

**LEASE LAW ROUNDUP 2010
(LEARNING FROM OTHER PEOPLE'S MISTAKES)**

**Copyright ©2011 Nancy Ann Connery
All rights reserved.**

LEASE LAW ROUNDUP 2010

Nancy Ann Connery
Schoeman, Updike &
Kaufman, LLP
60 East 42nd Street
New York, New York
nconnery@schoeman.com

INTRODUCTION

They say that the best way to learn is from your own mistakes, but the fact is that we'd all rather learn from other people's mistakes. This selection of cases is presented in the hope that we can all learn a lesson or two from the cases decided in 2010. Not all the cases reflected errors or mistakes; some cases simply represented a particular judge's "take" on a situation.

There were no ground-breaking leasing cases in 2010 (others may disagree), although a few surprises in contract interpretation. The courts focused on the same themes that have arisen in past years (e.g., the lease means what it says), and the cases are instructive in that they tell us that we need to pay attention to the basics.

COURT OF APPEALS

Barnan Associates LLC v. 196 Owners Corp., 899 N.Y.S.2d 724 (2010).

Facts and Holding: Coop's commercial lease included a tax escalation clause that defined the "base assessed valuation" as "the total fully assessed valuation (made without regard or giving effect to any exemption or abatement) of the parcel of [the subject land] for the New York City real estate tax year commencing July 1, 1979 and ending July [*sic*] 30, 1980" and the "base amount of real estate taxes" as "the dollar amount computed by and resulting from the application of the 'base tax rate' to the 'base assessed valuation'. The lease required the tenant to pay 14-1/2% of any increase in "such" real estate taxes on the said land, buildings and improvements over the "base amount of real estate taxes." The lease was executed in 1979. In 1981 the building was converted to cooperative ownership. In 2005, the tenant realized that the coop had been calculating the tax escalation without regard to tax abatements (which were passed through to the tenant-

shareholders) and commenced an action for alleged overcharges. The Supreme Court dismissed the tenant's motion for summary judgment finding the lease language ambiguous and also applying the "voluntary payment" doctrine. The Appellate Division found the lease unambiguous and directed judgment in favor of the tenant. The Court of Appeals interpreted the tax escalation clause in favor of the coop, holding that the language requiring the tenant to pay its share of increases in "such" taxes above the base amount of real estate taxes (which base amount taxes were to be determined without reference to abatements) logically meant that the subsequent year taxes should also be determined without reference to tax abatements. The court also noted that the tax benefit programs did not decrease the corporation's tax liability (the tax abatement program required the coop to pass through tax abatements to the tenant shareholders).

What's Interesting: First, the escalation clause was arguably ambiguous. Each of the 3 courts that looked at the issue adopted a different view of the clause. The lease explicitly said that base year taxes would be computed without reference to abatements. There was no corresponding provision as to the computation of subsequent year taxes. There was no general definition of real estate taxes that provided that taxes should be computed without regard to abatements. The Supreme Court explicitly found the clause ambiguous and held in favor of the coop (a) on the basis of the parties' course of conduct and (b) the voluntary payment doctrine. A factor in its decision was the lack of windfall to the coop, which passed through tax abatements to its shareholders. The Appellate Division, on the other hand, found no ambiguity and held in favor of the tenant, pointing out that the only description of real estate taxes in the lease was to real estate taxes levied by the City of New York (with no language indicating that taxes were to be determined without reference to abatements). The Court of Appeals interpreted the language in favor of the landlord.

Historically, landlords have defended against tenant claims for prior year overcharges by relying on (a) the voluntary payment doctrine (if the tenant fails to contest the landlord's formula for computing additional rent for years, the tenant is barred from disputing the formula subsequently) and (b) an interpretation of the statute of limitations that calls for the statute of limitations to start running, as to the landlord's method of computing the additional rent, on the date the first statement is issued (giving the tenant 6 years to dispute the formula). In this series of cases, the Supreme Court relied on the voluntary payment doctrine, the Appellate Division rejected it; and the Court of Appeals did not discuss it. So where are we?

Related Cases re Escalation Rent Overcharges

Citicorp North America, Inc. v. Fifth Ave. 58/59 Acquisition Co., LLC, 70 A.D.3d 408 (1st Dept. 2010) (court barred tenant's recovery of alleged overpayments of porter's wage escalations from 1993 by applying the voluntary payment doctrine).

Eighty Eight Bleecker Co., LLC v. 88 Bleecker Street Owners, Inc., 34 A.D.3d 244 (1st Dept. 2006) (20 year failure to challenge computation of tax escalation barred tenant from seeking recovery of overcharges under voluntary payment doctrine).

Goldman Copeland Associates, P.C. v. Goodstein Bros. & Co., Inc., 268 A.D.2d 370 (1st Dept. 2000) (tenant who failed to institute a challenge to the computational formula used by the landlord to calculate porter's wage escalation within 6 years after first statements, time barred from recovery of overcharges extending over a period of 12 years).

Kramer, Levin, Naftalis & Frankel, LLP v. Metropolitan 919 3rd Avenue, LLC, 6 Misc.3d 796 (Sup. Ct. N.Y. Co. 2004) (tenant who failed to challenge landlord's method of computing real estate tax escalation for more than 6 years after the first statement is time barred from recovering overpayments).

Fairfax Co. v. Whelan Drug Co., Inc., 105 A.D.2d 647 (1st Dept. 1984) (where coop's taxes decreased between the tax base year and subsequent tax year because of J-51 tax abatements, the tenant's tax escalation should have been computed with reference to the J-51 abatement, to avoid a windfall to the coop).

Park Square Garage, Inc. v. New York University, 27 A.D.2d 460 (1st Dept. 1967) (tenant leased non-tax exempt space in a building used partially for real estate tax exempt purposes, creating an issue as to computation of the tax that the court resolved through interpretation of the lease).

Moral

1. If your intent as landlord is to exclude tax abatements from the computation of real estate taxes, introduce that concept into the definition of real estate taxes.
2. If you are the tenant, check the City's records to see if there's a tax exemption or abatement in place before you sign the lease.
3. If you represent a not-for-profit or other landlord entity that may realize the benefit of a real estate tax abatement or exemption, address the issue in the lease if there's a pass-through of taxes or tax escalation clause.
4. If you're the tenant, check the landlord's calculations of lease pass-throughs and escalations promptly.

CONSTRUCTIVE EVICTION

See Broadway 36th Realty LLC v. London, 29 Misc.3d 1238(A) (Sup. Ct. N.Y. Co. 2010) below.

GOOD GUY GUARANTIES

Johnston v. MGM Emerald Enterprises, 893 N.Y.S.2d 176 (2d Dept. 2010).

Facts and Holding. MGM signed a lease that was guaranteed by its 2 principals (the “MGM Principals”). The lease rider stated that, as an inducement to the landlord to lease the premises, the MGM Principals personally guaranteed payment of an amount equal to one year’s rent in the event of default. The guaranty provided that “said amount [\$156,000] shall be considered a fair and reasonable sum to compensate Owner for said breach of Lease, and in consideration of Owner not seeking the rent due and owing for the then outstanding remainder of the Term of the Lease.” MGM assigned the lease to AMLG and AMLG’s principal executed a full guaranty of the lease. At the time of the assignment, the MGM Principals essentially reaffirmed their guaranty. AMLG defaulted and the landlord went after everyone. The court held that the landlord’s damage claim against both MGM and the MGM Principals was capped at 1 year’s rent, stating that the lease’s provisions were clear and unambiguous. The court also held that the guarantors could not offset any claims they or the tenant had against the landlord absent a specific provision permitting offset in the guaranty.

What’s Interesting

Although the court’s limitation of the liability of the MGM Principals was securely grounded in the language of the lease, it is not at all clear that the limitation of the guarantor’s liability either did, or was intended to, limit the tenant’s liability (based on the language cited in the lease).

Moral

Where a lease refers to a guaranty that’s limited in some fashion, should we now expressly state that any limitations on liability contained in the guaranty do not limit the liability of the tenant?

150 Broadway N.Y. Associates, L.P. v. Shandell, 910 N.Y.S.2d 763 (Sup. Ct. N.Y. Co. 2010).

Facts and Holding

Law firm signed a lease. Four of the partners signed a “good guy” guaranty of the obligations of the tenant through the date the tenant vacated the premises. The guarantors negotiated a release provision, to the effect that if

any guarantor (a) fully withdrew as partner, and (b) physically vacated the premises, he or she would be released from the guaranty if (1) all rent and additional rent due and payable under the lease was then current and (2) the release request included a signed statement by the law firm and the other guarantors certifying that conditions (a) and (b) had been met. The tenant was evicted in 2009 owing over \$250,000 in rent arrears. The landlord sued all 4 guarantors, but in January 2006 and in 2007 two of the guarantors had delivered a notice to the landlord advising the landlord that they had withdrawn from the firm. In the January 2006 withdrawal, all conditions for release were met, except that the January rent had not yet been paid and was in default, which default was cured by the end of the month. The landlord confirmed receipt of the release notice, but merely stated that to the extent the partner had complied with the lease provisions governing exculpation, the partner was released. After the tenant was evicted, the landlord claimed the release notice was ineffective because the tenant had not paid its January rent at the time the release notice was given.

The court, not surprisingly, called the landlord's reading of the release hyper-technical and also faulted the landlord for sandbagging (not the court's term) the partner by failing to advise him, at the time he withdrew, that he had not met the conditions for release. Looking at the purpose of the guaranty – to make sure the guarantors were liable for any unpaid rent at the time of withdrawal, the court held that the transitory late payment of rent did not negate the release.

Moral

Landlords can make life very difficult for good guy guarantors; so think before you sign one; negotiate appropriate release language; and, if there are any conditions to release, make sure you comply with all conditions.

Broadway 36th Realty LLC v. London, 29 Misc.3d 1238(A) (Sup. Ct. N.Y. Co. 2010).

Facts and Holding

Tenant's principal executed a good guy guaranty in connection with the lease, under which the guarantor guaranteed the tenant's obligations through the "Surrender Date," which was defined as the date the tenant vacated the premises, delivered the keys to the landlord, *and* paid all sums due and payable under the lease through the date of surrender. The tenant failed to pay rent, the landlord started a non-payment proceeding, the tenant subsequently abandoned the premises, and landlord sued the guarantor for all rent then payable under the lease. The court granted summary judgment to the landlord, dismissing the tenant's claim that its liability should be limited to the rent accruing through the date the tenant vacated the

premises, on the ground that under the terms of the guaranty the guarantor's liability under the guaranty would end only if the rent was current at the time the tenant vacated.

The court also refused to give the guarantor relief on its defense that the tenant had been constructively evicted because the landlord failed to make freight elevator service available. The defense was dismissed for a number of reasons, including the fact that the guarantor had waived all defenses available in the guaranty and *res judicata*. The court also noted, in *dictum*, that for there to be a constructive eviction, there must be a wrongful act by the landlord that deprives the tenant of the beneficial enjoyment or actual possession of the premises. Because the lease did not require the landlord to provide elevator service and there was no evidence that freight elevator service was necessary for the tenant to operate its business, there could be no claim for constructive eviction.

The court also denied the defendant's motion to amend its answer to add a defense of partial actual eviction based on the unavailability of the freight elevator, stating, among other things, that since the tenant was not actually denied access to the premises (the passenger elevator was available), there could be no actual partial eviction and no suspension of the tenant's obligation to pay rent.

YELLOWSTONES

Korova Milk Bar of White Plains, Inc. v. PRE Properties, LLC, 894 N.Y.S.2d 499 (2d Dept. 2010).

Facts and Holding. Tenant, a bar, received a notice of default that its patrons were engaging in illegal activities. Tenant failed to move for Yellowstone injunction until after its cure period had elapsed. The court held that tenant was not entitled to Yellowstone relief.

What's Interesting. The court resolved a conflict in the decisional law as to when the tenant must file for a Yellowstone, holding that the tenant must seek the Yellowstone injunction *before* its *cure period* has elapsed, stating that to the extent any of its prior decisions (citing at least 5 cases) fixed a different time period (e.g., until the lease actually terminated) for obtaining Yellowstone relief, those decisions were rejected.

C C Vending, Inc. v. Berkeley Educational Services of New York, Inc., 74 A.D. 3d 559 (1st Dept. 2010).

Facts and Holding. CC Vending, which was granted a number of exclusive concessions for vending machines, brought an action for a Yellowstone injunction to prevent termination of its contract. The court held that CC was a licensee rather than a tenant and therefore could not seek Yellowstone relief, stating that CC could be made whole by an action for money damages.

In its decision, the court noted the conditions that must be met for Yellowstone relief: (a) the party seeking the relief must demonstrate that it holds a commercial lease, (b) that it either received a notice of default, a notice to cure or a threat of termination of the lease, (c) that it requested injunctive relief “prior to the termination of the lease,” and (d) that it is prepared and has the ability to cure the alleged default by any means short of vacating the premises.

What’s Interesting.

1. This case presents yet another reason why license arrangements are preferable to leases (at least where the occupancy arrangement is truly a license, rather than a lease).
2. The court’s statement of the conditions for Yellowstone relief indicates that relief must be sought before the lease is terminated, rather than before the cure period expires.

Related Cases

Graubard Mollen Horowitz Pomeranz & Shapiro v. 600 Third Ave. Assoc., 93 N.Y.2d 508 (1999). In Graubard, the Court of Appeals explicated the scope of a Yellowstone injunction. It held that a Yellowstone injunction merely tolls the running of the tenant’s cure period. It does not affect the tenant’s liability for late fees and interest on rent paid into escrow (as part of the Yellowstone arrangement) and not to the landlord. It also set out the standard for a Yellowstone, which is: (a) the tenant must hold a commercial lease, (b) the tenant received a notice of default, a notice to cure or a threat of termination of the lease, (c) the tenant requested injunctive relief “prior to the termination of the lease,” and (d) the tenant is prepared and has the ability to cure the alleged default by any means short of vacating the premises.

NOTICES

The Provident Loan Society of New York v. 190 East 72nd Street Corp., 911 N.Y.S.2d 308 (1st Dept. 2010)

Facts and Holding. 75 year lease gave each party the right to re-determine the rent in accordance with a formula approximately once every 10 years. Notice of re-appraisal was required to be served 3-6 months prior to the

expiration of the then 10-year interval. The lease provided that if both parties failed to serve a timely re-appraisal notice, the existing land appraisal would continue to dictate the amount of the fixed rent for the next 10-year period. In this case, the landlord failed to make a timely request for re-appraisal; and subsequently brought an action against the tenant seeking a declaration of equitable relief. The court dismissed the complaint, noting that the parties were sophisticated entities, that the lease provided a specific remedy if both parties failed to request re-appraisal, and that the lease was clear and unambiguous.

What's Interesting

If the tenant was the one who failed to give notice, one has to wonder whether the court would have reached the same decision – especially given the many “time of the essence” option cases where courts have rescued tenants from untimely exercise of options.

Iskalo Electric Tower LLC v. Stantec Consulting Services, Inc., 2010 WL 5394890 (4th Dept. 2010).

Facts and Holding

Landlord and tenant entered into two leases, one of which was for property the landlord had not yet purchased (the “East Huron Lease”). The East Huron Lease provided that if the landlord was unable to deliver possession of the premises to the tenant by December 1, 2005, the landlord would provide notice to tenant on or before noon of October 31, 2005 so that tenant could extend its then existing lease to accommodate the delay. The tenant terminated both leases in March 2006 based on the landlord’s failure to deliver possession of the East Huron premises. One issue before the court was whether the landlord had properly given notice to the tenant of its inability to deliver possession by December 1, 2005, the notice having been given by fax to tenant’s corporate counsel, rather than to tenant’s CEO. The court excused the landlord’s failure to strictly comply with the notice provision since the tenant did not deny that it had in fact received the notice and did not show any prejudice caused by the defective notice.

What's Interesting

Sometimes the landlord wins! *Iskalo*, of course, differs from *Provident*, in that the *Provident* lease provided a specific remedy if there was a failure of notice.

Solow Bldg. Co., LLC v. Frelau LLC, 899 N.Y.S.2d 794 (N.Y. Sup. App. Term 1st Dept. 2010).

Facts and Holding. The tenant's lease contained a conditional limitation allowing the landlord to terminate the lease for non-payment of rent if any rent default was not cured within 3 days after service of a notice of default. The notice section of the lease allowed the landlord to serve default notices by hand delivery, with service effective upon tenant's signed receipt; by registered or certified mail, with service expressly effective 3 business days after mailing; and by recognized overnight courier (with no statement of when such notice became effective). Landlord delivered a 3-day rent default notice to Federal Express for delivery to the tenant on October 11, but the tenant (a restaurant) was closed the next morning when Federal Express first attempted delivery. Ultimately the tenant received the default notice on October 15. Tenant tendered a substantial portion of the rent arrears on October 17, and the landlord rejected the tender as untimely. The issue was when the tenant's 3-day cure period began to run. The landlord argued that the cure period should run from the date of delivery of the default notice to Federal Express. Stating that the point of a notice provision is to give the tenant actual notice, the court held that the tenant was deemed to have received notice on either October 15, when the notice was received by the tenant, or October 16, which was 3 business days after delivery of the notice to Federal Express. In either case, the landlord's notice of default was held ineffective since the default notice did not provide tenant with adequate notice and opportunity to cure.

Moral of All Cases

Give timely notice and pay attention to the lease notice provision.

LIABILITY OF INDIVIDUAL SIGNATORY TO LEASE

Courthouse Corporate Center LLC v. Schulman, 902 N.Y.S.2d 160 (2d Dept. 2010).

Facts and Holding.

Richard Schulman signed a lease on behalf of the tenant LAN Associates as "Richard Schulman, Pres." The landlord, exercising a conditional limitation, brought a holdover proceeding, which was settled with the tenant vacating the premises. The landlord then sued LAN Associates as well as Schulman (who had not signed a guaranty). The suit against Schulman was based on the allegation that LAN was not a business entity licensed to do business in New York. Schulman moved for summary judgment to dismiss the claim against him on the ground that he was acting as agent for LAN Associates. The court denied the motion, noting that the burden of proof was on Schulman, and stating that when an agent signs on behalf of a principal but does not disclose the identity or legal status of the principal, the agent may be held contractually liable for the contract.

What's Interesting.

Nothing. This is hornbook law we should all remember. If your client signs a lease as President (or in another capacity) of a non-existent entity, the client becomes individually liable.

RULE AGAINST PERPETUITIES

Tourneau, LLC v. 53rd and Madison Tower Development LLC, 896 N.Y.S.2d 631 (Sup. Ct. N.Y. Co. 2010).

Facts and Holding. Tenant leased the ground floor of a commercial building. The lease provided that the term of the lease would commence upon substantial completion of landlord's work (the "Commencement Date"). The landlord was affirmatively obligated to cause substantial completion by January 31, 2009, but the lease limited the tenant's remedies if the landlord failed to do so. The tenant was entitled to a rent abatement, and the tenant could terminate the lease if the landlord failed to meet an outside deadline. During construction, the building suffered some minor fire damage. The landlord exercised a right in the lease to extend the cancellation date by reason of a Force Majeure event. The tenant responded by stating that the lease was void under the Rule Against Perpetuities, since the lease did not provide that the tenant's estate must vest, if at all, within 21 years, and was an unreasonable restraint on alienation. The landlord defended on a number of grounds, one of which was EPTL §9-1.3, which implies a 21 year limit unless a contrary intention appears.

The court held that the lease effectively complied with the RAP in that it specified a date for completion and provided specific remedies if the landlord failed to deliver possession by the stated outside date. What the court did not address was whether the landlord's indefinite extension of the time to deliver possession by reason of a Force Majeure delay violated the RAP, or whether EPTL §9-1.3 "saved" the lease (it being arguable that the parties had evinced a "contrary intent" in the open-ended extension of the commencement date for Force Majeure delays).

Related Statutory Provisions

EPTL §9-1.1 (Rule Against Perpetuities)

EPTL §9-1.3 (d) (savings provision):

Unless a contrary intention appears ...Where the ... vesting of an estate is contingent upon ... the occurrence of any specified contingency, it shall be presumed that the creator of such estate

intended such contingency to occur, if at all, within twenty-one years from the effective date of the instrument creating such estate.

Moral

The litigation could have been avoided if the landlord had included a RAP clause in the lease, which, admittedly, is not customary.

PRORATION

Enjoy Realty Corp. v. Van Wagner Communications, LLC, 901 N.Y.S.2d 227 (1st Dept. 2010).

Facts and Holding

Advertising billboard lease provided for payment of rent annually, in advance, at the beginning of each year. The lease included a termination clause, which the tenant exercised on January 8, 2007 after already having sent a check to the landlord for the 2007 rent. The tenant stopped payment on its check and submitted a check to landlord for rent prorated to cover the period January 1 to January 8. The landlord then sued to recover the rent attributable to the period after January 8, 2007. The termination clause provided that if the lease was terminated, the tenant would not be entitled to the return of any additional or basic rent paid in advance and covering a period beyond the date on which the lease is terminated, and the lease provided for payment of rent in advance for each year on January 1. The court awarded judgment to landlord, holding that the lease clearly required the entire rent to be paid on January 1 and did not provide for return of any rent if the lease was terminated during the year.

Moral

If you want rent to be prorated, it's best to expressly provide for proration. However, the case is not really persuasive one way or the other on the issue, since the lease language clearly negated the concept of proration on a voluntary termination.

GOOD FAITH

6243 Jericho Realty Corp. v. Autozone, Inc., 71 A.D.3d 983 (2d Dept. 2010).

Facts and Holding

Landlord and tenant entered into a ground lease. The tenant had 210 days to obtain all necessary permits, approvals, and permits. If the tenant did not receive, or was denied or refused, such documents within the 210 day period, the tenant was entitled to terminate. The tenant terminated when it failed to obtain the documentation. The landlord sued for damages on the ground

that the tenant had not made a good faith effort to obtain the documentation, and won at the trial court level. Noting that all contracts imply a covenant of good faith and fair dealing, the appellate court affirmed the trial court judgment.