there is an inherent risk in deciding to immediately attempt to execute upon the judgment. This risk, however may be outweighed if, for example, the landlord believes that the tenant intends to file for bankruptcy. If the landlord does not regain possession of the leased premises prior to the bankruptcy filing, the landlord’s ability to remove the tenant from the premises may be significantly diminished.

Most landlords choose the other method of executing upon the judgment; the risk of judgment being stricken is less likely to occur because the tenant, not the landlord, carries the burden to strike, or in this case, open the judgment. Under this option, the landlord must serve the tenant with written notice in a form prescribed by the Pennsylvania Rules of Civil Procedure at least 30 days prior to the filing of the praecipe for a writ of execution.

The caveat, under this option, however, is that the landlord is prohibited from commencing execution proceedings against the tenant for a minimum of 30 days. The tenant then has 30 days after service of the notice to file a petition to open or strike confessed judgment. A petition not timely filed will likely be denied.

A petition to strike and a petition to open judgment are the two forms of relief available to the tenant. Clearly, the easiest way of preventing a judgment from being open or stricken is to follow terms of the warrant and the lease. If the landlord dots all of its “i’s” and crosses all of its “t’s”, it should have no trouble withstanding any attempt by the tenant to affect the landlord’s ability to execute upon the judgment.

In order to strike the judgment, the tenant must show a fatal defect or irregularity appearing on the face of the record. Courts generally strike a judgment if the judgment was not entered in accordance with the warrant, judgment was entered for items that were not permitted under the lease, the warrant is not in writing, or the warrant is not signed directly by the tenant. The last two bases for striking the judgment are predicted upon due process principles. If there is no proof that the tenant signed the warrant or if none exists, the landlord clearly should not be able to obtain judgment pursuant to this potentially oppressive and powerful tool.

In order to open the judgment, the tenant must present sufficient evidence supporting a meritorious defense to require submission of the issue to a jury. In making this determination, courts employ the same standard as that of a directed verdict and examine the evidence in the light most favorable to the tenant. Courts routinely open judgments based upon contract principles (i.e., breach of contract, misrepresentation and fraud).

If the tenant establishes prima facie grounds for relief, the court issues a rule to show cause. If the rule is issued, the landlord must answer the petition to open or strike judgment. In addition to issuing the rule, the court may allow the parties to conduct discovery and present testimony and other evidence in support of either the petition or answer.

The landlord does not waive any of its substantive rights even if the judgment is ultimately opened or stricken by the court. Of course, this is hardly a consolation prize for a landlord who now must embark on the long and grueling road of full blown litigation while the tenant remains on the leased premises for years until the case is ultimately decided.

Alan Nochumson

American Dream Or Procedural Nightmare: HUD Proposes Homebuyer Bill Of Rights

Designed To Empower Purchasers

While owning a home is the “American dream,” the process of purchasing one can become a nightmare. In a sympathetic response to the expense and hassle increasingly experienced by homebuyers, the Department of Housing and Urban Development (HUD) recently published proposed rules that would amount to a Homebuyer Bill of Rights.

The Bill of Rights would reform the regulatory requirements under the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. Section 2601, by supplying homebuyers with greater and more timely information in the nature and costs of the settlement process and with protection from unnecessarily high settlement charges that have developed over the years in the residential real estate industry.

EMERGE MORTGAGE BROKERS

At the time RESPA was enacted, single-family mortgages were mainly originated and held by commercial banks, savings and loan institutions and mortgage bankers. In the 1980s, however, mortgage brokers, with the rise of secondary mortgage market financing, began competing with these traditional loan originators. Typically, mortgage brokers render retail lending services, including counseling borrowers on loan options, collecting application materials, ordering required reports and assembling information required to consummate the home purchase. As such, mortgage brokers are generally viewed by borrowers as shopping on their behalf. This impression frequently deters borrowers from doing their own shopping for a loan originator and for other required settlement services that best meets their needs.

Mortgage brokers are paid for their services either directly by the borrower, indirectly by the lender or wholesale lender who purchases the loan or by a combination of both. Over the past decade, there has been litigation concerning the legality of indirect fees to mortgage brokers. Most courts have followed the HUD's finding that the legality of these fees turn on whether the total compensation to the mortgage broker is reasonably related to the total value of the services actually provided to the borrower.

DISCLOSURE REQUIREMENTS

HUD has not revised the current disclosure requirements under RESPA in decades. The backbone of the disclosure are the Good Faith Estimate (GFE) and HUD-1/1A forms. The current GFE contains a list of approximately 20 common settlement charges that the borrower is likely to incur at settlement and provides a place for the amount or range of each charge. The HUD-1/1A discloses these charges in major categories at settlement.

Current rules require the loan originator to provide the GFE to the borrower shortly after the borrower applies for the loan. In practice, loan originators frequently direct the borrower to fully complete the loan application and pay a significant fee covering the cost of a property appraisal and credit check before the borrower receives the GFE. In most cases, by the time the borrower receives the GFE, he or she has already selected that loan originator, paid the fee, and feels invested – making it highly unlikely he or she will choose another loan originator or other third-party settlement service providers.

To make matters worse, when the borrower receives the GFE after applying for the loan, the estimated settlement cost information is often unreliable and usually proves to be lower than originally estimated. By requiring a long listing on the GFE of each estimated settlement charge, the current rules not only fail to adequately highlight the major costs incurred at settlement, but also lead to a proliferation of charges without any actual increase in the work performed. For example, the current rules encourage loan originators to charge for several separate services-loan origination, document review and document preparation. It is sometimes difficult for the borrower to understand the explicit purpose for each of the services provided by the same loan originator. The same holds true for title and other third-party settlement service providers. As a result, it is common for these service providers to increase profits by charging “junk” fees for services that have little or no value in relation to the charge.

While the current rules require that a GFE be made in good faith and bear a reasonable relationship to charge the borrower is likely to pay at settlement, they do not establish any bright lines to assure that there is, in fact, a reasonable relationship between these estimates and ultimate costs at settlement. Under the rules, charges on the GFE are to be disclosed as a dollar amount or range. RESPA contains no sanctions for an inaccurate or incomplete GFE, or even for the outright failure to provide a GFE to the borrower.

PROPOSED RULES UNDER RESPA

Disclosing Mortgage Broker’s Role and Associated Fees

The proposed rules fundamentally change the way in which mortgage broker’s services and fees are disclosed and represented. Unlike the current disclosure requirements, which fail to adequately direct the borrower’s attention to the amount that the mortgage broker actually charges, the proposed rules require that any payment the mortgage broker receives from a lending institution be reported on the GFE as a lender payment to the borrower. The proposed disclosure rules also require mortgage brokers to make clear, at the outset, the maximum amount of compensation they could receive from the mortgage transaction, and include that amount in the GFE.

Under these rules, mortgage brokers would thus be unable to increase their compensation without the borrower's knowledge.

The proposed rules clarify the mortgage broker's role. Mortgage brokers would be obligated to advise borrowers that they do not offer loans from all funding sources and cannot guarantee the best terms available in the marketplace. The new GFE would also require mortgage brokers to describe their services and disabuse borrowers of the notion that they are their agent, an impression that can lead borrowers into believing that mortgage brokers are acting in their best interest, and prevent them from shopping for the best deal on settlement services.

Improving HUD's Good Faith Estimate Settlement Cost Disclosure

The proposed rule makes the GFE firmer and more useful for shopping purposes. First, the proposed rules limit the fees that mortgage brokers may charge borrowers at the loan application stage. Under the proposed rules, borrowers need only provide basic credit information and the address of the property to be secured by the mortgage, and mortgage brokers would be prohibited from charging borrowers any significant fee to receive a GFE. The GFE would be conditioned on the borrower's credit approval following the final underwriting and appraisal of the property. The fees paid by borrowers for the GFE would be for the cost of generating the GFE itself and would exclude amounts used to defray the cost of subsequent settlement services. This provision would encourage shopping and lessen the likelihood that fees for the GFE are unearned. Second, the new GFE would group and consolidate all fees and charges into major settlement cost categories. This approach would discourage loan originators and other settlement service providers from conjuring up a long list of junk fees merely to increase profits. Third, the revised GFE would aid in shopping after the application stage by requiring loan originators to distinguish those third party settlement services that have been selected by the loan originator and are required and those that the borrower may shop independently. The proposed rule would allow borrowers to shop for these services even after the borrower has selected the loan originator. Fourth, the proposed rules would allow loan originators to offer package arrangements with third party settlement service providers. This proposal would lower prices from borrowers to close the mortgage transaction. Fifth, the proposed rule would require loan originators not to exceed the amounts reported in the GFE by more than 10 percent, absent unforeseeable and extraordinary circumstances, for their total compensation, third party settlement services and government charges through settlement. The inclusion of these tolerances ensures that borrowers can either find prices within the estimates in the marketplace or come back to the loan originator for help identifying service providers who will accept those estimates, thus injecting discipline into these estimates while providing a margin for unforeseeable and extraordinary market fluctuations.

REGULATORY BARRIERS

The proposed rules would also remove regulatory barriers to making available to borrowers packages of settlement services and mortgage loans. Section 8 of RESPA specifically prohibits any payment for the referral of business, kickbacks, splits of fees and unearned fees in connection with mortgage transactions. Settlement service providers are thus prevented from offering these package arrangements and from drawing on their vast knowledge of the marketplace at the expense of borrowers. HUD believes that package arrangements would increase competition between settlement service providers, dramatically lowering the cost of closing mortgage transactions in the future.

To establish these objectives, HUD proposes a carefully defined safe harbor under RESPA for Guaranty Mortgage Package (GMP) transactions. Any entity may qualify for the safe harbor as long as it offers a GMP. The packager must offer the GMP to the borrower after the borrower submits the loan application, but before the borrower pays any fee to the packager. Among other things, the GMP must include: (1) a price for a comprehensive package of loan origination and all other settlement services required by the lender to the close the mortgage; (2) a mortgage loan with an interest rate guarantee; and (3) a written offer to guarantee the price for settlement services and the interest rate of the mortgage loan through settlement. The written offer would describe the package as including all services required by the lender to close the mortgage but would not itemize the specific services to be provided. The packager would, however, be required to inform the borrower of all settlement services which are excluded from the package.

In all, HUD believes that the "homebuyer bill of rights" will require greater disclosure, allow borrowers more choices, limit excessive settlement fees and encourage competition in the marketplace. These reform measures, if enacted, will help keep the American dream from turning into a procedural nightmare.

Alan Nochumson

Judge: Tenants Not Entitled

To Return Of Rent Money

What You Should Know Before Putting An Offer On A Home

Q: What are some things we should know about before submitting a written offer to purchase our first house?

– Stephanie Ann, Yardley

A. As the saying goes, "the devil is in the details." Before submitting an offer, be sure to consider the following:

1. Purchase price.

First, you should find out how much the house was sold for last, as well as the price of similar properties in the neighborhood. By getting this information, you will not only have a good idea as to how much the house is potentially worth, but you will also make sure that this amount is sufficient for the seller to pay his or her own mortgage against the house.

2. Security deposit.

In order to convince the seller to take the property off the market, you must generally agree to pay a security deposit, which will be held in escrow by a third party pending settlement. The more money that a buyer places in escrow prior to settlement, the more that buyer has "invested" in the real estate transaction. Although the security deposit will be held in escrow, most escrow agreements specifically prohibit the escrow agent from releasing the deposit monies to either the seller or buyer without mutual consent.

Another factor in determining the strength of the security deposit is when it is due. In many situations, the security deposit is paid in installments. The first deposit is typically due upon execution of the agreement of sale. The next installment, if any, is due after certain contingencies under the agreement of sale are either met or waived by the buyer. Clearly, the more money placed in escrow at execution of the agreement of sale, the stronger the offer is for the seller.

3. Settlement date.

Any seller wants settlement to occur as quickly as possible in order to reap the financial benefits of the real estate transaction and to lessen the time frame that the transaction can simply fall apart. However, unless this is a cash transaction where you are taking the property in “as-is” condition, you will need at least a month to close on a residential property due to the amount of time it will take to obtain financing to purchase the property and to perform a property inspection.

4. Mortgage financing.

Unless the property is being purchased for cash or being financed by the seller, you will need to get a loan to make the purchase. Most, if not all, buyers will include a provision in the agreement of sale making it contingent upon them obtaining such financing. The clause should include the amount to be financed, the interest rate of the mortgage loan, the type of the loan, a date certain that the buyer must apply for the loan, and a date certain that the buyer must obtain the mortgage commitment from the lender.

During the mortgage application process, your mortgage lender will obtain a monetary appraisal of the house. The agreement of sale should include a provision confirming that the buyer's obligation to purchase the house is contingent upon the house appraising for an amount equal to or in excess of the purchase price.

If you cannot afford the costs associated with a settlement or want to make improvements to the house after settlement, you may also consider including what is called a seller's assist as part of your offer.

Most mortgage lenders will allow you to obtain a "seller's assist" of up to 3 percent of the purchase price. For example, if you obtain a 3 percent seller's assist on a house with a purchase price of $100,000, you will receive $3,000 from the seller at settlement from the net sales proceeds.

5. Property disclosures and inspections.

In Pennsylvania, a seller of a residential property is required to disclose any material defects with the property that the seller knows of by completing a written property disclosure statement to you.

You should carefully review the property disclosure statement to determine if there are any disclosed material defects with the property and, if the offer is accepted, the buyer should provide it to the property inspector.

After the offer is accepted, you should make sure you are given a small window of opportunity to perform a property inspection. During that window of opportunity, buyers typically have the option of accepting the property in "as is" condition, enter into a mutually agreeable written agreement with the seller to either remedy the defects with the property or accept a credit therefor, or terminate the agreement of sale.