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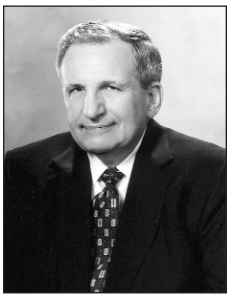
A Message from the Outgoing Section Chair



Melvyn Mitzner

At the inception of my term the outlook for the year was extremely promising. We were prepared to take on many projects. Some of these projects changed as they were affected by the attack of September 11. Immediately after the attack we formed a World Trade Center Committee led by Second Vice Chair (now Vice Chair) Matthew Leeds to interface with the New York State Bar Association (NYSBA) to draw up a Qs and As Web site and further deal with numerous issues—mostly dealing with leases, contracts, real estate taxes, title and possession, as well as insurance and damages to buildings and responsibilities of

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Landlord's Checklist of Silent Lease Issues—Supplement Enclosed

A Message from the Incoming Section Chair

John Privitera

After some dozen years of work on the Executive Committee of this Section, it is more than humbling to assume the role of Chair.

My involvement began when former Chair John E. Blyth of Rochester established the Environmental Law Committee to inform the general membership of this Section of emerging matters regarding environmental liability. John Blyth's vision, leadership and trust allowed me to build a new committee. John also granted me a sound lesson in the value of contributing to the overall professionalism of our Section.

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people who live in cooperative apartments and condominium units near Ground Zero, the former World Trade Center site. The members of Matthew's committee who participated and assisted were Ed Baer, Josh Stein, Karl Holtzschue, John Hall, Harold Lubell, Jeffrey Chancas, Beatrice Lesser and David Berkey.

Gains were made throughout the year in the area of legislation. The Executive Committee consistently worked (and commented) on legislation with the NYSBA staff. Projects worked (and commented) on included the Property Condition Disclosure Act (PCDA). If it weren't for the Real Property Law Section, the original disaster legislation passed by the legislature in 2001 would be the law today. Karl Holtzschue worked with the Governor's counsel, among others, to help make the bill a reasonable piece of legislation, including the $500 "opt out" provision. Other people who assisted Karl were Sam Tilton, Matt Leeds, John Privitera (the incoming Chair), Josh Stein, John Hall and John Blythe. Others, too numerous to name here, also assisted. The Session Law is Chapter 456 of the Laws of 2001.

T. Mary McDonald and her By-Laws Committee rewrote the by-laws and we now have an updated product for the future. On an ongoing basis, the Real Property Law Section's Executive Committee will be able to function sensibly in the future. Other members of the By-Laws Committee who assisted Mary on producing the final product were Lester Bliwise, Bernard Rifkin, Jon Santemma and John Vandernuet.

Robert Hoffman was able to meet and work with members of the NYSBA staff and legislative people from the legislature in working to defeat the Commercial Mechanic's Lien Bill for real estate brokers. He was assisted by his Co-chair, Gary Litke.

Karl Holtzschue helped lead a charge to defeat the proposed sex offender legislation that would require the disclosure, upon the sale or lease of residential real property, of the availability of certain sex offender information. This bill seems ridiculous.

Richard Fries chaired an Ad Hoc Committee on the proposed amendments to section 65 of the CPLR and received comments and advice from Jim Pedowitz, Karl Holtzschue, Steven Baum, Bernard Rifkin, Peter Coffey, Gerald Goldstein and Sam Tilton. A special thanks to this Committee for a job well done.

Michael Berey worked very hard with the NYSBA staff to set up a Web site for the Real Property Law Section, which—as of May 1, 2002—is up and functioning. Thank you, Michael.

Steven Alden wrote a very useful and erudite memorandum on the proposed High-Income Cost Mortgage Loans legislation (S.5005). Richard Fries, Steve Baum, Robert Hoffman, Joshua Stein, Leon Sawyko and Peter Coffey all participated in drafting the position of the Section on this legislation. Steve Baum also wrote a memorandum on the adverse effect this legislation would have on the foreclosure process. The bill is sometimes called the Predatory Lending Bill. It added difficult and varied notices to the default notice process on mortgage foreclosures on one- to four-family homes. Steve Alden's memo approved the need for corrective legislation, but commented that this proposed legislation needed substantial improvement. He commented on three areas of the bill: 1) high costs of home loans; 2) provisions concerning home improvement contractors; and 3) provisions, as Steve Baum pointed out, on specific notices to the mortgagor. I will not comment further on this bill, as we would need many pages to do so. Our recommendations have been forwarded to the legislature.

The Committee also commented on a proposed amendment to Real Property Law § 443 with regard to the relationship disclosure form that real estate brokers would be required to fill out when being retained by a seller or lessor of real property. Bob Hoffman and Gary Litke commented on the legislation.

The Executive Committee, at the request of Randy Lee, Esq., again looked into the issue of the "unlawful practice of law" by real estate brokers in drafting contracts of sale in one- to four-family home sales. (Previously the Executive Committee, pursuant to a prior request, refused to approve or solicit a change in law.) The reason given at that time was that in the upstate areas real estate brokers have for many years drafted contracts for residential transactions. Karl Holtzschue and Sam Tilton drafted a report, which the Executive Committee approved, that stated that the Real Property Law Section would not change our position. However, this has not changed the position of the Section to work for legislation preventing the unlawful encroachment of other people into the real property practice of law. A special thank-you to John Hall and George Grasser, who have worked arduously in this area.

Another bill we worked on was a new amendment to Real Property Law § 275 (S.6363) which allows for, under certain circumstances, the assignments of mortgage, for refinancing an existing loan. This legislation was commented on by many people. The idea is good. However, Governor Pataki and former Governor Cuomo vetoed former bills that passed the legislature which did the same thing.

We commented to the Secretary of State on a bad position taken by him on the PCDA; he kept to his opinion that the $500 "opt out" provision is a penalty, not a choice.

A subcommittee of the Title and Transfer Committee is working on updating our recommended title practices and they will report back this coming year.

The Section commented on a proposed bill to prevent lawyers from putting mortgages on their client's property to collect fees in a matrimonial case. This bill will probably pass the legislature. We all felt, which was best articulated by Steve Alden, that a chain of title void or avoidable fee mortgages could cause a non-suspecting future lender to have a mortgage whose enforceability would be questionable because of a bad matrimonial mortgage. It was felt that the legislature is trying to deal with a "one case" issue. The Section voted to take no position.

The work of the various Committees has been outstanding and, in particular, that of the Title and Transfer, Commercial Leasing, and Condominium and Cooperative Committees. Other Committees have had active sessions and I thank them all for their help. My congratulations to Joshua Stein, Austin Hoffman, Brad Kaufman, Michael Berey, Leon Sawyko, Karl Holtzschue, Sam Tilton, John Hall, George Grasser, Anne Reynolds Copps, Mindy Stern, Peter Coffey, Janet Sandra Stern, Jill Myers, David Zinberg, Robert Beebe, Jon Santemma, David Berkey, Joseph M. Walsh, Terrence Gilbride, Harold Lubdell, Joel Sachs, John Wilson, Ed Baer, Gerald Goldstein, Brian Essler, Carol Slater, Bob Hoffman, Gary Litke, Jerry Hirschen, Brian Lawlor and Richard Fries. The work of the Committees has been outstanding and the projects are too numerous to list.

I wish to thank the Publications Committee for their outstanding work on the *N.Y. Real Property Law Journal*. They are: Prof. Bob Zinman and his St. John's Law School students, Bill Colavito, Harry Meyer and Joseph De Salvo.

A very, very special thanks for the aid and assistance of my co-officers who helped me immeasurably: John Privitera (our new incoming Chair), Matthew Leeds, Dorothy Ferguson and Joshua Stein.

I learned much from those who went before and with whom I worked with as an officer. My immediate predecessor, Jim Grossman, who gave dignity to the pursuits of the Real Estate Bar. Steven Horowitz, who added quiet expertise and dignity to his chairship. Lorraine Power Tharp, the new NYSBA President, who worked aggressively and professionally for the Real Property Law Section. I wish Lorraine a very successful year as the NYSBA President. We all love her and we are all willing to assist her in any way possible. The last name on this list is that of John Hall, who added wisdom and foresight to his term. I learned much from all of them.

The staff of the NYSBA has been magnificent. I wish to thank those who especially helped me this past year. Special praise goes to Kathy Heider and her highly efficient staff. The twin legislature "mavens," Tom Barletta and Ron Kennedy were absolutely great. My thanks to Terry Brooks, Jean Nelson, Beth Krueger and Barbara Mahan.

I've attempted in the past year to involve as many of the Executive Committee members as possible and I tried to be all-inclusive with all of the members of the Executive Committee. I strongly believe John Privitera will be an outstanding Chair. I wish him a very successful year and I hope he achieves his mission for the Real Property Law Section. Good luck, John. If I can be of any help, please feel free to call on me.

Melvyn Mitzner

A Message from the Incoming Section Chair *(continued from page 97)*

As I assume the daunting task of following along the path of Melvyn Mitzner's skillful leadership, I am confident that we may rely upon the great work of our Committees.

Indeed, one of our finest Committee contributors is our newest officer. As I take the reins, I am privileged to welcome Joshua Stein of Latham and Watkins as our new Secretary. Joshua's productivity is legendary—he co-authored the "Tenants' Checklist of Silent Lease Issues" for our Section with S.H. Spencer Compton in 1999. I keep this tome right near my desk, complete with scribbles and yellow Post-its. I am pleased to add Part II of Compton/Stein, which you will find in this issue, to my desk reference. Thank you, Mel. Welcome, Josh.

John J. Privitera

Property Condition Disclosure Act: Another Interpretation

By Abraham B. Krieger

Much has recently been written about the Property Condition Disclosure Act (PCDA),[1] particularly involving the principle of *caveat emptor*. PCDA has generated significant attention by the bar on the shifting responsibilities of buyers and sellers of residential real property. Prior to this statute, New York's adherence to *caveat emptor* placed the responsibility of due diligence *almost* completely on the buyer. PCDA has since shifted a considerable burden to the seller; requiring completion and delivery of a comprehensive disclosure statement to prospective buyers setting forth the nature and extent of a seller's actual knowledge of the property's condition.[2] This article offers a different interpretation of the statute from that which holds that it contains an "opting out" election to the seller.

PCDA § 462(2) requires the seller of residential property to provide buyers with a disclosure statement containing comprehensive information of the property's condition. Under § 465(1) the buyer is entitled to a $500 closing credit, if a seller *fails* to provide the required statement.[3] Immediately after the statute was enacted, articles were written concluding that an available alternative was for sellers to "opt out" of providing the statement and concede a $500 closing credit to the buyer—thereby absolved of further liability, all on the presumed advice of counsel. This position suggests that by simply paying $500, sellers avoid potentially greater liability in litigation involving information contained in the statement.[4]

I refer the reader to the statute, the Senate and Assembly Memoranda in Support and the Governor's Bill Jacket[5] to independently determine what the statute says and, as significantly, what it doesn't say. I suggest that electing to "opt out" is *up in the air* at best, or misapplied at worst. Neither the legislative memoranda nor the statute itself addresses an opt out *choice*. To the contrary, the seller is affirmatively and expressly obligated to complete the disclosure statement and *failure* to do so entitles the purchaser to the equivalent of (in the author's opinion) a *private fine* for violating the statute.

The Senate Memorandum in support of the legislation states that:

Property Condition Disclosure Act: Implications of the $500 Credit

By Karl B. Holtzschue

The Property Condition Disclosure Act (PCDA) added a new article 14 to the Real Property Law (RPL §§ 460-467), which requires that a Property Condition Disclosure Statement (PCDS) be delivered by the seller to the buyer of residential real property prior to the signing by the buyer of a binding contract of sale.[1]

The PCDA provides for two remedies: (1) a seller who fails to deliver a PCDS on time must give a $500 credit against the purchase price to the buyer at the transfer of title; and (2) a seller who provides a PCDS is liable for actual damages only for a willful failure to perform as required by the PCDA (that is, to provide a PCDS that is true and complete).[2] These remedies are carefully worded. Note that the damages remedy expressly applies to a seller who *provides* a PCDS, not one who fails to do so. Consequently, the only statutory remedy for failure to deliver the PCDS on time is the $500 credit.

Legislative History

The $500 credit remedy was added at a late stage in the legislative process. A credit of $750 was first added in a redraft of the January 16, 2001 bill by the New York State Association of Realtors (NYSAR) in response to Governor Pataki's December 2000 veto of A.1173 of 2000.[3] Prior to that, no statutory remedy was provided in the 1999-2001 bills for failure to deliver a PCDS.[4] The objections filed by the Real Property Law Section of the New York State Bar Association included that there was no penalty for failure to deliver a PCDS.[5] The Governor's veto message repeated this objection, noting:

> Accordingly, prudent and well-counseled sellers, especially given the potentially enormous consequences stemming from completion of a PCDS, might well determine that the sounder course is to refuse to complete a PCDS.

Presumably, the proposal of the $750 credit by NYSAR on behalf of the sponsors was intended to meet the objection of lack of a statutory remedy for failure to deliver. In negotiations between the sponsors and the Governor's Counsel, the amount of the credit was reduced to $500.[6] NYSAR and the sponsors were aware at the time that Connecticut requires a credit of $300[7]

> This Act changes common law by statutorily requiring the seller to give answers to the buyer to questions asked in a property condition disclosure statement or pay a credit to the buyer on transfer of title. *The seller would remain liable under case law for fraudulent misrepresentations* (emphasis added).[6]

The statute's preamble states, "[T]his act is not intended to and does not limit existing responsibilities by a seller, buyer or agent concerning the condition of the property or potential liabilities or remedies at law, statute or in equity."[7]

> The language used throughout the statute states:
>
> [T]he Property Condition Disclosure Act *requires* (emphasis added) the seller of residential real property to cause this disclosure statement or a copy thereof to be delivered to a buyer or buyer's agent prior to the signing by the buyer of a binding contract of sale.[8]
>
> Furthermore:
>
> In the event a seller *fails to perform the duty prescribed in this article* (emphasis added) to deliver a disclosure statement prior to the signing by the buyer of a binding contract of sale, the buyer shall receive upon the transfer of title a credit of $500.00 against the agreed upon purchase price of the residential real property.[9]

This language *requires* completion of the disclosure statement and refers to the $500 closing credit as deriving from the seller's *failure* to provide disclosure. The $500 is never referred to directly or indirectly as a form of liquidated damages or election of remedies.

This interpretation of the rights and the responsibilities of the parties is in harmony with the express legislative intent to provide for complete and honest disclosure.[10] Full disclosure aids the parties in determining a fair price, facilitates the orderly transfer of residential real property, helps guarantee a successful closing process in which both parties are satisfied and cuts down on possible long term transaction costs, namely future litigation over alleged misrepresentation of property conditions or defects.[11]

The statute states that "[t]his Act is not intended to and does not limit existing responsibilities by a seller, buyer or agent concerning the condition of the property or potential liabilities or remedies at law, statute or in equity."[12] Section 467 states that "[n]othing contained in this article shall be construed as limiting an existing

and that it was being treated as a "buy-out" option by many sellers in Connecticut and that the Executive Committee of the New York State Bar Association had approved a version of the bill with a right of the seller to "opt out" of providing a PCDS without any credit to the purchaser.[8]

Implications

The clear understanding of the sponsors and the Governor's Counsel when the compromise bill was agreed to was that a seller could opt not to deliver a PCDS and that the seller then had to give the buyer the $500 credit at the closing. Giving a $500 credit is not a violation of the statute, but rather conformance with the remedy it provides. The Governor's veto message makes clear that attorneys for sellers "might well" advise their clients not to deliver the PCDS, describing such a seller as "well-counseled." The logical conclusion is that a seller's attorney should not be subject to any criticism for giving such advice. To the contrary, a seller's attorney has a duty to advise the client as to the risks of delivering a PCDS and the possible advantages of accepting the statutory penalty for non-delivery. The seller's attorney should also advise its client as to its potential liabilities under prior *caveat emptor* case law (e.g., for active concealment, partial disclosure and fraudulent misrepresentation).[9]

At several lectures I have given to explain the PCDA, attorneys present have frequently expressed the view that they would be inclined to advise their clients to pay the $500 and decline to deliver a PCDS, at least in larger transactions, in order to avoid the consequences of delivery. Among other things, many of the questions are ambiguous and use vague undefined terms such as "material defect," the environmental questions give only a partial list of petroleum products and hazardous and toxic substances, and delivery of a PCDS then imposes a duty to deliver a revised PCDS if the seller acquires knowledge which renders materially inaccurate a PCDS provided previously. Moreover, giving the buyer a $500 credit helps fund the property inspections by the buyer that the PCDA so strongly recommends.

Dealing with the PCDA: No PCDS Delivered

If the seller opts not to deliver a PCDS, the attorneys for both parties should consider the consequences. The seller's attorney may want to add a rider to the contract of sale: (1) making clear that the seller has declined to deliver a PCDS and that the buyer has agreed to accept the $500 credit; (2) expanding the acknowledgment by the buyer in the standard "as is" clause of its duties to inspect and check public records described in the PCDA. The purchaser's attorney should give a copy of an

legal cause of action or remedy at law, statute or in equity."[13]

The statute does not condone an attorney advising a client not to complete or deliver the statement and, as a consequence of such omission, merely suffer the limited consequence of the buyer's $500 closing credit. It expressly states that the common law action for fraudulent misrepresentation remains intact unaffected by the statute. Accordingly, the 1892 decision of the Court of Appeals in *Schumacher v. Mather*, which remains the law today, holds that "[R]epresentations of a vendor as to extrinsic facts affecting the quality or value of the thing sold, which are peculiarly within his knowledge, may be relied upon by the purchaser, and if the representations are false and he is misled thereby to his injury, he may maintain an action for damages."[14] It follows that the responsibility of the seller cannot simply be skirted by paying an (inconsequential) fine of $500. To conclude otherwise negates the legislative purpose and scheme of PCDA.

The statute clearly requires disclosure to the buyer at a level greater than existed previously. It does not purport to expand the seller's responsibility so long as the disclosure is forthcoming and accurate.[15] In fact, the statute expressly encourages the accepted practice of advising buyers to perform independent and thorough inspections of the property.[16]

Pending further clarification, it is our *responsibility* to advise sellers that the disclosure statement must be completed to the best of the seller's ability and knowledge and provided to buyers before signing a contract. Failing such disclosure and delivery, a seller who intentionally *fails* to provide the disclosure statement (presumably on advice of counsel) is in a far worse position coming into court on a post-closing litigation, having also violated the statute whose very stated purpose is pro-consumer and pro-disclosure.

The added danger of advising a seller to "opt-out" of PCDA may result in not only a possible breach or violation of the statute by the seller, but professional liability to the attorney who so counseled the client. Beware "the emperor's new clothes!"

Endnotes

1. N.Y. Real Property Law §§ 460-467.
2. *See id.* § 462(2).
3. *See id.* § 465(1).
4. RPL § 465(2): "Any seller who provides a property condition disclosure statement or provides or fails to provide a revised property condition disclosure statement shall be liable only for

uncompleted PCDS form to the buyer for its information as to the buyer's duties and the buyer's guidance in investigating the property. The buyer may want to provide the form to its home and pest inspectors and ask what questions will not be covered by the inspections. As to questions not covered, the buyer may want to ask the seller and/or add representations to the contract (which should survive the closing if they cannot be checked out before the closing).

Dealing with the PCDA: PCDS Delivered

If the seller does deliver a PCDS, the seller's attorney may want to add a rider acknowledging that the PCDS was delivered before the buyer signed the contract of sale. The seller's attorney should remind the seller about its duty to deliver a revised PCDS. The buyer's attorney may want to add a rider requiring the seller to cure defects revealed in a revised PCDS (the seller will want to be able to refuse to spend over an agreed amount, in which case the buyer can either accept the amount or cancel). The buyer's attorney should remind the seller's attorney about the duty to provide a revised PCDS and to provide the $500 credit at the closing. If the PCDS discloses any defects in title, it should be provided to the buyer's title insurance company (to prevent a claim of a failure to disclose facts known to the insured).

Conclusion

I strongly disagree with the implication in the article in this issue by Abraham Kreiger that the seller does not have a right to buy out of the PCDA for $500[10] and that the seller's attorney has a responsibility to advise the seller that the PCDS must be delivered. To the contrary, I agree with the Governor that a seller's attorney has a responsibility to advise its client of the risks of the PCDA and PCDS and that such a client would be "well-counseled." Advising a seller of the possibility that accepting the $500 credit as an alternative was contemplated and assumed by the Governor and the sponsors. The legislative history and background make this clear.[11] Attorneys should act accordingly.

Endnotes

1. *See generally*, Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 (Winter 2002).
2. RPL § 465 (1) and (2).
3. NYSAR was apparently providing logistical support for the sponsors of the bill, Assemb. Brodsky and Sen. Libous.
4. *See e.g.*, A.1762 of 2001, January 16, 2001. A 1993 version of the bill, S.4631-A, provided for actual damages for failure to deliver. *See* Appendix II to Holtzschue, "Caveat Emptor *Ain't What It Used to Be: New Developments, Trends and Practice Tips*", 25 N.Y. Real Prop. L.J. 3 (Winter 1997).
5. RPS Legislation Report No. 119, May 30, 2000. To many of us, failure to include a remedy for failure to deliver a PCDS made a

willful failure to perform the requirements of this article. For such willful failure, the seller shall be liable for the actual damages suffered by the buyer in addition to any other existing equitable or statutory remedy."

5. All available through the Internet or legislative office.
6. Sen. Thomas W. Libous, N.Y. State Senate Introducer's Memorandum In Support of S.5339-A, 2001.
7. *Id.*
8. RPL § 462(2).
9. *Id.*
10. Sen. Thomas W. Libous, N.Y. State Senate Introducer's Memorandum In Support of S.5339-A, 2001.
11. *Id.*
12. 2001 N.Y. Laws 5339-A. Preamble.
13. RPL § 467.
14. *Schumaker v. Mather*, 133 N.Y. 590, 30 N.E. 755 (1892).
15. 2001 N.Y. Laws 5339-A. Preamble.
16. Sen. Thomas W. Libous, N.Y. State Senate Introducer's Memorandum In Support of S.5339-A, 2001.

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The author thanks Craig Handler, our law clerk, for his valuable assistance in the preparation of this article.

mockery of the statute. To our astonishment, representatives of NYSAR actually argued prior to the veto that the RPS should not object to the bill because there was no penalty for failure to deliver a PCDS.

6. Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 at 18 (Winter 2002).
7. Conn. Gen. Stat. Ann. § 20-327c.
8. Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 at 16-17 (Winter 2002).
9. *See* Holtzschue, *Property Condition Disclosure Act Enacted*, 30 N.Y. Real Prop. L.J. 15 at 17 (Winter 2002); Holtzschue, "Caveat Emptor *Ain't What It Used to Be: New Developments, Trends and Practice Tips"*, 25 N.Y. Real Prop. L.J. 3 (Winter 1997). Mr. Krieger's reference in the accompanying article in this issue to *Schumacher v. Mather*, 133 N.Y. 590, 30 N.E. 755 (1892) is misplaced. *Schumacher* is frequently cited for the proposition that the buyer must use means available to detect the falsity of a statement made by the seller. It is almost never cited for the proposition that the seller has a duty to disclose facts peculiarly within its knowledge. *See* Holtzschue, *"Caveat Emptor"* in Warren's Weed, New York Real Property (2001). The case has no bearing on how to interpret the PCDA.
10. Mr. Krieger seems to base his conclusion on a review of the statute and the Senate and Assembly Memoranda In Support, where he admittedly does not find an express statement that the seller has an option not to deliver a PCDS. He does not refer to the Governor's veto message. Such a plain language approach is not sufficient, given the legislative history and background herein repeated and discussed and in which I participated.
11. There are, of course, no guarantees as to how courts will finally interpret the PCDA.

Karl B. Holtzschue is an attorney in New York City, a member of the Executive Committee of the Real Property Law Section of the New York State Bar Association, an Adjunct Professor at Fordham Law School, an author of books on real estate and a frequent lecturer.

Abusive Bankruptcy Filings in Foreclosures and Their Effects on Common Charge Liens: A Discussion and Proposal

By Richard M. Lombino

Introduction

The members of the board of managers (the "Board") of Lazy Lake Condominium (the "Condominium") located in Debtorville, New York are livid.[1] It seems that John Jones, the owner of unit 3A (the "Unit") in the Condominium, has filed for bankruptcy again. This is the third time Mr. Jones has filed.

Mr. Jones has not paid common charges[2] in over two years. His total arrears, together with late charges and legal fees, exceed $15,000. There is a first mortgage on the Unit in the original principal amount of $250,000 held by First Bank of Debtorville ("First Bank"). Mr. Jones also defaulted on his mortgage. As of today, his total arrears plus accrued interest[3] owed to First Bank total over $300,000. First Bank instituted a foreclosure action two years ago. The Board had filed a notice of lien on the Unit, and is second in priority to First Bank.

The Board was named and appeared in the foreclosure action. After nine months, a judgment of foreclosure was entered against Mr. Jones. A foreclosure sale was scheduled, and notice of the sale was given. The day before the sale, Mr. Jones filed for bankruptcy. The automatic stay applied, and the foreclosure sale was halted. This is the third time the sale has been stayed.

In the first two instances, Mr. Jones did not proceed with the bankruptcy case. After several months, the case was dismissed, and the stay was lifted. Unfortunately for the Board, the case was not "dismissed with prejudice," thus not barring his re-filing of another bankruptcy case for 180 days. Mr. Jones was free to file again at any time. To frustrate the Board even further, First Bank was not prompt in continuing the foreclosure in either instance. Once it did continue the action, it had to again schedule the sale and provide proper notice.

The result of these delays is that the Board has not collected thousands of dollars in common charges, and has incurred thousands of dollars in legal fees. There are also many other non-monetary results of these proceedings. The morale at the Condominium is at an all-time low. The annual meeting of unit owners was hostile. Unit owners are calling the managing agent daily to complain about Mr. Jones.[4] The members of the Board are constantly arguing at meetings about Mr. Jones. It appears there is no end in sight to this dilemma.

Condominium boards and unit owners are virtually powerless against them: abusive debtors. On the eve of a foreclosure sale, a debtor can file for bankruptcy and avoid losing his or her unit, sometimes for years at a time. The debtor can also file for bankruptcy protection numerous times, even after prior bankruptcies are dismissed.

This article will discuss the major problems and issues condominium boards and unit owners face in foreclosure actions that are stayed by bankruptcy filings, and will propose a statutory solution.

I. Discussion of the Problems

Along with the eternal truths of death and taxes, there is another unfortunate truth: there will always be debtors who abuse the bankruptcy system. The Bankruptcy Code[5] (the "Code") was created and designed to protect the debtor, and to enable the debtor to obtain relief from his or her mountain of debt. The main goals are to protect the "honest, but unfortunate debtor,"[6] to give the debtor a "fresh start,"[7] and to maximize the return to creditors.[8]

Unfortunately, there are crafty debtors owning condominium units who abuse and take advantage of the protections provided in the Code.[9] Through various maneuvers and tactics,[10] including serial filings[11] and transfers of fractional interests of the unit to family members or others who then file for bankruptcy,[12] a debtor can delay a foreclosure sale for years. During these delays, the debtor may not be making mortgage payments, or paying common charges. The debtor is living virtually expense free while continuing to accrue arrears, which may never be paid.

There are also unsophisticated debtors who inadvertently abuse the Code. These debtors are enticed by "mortgage consultants"[13] who promise the eradication of debt and saving of the home. Mortgage consultants may assist the debtor in multiple filings for bankruptcy protection to ward off the foreclosure, while collecting monthly fees from the debtor. These fees, sometimes totaling hundreds of dollars a month, could have instead been applied in a chapter 13 plan[14] to the arrears. Instead, these debtors are often left with larger debt, a damaged or destroyed credit history, and no home.

There are various other permutations of abuse devised by debtors and mortgage consultants, such as leasing the condominium unit and collecting rent from the tenants while continuing to fail to pay common charges, and filing for bankruptcy without any intention to proceed with the case.[15]

All of these actions damage the integrity of the bankruptcy system.

They affect the public's perception of the Code, and of our legislators' and courts' abilities to handle an abusive debtor. The board of managers of a condominium also appears to be helpless against these debtors, with the other unit owners left to bear the burden of the debt.[16]

II. The Power of the Automatic Stay

When a debtor files for bankruptcy, the automatic stay (the "Stay") is invoked pursuant to section 362[17] of the Code. The Stay freezes all property (real and personal) of the debtor.[18] Absent a party obtaining relief from the Stay, these assets cannot be further encumbered by creditors.[19] What makes the Stay so powerful is not only what it can do, but that it is *automatically* invoked when a debtor files.[20]

If real property is the subject of a foreclosure action and a foreclosure sale is scheduled, the Stay will halt the sale. Absent relief from the Stay, the plaintiff will be precluded from obtaining proceeds from the sale or title to the real property.

The Code, along with most state laws, has exemptions that protect a debtor's homestead in the event the debtor files for bankruptcy. Some state statutes have very large or unlimited exemption amounts, thereunder allowing a debtor to file for bankruptcy, halt a foreclosure sale, walk away from substantial unsecured debt (which will be discharged), and yet keep the homestead.

As part of the Code, the Stay was intended to protect the debtor from losing all assets by providing the debtor with much-needed time to reorganize. Unfortunately, many debtors and mortgage consultants abuse this powerful tool under the Code, and massive delays and monetary losses result from these abuses.[21]

III. Lien Priority

A condominium board has a statutory lien on the unit owner's condominium unit *as of right* for unpaid common charges.[22] Assuming there is no bankruptcy proceeding, a board can foreclose on this lien in the event arrears accrue and the lien is perfected by filing a notice of lien.[23]

A condominium board's statutory lien that is perfected after a mortgage is recorded is second in priority to the lien of the first mortgagee.[24] Therefore, any proceeds obtained in a foreclosure sale are paid to the first mortgagee, and then the excess, if any, is paid to the board to be applied against arrearages, with the remainder paid to other creditors and the debtor. When there are not enough funds to pay off the first mortgagee, or the first mortgagee makes the only bid at the sale (usually only in the amount of the outstanding debt), there is no surplus. In either situation, as discussed below, the Court of Appeals of the state of New York has held that a board's lien is wiped out. Thus, the board does not receive any proceeds from the sale.

In 1993, the Court of Appeals of the state of New York addressed these issues in *Bankers Trust Company v. Board of Managers of the Park 900 Condominium*[25] ("*Bankers Trust*"). In *Bankers Trust*, the first mortgagee had commenced an action to foreclose its mortgage on two condominium units.[26] The board of managers had a statutory lien[27] for unpaid common charges totaling over $50,000 resulting from the failure of the unit owners to pay common charges for over one and one-half years.[28] The board argued that a first mortgage foreclosure does not extinguish its lien for unpaid common charges.[29] Thus, after the sale, the new purchaser at the sale would be responsible for any prior unpaid common charges.[30] The trial court disagreed and granted summary judgment in favor of the first mortgagee. The Appellate Division, First Department affirmed the decision.[31]

On appeal to the Court of Appeals, the issue before the Court was whether section 339-z of the Real Property Law of New York "provides for the survival of the statutory lien for common charges in the face of a first mortgage foreclosure and the payment of the sums due pursuant to that lien out of any proceeds of the foreclosure sale or from the purchaser (grantee) at the foreclosure sale."[32]

Section 339-z provides, *inter alia*, that upon the "sale or conveyance" of a condominium unit, any unpaid common charges shall be paid out of proceeds of the sale.[33] The board argued that a first mortgage foreclosure sale is a "sale or conveyance," and that its lien for unpaid common charges should be paid for out of proceeds of the foreclosure sale or by the subsequent grantee.[34]

The Court of Appeals affirmed the decision of the lower courts and rejected the defendant's assertion that the "sale or conveyance" language would apply to a foreclosure sale.[35] The Court reasoned that the board's argument "is not supported by the plain language and meaning of the statute. The statute specifically establishes a lien for the common charges in favor of the Board of Managers but grants priority to liens for 'all sums unpaid on a first mortgage of record.'"[36] The Court stated that pursuant to section 1353(3)[37] of the Real Property Actions and Proceedings Law of New York, a first mortgage foreclosure sale extinguishes all other liens, except to the extent of any surplus in the sale.[38] The Court further noted "it is clear that the Legislature intended to subordinate liens for unpaid common charges to a first mortgage and it would be inconsistent with that intent to treat a first mortgage foreclosure as a 'sale or conveyance' within the meaning of section 339-z."[39]

IV. Present Remedies

Historically, courts were divided concerning whether or not common charges that accrue *after* the bankruptcy filing are dischargeable.[40] In an attempt to resolve this conflict among courts, Congress added sub-

section (16) to section 523(a) of the Code, which provides that a "fee or assessment" that becomes due and payable *after* a unit owner files for bankruptcy will not be discharged so long as such fee or assessment is payable for a period which the unit owner occupied the unit or the unit owner rented the unit and received rent payments.[41] Common charges that accrue *prior* to the bankruptcy filing remain dischargeable.

There are various other remedies presently available to assist all creditors.[42] Section 105(a)[43] of the Code provides *broad* equitable powers to a bankruptcy court.[44] It provides, *inter alia*, that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of . . ." the Code.[45] In the case of the abusive debtor, this provision has been helpful.[46]

Section 109(g)[47] of the Code enables the court under certain circumstances to dismiss a bankruptcy case *with prejudice*, which precludes a debtor from filing for bankruptcy for 180 days.[48] This temporary bar provides the creditors time to reinstate the foreclosure and go through with the sale, without fearing the Stay.

When discussing sections 105(a) and 109(g) of the Code, the Second Circuit noted these provisions "complement each other in arming the bankruptcy courts with a variety of weapons for use in controlling serial filers, a species not likely to become endangered in the foreseeable future."[49]

Other remedies include dismissing a case where the discharge of primarily consumer debts would be a substantial abuse,[50] dismissing a case for cause where it is in the best interest of creditors,[51] lifting of the Stay,[52] and allowing a condominium board to collect rents directly from tenants of non-occupant defaulting unit owners until any such non-occupant defaulting unit owner is once again current in common charges.[53]

Although these remedies are somewhat effective, they are all utilized *after* an abuse has occurred. If adopted, the proposal of this Article (discussed *infra)* will limit the abuses before they start.

V. Other Recommendations

The issue of debtors abusing the bankruptcy system by filing on the eve of a foreclosure sale has been discussed by various judges, scholars and other commentators.[54] The National Bankruptcy Review Commission[55] (the "Commission") discussed in its 1997 report[56] (the "Commission Report") the problem of the abusive debtor,[57] and made many proposals to improve the Code.[58]

The Commission proposed amending section 362 of the Code such that if a debtor has filed two or more petitions within six years of the filing of its current filing, and if the debtor has been a debtor in another case within the last 180 days, the Stay will not be invoked.[59] The Commission also proposed amending section 362 such that if the debtor transferred property to another individual who filed within the last 180 days, the Stay will not be invoked.[60] In each of these instances, however, the debtor could make application to the court to apply the Stay.[61] The Commission further proposed if a creditor can show that the debtor transferred all or a portion of the property for the purpose of delaying a foreclosure sale, a court could issue an *in rem* order barring application of the Stay to such property in any case for up to six years.[62]

The Bankruptcy Foreclosure Scam Task Force[63] (the "Task Force") issued a final report[64] in May, 1998 (the "Task Force Report"). The Task Force identified several problems in foreclosures,[65] and proposed various remedies, including judicial case management changes, modifications of national and local rules, indexing of real property, modifying the Stay, and criminal penalties.[66]

The proposals of the Commission and the Task Force have unfortunately not yet been adopted by the legislature.

VI. A Proposal to Limit the Abuse

Realistically, no matter what revisions are made to the Code, debtors will continue to find ways to abuse the bankruptcy system. The main purpose of this proposal is to lessen the degree of the abuse condominium boards and unit owners face in foreclosure actions that are stayed by bankruptcy filings. This can be accomplished by modifying section 362 of the Code.

Section 362 should be modified to prohibit debtors from filing for bankruptcy on the eve of the foreclosure sale by providing that if a foreclosure sale has been scheduled, and a debtor files for bankruptcy within thirty days of the sale, the Stay shall not apply as to the property which is the subject of the foreclosure sale. Additionally, if a debtor files for bankruptcy prior to the date which is thirty days prior to the sale, the Stay shall not automatically apply as to the property. Together with such filing, the debtor would be required to argue why the Stay should apply. All creditors would then have an opportunity to argue why the Stay should not apply, and the debtor would be given an opportunity to respond.

After the debtor and creditors are given the opportunity to respond, the bankruptcy court would issue a ruling as to whether the Stay should apply to such property. The standard for the court to apply would be that of *good faith*. If the court finds that the debtor filed in good faith, the Stay would apply. In order to halt a foreclosure sale, the debtor must deliver to the foreclosure sale referee an original file stamped copy of the order of the bankruptcy court approving the Stay being applied. If the court finds that the debtor did not file in good faith, the Stay will not apply, and the sale would continue as scheduled.

Factors to be considered by the court in determining good faith should include, but should not be limited to, (i) debtor's conduct in the instant case (whether debtor intends to perform its obligations, and whether debtor's conduct is an apparent abuse of the bankruptcy system), (ii) debtor's conduct in any prior bankruptcy case(s) (debtor's history of filings and dismissals), and (iii) fairness to creditors. The debtor's conduct in the case is thus a crucial component of this proposal.[67]

This proposal will prevent the foreclosure from being halted on the eve of the foreclosure sale, thus relieving a creditor from the burden of once again scheduling the foreclosure sale and complying with notice requirements. Ideally, this proposal should benefit *any* real property which is the subject of a foreclosure sale, not merely condominium units.

As stated earlier, common charges that accrue *prior* to the bankruptcy filing remain dischargeable. It should be noted that another method of limiting the abuse condominium boards and unit owners face would be to expand section 523(a)(16) of the Code (discussed *supra)* to include prepetition arrears as non-dischargeable.

Conclusion

Abusive bankruptcy filings halt foreclosure sales to the detriment of lenders, condominium boards and unit owners, among others. The Code must be modified to prevent this substantial abuse by debtors, and thus to restore the integrity of the bankruptcy system and its initial intentions.

Endnotes

1. This is a fictitious story. The town, condominium, its board of managers, the unit owner, the first mortgagee, and other miscellaneous facts have been created solely as an example for this article.
2. Common charges are monthly charges imposed on unit owners to pay for expenses of the condominium, including, but not limited to, maintaining the common elements of the condominium, managing agent's fees and legal fees.
3. Once there is an "Event of Default" (as that term is defined in the mortgage) by a mortgagor, the mortgage usually provides for a default rate of interest to accrue, which default rate is significantly higher than the regular interest rate. Therefore, even though a mortgagor may have a reasonable interest rate on his or her loan, after an Event of Default, the interest rate usually increases by a certain percentage which varies among lenders and often is the maximum rate allowable by applicable law.
4. Complaints include: "Why should I pay common charges when Mr. Jones doesn't have to?" and "Who is Mr. Jones' attorney? I should hire that lawyer."
5. 11 U.S.C. §§ 101-1330.
6. *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918).
7. *Id.*
8. *Id.* at 615.
9. *See Casse v. Key Bank Nat'l Ass'n* (*In re Casse*), 198 F.3d 327, 329 (2d Cir. 1999) (stating the debtors "embarked upon a series of filings . . . whose sole and transparent purpose was to frustrate . . . foreclosure proceedings"); *see also Final Report of the Bankruptcy Foreclosure Scam Task Force*, 32 Loy. L.A. L. Rev. 1063, 1074 (1999) [hereinafter "Task Force Report"], (noting the added clerical and judicial time because of these abusive cases).
10. *See* Task Force Report at 1070-74 (discussing five common abuses of debtors: (1) fractional interest transfers; (2) serial filings; (3) voluntary dismissals; (4) involuntary petitions; and (5) phony alias amendments to petitions).
11. *See Casse*, 198 F.3d at 330-32 (finding the debtors stalled numerous foreclosure sales by invoking the stay and humorously commenting if the debtors "fit this profile of serial filers, they are to be found not in the ranks of the nation's honest debtors, but among the Hannibal Lecters of current bankruptcy litigation"); *In re Jolly*, 143 B.R. 383, 386 (E.D. Va. 1992), *aff'd,* 45 F.3d 426 (4th Cir. 1994) (noting prior to the current filing, debtors had filed six times to avoid foreclosure on their condominium unit, and stating "[a]lthough filing a bankruptcy petition to prevent foreclosure is not, in and of itself, reprehensible or abusive, . . . bad faith multiple filings merely to forestall foreclosure may be abusive of court process"); *In re Spear*, 203 B.R. 349, 353 (Bankr. Mass. 1996) (finding that "repeated filings and dismissals, combined with Debtor's apparent intention to continue ineffectual filings in order to stay foreclosure constitutes bad faith warranting dismissal"); *see also* Task Force Report at 1066 (noting the problem of serial filings solely for the purpose of using the Stay to delay foreclosures); *but see Salem Bend Condo. Ass'n v. Bullock-Williams* (*In re Bullock-Williams*), 220 B.R. 345, 347 (B.A.P. 6th Cir. 1998) (stating "[a]lthough the record reflects that the Debtor had multiple bankruptcy filings and that four prior Chapter 13 cases were dismissed, it does not reflect that any of the filings were dismissed for bad faith"); Robin E. Phelan, *Green Regs and Scams: Comments on the Report of the Bankruptcy Foreclosure Scam Task Force of the Central District of California*, 7 Am. Bankr. Inst. L. Rev. 335, 337 (1999) (arguing "multiple or sequential filings that comply with the law, even if they delay creditors, are neither scams nor fraudulent").
12. *See* Judge Geraldine Mund, 1995 Am. Bankr. Inst. J. 35 (discussing abusive practices of debtors, including multiple filings and transfers of fractional interests).
13. *See* Task Force Report at 1067-69 (discussing the problem of mortgage consultants).
14. *See* 11 U.S.C. §§ 1321-1330.
15. *See Casse*, 198 F.3d at 332 (2d Cir. 1999) (stating "[t]he filing of a bankruptcy petition merely to prevent foreclosure, without the ability or the intention to reorganize, is an abuse of the Bankruptcy Code. Serial filings are a badge of bad faith, as are petitions filed to forestall creditors (citations and internal quotation marks omitted") (quoting *In re Felberman*, 196 B.R. 678, 681 (Bankr. S.D.N.Y. 1995)); *In re Spear*, 203 B.R. 349, 351 (Bankr. Mass. 1996) (noting debtor stated she intentionally filed three times solely to stay foreclosure proceedings); *see also* Task Force Report at 1066 (finding many debtors file without any plan to follow through with the cases).
16. The board of managers may choose to impose an assessment on all unit owners to compensate for the lost revenue from the defaulting unit owner, thereby adding to the common charges the non-defaulting unit owners are already paying.
17. 11 U.S.C. § 362.
18. 11 U.S.C. § 362(a).
19. *Id.*
20. *See* Task Force Report at 1068 (noting the power of the Stay, and the ease which one can use it because actions will be stayed "without the debtor having to prove any entitlement to injunctive relief"); Luis Chaves, *In Rem Orders–A Necessary Exception to the Stay*, 1998 Am. Bankr. Inst. J. LEXIS, *5 (noting the Stay provides "virtually anyone capable of filing a bankruptcy petition with the power to invoke the broad injunctive power of the bankruptcy court without any of the showings normally required to obtain an injunction–such as likelihood of success,

irreparable harm or the posting of a bond").

21. *See* Chaves, at *1-2 (noting the power of the Stay leads to abusive filings).
22. *See* N.Y. Real Property Law § 339-z (RPL).
23. *See* RPL § 339-aa.
24. *See* RPL § 339-z. Interestingly, it appears that it is unsettled whether a condominium board's lien perfected prior to the recording of the first mortgagee's mortgage is superior. *See* Kenneth M. Block and Jeffrey B. Steiner, *Condominium Mortgages: Courts Continue To Wrestle With Lien Priority Issues*, N.Y.L.J., Sept. 16, 1998, p.5, col.2 (discussing lien priority issues and citing *Bankers Trust*, *infra*).
25. *Bankers Trust Co. v. Board of Managers of the Park 900 Condo.*, 81 N.Y.2d 1033, 600 N.Y.S.2d 191 (1993).
26. *See id* at 1034-1035.
27. *See id.* at 1035.
28. *See id.* at 1034.
29. *See id.* at 1035.
30. *See id*.
31. *See id*.
32. *Id*. at 1035.
33. *See* RPL § 339-z.
34. *See Bankers Trust*, 81 N.Y.2d at 1036.
35. *Id*.
36. *Id*.
37. N.Y. Real Property Actions & Proceedings Law § 1353(3) (RPAPL).
38. *Bankers Trust*, 81 N.Y.2d at 1036; *see also Fleet Mortgage Corp. v. Nieves*, 707 N.Y.S.2d 671, 672 (2d Dep't 2000) (finding common charge lien would be "extinguished by the foreclosure sale except to the extent of any surplus").
39. *Bankers Trust*, 81 N.Y.2d at 1036.
40. The Seventh Circuit has held that postpetition fees and assessments are dischargeable because they arise from the condominium declaration, which is a prepetition contract (*see In re Rosteck*, 899 F.2d 694, 696-97 (7th Cir. 1990)), whereas the Fourth Circuit held that postpetition fees and assessments are non-dischargeable because the obligation to pay arises from a covenant running with the land and thus does not arise until assessments are due (*see River Place E. Hous. Corp. v. Rosenfeld (In re Rosenfeld)*, 23 F.3d 833, 836-37 (4th Cir. 1994)).
41. *See* 11 U.S.C. § 523(a)(16).
42. *See* Chaves at *4 (discussing present remedies of creditors against abusive debtors).
43. 11 U.S.C. § 105(a).
44. *See Casse*, 198 F.3d at 336 (stating Section 105(a) is a "provision phrased in such general terms as to be the basis for a *broad* exercise of power in the administration of a bankruptcy case." (emphasis added)) (quoting 2 Collier on Bankruptcy (15th ed. 1999) at 105-5 to -7 (footnote omitted)).
45. 11 U.S.C. § 105(a).
46. *See Casse*, 198 F.3d at 337-39 (noting that Section 105 provides bankruptcy courts "the power to sanction bad-faith serial filers . . . by prohibiting further bankruptcy filings for longer periods of time than the 180 days specified by § 109(g)", and citing nearly a dozen cases interpreting Section 105 broadly); *Jolly*, 143 B.R. 383, 388 (E.D.Va. 1992), *aff'd* 45 F.3d 426 (4th Cir. 1994) (affirming broad ruling of lower court which prohibited debtors from filing in *any* jurisdiction for 180 days).
47. *See* 11 U.S.C. § 109(g) (stating, *inter alia*, "no individual . . . may be a debtor . . . who has been a debtor in a case pending . . . at any time in the preceding 180 days if (1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case.").
48. *See* Task Force Report at 1083 (discussing current remedies, including the automatic 180-day bar and *in rem* relief).
49. *Casse*, 198 F.3d at 341. The court also stated that a bankruptcy court may, "in an appropriate case, . . . prohibit a serial filer from filing petitions for periods of time exceeding 180 days." *Id.* at 339.
50. *See* 11 U.S.C. § 707(b).
51. *See* 11 U.S.C. § 1307(c).
52. *See* 11 U.S.C. § 362(d).
53. *See* RPL § 339-kk.
54. *See Casse*, 198 F.3d at 330 (noting debtors filed the day before the foreclosure sale); *see also* Andree Brooks, *Talking Bankruptcy; Problems with Unit Owners*, N.Y. Times, Apr. 26, 1992, sec.10, p.5, col.1 (discussing the issue of non-payment of common charges and foreclosures, and commenting an "explosion in personal bankruptcies is undermining the financial safeguards built into the basic documents that govern . . . condominiums"); Question and Answer, *Delinquent Payments in a Condo*, N.Y. Times, June 15, 1997, sec.9, p.6, col.6 (answering questions from a frustrated unit owner regarding non-payment of common charges and foreclosures).
55. The National Bankruptcy Review Commission was established by Title VI of The Bankruptcy Reform Act of 1994. Pub. L. No. 103-394, 1994 U.S.C.C.A.N. (108 Stat.) 4106. The Commission was created to review and to make recommendations to amend the bankruptcy laws. The Commission filed its report on Oct. 20, 1997 with President William Jefferson Clinton, Chief Justice William H. Rehnquist and Congress.
56. Nat'l Bankr. Rev. Comm'n, *Bankruptcy: The Next Twenty Years, Final Report* (1997).
57. *Id.* at 276-80.
58. *Id.* at 7-8; *see also* Constantine Dean Pourakis, *Note: Final Report of the Bankruptcy Foreclosure Scam Task Force*, 7 Am. Bankr. Inst. L. Rev. 341, 353 (1999) (discussing the Commission's proposals).
59. Commission Report at 273-74.
60. *Id.* at 282.
61. *Id.* at 281.
62. *Id.* at 282; *see also* Pourakis, at 345-47 (noting the benefit of *in rem* relief).
63. The Task Force was created by the United States Bankruptcy Court of the Central District of California to examine abuses by debtors in the Central District, and to make proposals to limit or end such abuses.
64. *See Final Report of the Bankruptcy Foreclosure Scam Task Force*, 32 Loy. L.A. L. Rev. 1063 (1999); *see also* Pourakis (discussing in detail the Task Force Report and its benefits); *but see* Robin E. Phelan, *Green Regs and Scams: Comments on the Report of the Bankruptcy Foreclosure Scam Task Force of the Central District of California*, 7 Am. Bankr. Inst. L. Rev. 335, 336-37 (1999) (criticizing the Task Force Report as to its proposals).
65. *See* Task Force Report at 1068-73.
66. *See* Task Force Report at 1080-93.
67. *See Casse*, 198 F.3d at 332 (noting "[t]he nature of the . . . (debtors') conduct throughout this bankruptcy litigation lies at the heart of the case"). For a further discussion of good faith and bad faith on the part of the debtor, *see In re Spear*, 203 B.R. at 352-53 (discussing standard of bad faith); *see also* Pourakis, at 350-53 (discussing several cases and bankruptcy rules involving good faith).

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Committee on Not-For-Profit Entities and Concerns: An Outline of Real Estate Issues Affecting Not-for-Profit Entities

Introduction

Not-for-profit entities have many purposes. Conducting a real estate operation is seldom one of them. Directors, officers and staff of not-for-profit entities, and the attorneys who represent them, usually are not occupied with real estate as a primary responsibility. But not-for-profit entities require space, sometimes substantial space, in which to conduct their activities. The cost of space is likely to be a major item in the entity's operating budget, perhaps the largest after personnel costs for many organizations.

The Committee on Not-for-Profit Entities and Concerns was formed by the New York State Bar Association's Real Property Law Section in order to address the legal issues faced by not-for-profits in acquiring, operating and disposing of space. The Committee hopes to attract as members both real estate attorneys representing not-for-profit entities as clients, and attorneys primarily engaged in representing not-for-profit entities as in-house or outside counsel who have to deal with real estate issues.

Not-for-profit entities buy, sell, lease and operate property in the same manner as business entities. The representation of these entities in real estate matters requires above all a knowledge of real estate transactions generally. It is not the purpose of the Committee to review the general provisions of real estate contracts, leases and financing documents. We assume that a user of the outline provided below will be generally familiar with real estate concepts, and if not, will work with a knowledgeable real estate attorney.

Nonetheless, not-for-profit entities have specific concerns about real estate, and are often treated differently from other entities under New York law. The Committee on Not-for-Profit Entities and Concerns has attempted to identify real estate issues specifically relating to these entities by preparing the outline that appears below. Many of the issues will be familiar to real estate practitioners, but are presented from the perspective of a particular type of client. It is hoped that the outline will serve as a reference to attorneys representing and dealing with not-for-profit entities in real estate matters.

The Committee views the preparation of the outline as an on-going process. It is expected that the outline will be revised and updated from time to time in response to changing law and conditions, and to cover topics not yet addressed, such as real estate development by not-for-profits and government programs for the construction of units to be owned by not-for profits. The outline is intended to be as general as possible in order to be a resource for all types of not-for-profit entities.

Finally, it should be noted that the outline is the work of many contributors, including Committee members Helen Rosenberg, Richard Frankel, George Parker and Larry Gambino. The Committee Chairs, Anne Reynolds Copps and Mindy Stern, organized this project, provided material for the outline and offered valuable comments and suggestions. The entire Committee would like to acknowledge the contributions of Stephen A. Linde. Not only did he prepare substantive material but he undertook the enormous task of editing the materials provided by all into a cohesive format.

Outline of Real Estate Issues Affecting Not-for-Profit Entities.

1. Ownership of Property by Not-for-Profits.

1.1. Authorized by Not-for-Profit Corporation Law §§ 202(4),(5).

1.2. Each purchase (as well as each sale, mortgage or lease) by a not-for-profit entity must be authorized by vote of two-thirds of the entire board (unless there are 21 or more directors, in which case a vote of a majority of the entire board will suffice). Not-for-Profit Corporation Law § 509. In the case of a disposition of all or substantially all of the not-for-profit entity's assets, if the not-for-profit entity has members entitled to vote, the members must by two-thirds vote approve the transaction following board approval. Not-for-Profit Corporation Law § 510(a)(1).

1.3. Statutory benefits for property acquisition by certain types of not-for-profit entities, such as redevelopment companies. See, for example, article 5 of the Private Housing Finance Law, which permits direct sale by a municipality to a redevelopment company, without public bidding, of property taken by eminent domain, and also permits the grant of real property tax exemptions in connection therewith. *See* Private Housing Finance Law §§ 119 and 125. *See also*, as to local development corporations, section 1411(d)(2) regarding municipal or county sale or lease of property to a local development corporation without

appraisal, public notice, or public bidding.

2. Real Property Tax Exemption.

2.1. Entitlement.

(a) Under Real Property Tax Law article 4, title 2 (RPTL). *See* section 420-a through e.

(b) Under economic development zone statute—RPTL § 485-e.

(c) Specific to certain types of not-for-profit entities; for example Not-for-Profit Corporation Law § 1408 exempts from tax historic sites owned by historical societies for purposes of preservation

(d) Sections 33, 125, 577 and 1106-h of the Private Housing Finance Law provide for exemptions or payments in lieu of taxes, upon approval of the local legislative body, for housing companies that may be organized as not-for-profit entities.

2.2. Procedures; filing requirements in particular municipalities.

2.3. How to maintain if entity is reorganized or otherwise changed.

3. Zoning Issues.

3.1. NYC issues.

(a) Non-profit residences for the elderly as a specific residential use category.

(b) Non-profit hospital staff dwellings.

(c) Non-profit institutions—limitations on office space in residential districts (New York City Zoning Ordinance § 22-14)

3.2. Yonkers—The City of Yonkers permits "philanthropic institutions providing social services" only by special use permit which must be renewed, by application to the building commissioner upon notice to the city council, on a yearly basis. Section 43-73. It further provides that renewal is contingent on there having been substantial compliance with applicable codes, regulations and conditions of the special permit, and that "no renewal shall be made upon objections by a majority vote of the city council.

3.3. Padavan Law—Mental Hygiene Law § 41.34 preempts local zoning authority as to the siting of community residence facilities (for 4-14 mentally disabled individuals) which are licensed by New York State Office of Mental Health or New York State Office of Mental Retardation and Developmental Disabilities. It provides for 40 days' formal notice to the municipality of the site, the type of residence and number of residents. The only ground upon which the municipality can reject the siting of the facility is overconcentration; traffic and safety concerns are not legal grounds for rejection.

3.4. Limitations on zoning and land use restrictions affecting religious corporations.

(a) A zoning regulation may not completely exclude a religious organization from a residential district because the exclusion does not have a substantial relation to the safety, morals, public health, or general welfare of the community. *See Diocese of Rochester v. Planning Bd. of Brighton*, 1 N.Y.2d 508, 154 N.Y.S.2d 849 (1956); *Jewish Reconstructionist Synagogue of the North Shore, Inc. v. Incorporated Vill. of Roslyn Harbor*, 38 N.Y.2d 283, 379 N.Y.S.2d 747 (1975).

(b) A zoning regulation imposing burdensome requirements on a religious organization desiring to expand unconstitutionally abridges religious freedom unless an immediate and direct negative effect on the welfare, safety, and health of the community can be shown. *See Westchester Reform Temple v. Brown*, 22 N.Y.2d 488, 293 N.Y.S.2d 297 (1968), involving yard and setback requirements.

(c) Zoning boards must exhibit greater flexibility when they evaluate applications for religious use. *See Genesis Assembly of God v. Davies*, 208 A.D.2d 627, 617 N.Y.S.2d 202 (2d Dep't 1994), in which the court held that a municipality was required to grant a variance to a religious organization, although conditions to the variance could be imposed.

(d) However, the New York City Landmarks Law did not unconstitutionally impair the first amendment right to the free exercise of religion by a church that wanted to develop its property. *See Rector, Wardens and Members of the Vestry of St. Bartholomew's Church v. City of New York,* 914 F.2d 348 (2d Cir. 1990).

(e) A federal statute, the Religious Land Use and Institutionalized Persons Act of 2000, 42 U.S.C. § 2000cc, purports to restrict the ability of governmental entities to impose or implement land use regulations in a manner that imposes a substantial burden on religious exercise or unreasonably limits religious institutions or structures. The commerce clause is given as the constitutional basis for federal authority.

4. Property Ownership with Other Entities, Including Form of Co-Ownership Entity.

4.1. Co-ownership with another not-for-profit.

(a) Not-for-Profit Corporation Law §§ 202(a)(7) and 202(a)(15) provide statutory

authority for relationships with other not-for-profit corporations and redevelopment company partnerships.

(b) It is unclear whether a not-for-profit corporation can become a member of a limited liability company, as there is no express statutory authority therefor.

4.2. Co-ownership with a for-profit.

(a) Absence of statutory authority in Not-for-Profit Corporation Law § 202 for relationships with business entities raises question as to whether such relationships are permitted.

5. Transfer of Property by (or to) Not-for-Profits.

5.1. Transfer tax exemptions.

(a) State—$2 per $500 of consideration; no exemption for not-for-profit entities.

(b) New York City—generally 1.425 or 2.625 percent of gross consideration, depending on price. Exemption for transfers *to or from* an entity organized or operated exclusively for religious, charitable or educational purposes. New York City Administrative Code § 11-2106.

(i) Requirements of New York City RPT Form include indicating whether the transferor or transferee has obtained section 501(c)(3) status under the Internal Revenue Code and/or a sales tax exemption from the Department of Taxation and Finance, attaching copies of letters providing the foregoing and providing an affidavit stating that the same remains in effect.

(c) City of Yonkers—1.4 percent of gross consideration if the purchase price exceeds $25,000; paid by the seller. However, the entire transaction is exempt from the tax if the deed is "by or to" an entity that would qualify for 501(c)(3) status. Yonkers Code § 15-64B(2) (General Ordinance 3-1998).

(d) City of Mount Vernon—1 percent of consideration in excess of $100,000; paid by the purchaser. No exemptions for not-for-profits. Mt. Vernon City Code, chapter 234.

5.2. Mortgage recording tax exemptions.

(a) State—Tax Law § 253(1-a) exempts not-for-profit mortgagors from federal income taxation from the one-quarter percent special additional mortgage recording tax, and requires the mortgagee to pay this amount. If both mortgagor and mortgagee qualify for the exemption, then the tax is not due.

(b) Special mortgage tax exemption for Housing Development Fund Companies incorporated under the Private Housing Finance Law. *See* Private Housing Finance Law § 577.

5.3. Title issues for not-for-profits.

(a) Authority—If the not-for-profit entity is acquiring, the transaction must be properly authorized (see section 1.2 above). If the not-for-profit entity is selling, leasing or mortgaging and is a type B or type C corporation, then court approval is needed if the transaction affects "all or substantially all" of its assets. Not-for-Profit Corporation Law § 510(a)(3). A religious corporation requires court approval for the sale or mortgaging (other than a purchase money mortgage) of any of its real property and for the leasing of any of its real property for a term in excess of five years. In addition, the Religious Corporation Law imposes various requirements on certain kinds of religious organizations and in some cases permits the transfer of property without valuable consideration if made to a related religious corporation. *See e.g.* Religious Corporation Law § 455.

(b) Who can execute conveyance documents—determined by by-laws and authorizing corporate resolutions.

(c) Franchise tax exceptions—Department of Taxation form Ct-247 Franchise Tax Exemption Application can be filed in advance of the transaction. Certain types of not-for-profit entities are statutorily exempt from franchise taxes. *See, e.g.*, Not-for-Profit Corporation Law § 1411(f), which exempts local development corporations from income tax.

5.4. Special requirements.

(a) Judicial approval for religious corporations. Note that *Greek Orthodox Archdiocese of N. and S. Am. v. Abrams*, 162 Misc. 2d 850, 618 N.Y.S.2d 504 (Sup. Ct., N.Y. Co. 1994), , ruled that a post-sale modification of the terms of a purchase money mortgage received by the selling religious corporation at closing creates a new contract of sale the terms of which must be approved by the court.

(b) Regents' approval for chartered entities under the Education Law.

6. Leasing of Real Property by Not-for-Profit Corporations as Tenant.

6.1. Use clause restrictions in leases.

(a) A landlord may, by the terms of the lease, limit the use and enjoin violation of the limitations so imposed. *See Kem Cleaners v. Shaker Pine*, 217 A.D.2d 787, 629 N.Y.S.2d 492 (3d Dep't 1995); *Foresee Corp.*

v. Pergament Enters. of S.I., 198 A.D.2d 397, 604 N.Y.S.2d 123 (2d Dep't 1993). Such limitations are not generally favored and therefore will not be extended by implication beyond the terms of the restriction. *See Kem Cleaners*, *supra*, *Sky Four Realty Co. v. CFM Enters.*, 128 A.D.2d 1011, 513 N.Y.S.2d 546 (3d Dep't 1987).

(b) Follow the procedures of Not-for-Profit Corporation Law § 509 concerning the two-thirds approval of the board of directors.

(i) Review the corporation's by-laws and certificate of incorporation for reserved powers of any members concerning leasing authorization and specific uses.

(c) Does the intended use require administrative or other governmental approval?

(i) Does the use require a building permit or zoning variance?

– Who is obligated under the lease to obtain and pay for such permits and variances?

– Is the lease to be conditioned upon obtaining such permits and variances and, if so, by what date and should there be a limit on cost and duty to appeal negative determinations?

(ii) Will a certificate of occupancy be required prior to use?

– Is the lease to be contingent upon obtaining the certificate of occupancy?

(iii) Will other administrative or governmental agencies have to approve the intended use, e.g., the New York State Department of Health (certificates of need approval process)?

– Is the lease to be contingent upon obtaining such approvals?

(iv) When is the lease term to commence in relation to the above (e.g. after the last approval is obtained)?

(d) Does the use fall within the meaning of the charitable, religious or educational purposes of the corporation?

(i) Will the use affect the tax-exempt status of the organization?

(ii) Will it result in unrelated business taxable income?

6.2. Sales tax exemptions for tenant improvements.

(a) Sections 1105 and 1110 of article 28 of the New York Tax Law impose sales and compensating use taxes on retail sales of tangible personal property. Thus, purchases and sales of tangible personal property, including certain improvements to leased space, are subject to sales tax unless an exemption applies.

(b) There are two relevant exemptions to sales taxes relating to improvements to buildings and land.

(i) Section 1115(a)(15) and (16) of the Tax Law exempts from the sales tax certain improvements to real property of religious, charitable, scientific, or educational organizations described in Tax Law § 1116, quoted in section 6.2(c) below, and not-for-profit health maintenance organizations. Tangible personal property sold to contractors for use in erecting, adding to, altering or improving real property and structures of tax-exempt organizations is exempt when it is to become an integral component part of such real property or structure. 20 N.Y.C.R.R. §§ 528.16(a)(1) and 528.16(b).

(ii) Section 1105(c)(3)(iii) of the Tax Law provides an exclusion from sales tax "for installing property which, when installed, will constitute an addition or capital improvement to real property (defined in Tax Law § 1101(b)(9)), property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter."

(c) Tax Law § 1116(a)(4) provides an exemption from sales and compensating use taxes for the following organizations:

"Any corporation, association, trust; or community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h) of section five hundred one of the United States internal revenue code of nineteen hundred fifty-four, as amended), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

(i) However, 20 N.Y.C.R.R. § 529.7(2) provides:

"An organization is not exempt from tax because it is organized and operated as a nonprofit organization or because it appears to meet the requirements of this section. In order to establish its exempt status, it is necessary to file a completed application as set forth in subdivision (f) of this section and prove that the organization meets the statutory requirements."

(ii) To obtain the exemption an Application for an Exempt Organization Certificate Form ST-119.2 should be made to the New York Department of Taxation and Finance. Usually, the application is made once the federal tax exemption is obtained, although it can be made before.

(d) Nevertheless, an exemption from sales tax does not always apply because a taxpayer is dealing with an exempt organization. For instance, a for-profit owner of real property that leases a building to an exempt organization and makes improvements to that building is not exempt from paying sales taxes for those improvements. 20 N.Y.C.R.R. § 528.16(a)(1), example 4. The tax-exempt organization must own the land and/or building.

6.3. New York City Commercial Rent Tax.

(a) The New York City Administrative Code, title 11 Taxation and Finance, chapter 7 Commercial Rent or Occupancy Tax. For each year, or a portion thereof, every tenant shall pay a tax on the annual rent it pays to a landlord. New York City Administrative Code § 11-702.

(b) Section 11-701(6) exempts payments required to be made by the tenant for improvements to the space from the definition of rent. *See also, SIN, Inc. v. Dept. of Finance of the City New York*, 126 A.D.2d 339, 513 N.Y.S.2d 430 (1st Dep't 1987).

(c) New York City Administrative Code § 11-704(a)(4) and title 19, section 7-04(d) of the Rules of the City of New York provide that certain not-for-profit entities are exempt from payment of the N.Y.C. Commercial Rent or Ocupancy Tax:

"Any corporation, or association, or trust, or community chest, fund or foundation, organized and operated exclusively for religious, charitable, or educational purposes, or for the prevention of cruelty to children or animals, and no part of the net earnings of which inures to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation; provided, however, that nothing in this paragraph shall include an organization operated for the primary purposes of carrying on a trade or business for profit, whether or not all of its profit are payable to one or more organizations described in this paragraph."

(d) A person claiming an exemption under New York City Administrative Code § 11-704(a)(4) must make an application for such exemption to the Commissioner. See title 19, section 7-05 of the Rules of the City of New York.

6.4. Disposition of excess space by not-for-profits.

6.4.1. Leasing of excess space.

(a) Same concerns as a for profit entity. Review standard checklist of items a landlord desires in its lease.

(b) In addition, review Not-For-Profit Corporation Law § 509 concerning lease of real property.

(c) Review the Certificate of Incorporation and by-laws concerning board or member approval.

(d) Review any bank or bond financing documents to ensure that space can be leased (i.e., tax-exempt bond restrictions on leasing and such leasing affecting the tax-exempt status of the bonds).

(e) Review any enforceable restrictions in the chain of title to the real property.

(f) Are the rent and services provided for fair market value?

(g) Be careful of inurement and private benefit issues as these will affect not-for-profit's tax exemption status.

(h) Are there any regulatory restrictions when leasing to a certain entity or person?

(i) Will the lease and rental affect any reimbursement rates or grant monies?

(j) Leasing profits may generate Unrelated Business Taxable Income for federal income tax purposes.

6.4.2. Subleasing excess space.

(a) Review the main lease to determine rights to sublease or assign space.

(i) Distinguish between assignment and subleasing.

– What is the continuing obligation of the sublandlord or assignor?

(ii) Does the lease distinguish between affiliated or related entities?

(iii) Is the use permissible under the lease and under local zoning regulations? Is the use a possible competing use? Limit the use allowed to avoid competing use.

(b) Does the main lease prohibit the sublease or assignment of space? Is the consent of the landlord unqualified or conditional?

(i) If landlord consent is required, is such consent to be based on reasonableness?

(ii) What remedies does tenant have if landlord improperly withholds consent?

(iii) Is there a downsizing option in the lease?

(c) If the main lease permits the sublease or assignment of space, does it require that any gain on the differential in lease payments is to be provided to the landlord?

(d) Subletting at a profit may generate Unrelated Business Taxable Income for federal income tax purposes. This factor should be considered in establishing the sublease rent.

(e) Is there a recapture clause?

(f) How are the operating expenses and real estate taxes and the like to be shared? Percentage or are they capable of being assessed separately?

(g) Are there services (i.e. telephone coverage or phone number) to be provided between the tenant and the subtenant?

(h) Does the sublease include furniture, equipment, etc.?

(i) Make sure there is proper insurance coverage by the subtenant for its obligations.

(j) Does the main lease allow for alterations or must landlord consent to subtenant's alterations?

(k) Be careful of inurement and private benefit issues as it will affect not-for-profit's tax exemption status.

6.4.3. Space sharing arrangements.

6.4.4. Any disposition of excess space is subject to the limitation of Not-for-Profit Corporation Law § 204, which prohibits activities conducted for pecuniary profit or financial gain, except to the extent the activity supports the entity's other lawful activities then being conducted.

7. Staff Housing.

7.1. Applicability of rent regulation laws to rented units.

The New York City Rent Stabilization Law, New York City Administrative Code § 26-511c.(12)(h), provides that a not-for-profit hospital has the right to sublet to one of its employees any housing accommodation that it leases, and that the not-for-profit hospital does not need to obtain the landlord's consent before subleasing the accommodation to one of its employees. However, in *Manocherian v. Lenox Hill Hospital*, 84 N.Y.2d 385, 618 N.Y.S.2d 857 (1994), the Court of Appeals held this provision unconstitutional, on the ground that a requirement that owners of rent-stabilized apartments offer renewal leases to hospitals for apartments occupied by employees, based on the residency status of employee subtenants rather than on the residency status of the tenant of record (i.e., the hospital), as provided in the Rent Stabilization Law, New York City Administrative Code § 26-504a., did not advance a legitimate state interest that would justify impairing owners' private profit rights.

7.2. Exemptions from rent regulation laws for units leased to staff members or others in buildings owned by not-for-profit entities.

(a) New York State Emergency Tenant Protection Act.

Unconsolidated Laws § 8625a.(6): Housing accommodations that are not subject to regulation include housing accommodations owned or operated by a hospital, convent, monastery, asylum, public institution, or college or school dormitory or any institution operated exclusively for charitable or educational purposes on a not-for-profit basis. However, those accommodations occupied by a tenant on the date the not-for-profit organization acquires the housing accommodation, or which are occupied subsequently by a tenant who is not affiliated with the not-for-profit organization at the time of the tenant's initial occupancy, are subject to regulation under this Act.

(b) New York City Rent Stabilization Law.

New York City Administrative Code § 26-511c.(9)(c): Exemption from renewal lease requirement where a not-for-profit organization owns the housing accommodation and either: (i) the tenant's initial tenancy began after the owner acquired the property and the owner needs the unit due to its charitable or educational purposes, including staff housing or (ii) the owner needs the housing accommodation for a non-residential use to further its educational or charitable purposes.

(c) New York City Rent Stabilization Code.

Section 2520.11(f): Exemption for housing owned or operated by an institution operated exclusively for educational or charitable purposes on a non-profit basis, and that is occupied by a tenant whose initial occupancy is due to affiliation with the institution; however, units occupied by a non-affili-

ated tenant are expressly subject to the Code.

(d) New York City Rent Control Law.

New York City Administrative Code § 26-403e.(2)(b) and (g): Exemption from "housing accommodations" covered by the law for (i) a hospital, convent, monastery, asylum, public institution, or college or school dormitory or any institution operated exclusively for charitable or educational purposes on a non-profit basis, or (ii) housing accommodations in buildings operated exclusively for charitable purposes on a non-profit basis.

8. Issues Concerning Specific Types of Not-for-Profit Entities.

8.1. Religious corporations—(in addition to Not-for-Profit Corporation Law).

(a) Sale requires leave of Supreme Court. Religious Corporation Law § 12.

(b) Mortgage requires leave of Supreme Court unless purchase money mortgage. Religious Corporation Law § 12.

(c) Lease for a period of five years or more requires leave of Supreme Court. Religious Corporation Law § 12.

8.2. Specific religions.

(a) Protestant Episcopal Church.

(i) May not vote on resolution unless Rector of Church is present at vote.

(ii) Consent of Bishop is required.

(iii) Consent of Standing Committee of Diocese.

(b) Catholic.

(i) Consent of Bishop or Archbishop is required; in absence, Vicar-General or Administrator.

(c) Lutheran Catholic Church of Greek Rite.

(i) Consent of Bishop is required; in absence, Vicar-General or Administrator.

(d) African Methodist Episcopal Zion Church.

(i) Consent of Bishop required or annual conference.

(e) Presbyterian.

(i) Written consent of Presbytery.

(f) United Methodist.

(i) Written consent of the Superintendent;

(ii) Consent of the Preacher in charge; and

(iii) Majority vote at a meeting of the charge conference

– The meeting shall be on 10 days' notice

(g) Reformed Church.

(i) Consent in writing of the Classes.

8.3. Educational corporations.

(a) Charter schools

(i) Charter effective for up to five years. Education Law § 2853(1)(b)(1).

(ii) Charter school may own lease or rent its space. Education Law § 2853(3)(b).

(iii) Charter school may pledge assets to secure loans. Education Law § 2853(3)(b).

(iv) No right to use eminent domain to acquire realty. Education Law § 2853(e).

8.4. Public schools.

(a) Acquisition (Education Law § 404).

(i) By gift, grant, devise or purchase (Sub 1).

(ii) By eminent domain (Sub 2).

(b) Conveyance (Education Law §§ 402 and 405).

(i) Property must be determined to be no longer needed.

(ii) May be without consideration or upon such consideration as determined by Board of Education.

(iii) Conveyance must be submitted to voters at an annual or special meeting except for city school districts with a population over 125,000 governing body shall approve.

(c) Property of a dissolved district (Education Law § 1520).

(i) Sold at public auction after five days' notice.

(ii) Posting in three or more public places in town in which the school is located and in one conspicuous place in district so dissolved.

(d) Construction of school building (Education Law §§ 408 and 408a).

(i) Approval of plans and specs by Commissioner of Education required.

9. Hospitals (State owned).

9.1. May acquire real property by eminent domain by the Commissioner of Health. Public Health Law § 401(1).

9.2. May acquire by grant or purchase. Public Health Law § 401(15).

9.3. If acquired by the Board of Visitors, approval of the Commissioner of Health is required. Public Health Law § 404.

9.4. The Attorney General must approve title.

10. Mental Hygiene Facilities (State owned).

10.1. May acquire real property by eminent domain when the legislature has made appropriation therefor. Mental Hygiene Law § 71.01.

10.2. The Attorney General must approve the title.

11. Cemetery Corporations.

11.1. Cemetery corporations may not sell real property to a funeral entity. Not-for-Profit Corporation Law § 1506-a.

11.2. Cemetery corporations may acquire real property. Not-for-Profit Corporation Law § 1506-a.

(a) Cannot pay more than fair market value.

(b) Prior notice to cemetery board.

(c) Approval of Supreme Court.

11.3. In establishing a cemetery, the local legislative body must approve. Not-for-Profit Corporation Law § 1506(b).

11.4. Special rules for Kings, Queens, Rockland, Westchester, Nassau, Suffolk, Putnam and Erie Counties. Not-for-Profit Corporation Law § 1506(c).

(a) Consent of local legislative body.

(b) Restrictions or conditions may be imposed as public health and welfare require.

(c) Publish notice one time per week for six weeks in the newspapers in which session laws are published and as may be designated by legislative body.

(d) Public hearing.

(e) Maximum size 250 acres.

11.5. Special rules for rural counties—No cemetery may be established where 500 acres are already set aside for cemetery purposes. Not-for-Profit Corporation Law § 1506(d).

11.6. Cemeteries may acquire land by condemnation provided that the certificate of incorporation does not discriminate in designating who may be buried in the cemetery. Limit 200 acres. Not-for-Profit Corporation Law § 1506(h).

11.7. Sale of cemetery properties—three methods:

(a) Must be proved to Supreme Court:

(i) All bodies must have been removed.

(ii) All lots reconveyed to cemetery corporation.

(iii) No debts or liabilities remaining.

(iv) It is in the public interest to sell the land.

(v) Land is no longer needed by the community for cemetery purposes or is not suitable for cemetery purposes.

(vi) Sale is at current market value.

(vii) Notice to cemetery board.

(viii) Notice to holders of certificate of indebtedness.

(ix) Notice to any other interested persons.

OR

(b)(i) Land is not used or is not physically adaptable to burial purposes.

(ii) Sale will benefit the corporation and plot owners.

(iii) Sale is not to a funeral entity.

(iv) Proceeds less expenses shall be deposited to permanent maintenance funds.

(v) Notice to cemetery board.

(vi) Notice to holders of certificate of indebtedness.

(vii) Notice to any other interested persons.

OR

(c) May be transferred to municipality if all directors and trustees living and residing in New York unite in the conveyance. Must continue use as a cemetery.

The Committee wishes to thank Carol Carty, a summer associate at Holland & Knight LLP, for her assistance in the preparation of the outline.

American College of Real Estate Lawyers 2002

By Ross L. Schiller

The American College of Real Estate Lawyers (ACREL), founded in 1978, is a national organization of the foremost real estate attorneys in the United States. ACREL brings together lawyers distinguished for their skill, experience, and high standards of professional and ethical conduct in the practice of real estate law, who will contribute substantially to the accomplishments, achievements and good fellowship of the College and to the best interests of the bar and the general public. The objectives of the College are to promote high standards of professional and ethical responsibility in the practice of real estate law through the commitment to educate the bar by participating in law reform and judicial initiatives, making available continuing legal education programs and preparing current educational materials and developments.

Membership in ACREL is by invitation only. Generally, it is required that a nominee be a distinguished real property law practitioner licensed for not less than 10 years who must have demonstrated a willingness to devote time to improving real property law through writing, teaching, or participation in professional association activities. Prospective members are elected only after a nomination and balloting process.

While ACREL's membership consists of over 800 attorneys from nearly every state and the District of Columbia, the New York State Bar Association *N.Y. Real Property Law Journal* would like to welcome the addition of several new members from the New York area for the year 2002. The new members, their current firms, and information are as follows:

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Ross Schiller is a first year law student at St. John's University School of Law, and Student Managing Editor for the New York State Bar Association's *N.Y. Real Property Law Journal*.

Foreclosure No Longer Option for Matrimonial Attorney Fee Recovery

By Jay Bryan Mower

As of May 21, 2002, a new law[1] prohibits matrimonial attorneys from foreclosing on a mortgage or security interest acquired from a client on the client's primary residence to recover legal fees incurred by the client during a matrimonial action. However, while the law prohibits foreclosure actions, the law does not relinquish the underlying debt owed by the litigant to the attorney.

The law is limited in scope to matrimonial attorneys' use of a foreclosure action after a divorce action to guarantee payment by their client. The law does not prohibit the matrimonial attorney from obtaining a mortgage or security interest, which could put a cloud on the title of the client, but does prevent the attorney from using a foreclosure action to receive payment. The law also is specifically written to cover only the primary residence of the litigant and not additional property interests upon which the attorney may obtain a mortgage and move for foreclosure if the client has not paid his or her debt.

The new law arose from a case where a divorcee signed two mortgages over to an attorney (who then assigned them to his wife) for legal fees from a divorce proceeding that lasted eight years.[2] The scope of the new law beyond that case does not appear large, because most primary residences in a divorce action are often held as a tenancy-in-the-entirety between the spouses. Therefore, a foreclosure on one party's interest through a mortgage interest owed to an attorney would create a tenancy-in-common between the attorney and the remaining spouse. This tenancy-in-common, however, would be subject to a survivorship interest of the remaining spouse. If the attorney's client were to die first, the mortgage interest of the attorney would be terminated and the property would become the sole possession of the other spouse. While if the attorney's client survived the other spouse, the attorney would only gain a tenancy-in-common interest with the spouse's heirs.[3] The value of such an interest therefore appears limited.

While chapter 71, sections 1 and 2 of the Laws of New York appears limited in scope toward a specific bad situation, the law raises some concern that such exceptions to the foreclosure action could be further broadened by either new legislation or by analogy to include other legal fields or professional services. Such an erosion of the foreclosure action could have a more material adverse effect on real estate law. However, the law currently is limited to matrimonial attorneys and their use of foreclosures on a client's primary residence pursuant to a mortgage obtained from their client for legal fees associated with matrimonial cases.

Laws of New York, 2002

Chapter 71

AN ACT relating to prohibiting foreclosure on a primary residence under certain circumstances

Became a law May 21, 2002, with the approval of the Governor.

Passed by a majority vote, three-fifths being present.

THE PEOPLE OF THE STATE OF NEW YORK, REPRESENTED IN SENATE AND ASSEMBLY, DO ENACT AS FOLLOWS:

Section 1. Notwithstanding any law, rule or regulation to the contrary, no foreclosure action, nor sale pursuant to an order of foreclosure, shall be permitted on the primary residence of a litigant in a matrimonial action pursuant to a mortgage or security interest given by such litigant to his or her attorney to secure payment of legal fees in connection with such matrimonial action. Nothing in this act shall affect the indebtedness secured by any such mortgage or security interest.

Section 2. This act shall take effect immediately.

The Legislature of the STATE OF NEW YORK SS:

Pursuant to the authority vested in us by section 70-b of the Public Officers Law, we hereby jointly certify that this slip copy of this session law was printed under our direction and, in accordance with such section, is entitled to be read into evidence.

JOSEPH L. BRUNO
TEMPORARY PRESIDENT OF THE SENATE

SHELDON SILVER
SPEAKER OF THE ASSEMBLY

Endnotes

1. 2002 N.Y. Laws ch.71, § 1-2.
2. *See Schantz v. O'Sullivan*, 288 A.D.2d 536, 731 N.Y.S.2d 808 (3d Dep't 2001); *see also* John Caher, *Foreclosure Bill Set to Pass Legislature: Measure Bars Lawyers from Taking Clients' Houses*, 2002 N.Y.L.J. (April 30, 2002).
3. *See also Finnegan v. Humes*, 252 A.D. 385, 299 N.Y.S. 501 (1937), *aff'd* 14 N.E.2d 389, 277 N.Y. 682 (1938).

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Student Case Note

Co-op Apartments: Using the business judgment rule to determine the legality of terminating a tenant's lease. *40 West 67th Street v. Pullman*, __ A.D.2d __, 742 N.Y.S.2d 264 (1st Dep't 2002).

Facts: Appellant-corporation brought an action to terminate respondent-shareholder's (tenant's) lease pursuant to corporation by-laws allowing for a tenant's lease to be terminated in the event that at least two-thirds of the shareholders vote that such tenant is undesirable due to "objectionable conduct." A vote was held at a special meeting to determine whether respondent-tenant in question was "objectionable," resulting in 2,048 shares to terminate, 0 against, and 542 who either did not attend or vote.

Respondent-tenant claimed that the vote was not reasonable, and maintained the contention that "RPAPL 711(1) requires *judicial scrutiny* of the basis for this tenant's ejectment"[1] and not the "business judgment rule" handed down from *Levandusky v. One Fifth Avenue Apt. Corp*.[2] The Supreme Court, New York County (Judge Marilyn Shafer) granted tenant's motion to dismiss on the grounds the action taken by the corporation requires judicial scrutiny to determine legality with respect to tenant's ejectment.[3]

Appellant-corporation appealed to the Supreme Court of New York, Appellate Division, First Department, who modified in part and affirmed in part, dismissing appellant-corporation's second cause of action.[4]

Issue: Whether the standard of review for conduct pursuant to a co-op corporation's by-laws should require judicial scrutiny or a business judgment rule, where a tenant-shareholder is facing ejectment.

Analysis: The majority grounded its rationale on its interpretation of *Levandusky*, which states that the business judgment rule should apply to all co-op board decisions, to avoid "unnecessary confusion generated by . . . different standards."[5] The majority also found that co-op boards function to make the tenants' living conditions better and therefore require a certain amount of autonomy apart from the judiciary to make these decisions without being subject to judicial review. The majority (by a 3-2 decision) held that judicial review is not available to a tenant who is ejected by a co-op board's actions and decision.

A co-op board's actions are assumed to be made in good faith and thus their decisions have a rebuttable presumption. The majority also required that a tenant must establish a breach of fiduciary duty by misconduct or other improper action, in order to maintain a claim contending the rebuttable presumption. Respondent-tenant failed to establish a breach in this case.[6]

Dissent: The dissent argued that the holding will put co-op tenants at the mercy of co-op boards.[7] The dissent's interpretation of *Levandusky* pointed out that the decision is not, or at least should not be, applicable where a co-op board's decision affects a tenant's possession of property. The dissent argued that when a party is being evicted, there should be a higher standard of review.[8] The dissent further pointed out that *Levandusky* deals with a tenant who wanted to make renovations to his apartment and that the co-op board's decision not to give permission to make that renovation was the focus of review in that case—not a co-op board's decision to evict a tenant.

The most poignant argument by the dissent concerns applying the business judgment rule when a tenant is facing eviction.[9] While the dissent recognizes that it is important for co-op boards to make decisions concerning the general welfare of tenants, they should not be "shielded" from judicial scrutiny where their decision influences an eviction of a tenant.[10] Perhaps the *Levandusky* holding should be limited to "steam riser alterations." An additional argument for the dissent is that RPAPL § 711(1) should apply, which requires that any ejectment of an undesirable tenant requires judicial scrutiny to determine whether such ejectment was obtained in good faith.[11]

Stanley Liu '04

Endnotes

1. *40 W. 67th St. v. Pullman*, __ A.D.2d __, 742 N.Y.S.2d 264, 267 (1st Dep't 2002).
2. 75 N.Y.2d 530, 554 N.Y.S.2d 807 (1990).
3. *See Pullman*, 742 N.Y.S.2d at 270.
4. *Id.*
5. *Id.* at 268.
6. *Id.* at 269.
7. *Id.* at 273.
8. *Id.*
9. *Id.*
10. *Id.*
11. RPAPL § 711(1).

Landlord's Checklist of Silent Lease Issues

By S.H. Spencer Compton and Joshua Stein

In commercial leasing, a "standard form" doesn't necessarily say everything it needs to say. Here is a supplemental checklist to give any lease a "tune-up."

When a landlord and a tenant agree on the business terms of a substantial commercial lease, the landlord may ask its counsel to prepare the first draft of the lease. If you are that counsel, you will probably start the assignment by using some combination of the following (whichever apply(ies), the "Standard Form"):

- A standard form of lease, possibly recent but more likely not;
- A form of lease used in another recent transaction; or
- A similar lease negotiated between the same parties or their affiliates.

Whatever Standard Form landlord's counsel uses, it will probably cover the traditional leasing issues reasonably well. The Standard Form will not necessarily deal with recent developments in leasing law; recent reported cases; unreported litigation and disputes; newly discovered gaps and glitches in Standard Forms generally; or the consequences of changes in technology, the marketplace, and the world. To the extent that participants in other transactions have developed better ways to handle particular landlord-tenant issues or identified new issues or concerns that typical commercial leases have not covered, those improvements may not have found their way into the Standard Form.

Even if you know your Standard Form is somewhat out of date or needs work, though, you probably will not have time during any particular transaction to revisit the Standard Form and improve it. If you want to give the Standard Form a tune-up, or even a complete overhaul, you may find the task daunting, and incompatible with the timing and budget of any particular transaction. To accomplish it, you might first need to assemble a half dozen other leases that seem particularly well done, thorough, and up to date. Then you will need to read each and compare it against the Standard Form, updating and improving the Standard Form as appropriate.

This is a task that almost no particular transaction will ever support. It will probably never rise to the top of your "to do" list at any other time either. It is just too large and amorphous and a bit painful. But you should probably consider doing it once in a while anyway.

To simplify any such task, and to create a guide and starting point for any landlord's counsel who wants to rethink and perhaps update a Standard Form, the New York State Bar Association Commercial Leasing Committee recently appointed a subcommittee to prepare a "Landlord's Checklist of Silent Lease Issues."

The subcommittee tried to identify and collect leasing issues that a typical Standard Form might be likely to omit, or not adequately cover. These issues—the so-called "landlord's silent issues"—might arise from any of the causes or trends described above. And many of them also reflect the reality that judges hesitate to infer obligations or prohibitions in leases or contracts, particularly in New York, and particularly for the benefit of a landlord. Courts often say that if a landlord wanted to impose any particular obligation, burden, restriction, or prohibition on a tenant, the landlord had the opportunity to do so in the lease. If the landlord did not use that opportunity, then courts often deny the landlord a second chance. Landlords need to say everything the first time around. This checklist attempts to help them do exactly that.

The "Landlord's Checklist of Silent Lease Issues" complements an earlier "Tenant's Checklist of Silent Lease Issues," prepared by much the same subcommittee. It was published in the New York State Bar Association Real Property Law Section's *New York Real Property Law Journal* (Fall 1999); modified and republished in *The Practical Real Estate Lawyer* (May 2000); and has been extensively reprinted and recirculated. The "Tenant's Checklist" was intended to help tenants' attorneys identify and raise possible issues in lease negotiations, emphasizing tenant-oriented issues typically not addressed at all in landlords' lease documents. At the time of writing, the Tenant's Checklist is being updated for republication of a second edition in response to comments and suggestions received. Both the landlord's and the tenant's checklists will appear in the *Commercial Real Estate Leasing Manual* to be published by the New York State Bar Association Real Property Law Section, under Joshua Stein's supervision as general editor, in 2002 or 2003.

Special Supplement: Landlord's Checklist of Silent Lease Issues

What the Checklist Is and Does

The "Landlord's Checklist" focuses on commercial leasing issues that a landlord's Standard Form probably does not, but possibly should, cover. As a general proposition, the Landlord's Checklist tries to suggest pro-landlord changes in a Standard Form that will be relevant in at least 15 percent of commercial leasing transactions. To be included on the list, though, an issue must also be less than 50 percent likely to appear in a typical Standard Form—assuming that the Standard Form was intended to cover transactions of the type for which the issue is relevant, but has not been updated recently. The Landlord's Checklist ignores any provision that the subcommittee thinks is 50 percent or more likely to appear in a typical Standard Form, or likely to be relevant in less than 15 percent of commercial leases.

The subcommittee applied both the "15 percent test" and the "50 percent test" arbitrarily, capriciously, subjectively, and with no evidence, data, or other empirical information, validation, confirmation, or corroboration of any kind whatsoever. This test and its numerous random exceptions were applied inconsistently and unpredictably and based on pure whim.

When the co-chairs of the Silent Lease Issues Subcommittee first proposed creating a Landlord's Checklist of Silent Lease Issues, one of the more active members (and a former co-chair) of the Commercial Leasing Committee argued that a list of landlord issues would be amorphous and potentially unending. Shouldn't such a list ultimately include everything that any good lease should include? And if it does, what value does the list add? A landlord should simply start with a good Standard Form, our Committee member argued, then modify it to reflect the business deal and any particular concerns the transaction might create.

All this may be true. But the subcommittee co-chairs believe:

- A "good" Standard Form is not so easy to identify; and
- Even with a "good" Standard Form, you may benefit from having a somewhat condensed summary of the latest issues that the author of a "state of the art" Standard Form might wish to cover, all collected in one place.

The subcommittee believes that this Landlord's Checklist delivers exactly that—in a reasonably (and perhaps even surprisingly) succinct and contained manner—and will be useful to commercial leasing practitioners.

Does the Checklist Give Landlords an Unfair Advantage?

As another objection to this checklist, some might argue that Standard Forms are already landlord-oriented enough. No one benefits by piling on even more landlord rights and tenant burdens (also known as "gotcha" clauses in some cases). The landlord may respond to that argument by stating that once a tenant has possession, the tenant has all the leverage (and judicial sympathy), and the landlord merely has the words of the lease to fall back upon.

If landlords were playing on a level playing field, then perhaps lease forms would not need to be landlord-oriented; they could be "balanced" and "fair." The use of landlord-oriented Standard Forms (including "new and improved" landlord-oriented Standard Forms of the type this checklist suggests), merely represents some minimal effort to restore balance to the landlord-tenant relationship. Tenant's counsel would, of course, disagree.

Intended for Major Commercial Space Leases

This checklist is intended mainly for substantial commercial space leases, for both retail and office uses. Most issues here will apply to some leases but not others. Any reader should interpret every item in the checklist as if prefaced by the words: "if applicable, appropriate, desired, possible, and realistic under the circumstances, taking into account the size and nature of the transaction, the condition of the market, the landlord's project, the tenant mix, the needs and negotiating positions of the parties, the timing, and all other circumstances."

The checklist does not try to suggest which issues apply to which types of leases, or how a tenant might respond to most of these issues. Because of these limitations, this checklist is more suited for use by an experienced lease negotiator than by a novice. Even a novice, though, will find this checklist useful. Any reader of this checklist should use it prudently and with judgment, and not stop thinking just because something appears on this checklist.

This checklist is not intended to apply to residential leasing transactions.

Caveats, Warnings, Disclosures

This checklist does not represent a position statement or recommendation by the New York State Bar Association or its Real Property Law Section, Commercial Leasing Committee, any of its subcommittees, or any member of any of them. The checklist does not establish a "minimum standard of practice" and is neither exhaustive nor complete. It is

provided merely as a tool for leasing practitioners. It creates no legal duties or obligations. No representation or warranty is made regarding the enforceability, validity, or practical feasibility (or tenant palatability) of any provision suggested here. The checklist simply proposes issues that you may wish to consider adding to a Standard Form as appropriate under certain circumstances.

Though the authors of the checklist and the subcommittee members will be honored and pleased if anyone reads this checklist and mentions it in lease negotiations, this checklist does not estop any author or subcommittee member from taking any position in any lease negotiation.

Notes on Style

In the editing process, it was decided to express some of the landlord's "silent lease issues" as affirmative recommendations, to achieve a more direct and lively presentation. Thus, the checklist sometimes says a landlord "should" consider or even "should" incorporate specific provisions in its lease. You must take each such statement with a bushel of salt. The subcommittee does not purport to establish or define "standard" requirements for what any lease "should" or "should not" say. Every lease represents its own negotiation, depending largely on the parties and the business and marketplace contexts. The making of definitive one-size-fits-all recommendations would thus be inconsistent with reality—a bad joke. It does, however, simplify, streamline, and add life to the presentation.

This checklist mentions each issue only once, even if it might reasonably belong under more than one heading. No cross-references are provided in these cases. Any user of this checklist should read it from beginning to end.

Written from the Landlord's Perspective

This checklist considers lease negotiations from a landlord's perspective. It is a landlord's checklist. The subcommittee members do not necessarily believe that tenants should accept (or at least accept without objection), a landlord's position regarding any issue suggested in this checklist. To the contrary, when representing a tenant, members of the subcommittee would consider many suggestions in this checklist to be quite egregious. Nevertheless, most of the lease provisions suggested here come from actual landlords' leases proposed in actual transactions.

As a future project, it might be possible to develop a checklist of recommended "middle-ground" outcomes on all the major commercial leasing issues. For each issue, one would seek to identify the legitimate concerns of each party and figure out a reasonable way to accommodate those positions. Overall goals: (1) assure the landlord a reliable rental stream reflecting the occupancy value of the tenant's space; (2) give the tenant the flexibility it needs to run its business even as circumstances change in the future; and (3) give neither party a potential "holdup opportunity" where the terms of the lease allow that party to extract an unexpected "windfall" from the other side when the other side needs some form of concession or cooperation.

In other words, one would try to create the framework for a "fair" lease. Such efforts have been undertaken in the past. *See, e.g.*, Gary Goldman, *Drafting a Fair Office Lease* (ALI-ABA 2d ed. 2000). Although this all sounds like a great idea, "fairness" is very much in the eye of the beholder, much like trying to define "progressive," the "public interest," or "reform." To reach the right result in any particular case, it may make more sense to let each party identify its own needs for itself and then let the two parties negotiate to a reasonable middle ground that works under the particular circumstances. Of course, that approach tends to take longer and cost more than trying to define a standard "one size fits most" commercial lease.

Authorship Notes

The Silent Lease Issues Subcommittee is co-chaired by S.H. Spencer Compton and Joshua Stein, who were also the primary authors of this checklist. Both the landlord's checklist and the tenant's checklist were initiated and edited by Joshua Stein.

The Landlord's Silent Lease Issues subcommittee included Arthur Anderman, David Badain, Robert Bring, Philip Brody, Mordecai Bronstein, Louis Broudy, Steven Cohen, Kathleen Cook, Dorothy Ferguson, Glenn Frankel, Samuel Gilbert, Barry Goldberg, Gary Goodman, James Grossman, Andrew Herz, Austin Hoffman, Jonathon Hoffman, Gary Kahn, Benjamin Mahler, Alexander Phillips, Richard Pogostin, Robert Reichman, Robert Shansky, Karen Sherman, Barry Shimkin, and David Tell.

Please Comment

Changes, additions, and other improvements to this checklist are welcome. They will be taken into account as appropriate when this checklist is updated and republished. If you have suggestions for this checklist or would like to reprint it, or if you have suggestions for the previously published Tenant's Checklist of Silent Lease Issues, soon to be updated and republished, please send e-mail to joshua.stein@lw.com or shcompton@FirstAm.com.

Special Supplement: Landlord's Checklist of Silent Lease Issues

1. Alterations

1.01 *Completion Bond*. Before the tenant undertakes alterations estimated to cost above $_____, require the tenant to deliver a bond or letter of credit in an amount equal to 1__ percent of the estimated cost. If the landlord doesn't require such a measure because of the tenant's great credit, consider rescinding that concession if the tenant's credit changes or if the tenant assigns the lease.

1.02 *Restoration*. The fact that the landlord consented to any alteration does not waive the tenant's obligation to remove it and restore the premises at the end of the term.

1.03 *Artists' Rights*. The tenant should not install any artwork that would trigger the artist's right to prevent removal under federal law.

1.04 *Third-Party Fees*. The tenant should reimburse the landlord for its architect's and other professional's fees in reviewing plans and specifications.

1.05 *Supervisory Fee*. The landlord may charge a supervisory fee for supervising the making of alterations and reviewing environmental conditions. The landlord's wage schedule or standard rates in effect from time to time is *prima facie* evidence of reasonableness.

1.06 *ADA*. The tenant's alterations must comply with The Americans with Disabilities Act of 1990, 42 U.S.C. § 12101 et seq. (the "ADA").

1.07 *Labor Harmony*. The tenant's obligation to maintain labor harmony should relate not merely to construction, but also to any other activities at the property.

1.08 *Exterior Hoist*. If the tenant wants to use a hoist outside the building, all lease provisions, rules, and regulations that govern alterations and activities within the premises should also apply to the hoist. Require the tenant to remove the hoist by a certain date. Should the landlord have the right to "free rides" on any such hoist? If other tenants complain about the hoist or even try to claim rent offsets because of it, the tenant should indemnify. If the landlord has installed the hoist, provide for scheduling, charges, and the right to remove it.

1.09 *Tenant's Records*. Consider requiring the tenant to maintain records of the costs of its improvements for six years. This information may help in real estate tax protest proceedings.

1.10 *Warranties*. Require the tenant to provide a warranty on completed restoration work or at least an assignment of any warranty it receives from its contractor. If the tenant surrenders space, require the tenant to assign to the landlord any warranties the tenant received for any improvements or equipment surrendered.

1.11 *Modifications to Plans and Specifications*. If the tenant modifies its plans and specifications after the landlord's approval, the alterations as modified should still meet a certain level of quality, whether or not the landlord can control changes.

1.12 *Plans and Specifications*. The tenant must deliver plans and specifications (initial and as-built) in a specified (or more current) computer-aided design—computer-aided manufacturing (CAD-CAM) format using naming conventions and other criteria as the landlord approves or requires.

1.13 *Activities Outside Premises*. If the lease allows the tenant to perform any alterations outside the premises (e.g., cable or riser installations, or changes in elevator operation), then the tenant should comply with all the same requirements that would govern alterations within the premises.

2. Assignment and Subletting: Consent Requirements

2.01 *Change of Control*. Treat a change of control of the tenant (unless a public company) as an assignment. To monitor, require the tenant to: (a) represent and warrant current ownership structure at the time of lease negotiations, to establish a baseline and define "change of control"; (b) deliver an annual certificate from its accountant or attorney confirming the tenant's then current ownership structure; and (c) report any change of

control. Do not refer only to corporations, partnerships, and limited liability companies. The restriction on transferring equity should apply even to future entity types not yet known.

2.02 *Continuing Status as Affiliate*. If the lease allows "free transfers" to the tenant's affiliates, require the assignee or subtenant thereafter to remain an affiliate throughout the lease term. If affiliation ceases, the tenant must notify the landlord (but the landlord should not assume the tenant will remember to do so). At that point the transaction becomes a prohibited transaction requiring the landlord's consent and may, if not cured, become an event of default.

2.03 *Restriction.* Prohibit assignments/sublets to existing tenants in the building or for less than fair market rent or the present rent.

2.04 *Prohibited Subtenants/ Assignees*. Prohibit the tenant from subleasing to any entity (i) that is a tenant in the building or any other building the landlord (or its affiliate?) owns within a specified area, or (ii) with whom the landlord is actively negotiating or has recently negotiated. Consider prohibiting any assignment/sublet to (x) any party with whom the landlord (or its affiliate) is in litigation (or its affiliate), or perhaps even any party with whom other landlords have had significant litigation; (y) a controversial entity such as a terrorist organization even if for a permitted use; or (z) specified entities or their affiliates (such as a chain store or multi-site restaurant operator that may have become notorious for its aggressive litigation programs against landlords). On the other hand, the landlord may prefer not to limit itself to any particular grounds for disapproval and rely instead on its right to "reasonably" reject proposed transactions on grounds such as those suggested in this paragraph. This approach has the disadvantage of creating an amorphous factual issue that may need to be resolved by a judge.

2.05 *Discretionary Consents*. If as a business matter the landlord is not required to be reasonable about assignment or subletting, simply ban both (instead of requiring "consent in Landlord's sole discretion") to avoid possible claims of an implied obligation to be reasonable. Also try to negate any implication that the landlord must at least consider whatever proposal the tenant presents.

2.06 *Prohibit Collateral Assignment of Lease*. Any prohibition against assignment and subletting should also prohibit any collateral assignment of the lease (i.e., no mortgaging, encumbering, or hypothecating the lease).

2.07 *Assignment/Sublet of Other Tenants' Leases*. Even if other tenants' leases are assignable or sublettable, ask this tenant to agree not to accept an assignment of any other tenant's lease or a subletting of any of its premises in the building without the landlord's consent.

2.08 *Diplomatic Immunity*. Even if the landlord has agreed to be reasonable in granting its consent, prohibit assignment/subletting to any person entitled to claim diplomatic immunity, or to any domestic or foreign governmental entity.

2.09 *Fixture Financing*. Prohibit the tenant from financing its fixtures, or impose appropriate protective conditions upon any such financing arrangements.

2.10 *Future Transactions*. If the tenant assigns or sublets in compliance with the lease, then require the landlord's approval for any future modification or termination of that transaction, future subsubletting or recapture, or consent to a subtenant's assignment.

3. Assignment and Subletting: Implementation

3.01 *Tenant's Profit.* If the tenant must pay the landlord a share of the consideration or other profit the tenant receives from a subletting or assignment: (a) the landlord can audit the tenant's books and records, (b) any tenant revenue attributable to rent concessions under the lease belongs entirely to the landlord (a proposition that has a ring of fairness to it but

may reverberate with a dull thud); (c) if the tenant does not furnish the necessary information for the landlord to calculate assignment/subletting profits, the landlord may estimate and the tenant must pay the estimated amount until a correct amount is established; (d) the landlord may condition the closing of any assignment/subletting transaction on the tenant's acknowledging the amount of the landlord's profit participation; (e) the landlord may collect profit payments from the assignee or sublessee if the tenant fails to pay; and (f) for a sublease, amortize the tenant's transaction costs over the term of the sublease rather than up front. Consider requiring the tenant to pay the landlord's share of sublet profits in a present valued lump sum at sublease execution.

3.02 *Assignor Guaranty*. As a condition to any assignment that the lease allows, consider requiring any unreleased assignor—and any guarantor of the lease—to deliver a guaranty with full suretyship waivers or at least an estoppel certificate to confirm the signer is not released. In either case, state that if the lease obligations later change, the guarantor is not exonerated but also not responsible for any incrementally greater obligation.

3.03 *Subtenant Nondisturbance.* If the landlord agrees to provide nondisturbance or recognition rights to subtenants, require that the "nondisturbed" (or "recognized") subleases satisfy clear and objective standards. Before agreeing to nondisturb (or recognize) any actual or potential sublease, the landlord needs to be willing to be "stuck with" that sublease and all its terms if the main lease terminates. The landlord may want to require minimum rents, a certain form of sublease, arm's length negotiations, configuration of space (at least a full floor?), and other characteristics. If the tenant occupies multiple floors, try to limit the nondisturbed space to full floor(s) at the top or bottom of the tenant's stack. Subtenant nondisturbance or recognition agreements can create issues similar to partial release clauses in mortgages (cherry-picking and/or destruction of expected value), as well as opportunities for fraud or abuse. Any landlord obligation to deliver agreements to protect subtenants should be conditioned on an absence of any default under the main lease. If the landlord does agree to nondisturb a subtenant, the landlord may want to hold the subtenant's security deposit and may want the tenant to reimburse the landlord's legal fees in reviewing the sublease and negotiating the nondisturbance agreement.

3.04 *Contiguous Subleased Floors*. Consider requiring sublet floors to be contiguous—ideally at the top or bottom of the tenant's stack. Perhaps require that any subleasing maximize contiguity, to facilitate future transactions and flexibility.

3.05 *Recapture Right*. If the tenant wants to sublease 50 percent or more of its space, give the landlord a recapture right. If the landlord exercises any recapture right, consider requiring the tenant to pay the landlord a brokerage commission equal to what the tenant would have paid a third party to broker a comparable transaction. For any partial recapture right, require the tenant to pay for any demising wall or other space separation expenses that may arise. These could include code compliance expenses to establish a legally separate occupancy.

3.06 *Transactional Requirements*. For any assignment/sublet, independent of any consent requirements, the tenant must also satisfy certain conditions (e.g., permitted use, reputation and net worth of assignee/subtenant, no violation of exclusives) and delivery of certain documents satisfactory to the landlord (e.g., assignee/subtenant's certified financial statements, unconditional assumption of the lease, reaffirmation of guaranties).

3.07 *Prohibited Use*. Even if the tenant has certain rights to assign or sublet, the new occupant should expressly remain bound by the use clause in the lease.

Although that proposition may seem self-evident, courts may infer some unintended flexibility on use if the parties negotiate a right to assign or sublet.

3.08 *Rent Increase Upon Assignment*. If the tenant assigns, let the landlord increase base rent to fair market. When assigning a lease with percentage rent, consider resetting the base for the rent calculation—either to current market or, in the case of retail space, the sum of existing base rent plus the average percentage rent for some specific period before the assignment. (Anemic percentage rent will, however, often correlate with a tenant request to assign or sublet.)

3.09 *Leasing Agent*. Require the tenant to designate the landlord's managing agent as leasing agent for any contemplated assignment or sublet.

3.10 *Processing Fee*. Charge a processing fee for any assignment/subletting, payable when the tenant submits an application.

3.11 *Advertisements*. The landlord should have the right to pre-approve any advertisements for assignment or subletting.

3.12 *ADA*. Prohibit any assignment or sublet that triggers incremental ADA compliance requirements in the building or by the landlord in the premises.

3.13 *Confidentiality*. The tenant should be required to keep confidential the terms of any assignment or sublease, particularly if the tenant's pricing is below current market (or the landlord's conception of current market) or the landlord's asking price for direct space.

3.14 *Partial Subleases*. Wherever the lease refers to subletting, it should refer to a subletting of "all or any part of" the premises, because a bare reference to subletting may let the tenant argue that the provision relates to a sublet of the entire premises only. This is yet another example of how a literal and narrow reading of words (or the possibility of a literal and narrow reading of words) produces ever-longer legal documents.

3.15 *Breach of Anti-Assignment Covenant*. A breach of the covenant not to assign the lease without the landlord's consent should be an automatic event of default, not merely a generic default for which the tenant might be entitled to a cure period.

4. Bankruptcy

4.01 *Multiple Leases*. If the same tenant leases multiple locations, try to structure the transaction as a single combined lease for all locations, to prevent the tenant from cherry-picking in bankruptcy. If the landlord must use multiple leases, try to cross-default them and date them the same date.

4.02 *Shopping Center Premises*. Bankruptcy Code § 365 gives a landlord greater rights in the event of a tenant's bankruptcy if the landlord's building is a "shopping center." But the statute does not define "shopping center." Within reason and the bounds of good taste, the landlord may be able to include favorable language in the lease to confirm that the building is a "shopping center."

4.03 *Characterize TI Contribution as Loan?* To the extent that the tenant's rent represents reimbursement to the landlord for tenant improvements, consider restructuring such payments as payments on a loan, independent of the lease, evidenced by a note secured by (at least) a pledge of the tenant's leasehold. This structure may give the landlord an argument to avoid Bankruptcy Code limitations on the landlord's claim for "rent," although the landlord would then face all the risks of being a secured or unsecured creditor instead. The landlord's choice of poison will vary with the circumstances, but the landlord and its counsel may want to consider the issue in structuring the lease.

4.04 *Letters of Credit*. If the tenant delivers a letter of credit in place of a security deposit for more than a year's rent, consider the effect of Bankruptcy Code § 502(b)(6). Check the drawdown conditions of the letter of credit to confirm that the landlord has the right (though not the obligation) to draw upon the letter of credit if

the tenant files bankruptcy, even if the tenant is totally current on the lease.

5. Bills and Notices

5.01 *Who May Give Notices*. Provide that the landlord's counsel or managing agent (as engaged from time to time) may give notices on behalf of the landlord.

5.02 *Tenant's Notices*. Copies of notices by the tenant (or perhaps just notices of alleged landlord default) should also go to the landlord's counsel.

5.03 *Next Business Day Delivery*. Define "overnight" delivery as "next business day" delivery, to avoid occasional case(s) saying "overnight" doesn't mean any particular number of nights (more bad cases producing ever-longer documents).

5.04 *Routine Rent Bills*. Avoid any suggestion that the landlord cannot send routine rent bills by ordinary mail and only to the tenant (no copies to, e.g., counsel).

6. Compliance with Laws

6.01 *Notice*. Require the tenant to give prompt notice to the landlord of any violation of any legal requirement that applies to the premises or the building.

6.02 *Improvements Required by Law*. Require the tenant to perform all improvements to the premises required by law. If the tenant resists (as the tenant probably will), consider limiting the tenant's obligation to future enacted laws. (The tenant will probably still resist and the parties will probably reach the usual negotiated outcome in any space lease: the landlord will bear the risk of present and future laws that generally govern similar buildings and the tenant will be responsible for legal requirements that arise from the tenant's specific or unusual use of the space.)

6.03 *ADA*. If the tenant uses the premises as "public accommodation" or for any other use that triggers extra ADA requirements in the building, the tenant should pay for that work.

6.04 *Definition*. Define "laws" broadly to include future enactments and amendments, insurance regulations and requirements, utility company requirements, administrative promulgations, and recorded declarations.

7. Consent

7.01 *Reasonableness*. When the landlord agrees to be "reasonable," establish criteria for reasonableness. Any mortgagee's disapproval of a matter should automatically constitute a "reasonable" basis for the landlord to withhold consent. Without some criteria or clear flexibility for the landlord, the interpretation of "reasonableness" can require a litigation that will often be stacked in favor of the tenant.

7.02 *Scope of Consent*. Any consent applies only to the particular matter under consideration.

7.03 *Deemed Consent*. If the landlord has agreed that failure to grant or withhold consent within ___ days is deemed consent, try to: (a) have this concept apply only in particular areas (e.g., consents to transfers), (b) require a reminder notice before the deemed consent arises, and (c) require both the original notice and the reminder notice to state conspicuously (in all capital letters boldface) that the landlord must respond within that period and what happens if the landlord does not.

7.04 *Expenses*. Require the tenant to pay any expenses the landlord incurs, including legal costs, in connection with any consent.

7.05 *Conditions to Consent*. Even when the landlord has agreed to be reasonable about a consent, build in conditions such as no pending default; the tenant must deliver estoppel certificate and copies of all relevant documents; other requirements tailored to the particular consent at issue; etc. Keep in mind that the landlord may forget to impose such requirements as a condition to the consent when issued.

7.06 *No Representation*. The landlord's consent to anything is not a representation or warranty that the matter consented to complies with law or will be appropriate for the tenant's needs.

7.07 *Survival of Conditions to Consent*. Whenever certain conditions must be satisfied for the tenant to obtain the landlord's consent (or to take any action without the need for the landlord's consent), consider as a general proposition whether the lease should require the tenant to cause those conditions to remain satisfied even after the consent is granted.

7.08 *Limitation of Remedies*. If the landlord unreasonably withholds consent when the lease requires the landlord to be reasonable, the tenant's only remedy is specific performance (not monetary damages). Backup position: expedited arbitration, perhaps with the potential arbitrator(s) designated in the lease.

8. Default

8.01 *Guarantor's Net Worth.* Provide that a decline in a guarantor's net worth or the bankruptcy of a guarantor (either an express guarantor or an unreleased assignor of the lease) is an event of default. This should be perfectly enforceable against a tenant.

8.02 *Cross Defaults*. Provide for cross defaults as against other leases with the landlord or its affiliates, or even against other obligations of the tenant or its affiliates.

8.03 *Default Notices*. Provide that default notices need not specify cure periods.

8.04 *Impairment of Business*. Define an event of default to include events (beyond the usual insolvency list) that may indicate the tenant is getting ready to shut down. These might include the tenant's announcing that it will make substantial distributions/dividends outside the ordinary course of business; shutdown of other locations; suspension or termination of a substantial part of the tenant's business; or layoffs.

8.05 *No Right to Cure Event of Default*. Once an event of default has occurred, should the tenant have a wide-open cure right, even after a cure period has already lapsed? Whenever the landlord can exercise remedies "if an event of default shall have occurred and be continuing," this language effectively gives the tenant an open-ended right to cure the event of default. Is that what the landlord wants?

8.06 *Discount for Timely Payment*. Consider increasing "face rent" in the lease by __ percent; provided however, that if the tenant pays by the ____ day of the month, the tenant is entitled to a discount equal to the overstated portion of the rent.

8.07 *All Rent Due at Signing*. Consider requiring the tenant to pay all rent for the term of the lease at signing, but the landlord agrees to accept monthly installment payments only so long as no event of default exists.

9. Destruction, Fire, and Other Casualty

9.01 *Rent Abatement*. Limit the tenant's rental abatement right to the amount of rental income insurance proceeds the landlord receives under the landlord's casualty insurance. (Any such provision must, however, be carefully coordinated with the landlord's insurance program for the property, to prevent surprises and problems.)

9.02 *Time to Restore*. If the landlord has the right or obligation to restore after casualty, measure any deadline from the landlord's receipt of insurance proceeds rather than from the date of the casualty.

9.03 *Termination Right; Limitation on Restoration*. No right (or limited right) for the tenant to cancel upon casualty. To the extent the lease requires the landlord to restore, impose appropriate conditions, including recovery of adequate insurance proceeds.

9.04 *Tenant Waiver.* Require the tenant to waive the provisions of New York Real Property Law § 227 (which allows a tenant to terminate a lease in the event of a casualty that renders the premises untenantable), and comparable provisions in other states.

10. Development-Related Issues

10.01 *Air and Development Rights*. Consider the effect of including air rights and development rights in the

definition of the landlord's property. The tenant should waive any right to object to any merger of air rights, and should agree to sign any zoning lot merger if asked.

10.02 *Landmark District; Historic Designation*. If the building is located in a landmark district or similarly protected area and local law (e.g., New York City law) requires it, include in the lease a notice of such landmark status. The tenant should agree: (a) not to file for historic designation of the premises, and (b) to oppose any such designation.

10.03 *Relocation Right*. The landlord can relocate the tenant to comparable premises in the building or in some other specific building the landlord owns.

10.04 *Demolition*. The landlord can terminate the lease after reasonable notice if the landlord intends to demolish. Set as low as possible a standard for the landlord to satisfy. For example, avoid any requirement that the landlord must be unalterably committed to demolition or must have terminated other leases or obtained a demolition permit. Give the tenant incentives to cooperate. Set up a process so the landlord will find out quickly whether the tenant will try to fight the early termination of the lease. For example, the lease can require the tenant, promptly after receiving a termination notice, to deliver an estoppel certificate and an increased security deposit. Pay the tenant only if the tenant vacates strictly on time.

10.05 *Building Name and/or Address*. The landlord can change the name or address of the building. The tenant will not refer to it by any other name.

10.06 *Building Standard Specifications*. The landlord can modify building standard specifications.

10.07 *Construction Restrictions*. Nothing in the lease limits by implication the landlord's right to construct or alter any improvements anywhere on the landlord's property. Any such restriction must be expressly stated and is limited to its terms.

11. Electricity

11.01 *Change of Provider*. If the landlord changes the electricity provider for the building, the tenant must use the new provider, to the extent legally allowed, even if the tenant directly meters its own consumption.

11.02 *Delivery of Electrical Service*. The tenant's electrical usage is subject to conservation measures and power grid availability.

11.03 *Resale*. Prohibit the tenant from reselling electricity.

11.04 *Electrical Service*. If the tenant's space is directly metered, require the tenant to keep the landlord informed of the tenant's electrical consumption, with copies of bills. This may facilitate the landlord's long-term planning of electrical service for the building.

12. End of Term

12.01 *Obligation to Restore*. Require the tenant to restore at the end of the term. That obligation should survive expiration or sooner termination of the lease. If the tenant does not complete restoration or other end of term activities (e.g., remediation?) by the expiration date, the tenant must pay holdover rent until completion.

12.02 *Landlord's Property*. At the landlord's option, the tenant must leave behind any improvements, fixtures, or personal property that the landlord paid for (including through a rent abatement).

12.03 *Cables, Conduits*. The landlord retains ownership of all cables and other wiring in the building. The tenant should remove cables, conduits, wires, raised floors, and rooftop equipment at the end of the lease term either in all cases or at the landlord's request. The tenant should indemnify the landlord from all liability in connection with that removal.

12.04 *Holdover.* Consider providing that if the tenant fails to vacate the premises at the end of the term, the tenant must pay the greater of (a) ___ percent of final adjusted rent under the lease and (b) [150 percent] of fair market rent as a use

and occupancy charge. Calculate the charge on a monthly basis for an entire month for every full (or partial) month the tenant holds over.

12.05 *Tenant Waiver*. The tenant waives the provisions of any civil procedure rule that would allow a court to issue a stay in connection with any holdover summary proceedings instituted by the landlord. (In New York, the statutory reference is New York Civil Practice Law and Rules § 2201.)

12.06 *Abandoned Personalty*. Upon lease termination, any personalty in the premises is deemed abandoned and the tenant must pay to remove and store it.

12.07 *Consequential Damages*. If the tenant holds over, the tenant should agree to pay all damages the landlord incurs, including consequential damages such as the loss of the next prospective tenant.

12.08 *Time of Essence*. "Time is of the essence" for the tenant's obligation to vacate the premises.

13. Environmental

13.01 *Reports; Inspections*. The tenant should agree to deliver, or reimburse the landlord's cost to obtain, updated environmental reports. The landlord can inspect the premises on reasonable belief that a violation of environmental law exists, all at the tenant's expense.

13.02 *High Risk Uses*. For a gas station or other high-risk use whole building lease, consider: (a) establishing an environmental baseline by undertaking a sampling plan before occupancy (this will establish what problems, if any, already exist); (b) requiring periodic monitoring, especially at locations where groundwater might be readily affected, and along perimeter areas where migrating oil can be detected; (c) obtaining an indemnification that is both very broad (all environmental risks) and very specific (particular environmental issues arising from the tenant's particular business); (d) if no environmental liability insurance is available, having the tenant post a bond; (e) if underground tanks already exist, having the tenant (i) accept the tanks "as-is," (ii) comply with all applicable laws, including obtaining all permits (as well as annual registration and recertification), (iii) post all state-required financial assurances, (iv) maintain, repair and replace, if required, all tanks, and (v) maintain all required records and inventory controls.

13.03 *Required Tank Removal*. Consider whether the landlord should have the option to require tank removal, assessment, and clean-up at the end of the lease term.

13.04 *Landlord Indemnification*. If the landlord agrees to indemnify the tenant for past environmental problems, limit this indemnification to any liability that exists under present law based on present violations. Exclude any liability arising from future laws or amendments of existing laws.

13.05 *Interior Air Quality*. The landlord has no liability for bad air or "sick building syndrome." The landlord may prohibit smoking.

14. Escalations

14.01 *Operating Costs*

14.01.A *Reality Connection.* When negotiating the operating cost escalation clause, confirm that the clause, particularly as negotiated, matches the landlord's actual practices in operating the building, so the landlord is capable of making the required calculations.

14.01.B *Off-Site Costs.* Avoid limiting "operating costs" to those incurred physically within the particular building. The landlord may incur off-site operating costs, such as in a multi-use project (e.g., holiday decorations in a central plaza) or for off-site equipment, installations, traffic improvements, shuttle bus services, or the like to benefit the building.

14.01.C *Use of Generally Accepted Accounting Principles (GAAP).* In defining operating "costs" (not "expenses," perhaps an accounting term of art), try not to refer to GAAP. The term often arises in two places: (a) defining what the landlord can pass through to

tenants; and (b) excluding "capital" items. Regarding (a), GAAP requires matching of revenue and expenses, forcing the landlord to reduce costs by any related income received. Examples: recovery of heating, ventilation, and air conditioning (HVAC) overtime costs from tenants (not all of this is actually expended, such as amortization of an energy management system); telecommunications (revenue from rooftop antennas); and parking garage income. Regarding (b): (i) Positive for landlords—the American Institute of Certified Public Accountants (AICPA) is reviewing disparity of practice as to capitalization and expense, and this may help landlords pending issuance of a formal statement. (ii) Negative for landlords—GAAP may treat preventive maintenance as "capital."

14.01.D *CAM.* Avoid the term "CAM" because operating cost escalations cover far more than common area maintenance.

14.01.E *Major Repairs*. Do not necessarily limit multiyear amortization of large repair costs to "capital" items. Particularly if leases limit escalations or if the landlord is concerned about base years for new leases, the landlord may want the ability to spread major non-capital repair costs over multiple years.

14.01.F *Broad Definition of Costs*. Consider any special characteristics of the property that may lead to landlord costs outside the escalation definitions in the lease. For example, if a reciprocal easement agreement imposes costs similar to real estate taxes or operating costs, expand the appropriate definition to include them.

14.01.G *Timing*. Try not to agree to tight time limits (or, worse, a "time of the essence" provision) for the landlord's obligation to provide operating statements. The landlord should, of course, try to be timely, based on cases that have required such timeliness based in part on an inferred "fiduciary duty" because the landlord controls the information.

14.01.H *No Fiduciary Duty*. Negate any fiduciary duty regarding operating cost escalations and their administration.

14.01.I *Reserve Charge*. To avoid the common arguments about how to treat "capital" items, consider establishing an annual per square foot capital reserve charge. The landlord would not be required to account for these funds and the lease would define categories of "capital"-type costs to which tenants need not contribute. (If, however, this reserve charge stays constant from year to year, including the base year, then it will never let the landlord collect a penny of escalations under the typical pass-through of only increases in operating costs. Therefore, make it a separate additional charge.)

14.02 *Audit Issues (Operating Costs)*

14.02.A *Condition for Audit.* The tenant may audit operating costs only if those costs increase more than a specified percentage over a specified prior year or base year.

14.02.B *Auditors.* Prohibit contingent fee auditors. If the landlord agrees to reimburse audit costs (such as if the tenant's audit reveals a certain level of mistakes), then negate any reimbursement to contingent fee auditors. Consider requiring a national CPA firm. Insist that such firm agree to notify the landlord of any undercharges or errors in the tenant's favor that the audit discloses.

14.02.C *Costs of Audit.* Ask the tenant to pay for the landlord's out-of-pocket costs in connection with any audit of operating costs (e.g. photocopying, staff time, document retrieval, accountants' time spent answering inquiries, etc.).

14.02.D *Confidentiality.* Require the tenant to sign a confidentiality agreement satisfactory to the landlord for any audit and its results before disclosing any records or information to the tenant or to a lease auditor. The agreement should, among other things, prohibit the tenant and its advisors from disclosing the existence of any audit or any of its results, particularly to other tenants in the building. Breach

should be an incurable default under the lease.

14.02.E *Limits.* Limit timing, frequency, and duration of audits.

14.02.F *Inspection Restrictions.* Allow the tenant (or its representative) to examine specified books and records only, and only for a specified period, but prohibit copying. Require that any audit comply with the landlord's reasonable requirements and instructions.

14.02.G *Threshold for Payment.* If overcharges (net of undercharges) total 3 percent or less of total annual operating costs (a generally accepted definition of "materiality"), then the tenant should not be entitled to any correction or any reimbursement of its audit costs. Define carefully the factor to which the 3 percent is applied. Use as large a number as possible. For example, refer to 3 percent of gross annual operating costs rather than 3 percent of the tenant's escalation payment.

14.02.H *Dispute Resolution*. Provide a private and final mechanism (e.g., arbitration) to resolve disputed operating costs.

14.02.I *Claims*. Require specificity, completeness, and finality in any tenant claim of discrepancy or error.

14.03 *Other Escalations.*

14.03.A *Porter's Wage.* Include fringe benefits and all other labor costs. The wage rate used should not reflect "new hire" or other transitional wage rates.

14.03.B *Consumer Price Index*. Use the Consumer Price Index For All Urban Areas (CPI-U) index. Many believe that this index has historically increased faster than the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) index.

14.04 *Generally*.

14.04.A *No Decrease*. Escalation formulas should never allow rent to go down.

14.04.B *Examples*. For any complex or intricate escalation formula, consider adding an example, but don't make the numbers dramatic.

14.04.C *Liability for Refunds*. The landlord's liability for any refund of overpaid escalations should terminate after a specified number of years (and automatically upon any sale of the building?), to prevent open-ended obligations or issues upon a sale of the building.

14.04.D *Survival; Timing*. Limit the time during which the tenant may challenge any escalation. (Be careful, though. The tenant may try to make this reciprocal for the landlord's billings.) All the tenant's obligations regarding escalations should survive the expiration or sooner termination of the lease.

15. Estoppel Certificates

15.01 *Lender Requirements*. Require any additional information a lender might request.

15.02 *Ratify Guaranty*. Allow the landlord to obtain a confirmation/ratification of any guaranty, not merely an estoppel certificate from the tenant.

15.03 *Exhibit.* Attach form of certificate as lease exhibit (conform to typical lender requirements), with flexibility for future lender requirements.

15.04 *Estoppels.* The tenant should agree to deliver future estoppel certificates at any time on the landlord's request. Provide that such certificates shall bind the tenant whether or not the landlord can demonstrate detrimental reliance. (Is such a concept enforceable?)

15.05 *Reliance*. Allow reliance by prospective purchasers, mortgagees or any participant in a future securitization, including rating agencies, servicers, trustees, and certificate holders.

15.06 *Failure to Respond*. Establish specific meaningful remedies for failure to sign estoppel within short period, such as deemed estoppel, power of attorney to execute, or a nuisance fee (e.g., $100 per day).

15.07 *Attach Lease*. Require the tenant (if asked) to attach a copy of the lease and all amendments to any estoppel certificate.

15.08 *Legal Fees*. If the landlord agrees to give an estoppel, require the tenant to pay the landlord's legal fees and expenses.

16. Expansion/Renewal Options

16.01 *Timing*. Make time of the essence for any option or right of first refusal. Say that timely notice is an agreed and material condition of exercise. Recognize that the courts sometimes validate late exercise after the fact. Perhaps provide for a protective rent adjustment in this case (e.g., to fair market if the lease would not otherwise require fair market rent).

16.02 *Multiple Bites at the Apple.* If the landlord offers "first refusal" space and the tenant does not take it (or if the tenant declines to exercise an option), then for a specified number of months the tenant's first refusal rights (and any options that would otherwise apply) should be waived, at least where they relate to comparable space, broadly defined.

16.03 *Timing*. The exercise deadline must be early enough to give the landlord time to relet. The timing also needs to coordinate with other leases to facilitate assembling large blocks of space if the landlord is inclined to do so. On the other hand, the landlord prefers to be obligated to give the tenant as little lead time as possible, to maximize the landlord's flexibility in dealing with unexpected changes in occupancy.

16.04 *Coordination of Options.* Time the exercise and lapse dates for options so that adjacent blocks of space may become available to the landlord at the same time.

16.05 *Update Due Diligence*. Reconfirm the due diligence requirements (e.g., financial statements) for the tenant.

16.06 *Option Subject*. Make any expansion option subject to existing exclusives and renewal clauses of other tenants. Avoid overlapping expansion options. Limit the tenant's remedy if the landlord inadvertently allows overlapping options.

16.07 *Carveouts from Purchase Rights*. If the tenant negotiates an option or right of first refusal to purchase, exclude: (a) foreclosure or its equivalent; (b) any subsequent conveyance; (c) transactions between the landlord and affiliates or family members; (d) other permitted transactions, such as transfers of passive interests or creation of preferred equity for mezzanine lenders (and any exercise of remedies by the lender); and (e) if the tenant "passes" on its pre-emptive right, then all subsequent transactions.

16.08 *Conditions*. Condition any option exercise on the tenant's: (a) not being in default (and not potentially being in default) both on the exercise date and on the effective date, and perhaps even for ____ years before the exercise date; (b) not having assigned the lease; (c) retaining a certain minimum occupancy; (d) actually operating in the space; and (e) satisfying a net worth test (fixed dollars or rent multiple) for at least ____ years before exercising the option.

16.09 *Option Rent*. Set a "floor" for option rent equal to the previous rent under the lease.

16.10 *Covenant to Notify*. Require the tenant to notify the landlord if the tenant needs more space, to give the landlord a chance to provide it in this or some other building. (The landlord might, however, better achieve the same result by saying nothing in the lease and just maintaining a good relationship with the tenant.)

16.11 *Option Maintenance Fee*. Require the tenant to pay a nominal annual fee to preserve future options, to give the tenant an incentive to terminate any option rights that it does not truly need.

16.12 *Miscellaneous.* Options may not be separately assigned. They terminate if the tenant subleases more than a certain percentage of the premises or assigns the lease or if specified other events occur.

17. Failure to Give Possession

17.01 *No Liability*. The landlord should incur no liability for failing to deliver possession on the commencement date for any reason, including holdover or construction delays. The tenant's obligation to pay rent should commence on possession. Perhaps extend the term by the duration of any landlord delay in delivering the premises.

17.02 *Delivery Procedure.* Try to tie the "Commencement Date" to an objective event—preferably within the landlord's control—or a date, rather than to any notice from the landlord. Notices are often not as easy to give (and give quickly) as they may sound to attorneys drafting leases. Any delay in giving a commencement date notice will mean lost revenue.

17.03 *Condition of Premises*. For delivery of the premises, substantial completion is sufficient (e.g., temporary certificate of occupancy).

17.04 *Termination Right*. The landlord may want a termination right if the landlord ultimately cannot deliver possession by a date certain.

17.05 *Delivery Dispute*. Provide for a short deadline for the tenant to report any issue or problem about the premises or the landlord's work. Better, state that taking of possession constitutes acceptance for all purposes.

17.06 *Rent Abatement*. To the extent the landlord agrees to give the tenant a rent abatement for late delivery, limit the duration of the abatement (e.g., if the rent abatement exceeds a set number of days, thereafter the tenant's only rights are to terminate or wait). Try to defer any such abatement (e.g., spread it out in equal annual installments over the remaining term of the lease), to reduce immediate damage to the landlord's cash flow at a time when the landlord may be under financial stress.

18. Fees and Expenses

18.01 *Fee and Expenses.* Collect a fee (and expenses) to review any plans, specifications, or request for consent/waiver. Avoid a flat fee. Set the fee according to a formula based on the size of the job, with a minimum floor.

18.02 *Attorneys' Fees and Expenses*. The tenant should reimburse the landlord's attorneys' fees and expenses both broadly and with specificity (e.g., for actions and proceedings, including appeals, and in-house counsel fees and expenses). The reimbursement obligation should cover attorneys' fees and expenses incurred in connection with: (i) any litigation the tenant commences against the landlord, unless the tenant obtains a final judgment; (ii) negotiating a lender protection agreement for the tenant's asset-based lender; (iii) the landlord's (or its employee's) acting as a witness in any proceeding involving the lease or the tenant; (iv) reviewing anything that the tenant asks the landlord to review or sign; and (v) bankruptcy proceedings.

18.03 *Witnesses*. The tenant should indemnify the landlord if the landlord or its personnel are called as a witness in any proceeding related to the lease or the tenant.

19. Future Documents and Deliveries

19.01 *Tenant's Financial Condition*. The tenant must deliver annual financial statements for itself and any guarantor. If the financial condition of either deteriorates, negotiate the right for a security deposit, rent adjustment, or other consequences.

19.02 *Reporting*. The tenant must immediately report, for the tenant and any guarantor: (i) any adverse change in financial position; and (ii) any litigation that could adversely affect ability to perform.

19.03 *Further Assurances*. Require the tenant to enter into any amendments that the landlord reasonably requests to correct errors or otherwise achieve the intentions of the parties, subject to reasonable limitations.

19.04 *Future Events*. The parties should agree to memorialize any commencement date, rent adjustment, or option exercise in a lease amendment.

19.05 *Termination of Lease Memo*. If the tenant obtains a memorandum of lease, then: (a) the tenant should covenant to execute and deliver a termination of memorandum of lease in recordable form if the lease terminates early; and (b) consider requiring the tenant to sign such a termination at lease execution, to be held in escrow.

19.06 *Governmental Benefits, Generally*. The tenant must coop-

erate as necessary to help the landlord qualify for any tax or governmental benefits (e.g., tax abatements) that would otherwise be available.

19.07 *Permitted Disclosure*. If the landlord agrees to any confidentiality restrictions, or if state law automatically infers such restrictions, then the landlord should ask for the right to disclose to mortgagees or prospective purchasers any information about the tenant or any guarantor.

20. Guaranty

20.01 *Social Security Number/ Address*. State the social security (or driver's license) number and home address of any individual guarantor beneath his or her signature line. This underscores the fact that the guaranty is intended to constitute a personal obligation of the guarantor and may facilitate enforcement.

20.02 *Guarantor Consents*. Tailor the guarantor's consent/ waiver boilerplate to reflect circumstances of the lease, such as pre-consent to any future assignment of lease, and any state-specific language necessary or helpful for a guaranty (e.g., a reference to New York Civil Practice Law and Rules § 3213).

20.03 *Lease Assignment*. If the landlord sells the property, then the guaranty should by its terms automatically travel to the purchaser, whether or not the transfer documents say so.

20.04 *Net Worth*. Any net worth test or other financial covenant should apply to both the tenant and the guarantor. Tailor the covenant as appropriate.

20.05 *Estoppel Certificate*. The guarantor should agree to issue estoppel certificates upon request.

20.06 *Springing Guaranty*. Consider a springing guaranty if certain adverse events occur (such as a reduction in the tenant's or a guarantor's net worth). Remember: the guarantor must sign the guaranty when the tenant signs the lease.

20.07 *Tenant Bankruptcy*. The guarantor (and any unreleased assignor) should acknowledge its liability is not limited as a result of any limitation of the landlord's claim against the tenant for "rent" in bankruptcy (11 U.S.C. § 502(b)(6)).

20.08 *"Good Guy" Guaranty*. Consider a "good guy" guaranty (i.e., a guaranty of rent and perhaps all other obligations under the lease, continuing only until the tenant surrenders the premises vacant, in satisfactory physical condition, and free of any occupancy rights).

20.09 *Security*. Consider securing a lease guaranty obligation with a letter of credit or other security. By tying such a letter of credit to a guaranty rather than to the lease, the landlord may reduce the likelihood—perhaps already low—that the tenant's bankruptcy estate could "claw back" letter of credit proceeds beyond the landlord's permitted claim for rent in the tenant's bankruptcy.

21. Inability to Perform

21.01 *Triggering Event*. If the tenant negotiates a force majeure clause, have the tenant agree to notify the landlord promptly of any "force majeure" event. The extension of time continues only so long as such triggering event actually causes the tenant delay.

21.02 *Exception to Force Majeure*. Force majeure should not cover any monetary obligation.

21.03 *Governmental Consents*. For the landlord, force majeure should include a failure to obtain governmental consents or permits.

22. Insurance

22.01 *Additional Insureds*. Include the landlord and its managing agent and mortgagee as "additional insureds," not "named insureds," because the latter may owe premiums.

22.02 *Changed Requirements*. Conform the insurance requirements in the lease to those in the landlord's mortgage (and any future changes in the mortgage). Allow the landlord to change the requirements in the lease as needed to comply with the landlord's and any mortgagee's future reasonable requirements

22.03 *Business Interruption Insurance*. Any rental/business interruption insurance should cover additional rent (e.g., escalations and tax pass-throughs) and percentage rent as well as base rent.

22.04 *Evidence of Insurance*. Require "evidence" of insurance (ACORD 27 form) or a copy of the tenant's insurance policy at lease signing, not a "certificate" of insurance (ACORD 25 form), which is often regarded as worthless unless modified. Try to get an ACORD 27 form (or its equivalent) not only for property insurance, for which it was designed, but also for liability insurance.

22.05 *Landlord Insures*. Consider having the landlord insure the tenant's improvements (with the tenant reimbursing the allocable premium either directly as additional rent or as an operating expense), and having the landlord restore (or give the landlord the right to require the tenant to restore) with any insurance proceeds.

22.06 *Plate Glass Insurance*. Require any retail tenant to carry plate glass insurance.

22.07 *Insurance Broker*. Allow the landlord (at its option) to deal directly with the tenant's insurance broker to obtain any insurance documents the lease requires. But doing so imposes no liability or obligation upon the landlord.

22.08 *Approval Rights*. Allow the landlord to approve the identity and financial condition of the tenant's insurance carriers.

22.09 *Waiver of Subrogation*. Understand "waiver of subrogation." This is a tricky topic, often wrongly handled. These clauses should be mutual, covering all losses caused by any insured risk (even negligence of the landlord or the tenant), provided the insurance carrier has consented to the waiver. Such consents often appear in standard insurance policies, although this should be confirmed.

22.10 *Tenant's Rights to Proceeds*. Make any right of the tenant to receive insurance proceeds subject to the rights of the landlord's mortgagee.

22.11 *Tenant Failure to Insure*. If the tenant fails to insure and a fire occurs, then the tenant is liable for the entire loss and not merely the unpaid insurance premiums—even if the landlord knew about the failure to insure. (Such a provision responds to cases that limit the tenant's liability to the amount of the unpaid premiums.)

22.12 *Insurance Advice*. Work with the landlord's insurance broker/consultant to check, update, and improve the insurance requirements of the lease as appropriate, such as to take into account whatever changes in insurance requirements and practices ultimately arise from the resolution of "terrorism insurance" in the wake of September 11.

23. Landlord's Access To Premises

23.01 *Emergency Contact*. The tenant should provide the name and telephone number of an emergency contact.

23.02 *Reconfiguration*. The landlord may reconfigure or change the means of access to the premises.

23.03 *Notice Requirements*. The landlord may enter without notice in an emergency. Even absent an emergency, oral notice to someone on site should suffice. This is yet another example of an area where a requirement for "written notice" may sound perfectly reasonable but in the real world is completely impractical.

23.04 *Keys*. The tenant should deliver copies of all keys and access codes to the landlord. The landlord should consider, though, whether it truly wants whatever liability travels with the keys and access codes, especially if the tenant's inventory or other property is unusually valuable. The landlord may prefer to be selective about requiring keys and access codes.

23.05 *No Eviction*. The landlord's entry to or inspection of the premises does not entitle the tenant to any rights or remedies—it is not an actual or constructive eviction of —or any claim, offset, deduction, or abatement of rent.

23.06 *Purpose of Access*. The landlord may: (a) show the

premises to prospective purchasers, mortgagees or appraisers or, during the last [12] months of the term, to prospective tenants; and (b) post "for sale" and "for rent" signs.

24. Landlord's Liability

24.01 *Exculpation*. Limit the landlord's liability to its interest in the property. Negate personal liability of the landlord or its partners, members, managers, officers, directors, and the like. Recent cases have applied the "implied covenant of good faith and fair dealing"—a tort theory of liability—to sidestep exculpation clauses in leases. To avoid the possible effect of such cases, state that the landlord's exculpation applies not only to claims under the express terms of the lease, but also claims of any kind whatsoever arising from the relationship between the parties or any rights and obligations they may have relating to the property, the lease, or anything related to either.

24.02 *Landlord Default*. Give the landlord the same open-ended cure periods for non-monetary defaults that tenants typically obtain—no landlord default so long as the landlord has commenced and is diligently prosecuting cure of its default.

24.03 *Liability*. No further liability of the landlord if the landlord transfers or assigns its rights and obligations in the premises.

24.04 *Liability for Prior Owner's Acts*. As a rather aggressive position, say that after any conveyance of the property (even outside foreclosure), the new owner is not liable for (and the tenant may not assert any credit or counterclaim because of) any claims the tenant might have had against the former owner, such as for overcharges and refunds of escalations.

25. Landlord's Representations

25.01 *Express Not Implied*. No implied covenants, representations, or warranties of the landlord. Limit the landlord's responsibilities to those expressly set forth in the lease.

25.02 *Merger*. Provide for the merger of any agreements, written or otherwise, predating the lease. Any statements or representations on the landlord's website or in the landlord's advertising are not part of the lease.

25.03 *Other Leases*. The landlord makes no representations, warranties, or covenants regarding other tenants (past, present, or future) or the terms of their leases.

26. Maintenance and Repairs

26.01 *No Overtime*. The landlord has no obligation to do any work at overtime or premium rates.

26.02 *Tenant's Obligation*. The tenant must maintain and repair parts of the building—including storefronts and sidewalks—that exclusively serve the premises.

26.03 *Right to Perform*. If the tenant's acts or omissions cause damage to another tenant's premises, the landlord can repair them at this tenant's expense.

26.04 *Broad Repair Obligations*. Where the tenant has broad repair obligations, expressly include "ordinary or extraordinary, structural or nonstructural, foreseen or unforeseen" repairs.

26.05 *Specify Repair Obligations*. Avoid distinguishing repairs as "structural" (the landlord's responsibility) and "nonstructural" (the tenant's responsibility). Be specific about drawing these lines. Otherwise, a court may decide what the parties intended.

26.06 *Periodic Upgrades.* Beyond maintaining the premises "as is," the lease could require the tenant to upgrade and renovate every ___ years, to keep the premises exciting and new, particularly for retail space.

27. Occupancy

27.01 *"As Is" Condition*. The tenant should represent and acknowledge that it takes possession of the premises in its "as is, where is" condition as of the commencement date.

27.02 *No Obligation Except Specific Work*. The landlord need not perform any work or make any installations to prepare for the tenant's occupancy, except as the lease expressly requires.

27.03 *Tenant Covenants*. The tenant should covenant to install its fixtures, open for business, and operate for at least a certain minimum period.

28. Percentage Rent and Radius Clause

28.01 *Increases*. Provide for an increase in percentage rent upon any change of use or change of the tenant.

28.02 *Inclusions/Exclusions*. For percentage rent purposes, include any catalog or Internet sales made through the store. Prohibit the tenant from claiming any credit for goods that a customer bought through a catalog or over the Internet (unless previously included in store sales). Exclude sales to the tenant's employees only if they are made at a discount.

28.03 *Limit Percentage Rent Penalty Period*. In a retail lease, if a co-tenancy or other problem allows the tenant to pay percentage rent only, restore the fixed rent when the problem is solved, or limit the percentage-rent-only period. After a certain time, allow the landlord to require the tenant to either terminate or resume paying full fixed rent.

28.04 *Effect of Casualty.* If the premises are closed part of the year because of a casualty or condemnation, adjust the "breakpoint" for percentage rent downward. (This assumes the "breakpoint" is expressed as a fixed dollar amount rather than as a formula referring to actual fixed rent payable from time to time. The latter would be more common, so this problem usually does not arise.)

28.05 *Gross Sales*. Define gross sales to include sales by subtenants and concessionaires.

28.06 *Fixed Rent Increases*. Increase fixed minimum rent (and percentage rent breakpoint) periodically over time based on increasing gross sales.

28.07 *Audit Right*. Allow the landlord to audit the tenant's gross sales. If the tenant underpaid percentage rent by more than 3 percent, the tenant pays interest and costs of audit.

28.08 *Kickout Right*. The landlord may terminate if percentage rent has not reached a certain level by a certain date.

28.09 *Recordkeeping*. Require the tenant to maintain records sufficient to make any audit meaningful.

28.10 *Radius Clause.* Include a "radius clause" in any lease requiring percentage rent, i.e., the tenant may not compete with itself within a restricted area without the landlord's consent.

28.11 *Violation.* If the tenant violates the radius clause, consider requiring the tenant to include as "gross sales" (for percentage rent purposes) the greater of (a) a specified percentage of gross sales at the premises; or (b) the gross sales of the tenant's store in the restricted area.

29. Quiet Enjoyment

29.01 *Conditions.* New York law (and probably the law of other states) implies a covenant of quiet enjoyment if the lease is silent. Consider providing that quiet enjoyment is subject to the rights of mortgagees, ground lessors, and all other terms of the lease. Condition the covenant of quiet enjoyment upon the tenant's not being in default under the lease.

29.02 *Limit Obligation to Provide Services*. Limit the landlord's obligation to provide services and other obligations regarding the building to bare occupancy and express obligations under the lease. Prevent courts from using the "covenant of quiet enjoyment" as the basis to infer possible landlord obligations to provide services beyond those the lease requires.

30. Real Estate Taxes

30.01 *Tax Contests*. The tenant may not contest taxes without the landlord's consent. If the landlord does consent, the landlord may want the right to require the tenant to post a bond or letter of credit in the amount of any contested taxes (assuming the tenant did not need to pay the taxes as a condition to the contest).

30.02 *Business Improvement District (BID) Charges and Special Assessments*. Include any "BID" charges and special assessments of any kind in the definition of "Real Estate Taxes."

30.03 *Base Year Real Estate Taxes*. Define "Base Year Real Estate Taxes" as "net of any special assessments" and "as finally determined."

30.04 *Further Assurances*. The tenant should agree to assist the landlord, as reasonably necessary, to qualify for tax abatements and benefits (e.g., Industrial Commercial Incentive Program [ICIP] in New York City). If the landlord obtains such benefits, the lease should indicate whether the landlord or the tenant will ultimately gain the economic benefits of the program and how those benefits interact with real estate tax escalations.

30.05 *Estimated Tax Payments*. Consider requiring the tenant to make monthly estimated tax payments, especially when the landlord's mortgage requires tax escrow payments.

30.06 *Management Fee*. If the landlord protests real estate taxes, impose an extra management fee to compensate for the landlord's time, trouble, and effort.

30.07 *Imperiled Abatement*. If the property benefits from any tax abatement, deferral, subsidy, or the like, state that if anyone ever challenges the validity of such benefit, then the landlord can require the tenant to pay monthly (just like a regular payment of real estate taxes) an appropriate contribution toward whatever incremental taxes the landlord might owe if the challenge succeeds. The landlord would refund these payments if the challenge failed. Without a structure like this, the landlord will bear much of the risk of any challenge and in practice may be unable to shift much of that risk to tenants.

30.08 *Transfer Taxes*. Consider possible transfer taxes on the lease. New York, for example, imposes a transfer tax on leases with terms beyond 49 years (including extension periods).

30.09 *Contest Expenses*. Have the tenant pay its proportionate share of the cost of the landlord's real estate tax counsel in seeking to lower assessment, instead of merely subtracting the landlord's legal fees in the event of a successful tax contest.

31. Remedies of Landlord

31.01 *Yellowstone Injunction*. Consider whether the landlord can proactively add language to the lease to limit the availability and effect of so-called "Yellowstone" injunctions under New York law. For example, consider some or all of the following, each of which responds to one or more of the issues that arise in "Yellowstone" proceedings:

31.01.A *Waiver?* Require the tenant to waive its right to bring a "Yellowstone" injunction (probably not enforceable).

31.01.B *Financial Defaults*. The tenant should acknowledge the tenant cannot obtain a "Yellowstone" injunction for any financial default, even if uncertainty or disagreement exists (which it always will, in these cases) about the tenant's obligations. The tenant must pay first, and fight later.

31.01.C *Cure Period Extension Rights*. The tenant may obtain an open-ended cure period—and a period in which to litigate an alleged default—by depositing with the landlord as security an amount equal to the *landlord's* estimate of the cost to cure the alleged default. The making of such a deposit is the only way the tenant can evidence its ability and desire to cure the default, but if the tenant makes the deposit the tenant can remove all time pressure.

31.01.D *Other Rights and Remedies*. State that a "Yellowstone" injunction, if granted, limits only the landlord's right to terminate the lease and does not limit any other rights or remedies (e.g., late charges, default interest, and reimbursement of the landlord's expenses).

31.01.E *Final Cure Period Before Eviction*. State that if the landlord obtains a warrant of eviction, the tenant will automatically have—or the landlord can agree at any time to grant the tenant—a short final cure period before the landlord proceeds with actual eviction. A "last clear opportunity to cure" at the end of the eviction proceeding should substantially undercut the basis for a "Yellowstone" injunction.

31.02 *Default Rate*. The tenant covenants to pay interest at the agreed default rate on amounts past due *even after judgment* (when the statutory judgment rate would otherwise apply).

31.03 *Interest and Late Charge*. Provide for interest on late payments (in addition to a late charge). Multiple defaults or bounced checks within a specified period have special consequences. For example: a higher late fee; a larger security deposit; the next default is incurable; or future payments—or at least all payments for the next [12] months—must be made by certified or cashier's checks or wire transfer.

31.04 *Waiver of Counterclaims*. Require the tenant to waive counterclaims other than compulsory counterclaims.

31.05 *Rights of Redemption*. Require the tenant to waive any and all rights of redemption under existing or future laws.

31.06 *Nonpayment*. If the tenant does not pay rent, allow the landlord to exercise a "conditional limitation" right and terminate the lease, not merely commence nonpayment proceedings. (Many Standard Leases establish a "conditional limitation" only for all defaults except failure to pay rent.) The lease should expressly provide that even if the landlord tries to exercise a conditional limitation right to terminate the lease, the landlord may still prosecute a proceeding for nonpayment of rent, and need not elect between the two unless and until the landlord actually obtains one or the other.

31.07 *No Mitigation*. Provide that the landlord has no obligation to mitigate damages.

31.08 *Inducement Repayments*. If an event of default occurs, the tenant must repay the unamortized balance of the landlord's rent concessions, brokerage commissions and contribution to the tenant's work. (The tenant will argue that this gives the landlord double compensation. That may be true—but only if the tenant actually pays the damages provided for in the lease. The landlord can agree to offset any liquidated damages provided for in the lease by the damages suggested in this paragraph if the tenant actually pays the latter damages. But in that case, why bother?)

31.09 *Right to Cure*. The landlord can cure the tenant's defaults and bill the tenant for the landlord's expenses, with interest at the default rate as additional rent.

31.10 *Specific Performance*. Try to provide that the landlord can obtain specific performance regarding all nonmonetary covenants, both negative and affirmative (supervised and monitored by a special master if necessary).

31.11 *Intermediate Remedies*. Establish intermediate remedies for defaults that a court would probably reject as a basis to terminate a lease—such as failure to deliver financial information or an estoppel certificate. These intermediate remedies could be meaningful without being draconian, such as a nuisance fee ($100/day), a temporary rent adjustment, a suspension or deferral of some privilege or benefit, or the like. And if the tenant's "minor" default continues for a specified period, at some point make it an event of default.

31.12 *Abandonment.* The landlord's seizure of the premises based on "abandonment" can be dangerous, because of uncertainty about what "abandonment" means. Try to define it in the lease, e.g., nonpayment of rent and physical absence from the premises for a specified period.

31.13 *All Payments Are "Rent."* Describe/define all payments to be made by the tenant under the lease as "rent" to obtain "summary dispossess" rights for nonpayment. This characterization will have mixed consequences in bankruptcy, though, so the landlord may wish to be strategic about this issue.

32. Rent

32.01 *Payment*. The lease should include an express covenant to pay rent, not merely a schedule of rental amounts. Allow the landlord to require all payments by wire transfer.

32.02 *Rent Concessions*. The landlord should have the right to undo a rent concession if

the tenant defaults before the concession has been fully applied. Also, consider extending a rent concession for a longer period (e.g., six months of 50 percent rent rather than three months of free rent) or in stages over the lease term (e.g., one month free every 24 months rather than several months free at the beginning). Condition any rent concession on the tenant's finishing its initial alterations by a certain date.

32.03 *Rent Not Per Square Foot*. State rent as a flat amount rather than based on the square footage of the premises, to avoid controversy about square footage and remeasuring. Avoid any statement about the square footage or rentable square footage of the premises.

32.04 *Remeasurement*. If possible, negate any possible remeasurement of the space or the common areas. If the tenant insists on the right to remeasure, provide for a particular formula for measurement (e.g., that of the Building Owners and Managers Association [BOMA]) with the landlord's architect/space planner to certify such measurement to the landlord. If the tenant later brings an action against the landlord for bad measurement, the landlord may have a claim over against the design professional.

32.05 *Stock Options*. For tenants with initial public offering (IPO) potential, consider whether to require (or accept) stock, options, or warrants. (This paragraph was added early in the development of this checklist, sometime before April 2001. Recognizing that business cycles have not yet been repealed, the subcommittee decided to leave this paragraph in place, as it may become important again.)

32.06 *Waiver*. The tenant waives New York Real Property Law § 232(a) and (c), which automatically convert a terminated lease into a month-to-month tenancy (with notice requirements for termination) if the tenant keeps paying. (Some subcommittee members reject such a waiver. They say the cited statute is reasonable and equitable.)

32.07 *Free Rent.* Define the free rent period to end on a particular date (defined in the term sheet), not a certain number of months after the occurrence of an event (e.g., lease signing or delivery of premises). This approach shifts to the tenant the financial risk of protracted lease negotiations.

32.08 *Commercial Rent Control*. Leases already require the tenant to make a corrective payment when rent control terminates. Consider requiring the tenant to escrow the shortfall amount with the landlord each month during any rent control, and pay interest on the shortfall.

32.09 *Lockbox*. If the tenant pays rent into a lockbox, the landlord should not be deemed to have accepted a rent payment until ___ days after deposit in the lockbox. Deposit of the check does not waive the landlord's right to object to the payment. This lets the landlord correct the lockbox administrator's mistakes and preserve rights.

33. Rules and Regulations

33.01 *Compliance*. The tenant must comply strictly with the rules and regulations attached as an exhibit to the lease, and any later changes (reasonable changes?) that the landlord makes. Consider whether the landlord's rules and regulations correctly reflect present circumstances and building operations.

33.02 *No Liability*. No liability if the landlord does not enforce the rules or regulations against other tenants, or if other tenants violate them.

33.03 *Lease Incorporation*. If the rules and regulations contain anything unusually important, move it to the body of the lease. Courts may ignore rules and regulations. Provide that if any conflict exists between the rules and regulations and the lease, the lease governs.

33.04 *Recycling*. Consider requiring the tenant to separate its waste. The landlord's requirements may exceed those of applicable law.

34. Security

34.01 *Segregated Account*. Comply with any state-specific

requirements regarding how to hold security deposits (e.g., New York General Obligations Law § 7-103 and related provisions). When these provisions require notices to the tenant relating to the security deposit, try to build those notices into the lease if possible.

34.02 *Letter of Credit*. Consider requiring a security deposit to be in the form of a letter of credit to try to reduce impact of any possible tenant bankruptcy.

34.03 *Letter of Credit Requirements*. If the security deposit is in the form of a letter of credit, require that (a) the issuing bank be a New York Clearinghouse bank; (b) the letter of credit be drawable at a bank branch in the same city as the landlord upon presentation of merely a sight draft (no drawing certificate); (c) the letter of credit be an "evergreen" or the bank must notify the landlord within not less than a specified number of days of any failure to renew and the landlord may draw; (d) even if the letter of credit is an "evergreen," the issuer must confirm the current expiry date upon request; (e) the letter of credit will not expire until at least a specified number of days after lease expiration; and (f) the landlord can transfer the letter of credit without charge to the landlord's lender or purchaser.

34.04 *Waiver*. Require the tenant to waive any damages claim against the landlord for wrongful drawing on the letter of credit, and any right to enjoin or otherwise interfere with a drawing on the letter of credit.

34.05 *Security Deposit is Additional Rent*. Provide that the obligation to deliver any security deposit (or increase therein) is deemed Additional Rent.

34.06 *Replenishment*. Require the tenant to promptly replenish the amount of any security that the landlord draws, or restore the letter of credit accordingly.

34.07 *Increased Security*. A rent increase should trigger a requirement to post increased security. Are there any other circumstances that should trigger such a requirement?

34.08 *Mortgagee Requirements*. Accommodate future mortgagee requirements (e.g., a right to pledge the landlord's interest in the security deposit or to transfer any letter of credit to the mortgagee). If the tenant ultimately needs to cooperate with these measures, establish a tight time frame for that cooperation. Allocate any resulting costs, including attorneys' fees.

34.09 *Lien on Personalty*. Consider taking a lien on the tenant's personal property, perfected with a UCC-1 filing.

35. Services Provided by Landlord

35.01 *Additional Services*. If the landlord agrees to provide additional electricity or HVAC condenser water at the tenant's expense if available at the premises, the landlord should have the sole right to determine how much it needs for other tenants, including a reservation of capacity for future needs.

35.02 *HVAC*. Express HVAC standards as design criteria, not as performance specifications. The landlord's only obligation is to operate HVAC in conformance with design criteria. The tenant is responsible for distribution within the premises.

35.03 *Tenant Complaints*. Limit who can complain about any building services. Require a written notice of any such complaint, signed only by specified officers of the tenant.

35.04 *Tenant-Provided Services*. Prohibit the tenant from providing its own building-related services, especially where this could create labor problems.

35.05 *Changes in Building Operation*. Allow the landlord to change how the building operates and the services the landlord provides, subject to reasonable standards.

35.06 *Early Air Conditioning*. If the landlord provides air conditioning before the regular air conditioning season (because of hot weather or tenant requests), the landlord may charge tenants for that extra service, even if the lease does not yet require air conditioning.

35.07 *Specifications*. To the extent that the landlord agrees to comply with specifications

for any services to be provided, consider the assumptions that underlie those specifications. For example, elevator specifications assume a certain level and distribution of occupancy and usage. If the tenant installs a cafeteria, this may alter traffic patterns so much that the landlord should no longer be bound by the elevator specifications.

35.08 *Telecommunications/Fiber Optics Cable Provider*. Consider requiring the tenant to use the landlord's telecommunications/fiber optics cable provider. The landlord can change providers and has no obligations to the tenant to continue to use any particular provider. (This area is under constant review and change by the Federal Communications Commission.)

36. Subordination and Landlord's Estate

36.01 *Financeability Provisions*. To avoid negotiating a separate subordination, nondisturbance, and attornment agreement (an "SNDA"), include directly in the lease all mortgagee protections and benefits that an SNDA would typically give a mortgagee. Require the tenant to confirm these protections if a mortgagee so requests, with the form of confirmation attached as an exhibit (perhaps as part of the form of estoppel certificate). Build in flexibility to add any other SNDA protections that a mortgagee might (reasonably?) require.

36.02 *SNDA Form*. Require the tenant to execute the SNDA form required by the landlord's mortgagee. If the landlord delivers that form of SNDA and the tenant does not sign and return it within a specified period, then the landlord is deemed to have performed all its obligations regarding obtaining an SNDA from that mortgagee.

36.03 *Expenses*. Require the tenant to reimburse the landlord's expenses for delivering any SNDA from the landlord's mortgagee, including the landlord's reasonable attorneys' fees.

36.04 *Condominium or Ground Lease*. The landlord should retain rights to create a condominium regime or to enter into a ground lease. The tenant must cooperate, as reasonably necessary, provided the new structure produces no material adverse impact on the tenant. Allow the landlord to equitably adjust escalation formulas if the building becomes a condominium or is otherwise changed.

36.05 *Mortgagee Modifications*. The tenant should agree to any reasonable modification a mortgagee requests, if it does not materially reduce the tenant's rights or increase its obligations.

36.06 *Mortgagee Right to Subordinate*. Any mortgagee can unilaterally subordinate its mortgage to the lease, in whole or in part, and the tenant shall be bound by such subordination, whether or not the tenant has been notified of it.

36.07 *Lease Subordinate*. Provide that the lease is automatically subject and subordinate to the landlord's existing or any future fee mortgage. Try not to condition subordination on delivery of a nondisturbance agreement.

37. Tenant's Equipment and Installations

37.01 *Electromagnetic Fields (EMF)*. The tenant should covenant not to cause any EMF interference. If the tenant generates EMF interference, the tenant must solve the problem and the landlord has no liability. The landlord can control placement of machines that may cause EMF, even within the premises.

37.02 *Satellite Dishes*. The landlord should control roof rights, including penetration, relocation, and size and weight of dish. The tenant should remove its dish and restore the roof at the end of the term. The tenant should indemnify the landlord against all liability in connection with the tenant's rooftop equipment. The landlord can charge for the tenant's use of rooftop space. The landlord may require the tenant to relocate equipment elsewhere on the roof, at the tenant's expense.

37.03 *Conduits and Risers*. The landlord should control/coordinate use of conduits and risers that run through or adjacent to the premises.

No landlord liability for claims arising out of the tenant's use of conduits and risers. The landlord can recapture unused conduit or riser space and require the tenant to remove cable no longer in use.

37.04 *Signage and Identity*. The landlord controls all rights to exterior signage (including the name of the building, the flagpole, and rights to install plaques or other identification), even if exterior signage affects light and air. The landlord should prepare and install all signs at the tenant's expense. Alternatively, the tenant's signs must comply with signage criteria to be attached as a lease exhibit, which the landlord may modify or update from time to time. For future changes in signage criteria, give the landlord an express right to upgrade the tenant's signs, perhaps at the landlord's expense. The tenant must cooperate.

37.05 *Uniform Elevator Lobbies, Signage, Entrance Doors and Window Shades*. Require all tenants to maintain uniform elevator lobbies, signage, entrance doors and window shades. Alternatively, consider giving the landlord the right to require future uniformity.

37.06 *Supplemental HVAC, Back-Up Generator, and Fuel Tank*. The tenant must maintain its equipment in compliance with law and good practices (e.g., monthly inspections), and keep written maintenance records. These installations become the property of the landlord at the end of the term, delivered in good working order together with permits, warranties, and maintenance history documents. Restrict testing of back-up generator (very noisy).

38. Use

38.01 *Narrow Use*. Draft the use clause narrowly (e.g., not general office use, but general office use *for computer consulting*). Then say: "and for no other use."

38.02 *Recapture Right*. In a retail lease with an operating covenant, consider negotiating a continuous or periodic recapture right if the tenant ceases to operate for a stated period. Structure it so a lender may exercise it after foreclosure. For example, it should not be a one-time right that goes away after a short period of closure.

38.03 *Prohibited Use.* Prohibit the tenant from reselling to other tenants any telecommunication services, satellite capacity, electricity, or other utility or service.

38.04 *Internet.* In a retail lease, consider prohibiting in-store advertising promoting the purchase of merchandise over the Internet. (Some members of the subcommittee note that landlords who have tried to establish such prohibitions were generally laughed at, and such prohibitions do not seem likely in the future.) Consider requiring the tenant to include the name and address of the premises, as appropriate, in all Internet advertising. The tenant's Internet sales from the store should be subject to the same use limits as the sales the lease otherwise allows.

38.05 *Single-Store Operation.* Require the tenant to use and operate the premises only as a single retail operation (no separate stores or stalls, except bona fide licensed departments or concessionaires not operated under a separate name). No part of the premises can be segregated from the balance for use as a separate store, with or without a separate entrance.

38.06 *Exclusive Uses*. Track exclusive uses to avoid conflict. The landlord would ideally have no liability for conflicting exclusive use clauses or enforcement of exclusive use clauses. Alternatively, consider having the tenant's only remedy for the landlord's violation of the exclusive use clause be the right to pay percentage rent only or to obtain an assignment from the landlord of its rights against the infringer. Carve out from any "exclusive use" any store that operates the same use as one of multiple uses, but not its primary use.

38.07 *Loss of Exclusive*. If the tenant does not use its exclusive use right, then the right permanently terminates. (A temporary termination is not very helpful to the landlord.)

38.08 *Covenant of Continuous Operation*. Require the tenant to open and stay open during certain prescribed hours with sufficient personnel and inventory. What measure of damages for breach? Provide for remedies other than an injunction (e.g., higher rent), because an injunction probably won't be granted.

38.09 *Certificate of Occupancy*. Provide that delivery of a certificate of occupancy is not a representation by the landlord that the tenant may use the premises for the permitted use.

38.10 *Co-Tenancy*. Provide for flexibility in co-tenancy requirements to accommodate possible future changes in the retail marketplace. Avoid such tight requirements that over time they may become impossible to satisfy. Terminate the co-tenancy requirements at some point.

38.11 *Odors.* If the tenant's operations emit odors (e.g., a restaurant or a donut store), define in the lease specific odor mitigation measures, rather than a general obligation of the tenant to control or prevent odors. Allow the landlord to impose additional odor control measures if the initial measures do not work.

39. Vault Space

39.01 *Use and Occupancy*. Vault space may lie outside the boundaries of the landlord's property. The landlord makes no representation about any right to use or occupy such space. If the tenant uses the vault space, the tenant must maintain, repair, and pay any municipal fees imposed from time to time.

39.02 *Diminution*. Any reduction of vault space (e.g., use by any government or utility) does not entitle the tenant to any rights.

39.03 *Recapture Right*. The landlord may recapture any vault area as required by a public utility in connection with furnishing utility services to the building or the premises or otherwise.

40. Miscellaneous

40.01 *Continued Status*. The tenant should agree to update its representations and warranties from time to time and to maintain good standing throughout the lease term.

40.02 *Survival.* The tenant's obligations and liabilities under the lease should survive expiration or sooner termination of the lease.

40.03 *Independence of Covenants; No Termination Right*. The tenant acknowledges the independence of covenants and waives any right to terminate for the landlord's default.

40.04 *Diplomatic Immunity*. If applicable, the tenant should waive diplomatic immunity.

40.05 *Tenant's SEC Filing*. A publicly held tenant whose lease is a "material obligation" must file a copy of the lease with the tenant's publicly available SEC filing. Consider having the tenant: (a) represent that the lease is not a "material obligation"; (b) agree to notify the landlord if the tenant is later required to publicly file the lease; and (c) agree to try to have rental information redacted or given "confidential" treatment.

40.06 *Undesirable Elements*. The tenant is responsible for any undesirables that the tenant attracts (e.g., vandals and protesters).

40.07 *Confidentiality*. The tenant shall keep the terms of the lease confidential.

40.08 *Arbitration*. If the tenant can arbitrate disputes, condition this right on no rent default. Expressly exclude any rent dispute from the arbitration right. If the landlord cares about quick resolution of any arbitrated dispute, agree on possible arbitrators directly in the arbitration clause, rather than leave their selection until a dispute arises.

40.09 *Interpretation*. Say once that "include" means "without limitation."

40.10 *Concessions.* To the extent that the landlord gives the tenant any special "right" or "privilege," condition it on certain minimum occupancy? No default? Other criteria or conditions? What were the landlord's assumptions when the landlord agreed to the concession, and what happens if those assumptions stop being true? For example, if the

tenant's good credit eliminates any requirement for bonds or other landlord protections, undo this concession if the tenant's credit turns bad. Can the tenant exercise any privilege only once or within a certain period? Or does it apply throughout the lease term? Can the tenant assign the privilege if the tenant assigns the lease? If the tenant exercises any privilege or right, should the landlord be able to require an estoppel certificate or other documents? These issues potentially arise for every tenant "right" or "privilege," including permitted assignments, release from liability, options, exclusive uses, etc.

40.11 *Marked Leases*. When preparing final lease documents for signature, mark them against landlord's standard form to facilitate future lease review projects and administration.

41. Due Diligence

41.01 *Credit*. Perform a credit check and UCC search for the entity that will be the tenant under the lease (not just its parent or affiliate).

41.02 *Financial Statements*. Examine the tenant's and the guarantor's financial statements.

41.03 *References*. Obtain references for the tenant and its principals.

41.04 *Tenant Representations*. Obtain representations and warranties regarding the ownership structure of the tenant, perhaps backed by a secretary's certificate and copies of documents.

41.05 *Identities of Tenant and Guarantor*. Determine the entity on the lease, and the identity of any guarantor and stock ownership.

42. Other Documents

42.01 *Good Standing, and Organizational Documents*. Obtain and review the tenant's good standing certificate and organizational documents. Ask for an organizational chart if the tenant's structure is complex.

42.02 *Entity Documents.* Obtain certified copies of filed charters, and the like, to confirm exact names.

42.03 *Opinion of Counsel*. For a major lease, consider obtaining an opinion of counsel about the tenant's due authorization, execution, and delivery of the lease, though not necessarily enforceability.

42.04 *SEC Filings*. If the tenant is publicly held and any previous lease of the tenant was a "material obligation," the tenant should have incorporated that prior lease in a previous SEC filing. As a strategic matter, the landlord may wish to review this filing and see what the tenant accepted in the previous transaction.

42.05 *Brokerage.* Consider the effect of a possible tenant default on the landlord's liability for unpaid brokerage commissions. What about an early lease negotiated termination based on a change in the tenant's financial condition? Try to negate any further payment obligations to the broker in any such event.

42.06 *UCC-1 Financing Statement.* If the landlord obtains a security interest in the tenant's personal property.

42.07 *Memorandum of Lease and Release.* If the lease requires the landlord to sign a memorandum of lease, also obtain a release of memorandum of lease, and deposit it in escrow with the landlord's counsel.

42.08 *Guaranty.* Executed by the correct guarantor.

42.09 *Letter of Credit.* Review form in advance, obtain lender sign-off as needed.

42.10 *Certificate of Insurance.* Have insurance consultant review certificate as well as underlying insurance coverage.

42.11 *Taxpayer Identification Number; W-9 Form.* Require the tenant's taxpayer identification number under the tenant's signature. (Sooner or later the landlord will need it. If the tenant delivers an interest-bearing security deposit, the landlord will need the taxpayer identification number immediately.) Consider incorporating the tenant's W-9 Form certifications into the body of the lease to avoid the need for a separate form.

43. Post-Closing; Monitoring

Note: The following handful of suggestions on lease administration and enforcement is not intended as a com-

plete guide to administering and enforcing leases.

43.01 *Insurance.* Monitor expiration dates of insurance. Update coverage limits and requirements as markets change.

43.02 *Delivery of Premises.* Issue formal notice and confirmation of delivery of the premises.

43.03 *Future Deliveries.* To the extent that the lease requires the tenant to make future or periodic deliveries (e.g., financial statements, certificate of ownership structure, estoppel certificates), ask for them.

43.04 *Future Events.* Memorialize any exercise of an option, delivery of additional space, and the like, and the resulting rent adjustments.

43.05 *Alteration Consents*. A lease sometimes says the tenant need not remove its alterations and restore the premises at the end of the term unless the landlord requires such restoration as a condition to the landlord's approval of the particular work. In those cases, the landlord must remember to exercise its right to require restoration when appropriate.

43.06 *Pre-Emptive Rights.* Remember to give the tenant notices of available space, and other notices, under the tenant's rights of first refusal and other pre-emptive rights.

43.07 *L/Cs.* Monitor expiration dates; draw at the earliest possible opportunity if necessary.

43.08 *Tickler Reminders.* If the tenant persuaded the landlord to remind the tenant of certain matters (e.g., restoration obligations, option exercise deadlines), establish appropriate reminders in the landlord's calendar. Counsel may also wish to make appropriate "tickler" entries but should avoid creating ambiguity about counsel's responsibility for remembering.

43.09 *Future Amendments*. If the landlord and the tenant amend the lease, the landlord may want to obtain guarantor consent; amend any recorded memorandum of lease; and take other steps to protect the landlord's interests.

43.10 *Abandonment*. If the tenant appears to have moved out, then before entering and taking control of the premises, consider sending an "estoppel" notice to the tenant reiterating the lease provisions on "abandonment" and inviting the tenant to confirm that it has not abandoned the premises. If any doubt exists about whether abandonment has occurred, consider using a summary possession action rather than self-help, to avoid claims of wrongful eviction.

43.11 *Change of Address.* If the landlord relocates, should send a formal notice of change of address.

43.12 *Estoppels.* The landlord may wish to request periodic estoppel certificates simply to try to prevent future issues. Request an estoppel certificate (or include equivalent language in the documentation) for any amendment, consent, waiver, favor, or other concession of any kind. Include "reliance" language to support enforceability.

43.13 *Advice and Administration Memo*. The landlord may desire a memorandum summarizing important provisions of the lease and advising the landlord on actions the landlord should remember to take to avoid problems, issues, or disputes.

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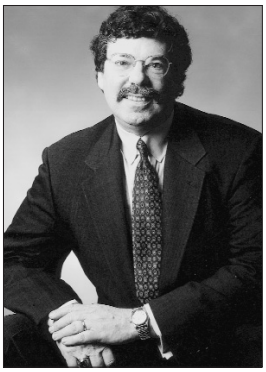
BERGMAN ON MORTGAGE FORECLOSURES
Interest on the Mortgage—A New Formula

By Bruce J. Bergman



If anything ought to be a pedestrian, mechanical task for which the procedures were refined generations ago, computation of the interest due on the mortgage is it. Whether the numbers are being considered for a referee's computation, computing a bid for the foreclosure sale or for reinstatement or payoff of the debt, there should be comfort that all was graven in stone. Well, not so, and it was the Court of Appeals which piercingly conveyed this message in *Spodek v. Park Property Development Associates*.[1]

In a nutshell, this perhaps surprising decision rules that the holder of a note in default is entitled to interest on each installment from the date the sum is due on *both* the principal and interest portions until the date liability is fixed. (In a foreclosure action, this means until acceleration. But more on that later.) Although the case involved a promissory note and not a mortgage, it clearly has significant application to mortgage foreclosure actions in New York.

A part of the whole interest computation issue is the idea that the rate of interest which will apply can change during the course of a foreclosure action. Although the new ruling relates to the earliest state of mortgage default, there is a symmetry in addressing that last.

Assume then that a borrower is in default for some number of months so that ultimately the mortgagee accelerates the full mortgage obligation. This accelerated balance now bears interest at what is variously called the "legal" or judgment rate, in New York (9 percent). (The "note" or contract rate does not apply.) This 9 percent rate prevails, however, only if the mortgage is silent about some other (and usually higher) rate. This is thought of as the default rate and most mortgages will wisely make provision for it.[2]

Because the default interest is not a loan, it cannot be condemned as usurious. So the mortgage could denominate the default rate as 14 (16, 24) percent—or *any* percentage. What rate is appropriate for *business* purposes is a different but compelling issue. The point remains, though, that the accelerated mortgage balance can and usually does yield a higher default rate which has no limit.

Once the foreclosure case wends its way to issuance of the judgment of foreclosure and sale, the sum due reverts to yielding interest at the judgment rate of 9 percent. The exception to the rule is that the balance can continue to bear the default rate if the mortgage clearly states that the default rate is to survive and not merge into the judgment.[3]

Returning to the new case, here is what it means in practical terms. Assuming a modest residential mortgage (the concept would be the same for a large commercial mortgage) a monthly mortgage payment of $1,000 is due on January 1 and monthly thereafter, consisting of (for this example) $700 interest and $300 principal. (Assume that the interest rate in the note is 7 percent.) The payments for January, February and March are not made, so on April 10, the lender or servicer accelerates the full $100,000 balance of the loan.

As mentioned, there had never been doubt that the accelerated $100,000 bears interest either at the note rate (7 percent)—or the default rate if the mortgage so provided—until issuance of the judgment of foreclosure and sale. As to the three missed payments, interest would have been computed at the note rate on the principal only (in this example, $300)—not the interest (here, on $700). With this new case, though, interest is to be assessed on the aggregate of both principal and interest, that is, on the full $1,000 for each missed payment from the date each payment was due until acceleration.

One reason such a ruling was perhaps unexpected was because it looks like it might be interest on interest (i.e., compounding)—which is often condemned. The Court of Appeals, however, found this to be an interpretation of a statutory provision (CPLR 5001) for simple interest. The decision was also stated to be consistent with the time-honored recognition that the purpose of awarding interest is to make an aggrieved party whole—something mortgagees will well appreciate.

And now to the everyday consequences of all this.

- Prior to acceleration, the longer a loan is in default, the more interest it will now yield.
- How meaningful this will be on one loan is problematical—but this applies to all mortgages in any portfolio in New York. That clearly elevates its importance.
- If there is to be a reinstatement—even months or years after acceleration—because the balance would then have been de-accelerated, it would be reasonable for a mortgagee to demand interest

upon each past due installment (on principal and interest) from the date that payment would have been due. That can become a significant amount.

There is a caveat to all this, which is that in an equitable action like foreclosure the court retains discretion in the award of interest. So, if there were some fault or delay attributable to the mortgagee, the court would not be mandated to award interest under this new formulation. Such discretion, though, is rarely invoked, leading to the conclusion that the new rule should apply most of the time.[4]

Endnotes

1. 96 N.Y.2d 577 (2001).
2. For a more expansive discussion of the interest rate which applies at various stages of the mortgage foreclosure action, see 1 *Bergman on New York Mortgage Foreclosures*, § 1.11[1], Matthew Bender & Co., Inc. (rev. 2002).
3. *Banque Nationale De Paris v. 1567 Broadway Ownership Associates*, 248 A.D.2d 154, 669 N.Y.S.2d 568 (1st Dept. 1998); *Marine Management v. Seco Management*, 176 A.D.2d 252, 574 N.Y.S.2d 207 (2d Dept. 1991). *See also* 2 *Bergman on New York Mortgage Foreclosures*, § 27.04, Matthew Bender & Co., Inc. (rev. 2002).
4. For a full discussion of interest curtailment cases, see 1 *Bergman on New York Mortgage Foreclosures*, § 2.20[3], Matthew Bender & Co., Inc. (rev. 2002).

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