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# N.Y. Real Property Law Journal

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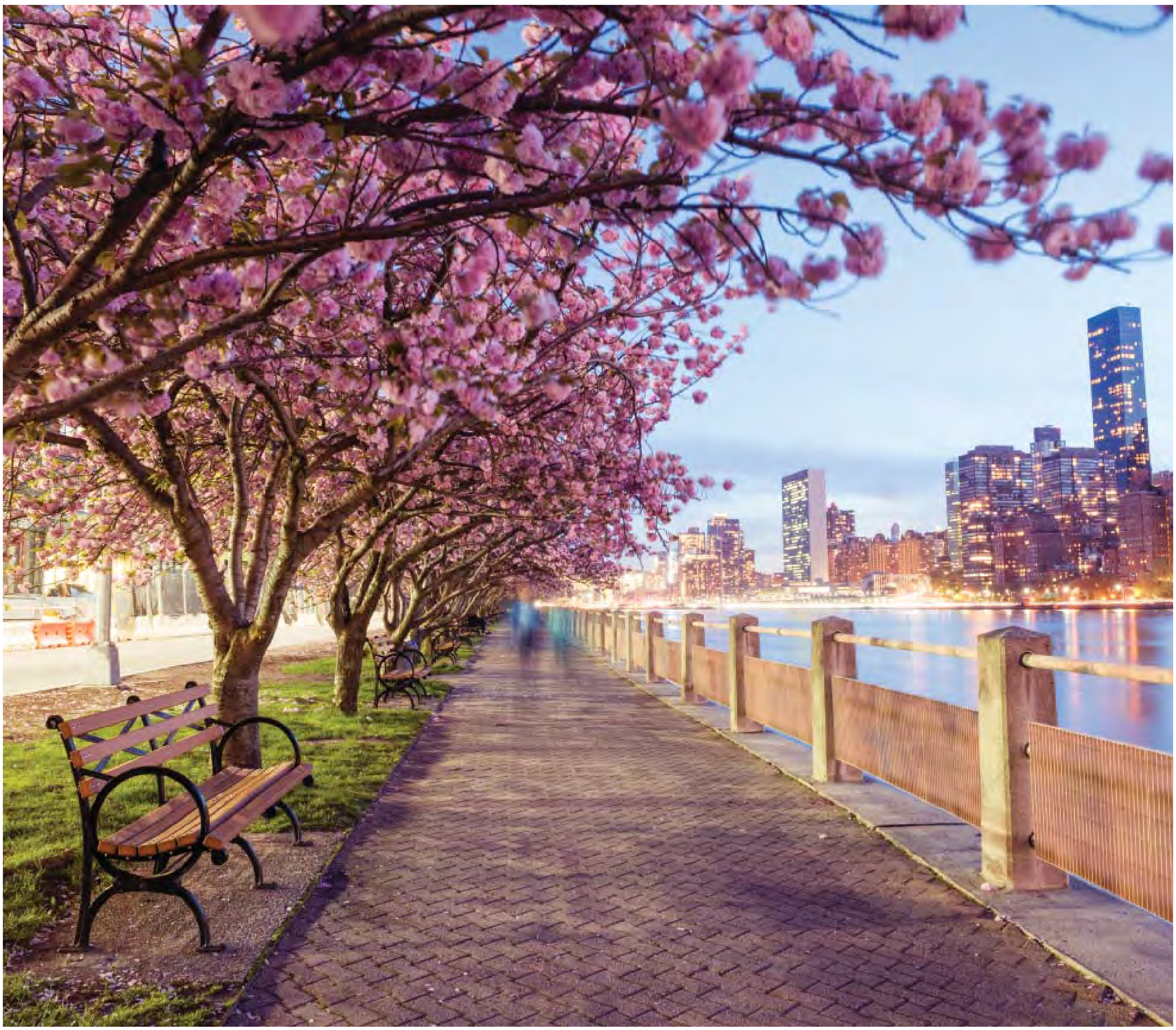

# Message from the Chair

I write this message shortly after returning from a successful Section meeting held at the NYSBA Annual Meeting in January. In addition to opportunities for CLE and collaborating on projects, the Annual Meeting was an opportunity to recognize a few of the accomplishments of some of our Section's members.

At our Executive Committee meeting we recognized Lisa Stenson Desamours, District Representative for the 9th District. Lisa has organized many social and educational events for members of her district—most recently a workday for Habitat for Humanity. In November, Metropolitan College of New York named Lisa as a "Phenomenal Woman of Power."

At our business meeting Michelle Wildgrube was elected Secretary for the Section. She will assume this position in June. As the District Representative for the 4th Judicial District, Michelle has collaborated with other district representatives, both from our Section and other Sections, to offer continuing legal education programs and social events to members in her district. She also serves as one of our Section's representatives in the House of Delegates and as Vice-Chair of the NYSBA Committee on Membership.

During the business meeting scholarships were awarded to law school students. Two scholarships were established by our Section to honor past Section chairs, Lorraine Power Tharp and Melvyn Mitzner, both of whom were active and valued members of our Section and the greater legal community. Marissa MacAneney, a student at St. John's School of Law, and Lauren Richardson, a student at New York University School of Law, were each awarded a scholarship. We look forward to great things from both of these women in the future.

At the business meeting we also recognized Diane Lowenberger as "Contributor of the Year" to the *Digest* on our Section's Community Page. The *Digest* is an invaluable resource for sharing information. Diane regularly responds to questions raised by other members. If you are not signed up for the *Digest*, I encourage you to do so. To those who are signed up, please use it. Your questions, responses to other's questions and posts of relevant information make this a more useful and interesting forum for all of us.

At our luncheon Richard Fries was recognized with the Real Property Law Section's Professionalism Award. This is the highest award given by our Section. It recognizes an attorney who has demonstrated an outstanding level of competence, legal ability and achievement, made a strong contribution to the improvement of the practice of law, engaged in mentoring and maintained the highest ethical standards. Congratulations to Richard. His countless contributions to our Section and to our profession make him truly deserving of this award.

With the Annual Meeting behind us, we now look ahead to future Section activities. Members, in conjunction with the CLE Department, will be presenting a seminar entitled "A Guide to Real Estate Closings." This program will cover the basics of residential real estate closings and will be offered live in five locations across the state during the month of June.

Our Committee on Condominiums & Cooperatives has formed two subcommittees. One of these subcommittees will be reviewing and updating forms for governing documents contained in condominium offering plans. The other subcommittee will be working to create a Tax Cuts and Job Acts—compliant attorney's income tax opinion for new offering plans. If you are interested in working on either of these projects, contact Amy, our staff liaison, at ajasiewicz@nysba.org and she will add your name to the subcommittee of interest to you.

Antar Jones, co-chair of our Diversity Committee, is planning to host a reception in April. Several of the District Representatives from the greater metropolitan area are working on plans to offer a CLE and reception this spring as well. So watch for notices about these events.

Jerry Antetomaso is finalizing plans for our Summer Meeting. This year we are headed to Water's Edge Resort & Spa in Westbrook, Connecticut. This is a beautiful beach resort on the Long Island Sound. There are activities for everyone at the resort, and many attractions to explore in the surrounding area. Our destination meetings are casual. They offer a unique opportunity to meet and get to know colleagues from across the state. Jerry is planning two mornings CLE programs for us as well, which I'm sure will be interesting and informative. If you have never attended our Summer Meeting in the past, please inquire about any discount to be offered this year to first-time attendees. So mark your calendars for July 26-29. I hope to see you there.

**Trish Watkins**

# Table of Contents

# Ducking the Cranes: Protecting Neighbors During Construction

By Brian G. Lustbader

Just what are the standards governing builders' obligations to protect adjacent properties during construction? And what access must those adjacent property owners grant to those builders and developers? These are important questions to ask whether one is representing the building party or the adjacent property owner. The law is still not fully settled on all the critical issues, but there have been several pertinent court decisions since publication of my Winter 2014 *New York Real Property Law Journal* article setting forth the then-applicable standards governing how a builder gains access to neighboring properties for protection during construction.[1] This article reviews those recent cases so both sides can better understand how to negotiate in this arena.

As is often the case, the "devil is in the details," and, while the *Rosma* decision spelled out a number of those details, many were either not addressed or were not fully fleshed out. Moreover, the *Rosma* decision is not binding on other courts because it was rendered by a lower court, and there had not been any decisions of importance from New York appellate courts in this area as of late 2013 when I prepared my article.

**Brian G. Lustbader**

## Background

My earlier article reviewed the statutory and regulatory framework for this developing area of construction law, citing the most informative of the cases that had been rendered as of that date, a 2004 case rendered by the Supreme Court in Brooklyn, the *Rosma Development* decision.[2]

The applicable statute is Real Property Action and Proceedings Law § 881 (RPAPL 881), which states that when the building party seeks a license from the adjacent property owner to protect that adjacent property during the construction work and the adjacent property owner refuses to grant the requested license, the building party may go to court to get the license and the court is to grant that license "in an appropriate case upon such terms as justice requires." The entire statute reads as follows:

> When an owner or lessee seeks to make improvements or repairs to real property so situated that such improvements or repairs cannot be made by the owner or lessee without entering the premises of an adjoining owner or his lessee, and permission so to enter has been refused, the owner or lessee seeking to make such improvements or repairs may commence a special proceeding for a license so to enter pursuant to article four of the civil practice law and rules. The petition and affidavits, if any, shall state the facts making such entry necessary and the date or dates on which entry is sought. Such license shall be granted by the court in an appropriate case upon such terms as justice requires. The licensee shall be liable to the adjoining owner or his lessee for actual damages occurring as a result of the entry.[3]

## Previously Unaddressed Issues

Among the previously unaddressed questions that have since been addressed are the following: (1) Whether there any circumstances where the license will be denied altogether, that is, where the court will find that the matter before it is *not* "an appropriate case [to grant the license]"; (2) Whether the building party is required to pay the adjacent owner's legal and engineering fees incurred in connection with negotiating and entering into the license agreement; (3) Whether the building party is required to pay a "license fee" to the adjacent owner and, if so, whether the adjacent property owner's actual economic losses should inform the amount of that fee; and (4) If the duration of building party's work exceeds the term set forth in the license, whether the neighbor may require the building party to pay some sort of additional fees, liquidated damages, to the adjacent property owner.

### 1. Outright Denial of License

In view of the fact that RPAPL 881 states that the court *shall* grant the license for access, an initial question concerns whether a court will ever deny such a license altogether. Theoretically the answer could be yes, as the statute states that the court shall grant the license "in an appropriate case," thereby implying that there can be circumstances where it may be "appropriate for the court to deny the license. Notwithstanding the "out" offered by the statute, as a practical matter the answer is almost universally no. That is, in virtually every reported decision, the courts have granted the license in some fashion.

There is one recent decision, rendered by the Appellate Division, where the license was denied outright, albeit in circumstances whereby the building party was to be permitted to reapply for the license.[4] In that 2014 decision, the First Department ruled that the building party had failed to show that its use of a swing scaffold over the adjacent property was "reasonable and necessary," and reversed a lower court's granting of the license.[5] Although no additional explanation was provided in that decision, presumably the court was not convinced that use of the swing scaffold was the least intrusive method possible, and therefore required the building party to investigate other methods of performing its work, after which it would be able petition the court anew for a license under RPAPL 881.

**2. Payment of Legal/Engineering Fees**

Of critical importance to adjacent property owners is whether they will be reimbursed for fees they incur for attorneys and, where necessary, engineers, when negotiating the license agreement and, if the matter is litigated, fees incurred in court proceedings under RPAPL 881. While there have been a number of lower court decisions granting attorneys' fees, there was no appellate division authority to that effect until the recent *DDG Warren* decision.[6] In that case, the First Department ruled that it was appropriate for the court to grant attorneys' fees, including fees incurred in the court proceedings, to the adjacent property owners. In addition, the court ruled that such fees should be payable to all three sets of counsel who had opposed the building party's RPAPL 881 petition. A like ruling was also rendered in the *North 7-8* case, out of Brooklyn Supreme Court in 2014.[7]

This reasoning has apparently not swayed all judges, however. In a very recent decision, *2225 46th St. LLC*,[8] a Queens Supreme Court judge ruled that no attorneys' fees would be awarded due to the minor nature of the building party's work, even though that same court did award a license fee to the adjacent property owner. In an earlier decision, *MB-REEC Houston Property Owner*,[9] a New York County Supreme Court judge denied the requested awarding attorneys' fees, stating that such fees are "rarely granted in RPAPL 881 cases." The court distinguished the *North 7-8* case on its facts, and then stated that the attorney fees were granted there "not as in incident to litigation but as a condition of the license."[10]

**3. Standards for Assessing License Fees**

A common misconception is that the license fees granted by the courts are to be based on economic loss(es) that the adjacent property owner has suffered or will suffer. In point of fact, the courts typically do not take into account actual economic loss in assessing license fees. Instead, they will review what other courts have awarded in similar circumstances and simply assign a value they deem to be commensurate with those other decisions. In other words, the courts' "standard," such as it is, is a subjective one.

Representative of this type of subjective reasoning is the *North 7-8* decision referenced above,[11] where the protection consisted of, among other things, installation of a wooden fence and access to airspace above the adjacent owner's property, plus construction of a temporary safety balcony on the adjacent property. There, the court referenced two other cases that had awarded license fees for lesser intrusions, including the *Rosma* case noted above, where $2,500/month had been awarded.[12] After reviewing those decisions, and based on the more intrusive nature of the protection before it, the *North 7-8* court awarded $3,500/month license fee, for one year.[13]

A similar result obtained in the *Snyder* decision from 2014,[14] where the court granted a license to install temporary overhead protection in the rear yard of the adjacent premises, including sidewalk bridging and scaffolding, as well as scaffolding that extended into the airspace above the adjacent premises. As for a license fee, the court reviewed prior decisions granting license fees, including *Rosma* and *North 7-8*, and apparently determined that the level of intrusion was somewhere in between those two, and awarded a $3,000/month license fee.[15]

Such subjective decision-making may be changing. Two more recent decisions have attempted to inject a level of objectivity into this determination. In the first, the *Van Dorn* decision in 2016, the court evaluated the evidence submitted as to the lost use of a terrace and, based on that evaluation, awarded $2,000/month license fee, a ruling that was affirmed on appeal to the Appellate Decision.[16] In the second, the *2225 46th Street* decision referenced above, the court refrained from awarding a license fee on an immediate basis, but instead ordered the parties to retain real estate brokers to report on the appropriate value of the lost space, with a very specific directive: "Rather than set a somewhat arbitrary fee, this Court directs the petitioner and respondents to each submit one expert affidavit from a real estate expert as to the value of the use and occupancy of ten (10) feet of a backyard piece of property in the subject area."[17] For the sake of certainty, it is to be hoped that such objectivity may continue in future decisions.

There have also been a few decisions where the courts have refused to award any license fees at all. This has typically been in the situation where the building party is performing government-mandated repair work as opposed to elective work for profit, usually to perform Local Law 11 masonry repair work.[18] This is not a universal rule, however. In the *Van Dorn* case noted above, the court granted a license fee to the adjacent property owner, even though the work in question was New York City Local Law 11 work, i.e., government-mandated.[19] That ruling was affirmed on appeal to the Appellate Decision, as noted above.

**4. Liquidated Damages for Late Completion**

As a dis-incentive to the building party, the adjacent property owner will often demand that the builder pay an increased license fee if the work exceeds the term set forth in the license agreement. This type of increase fee, or liquidated damages, if you will, has been sanctioned by the courts. For example, in the *Snyder* decision referenced above, the court assessed a license fee of $3,000/month, for four months, and further ruled that that amount was "to be substantially increased if the work is not completed within four months from issuance of the license."[20]

Providing that a license fee "will be substantially increased" if a completion deadline is not met, does not provide any certainty as to what that increased fee will be. Better practice is to specify a new, higher dollar amount under those circumstances. However, it is not yet clear whether and, of so, to what extent the courts will permit such increase(s). For example, in the above-cited *Van Dorn* case,[21] the Supreme Court ruled that the license fee would increase to $500/day if the builder performing the work did not complete in the time frame set forth in the license. On appeal, the First Department affirmed virtually the entire lower court decision, except for that liquidated damage provision.[22] The appellate court did not disallow the liquidated damages either. Instead, it required that the parties reapply to the court for consideration of a higher fee if and when the work extended beyond the permitted term.[23] No reasoning was given for this reversal, although the appellate court may have been concerned about the potentially excessive amount of that $500/day amount, as it translates to $15,000/month, more than seven times the original $2,000/month license fee ordered by the lower court.

One possible way to draft a license agreement to avoid such a court reversal might be to specify a higher amount, but closer to the original license fee. For example, if the license fee for the basic construction term were $2,500 per month, perhaps the liquidated damages should be no more than double that amount, say $5,000 per month, not the more than seven times that amount that was provided for in the *Van Dorn* case. So long as the increased amount is reasonably tied to the original amount, the courts might very well sustain it. Indeed, one of the courts' mantras in this area has been to prevent overreaching by either party.[24]

## Adverse Consequences from Overreaching

A very recent case, decided just this past summer, demonstrates the risks of overreaching, of overplaying one's position. In that case,[25] the adjacent property owner sought to hold up the building party until his financial terms were met, but wound up with not receiving any compensation, at least not right away, while the builder was permitted to proceed. There, the builder of a six-story building, Chelsea Partners, had been stymied in completing its work by the owner of an adjacent three-story building, a Dr. Molle.[26] In fact, Dr. Molle had obtained a partial stop work order against Chelsea's construction for failure to adequately provide information to him and failure to protect the roof of his building. Chelsea argued that it had attempted to reach an agreement for access to install roof protection, but Dr. Molle had adamantly refused such access.[27]

The procedural process was not typical. Rather than seek an order from the court under RPAPL § 881, Chelsea brought an Article 78 proceeding against the Department of Buildings seeking rescission of the latter's stop work order.[28] Thereafter, because Dr. Molle had not been not a party to the Article 78 proceeding, he moved to intervene and, upon intervention, obtain confirmation of the stop work order.[29] The court took it upon itself to get the parties to settle, conducting some three conferences with them during the summer of 2017.[30] At one of those conferences, Dr. Molle agreed to allow Chelsea limited access to inspect his roof and prepare an architect report, at Chelsea's expense, both of which were done.[31] However, thereafter Dr. Molle refused to consent to have the protection installed until his monetary demands, including a weekly license fee, were met, all the while refusing to entertain any counter offers.[32]

The court dealt with Dr. Molle's intransigence in a unique way. It did not order the Department of Buildings to rescind the stop work order (it actually dismissed the Article 78 petition), but instead found that Chelsea had provided Dr. Molle with all the relevant documentation, so ordered the latter to grant Chelsea access to install the necessary roof protection, which would in turn result in lifting the stop work order.[33] At the same time, the court directed the parties to negotiate financial terms, permitting them to seek further relief from the court if necessary.[34]

In a very real sense, this case demonstrates the risk the adjacent property owner takes if he or she attempts to overplay their cards. As noted above, the courts will not sanction overreaching.[35] Thus, while the adjacent property owner may indeed have leverage over the builder in the sense that the former may be able to hold up construction for a time, if he or she becomes totally intransigent the court has the means to cut through the intransigence and permit the construction to proceed, and to do so without yielding to the adjacent property owner's unreasonable demands.

## Conclusions

From this analysis of recent cases, there are a number of important takeaway messages for preparation of license agreements, whether one is a building party or the adjacent property owner adversely affected by the construction. First, one way or another, the builder will obtain the license sought, so the adjacent property owner should make its demands as palatable as possible to the building party. Second, the builder should be prepared to pay the reasonable attorneys' fees, and, where required, engineering fees, incurred by the adjacent property owner. Third, the builder should be prepared to pay a license fee, and a court might require that fee to be connected to some ascertainable financial loss that the adjacent property owner will suffer. The courts may not impose a license fee for government-mandated work, but that is not a settled question. Fourth, it may be appropriate to require the building party to pay liquidated damages, a higher license fee if the builder fails to complete in timely fashion. And underlying all of these considerations, both parties should keep in mind—and avoid—undue demands that a court might find to be overly aggressive, i.e., overreaching.

## Endnotes

1. Brian G. Lustbader, *Gaining Access to Neighboring Properties for Protection During Construction*, N.Y. Real Prop. L.J., Vol. 42, No.1, 9-12 (2014).
2. *Rosma Dev., LLC v. South*, 5 Misc. 3d 1014(A), 798 N.Y.S.2d 713 (Sup. Ct. Kings Co. 2004).
3. *Id*.
4. *Board of Managers of Artisan Lofts v. Montgomery*, 114 A.D.3d 491; 979 N.Y.S.2d 811(1st Dep't 2014).
5. *Id.*
6. *DDG Warren LLC v. Assouline Ritz 1 LLC*, 138 AD 3rd 539, 30 NYS 3rd 52 (1st Dep't 2016).
7. *North 7-8 Investors, LLC v. Newgarden*, 43 Misc. 3d 623, 982 N.Y.S.2d 704 (Sup. Ct., Kings Co. 2014).
8. *2225 46th St LLC v. Giannoula-Hahralampopoulos*, 55 Misc. 3rd 621, 46 NYS 3rd 772 (Sup. Ct. Qns Co. 2017).
9. *MB-REEC Houston Property Owner LLC v. The Bd. of Managers of 179 Ludlow St. Condominium,* 2016 WL 3632471(Sup. Ct. N.Y. Co. 2016).
10. *Id.,* 2016 WL 3632471*2.
11. *See* note 7, *supra.*
12. *See* note 2, *supra*.
13. *See* note 7, *supra*.
14. *Snyder v. 122 East 78th Street NY LLC*, 2014 WL 6471483 (N.Y. Sup.)
15. *See* notes 2 & 7, *supra*.
16. *Van Dorn Holdings LLC v. 152 W. 58th Owners Corp.*, 2016 N.Y. Misc. LEXIS 3077 (Sup. Ct., N.Y. Co. Aug. 19, 2016), *aff'd in part and rev'd on other grounds,* 149 A.D.3d 518, 52 N.Y.S.3d 316 (1st Dep't 2017).
17. *See* note 8, *supra*.
18. *401 Broadway Bldg. LLC v. 405 Broadway Condominium*, 2014 WL 3853846 (Sup. Ct. N.Y. Co. 2014), which followed the decision rendered in *10 East End Ave. Owners, Inc. v. Two East End Ave. Apartment Corp.*, 35 Misc. 3d 1215(A), 951 N.Y.S.2d 84 (Sup. Ct., N.Y. Co. 2012).
19. *See* note 16, *supra*.
20. *Snyder*, *supra,* note 14, 2014 WL 6471483*11.
21. *See* note 7, *supra*.
22. *Van Dorn Holdings LLC v. 152 W. 58th Owners Corp.*, 149 A.D.3d 518, 52 N.Y.S.3d 316 (1st Dep't 2017).
23. *Id.*
24. *See North 7-8 Investors, LLC, supra,* note 7, 43 Misc. 3d at 628.
25. *Chelsea Partners LLC v. New York City Dept. of Bldgs.*, 2017 N.Y. Misc. LEXIS 3264, *7; 2017 N.Y. Slip Op. 31832(U), **3 (Sup. Ct. N.Y. Co. 2017). I am indebted to my colleague, Ariel Weinstock, Esq., for bringing this case to my attention.
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. No monetary amounts were recited in the opinion, but presumably the amount demanded was steep, or else the builder would have agreed to pay it.
33. *See* note 25, *supra*.
34. *Id.*
35. *See* note 22, *supra*.

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# New Conflict of Interest Disclosure Law for Co-Ops (and Maybe for Condominiums)

By William D. McCracken

Over the last several months, New York co-op and condo lawyers have been abuzz with speculation about an unusual and almost unprecedented new disclosure law passed last year by the New York State legislature. The new legislation, effective January 1, 2018, adds a provision to the Business Corporation Law (Section 727) and the Not-for-Profit Corporation Law (Section 519-a) requiring co-op boards to report to their shareholders annually on interested party contracts.[1]

William D. McCracken

This is new. In the past, shareholders were not privy to details regarding interested-party contracts unless either the board voluntarily disclosed them or the shareholders sued the co-op.

Now, every co-op board must distribute an annual report to the shareholders, signed by each director, containing information on all contracts that were entered into or approved by the board where there was at least one so-called "interested" director.[2] The report must include a list of all such contracts, and for each contract, must state the contract recipient, the contract amount, the purpose of entering into the contract, and the term of the contract.[3] In addition, the report must include information about each meeting at which such contracts were considered, including which directors attended, how each director voted on such contract, and the date of each vote on each contract.[4] If the board approved no contracts during the year in which a director had a financial interest, this must be stated.[5] In other words, every co-op must issue this annual report even if (which will often be the case) the co-op did not enter into any interested party contracts during the year.

## What Is an "Interested Party Contract"?

In order to understand the new legislation, one needs to understand New York's existing law regarding interested party contracts. Ordinarily, a co-op board's decision to enter into a contract is protected by the business judgment rule, which creates a heavy burden for anyone seeking to challenge a co-op board's business decision in court. However, the business judgment rule presupposes that the co-op's directors are disinterested—that is, that they do not have any conflicts of interest relating to the subject transaction—and thus can be presumed to act in the co-op's legitimate interests. On the other hand, by definition, an "interested party contract" is one in which one or more of the directors may have divided loyalties.

When the co-op enters into an interested party contract, there is already a complicated set of standards (contained in § 713 of the BCL and § 715 of the NPCL, which the new law expressly cites)[6] to determine whether the contract is enforceable. In short, interested party contracts are *not necessarily* void or voidable, *if* the material facts regarding the director's interest were disclosed to the board in good faith *and* the board approved the contract without counting the interested director's vote. But that's not the end of the analysis. Even if the contract was *not* properly ratified, it can still be enforceable *if* the other contracting party shows that the contract was fair and reasonable to the co-op at the time it was approved. Conversely, if these standards are not satisfied, the board might be able to repudiate the contract at a later time, or a court might void it in an action brought by a shareholder.

Suffice it to say, application of these standards to a specific transaction is not always self-evident. If an alleged interested party contract is ever challenged in court, it is likely to result in fact-intensive (read: lengthy and expensive) litigation to determine whether the interested party contract is valid, or whether the board members breached their fiduciary duty to the co-op by agreeing to it.

## An Imperfect Fit?

Not only is New York's conflict of interest law difficult to parse on its own terms, it is in some ways an uneasy fit with co-op practice. A classic example of an interested party transaction as it applies to co-ops would be when a director, who is also an architect, receives a substantial contract to redesign the building's lobby. That contract would obviously need to be properly ratified and disclosed. But what if the director *volunteers* the services of his firm for free? That is work that would otherwise go to a disinterested third party, but it is also probably saving the co-op a lot of money. Does that arrangement need to be disclosed?

Co-ops require that tenant-shareholders enter into alteration arrangements before making physical changes to their units. Do directors who enter into alteration agreements for their own apartments need to disclose the details of their planned renovations to their neighbors? If so, that could constitute a serious invasion of privacy and may dissuade many capable individuals from serving as directors.

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There is also another problem somewhat unique to co-ops. The disclosure laws presume that the co-op is being run by the board of directors. In many cases, however, the management company, not the board, effectively controls the building. Plum contracts go not to board members, but to associates of the managing agent or superintendent. The new disclosure law does nothing to address those conflicts of interest, which can be just as serious (if not more so) as conflicts involving board directors.

In addition, in some buildings, board members with brokers' licenses can wield undue influence on (and earn fees from) purchases and sales in the building. These arrangements undeniably implicate such board members' fiduciary duties to the co-op. However, because of the way the statute is drafted, as long as that board member does not enter into a contract directly with the co-op, the relationship probably does not need to be disclosed in the annual reports.

## A Solution in Search of a Problem?

By all accounts, the new disclosure law was not legislation sought by the co-op community. In fact, reports indicate that most commentators were opposed to the legislation on both technical and substantive grounds. In fact, it is remarkable that despite being on the books for many years, there are relatively few published decisions analyzing BCL § 713 or NPCL § 715 (and not surprisingly, none on the new law).[7] Of those, only a handful of decisions apply the law in the co-op context.[8] This was not an area of significant activity or attention.

Nevertheless, the new legislation was introduced in June 2017 and signed into law by Governor Cuomo in September. It may be a sign of the haste in which the law was passed that it does not apply more broadly than it purports to do. As indicated by its official preamble, the legislation was apparently intended to address "conflicts of interests for *condominium* and cooperative housing" (emphasis added), but because the law did not amend the Real Property Law, condominiums (other than the minimal number of "incorporated" condos) are currently excluded from the disclosure requirements.[9] A bill has been introduced in the New York State legislature to amend this apparent oversight, so condominium boards should be prepared to revise their procedures to comply with the disclosure requirements discussed in this article.[10]

Other questions remain open about the substantive and procedural requirements of the new law, but those will likely only be answered through trial and error by individual buildings. (Perhaps it is for the best that the new law also does not prescribe any specific penalties for noncompliance.) Because the new law has now gone into effect, we would encourage co-ops (and condominiums) to consult with their legal counsel as soon as possible to determine how best to implement the new disclosure regime.

## Endnotes

1. N.Y. Bus. Corp. Law § 727 (McKinney 2018); N.Y. Not Prof. Corp. § 519-a (McKinney 2018).
2. N.Y. Bus. Corp. Law § 727(a)(2) (McKinney 2018).
3. N.Y. Bus. Corp. Law § 727(b)(1) (McKinney 2018).
4. N.Y. Bus. Corp. Law § 727(b)(2) & (3) (McKinney 2018).
5. N.Y. Bus. Corp. Law § 727(c) (McKinney 2018).
6. N.Y. Bus. Corp. Law § 727 (McKinney 2018); N.Y. Not Prof. Corp. § 519-a (McKinney 2018).
7. N.Y. Bus. Corp. Law § 713 (McKinney 2017); N.Y. Not Prof. Corp. § 715 (McKinney 2017).
8. Those decisions include *Barbour v. Knecht*, 296 A.D.2d 218 (1st Dep't 2002) (defendants' participation in the board's decision was permissible because their interested relationships were fully disclosed); *Park River Owners Corp. v. Bangser Klein Rocca & Blum, L. L. P.*, 703 N.Y.S.2d 465 (1st Dep't 2000) (resolution to terminate defendant law firm's retainer was not supported by a majority of plaintiff's disinterested directors); *Strax v. Murray Hill Mews Owners Corp.*, 10 Misc. 3d 65, 809 N.Y.S.2d 759 (1st Dep't 2005) (cited in dissent); *Radwan v. Tsikasis*, 2012 N.Y. Slip Op. 32028(U) (Sup. Ct. N.Y. Co. 2012) (enjoining defendant directors from voting on questions before the board in which they are financially interested); and *181 East 73rd Street Co. v. 181 East 73rd Street Tenants Corp.*, No. 87 Civ. 3362 (RO), 1990 U.S. Dist. LEXIS 4063 (S.D.N.Y. 1990) (sponsor's commercial lease with co-op was not procedurally unconscionable).
9. New York State Senate Bill S6652A, The New York State Senate, http://legislation.nysenate.gov/pdf/bills/2017/S6652A.
10. New York State Senate Bill S7279, The New York State Senate, https://www.nysenate.gov/legislation/bills/2017/S7279.

# An Overview of Real Estate Loan Forbearance Agreements—Part I

By Richard S. Fries

**Richard S. Fries**

Today's distressed real estate loan is a complicated affair, with many diverse parties pursuing objectives and interests quite different and more complex from those just a few years ago. Layer upon layer of debt—real estate, mezzanine, preferred equity—have become the norm; lenders and investors have competing interests and remedies; relationships among lenders (some "in the money" and some not) have become as important, contentious and sophisticated as relationships between mortgage lenders and borrowers of real estate down cycles past.

Today's capital stack is filled with national and international hedge or private equity funds, or opportunistic or strategic lenders, which may have purchased a debt position at a discount, or even originated the loan with the intention (or hope) of becoming the owner of the collateral through foreclosure. These lenders often provide financing with interest rates and covenants that increase the prospects of default in a rising interest rate environment or, as now, at the tail end of the real estate cycle. These (often unregulated) lenders may have increased litigation staying power as a result of: (1) a greater ability to own, hold, manage, and liquidate the collateral at a profit; (2) their low basis in the underlying obligation; and (3) far less regulatory scrutiny of their capital structure, loan-loss reserves, or financial condition.

By the same token, borrowers and their investors are litigating vigorously, invoking a plethora of challenges, tactics and strategic delays throughout the judicial process. This may induce "lender fatigue"—the phenomenon by which a lender, "exhausted" from the costs and unpredictability of litigation, maintaining the collateral and regulatory oversight, will offer a borrower a favorable workout structure, or even a discounted repayment, in order to "stop the bleeding."

Loans may be current; the borrower may have never defaulted on a loan obligation in the past and its project may be well maintained. Nonetheless the project may fall victim to the cycle, a softer market or unforeseen capital events. These circumstances cry out for a balanced and workable forbearance agreement. This article (in two parts) sets forth a primer on what such a forbearance agreement—perhaps the most common commercial loan workout device—should look like.

## Strategies, Techniques and Objectives.

The forbearance agreement adheres to the following principle: In exchange for economic and legal concessions, the lender obtains certain credit or collateral enhancements and/or remedies.

"Concessions" include: (1) restraint or forbearance from accelerating the loan and/or pursuing foreclosure and other legal remedies; (2) extension of the maturity date; (3) waiver of economic or covenant defaults; (4) suspension of principal amortization or interest payments; (5) reduction of the interest rate; (6) partial release of collateral; (7) release of guarantors or reduction of their obligations; (8) the opportunity to repay the indebtedness at a discount; (9) modification or waiver of covenants or capital requirements; (10) additional loan advances; or (11) an exchange of debt for equity.

"Enhancements" in favor of the lender include: (1) the cure of legal, document or perfection deficiencies; (2) concessions or contributions from other lenders in the capital stack; (3) additional collateral from a sponsor, guarantor or equity investor; (4) an additional guaranty of a previously non-recourse loan, debt service, project completion or other financial obligations; (5) an increase in the scope of guaranteed obligations, or new "recourse" events; (6) more loan covenants, financial reporting or monitoring rights; (7) control of the project revenue (cash collateral) through a cash management agreement; (8) a cash flow sweep tied to an approved budget, controlled expenditures, or a new or improved revenue stream; (9) a capital infusion to stabilize the project or reduce the indebtedness; (10) ratification of the loan documents and lien priority; (11) waiver and release of defenses and counterclaims; and (12) consent to remedies.

Negotiating the trade-off of concessions for enhancements—framed against the backdrop of uncertain market conditions or asset classes (such as retail, hospitality or high-end condominium construction), rising interest rates, densification of real estate, e-commerce, scarcity of institutional replacement financing, suffocating regulation and risk retention rules, backlogged courts, crafty lender liability defenses and judicial and legislative sympathy—has become an art form like never before.

## Essential Provisions

The "state of the art" commercial real estate loan forbearance agreement should include the following essential provisions:

### Acknowledgment of Indebtedness

The lender's "ticket for admission" for forbearance is the unequivocal acknowledgment by borrower and all guarantors (including "bad boy" guarantors) that defaults have occurred and the entire debt is immediately due and payable in full without defense, offset, or counterclaim. (In certain circumstances, the borrower may resist waiving defenses to the indebtedness; these are rare, limited and if granted must be fact specific.)

### Ratification of Loan Documents

The lender wants to cure any and all loan or document defects, oversights, incomplete signatures or failures to perfect its security interests in its collateral. The borrower and guarantors will ratify and confirm the validity, enforceability and binding nature, both at the time of delivery and on the date of the forbearance agreement, of all loan documents. Borrower and guarantors will acknowledge that all of their financial obligations are duly and properly secured by mortgages and all other security or collateral instruments and the priority of the lender's lien.

### Waiver of Defenses and General Release

No one likes to release defenses or claims. However, the prudent lender will not make any significant economic concessions or grant meaningful forbearance unless the lender is assured of a clean slate when the forbearance period has expired. The borrower—looking for forbearance, economic concessions or an avoidance of foreclosure, receivership or springing recourse—should suppress its "creative word processing" and acquiesce. The forbearance agreement should provide that borrower, guarantors and their affiliates unconditionally waive and release all defenses to repayment and all claims against lender relating to the loan documents, the obligations, the mortgaged property and the dealings between the parties.

The negotiation of the release can be arduous. Invariably, borrowers will—and should—give in on this point. In complex, multi-tranche, multiple collateral transactions, the parties may carve out from the release specific facts, claims, defenses or a limited course of dealing. Duration of the forbearance plays a role, as does the quality of the lender's economic concessions. For example, for a one-year forbearance, a suspension of debt service or a discounted repayment option, the borrower is far more willing to release its "claims" than it would be for lender's agreement to forbear enforcement for a few weeks.

### Forbearance Expiration Date

The lender agrees to forbear acceleration of the indebtedness (unless that has already occurred) and/or the exercise of its legal remedies until a negotiated date certain (the "forbearance expiration date"), which may be extended. The forbearance lasts as long as borrower and guarantors fully and timely satisfy all obligations set forth in the forbearance agreement. Subsequent defaults end the lender's forbearance obligation.

Built-in options to extend the forbearance expiration date if economic milestones are met or "good news events" transpire (or to shorten the term if milestones—such as receipt of a refinancing term sheet—are not met) make for an enduring, lively and closely watched period of forbearance.

### Payment Modification

A key economic component is the modification or suspension—for the term of the forbearance, or longer—of the contractual debt service payments. These are pure business points, based on cash flow, capital improvements and deferred maintenance needs, recourse, reputation or the parties' leverage in the workout. Principal and interest rate relief or deferral generates needed cash flow. Even in a low interest rate environment, "debt service relief" for large, distressed, projects, adds up. The "ask" is an easy one to make; the "give," more nuanced.

Here's the structure: monthly principal installment payments are suspended (or reduced); interest is modified into a "note rate/pay rate" model whereby interest will continue to accrue at the contract, or note, rate but borrower pays interest monthly at a lower "pay rate." The difference (the "contract interest shortfall") is accrued and *either* paid on the forbearance expiration date or other date certain, or forgiven once borrower has performed its obligations and repaid the indebtedness (as such may be reduced) when due.

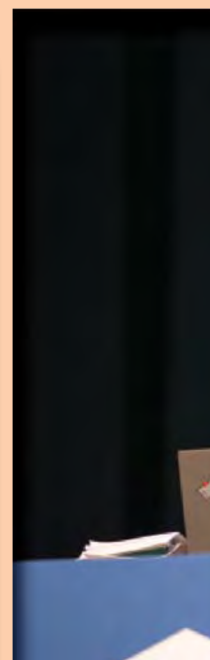
Lender should also accrue interest at the default rate and the difference between the default and pay rates (which erodes equity remarkably quickly) will be forgiven when the remaining indebtedness has been repaid or certain benchmarks (such as reaching certain stabilization levels) have been achieved. This "default rate" accrual—particularly if there is recourse—creates additional leverage for the lender and economic motivation for the borrower to perform. From the lender's perspective, the forgiveness should occur *only after* the other contractual obligations have been met—never when the forbearance agreement is first executed.

Part two of this article will explore certain creative economic solutions for a loan in distress and the type of remedies the lender can implement in exchange.

**Richard S. Fries is a partner at Sidley Austin and co-leader of its global real estate practice. He is the co-chair of the Real Estate Financing Committee of the Real Property Law Section of the New York State Bar Association.**

# Real Property Law Section at the 2018 Annual Meeting


NYSBA
NEW YORK STATE BAR ASSOCIATION




NYSBA

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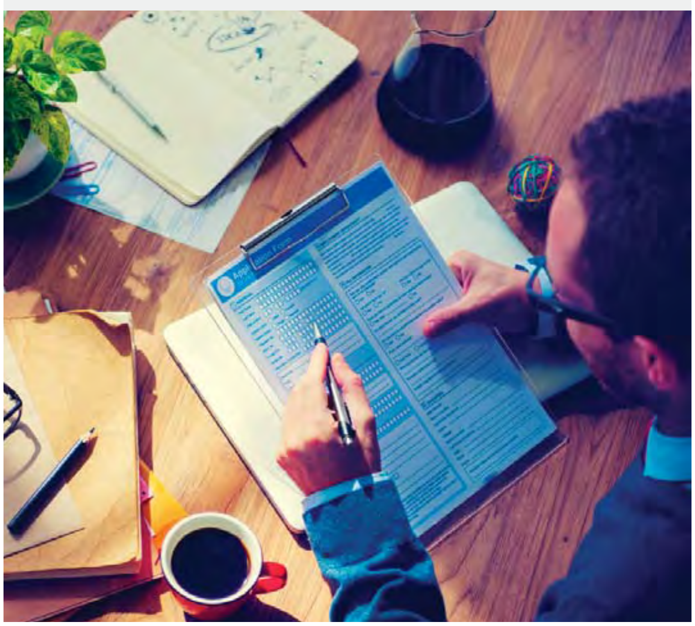

# Attorney-Owned Title Insurance Agencies: Legislative Sausage Making in 2014

By Michael J. Berey

**Michael J. Berey**

The Fall 2017/Winter 2018 *New York Real Property Law Journal* (Volume 45, No. 3) included an article by my esteemed colleague in title, Marvin Bagwell, "May an Attorney Refer the Attorney's Real Estate Clients to a Title Agency Owned by the Attorney? The Battle for New York."[1] Mr. Bagwell's article explained differences in real estate and title insurance practices between upstate and downstate New York, summarized opinions that have been issued by the Ethics Committee of the New York State Bar Association dealing with attorney-owned title agencies, and concluded, as to New York, referencing the enactment of title insurance agent licensing legislation in 2014.

Legislation requiring the licensing of agents writing title insurance in New York, Part V of the 2014-2015 Executive Budget,[2] enacted as Chapter 57 of the Laws of 2014 on March 31, 2014, included a new Insurance Law § 2113 ("Title insurance agent commissions; disclosure").[3] Under Section 2113 (e), "[f]or the purposes of this chapter, an attorney or his or her law firm may represent a client in a matter and may also act as a title insurance agent in such matter subject to applicable law."[4] Mr. Bagwell's article states that "[n]o one is sure what 'applicable law' means. Does it mean the Ethics Opinions? However, they are not laws. Is the phrase a nullity because there are no applicable laws? We do not know."[5] This article sets forth for the record the intention of Section 2113(e) which I know from my having participated in a meeting in Albany in which agreement on the text of Section 2113(e) was reached.

This article is not intended to discuss the merits of or the authority of attorneys to issue title insurance policies as title agents for their clients. I leave that to those more experienced in the technical aspects of legal ethics, the legislature as it may deal with this issue in the future, and, perhaps, the courts. My knowledge of legal ethics is, for the most part, endeavoring to do the right thing.

A meeting was convened on the second floor, known generally as the "Executive Chamber," in the State Capitol on March 25, 2014, to resolve for the proposed agent licensing legislation the question of the authority of attorneys to write title for their clients as agents for title insurance companies licensed in New York. The stakeholders at the meeting were the Governor's Office, the New York State Bar Association and the New York State Land Title Association (NYSLTA).

At the meeting for the Executive were George Haggerty, the Governor's Deputy Secretary for Financial Services, and three members of the Governor's staff involved in the drafting of the legislation. Attending for the New York State Bar Association were Ronald Kennedy, its Director of Governmental Relations; Kevin Kerwin, its Deputy Director of Governmental Regulations, and Gerard Antetomaso, a highly respected real estate attorney based in Webster, New York. At the meeting for the New York State Land Title Association were this author, who was then the President of the Association, and Scott Wexler and Kate Corkery of Ostroff Associates, Inc., the Association's representative in Albany.

Not having previously been involved in what has been referred to me as the legislature sausage-making process, the experience was remarkable and it has therefore remained clear in my memory. To confirm what I recall, I have reviewed a memorandum I prepared the next morning, March 26, for the Executive Committee of the NYSLTA on the specifics of the meeting, a Memo in Support of the final legislation, referenced below, and other notes that I had imaged for my records.

Section 2113(e) was not included in the original agent licensing legislation. It was presented to NYSLTA at the meeting called by the Governor's Office as a means to bridge the gap between NYSLTA and NYSBA on the issue of attorneys writing title for their clients. The intention of Section 2113(e), as presented by the Governor's office, was to continue existing local practices as to the writing of title insurance in downstate and upstate New York, which local practices were well explained in Mr. Bagwell's article.

Not having known of the text of Section 2113(e) before the meeting, NYSLTA brought to the table the following proposed text: "An attorney or a law firm may represent a client in a matter and act as a title insurance agent for the issuance of a policy of title insurance in such matter as may be permitted by the Rules of Professional Conduct for attorneys of the New York Unified Court System." NYSLTA had in mind, particularly, Ethics Opinion 753, which states the following:

> A lawyer owning mortgage brokerage and title abstract business may not, even with informed consent, represent buyer or seller and act as

> mortgage broker in the same transaction or act as the title abstract company with respect to non-ministerial tasks but may where the client consents after full disclosure, act as an abstract company with respect to purely ministerial work. The lawyer...may not represent the lender in transaction in which the lawyer's title company acts in other than a ministerial capacity.[6]

In response to this request by NYSLTA, it was noted by Mr. Haggerty, and agreed by all in the meeting, that the reference to "subject to applicable law" in Section 2113(e) was "sufficiently broad" to meet NYSLTA's concern.[7] As the conversation was summarized in my Memorandum of March 26 to NYSLTA's Executive Committee, it was agreed that "within its scope are the Rules of Professional Conduct applicable to attorneys, contained in an appendix to the Judiciary Law[8] and the rulings of the Insurance Department, now part of the DFS." NYSLTA agreed to the language of Section 2113(e) based on that understanding.

I requested that this legislative intention be recorded in a memorandum of support to the agent licensing bill. We were advised that this could not be done, presumably because the usual form of a Memo of Support had already been posted on the State Assembly website;[9] in any event, the Memo of Support included only a limited outline of the Executive Budget. Documents dealing with the budget bill had already been prepared and, it is reasonable to presume, issued.[10]

On March 29, NYSLTA issued a Memorandum in Support of the legislation which this author has been advised was delivered to the Governor's office, to State legislative leadership, and to other Members of the legislature the same day. It affirmed the Association's support for the agent licensing legislation, noting that

> NYSLTA supports the provision which recognizes and accommodates the custom and practice of abstractors and attorney/agents in the western and northern parts of the State, while preserving the requirement that attorneys remain subject to all applicable laws, including but not limited to the Rules and Regulations of the Department of Financial Services as set forth in its Opinion[s] and Circular Letters, the New York Code of Professional Responsibility, and the Ethics Opinions of the New York State Bar Association.[11]

The Executive Budget, including Part V, was passed by both houses of the legislature, and signed into law by the Governor, on March 31, 2014.

At the meeting on March 25, NYSBA proposed the following alternative text: "Nothing in this section shall be deemed to prohibit an attorney or his or her law firm from representing a client in a matter and acting as a title insurance agent in such matter or be deemed to prohibit payment by the client (i) for actual services rendered by an attorney for the purposes of representing his or her client and (ii) to an attorney in his or her capacity as a title agent." The response to NYSBA's proposal from the Governor's representatives was clear, and I remember it well; Section 2113(e) as drafted was "all that it was going to get."

In summary, the legislation, to employ an overused colloquialism, "kicked the can down the road," not disrupting existing downstate and upstate practices for the issuance of title insurance policies, and effectively incorporating into the legislation by its reference to "applicable law" the Rules of Professional Conduct, applicable ethics opinions, and rulings of the state's insurance regulator.

## Endnotes

1. Marvin Bagwell, *May an Attorney Refer the Attorney's Real Estate Clients to a Title Agency Owned by the Attorney? The Battle for New York*, N.Y. Real Prop. L. J., Vol. 45, No. 3, 13 (2017/2018).
2. New York State Senate Bill 6357-D, New York State Assembly Bill 8557-D.
3. N.Y. Ins. Law § 2113 (McKinney 2014).
4. N.Y. Ins. Law § 2113(e) (McKinney 2014).
5. Bagwell, *supra* note 1, at 22.
6. NYSBA Comm. on Prof'l Ethics, Formal Op. 753 (2002).
7. N.Y. Ins. Law § 2113 (McKinney 2014).
8. The Rules of Professional are not in an Appendix to the Judiciary Law as was the case with the Code of Professional Regulations, which was superseded in 2009. The Rules of Professional Conduct are codified at 22 NYCRR Section 1200.
9. New York State Assembly Memorandum in Support of Legislation, New York State Assembly, http://nyassembly.gov/leg/?default_fld=&leg_video=&bn=A08557&term=2013&Memo=Y.
10. 2014-15 Archive, New York State Division of the Budget, https://www.budget.ny.gov/pubs/archive/fy1415archive/1415archive.html.
11. Title Insurance Agent Licensing Memorandum in Support, New York State Land Title Association, Inc., http://nyslta.org/sites/default/files/Memorandum%20in%20Support_3-29-2014%20to%20post.pdf.

**Michael J. Berey, a Senior Underwriting Counsel for the First American Title Insurance Company, was formerly a Senior Vice-President for the Company and its Chief Underwriting Counsel for New York State.**

# Bergman on Mortgage Foreclosures
# Court Allows Borrowers Standing Defense by the Back Door

By Bruce J. Bergman

Lenders, of course, are aware that standing has likely become the most ubiquitous borrower defense in the foreclosure realm. It can often be problematic. But there is a salutary aspect to all this: the standing defense is waived if not interposed in an answer or a pre-answer motion. There is considerable case law buttressing this proposition and it is meaningful because it saves lenders the burden of suffering a standing defense, for example on the eve of sale.

All that noted, there is a case which affords borrowers another (and more dilatory method) to pursue the otherwise waived standing defense—through amending an answer. [See *U.S. Bank National Association v. Sharif*, 89 A.D.3d 723, 933 N.Y.S.2d 293 (2d Dept. 2011)].

How nefarious this can be is best understood with a mention of the facts—but briefly first the legal principles applicable to amending an answer.

If a defendant desires to amend an answer already interposed (in our milieu, that defendant typically is the borrower) a motion for relief is to be freely granted by the courts, absent prejudice or surprise directly resulting from the delay in seeking that leave. This prevails unless the proposed amendment is palpably insufficient or patently devoid of merit. Mere lateness is not a bar to the amendment; rather it must be lateness coupled with sufficient prejudice to the other side.

So what happened in this case? Here, the borrower made no motion attacking the complaint on the ground of standing and, although he submitted an answer, it contained no standing defense. The foreclosing plaintiff thereupon moved for summary judgment to dispose of the other defenses in the answer.

Upon appeal, the court ruled that waivable defenses (such as standing) can nevertheless be interposed in an answer which is amended by leave of the court—so long as that amendment does not cause the other party prejudice or surprise resulting directly from the delay.

**Bruce J. Bergman**

In this case, it so happens that the plaintiff had a weak response to the standing defense sought to be put in the amended answer (it was an assignee of the mortgage but that assignment did not include the note or bond). Therefore, the court was able to find that the standing defense was *not* palpably insufficient. Nor could the lender prove surprise or damage from the delay in the borrower seeking now to employ the standing defense. Indeed, in most cases, it would be very difficult for a lender-plaintiff to defeat the amendment motion on the grounds of surprise or prejudice.

In sum, under many circumstances, even though the standing defense will have been waived, a motion to amend the answer will be an efficacious way for a borrower to first raise the defense and thereby cause further delay in the case.

**Mr. Bergman, author of the four-volume treatise,** *Bergman on New York Mortgage Foreclosures,* **LexisNexis Matthew Bender, is a member of Berkman, Henoch, Peterson, Peddy & Fenchel, P.C. in Garden City. He is a fellow of the American College of Mortgage Attorneys and a member of the American College of Real Estate Lawyers and the USFN. His biography appears in** *Who's Who in American Law* **and he is listed in** *Best Lawyers in America* **and** *New York Super Lawyers***.**

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## *N.Y. Real Property Law Journal*
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