

# HG&G UPDATE

Hofheimer Gartlir & Gross, LLP

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## LEASE OR LICENSE? BENEFITS & PITFALLS

When a party is interested in permitting another party to use or occupy its non-residential space, the agreement governing the relationship can be drawn as either a lease or license. Which form the agreement takes can have a substantial impact on the rights of the parties. In theory, a lease is a conveyance of an interest in real property, while a license is a grant of the privilege to use property owned by another. To choose the form of agreement that best suits your needs, you should understand the benefits and potential drawbacks of each form. Leases are generally more favorable to occupants because of the many statutory and common law protections granted to tenants and applicable to conveyances of real property. A licensee's statutory and legal protections, on the other hand, are minimal and generally arise solely from the contract itself. For this reason, parties to a license have greater flexibility in how the agreement is drafted.

As an example, in New York City a holdover tenant under a lease is considered a month-to-month tenant and, therefore, is entitled to a 30-day notice before he or she may be dispossessed. In contrast, a licensee who holds

over may be removed after only a 10-day notice.

An occupant's rights during a dispossess action differ depending on whether the occupant is a tenant or a licensee. Since the theoretical basis for a tenant's occupancy, the lease, is considered an interest in real property, the tenant is entitled to protection "in equity" rather than "at law." For this reason, when a dispossess action is brought a tenant may be entitled to the equitable relief of an injunction to stay eviction, while a prevailing licensor is entitled only to damages based on a breach of contract. In New York, commercial tenants who dispute an alleged default may petition a court to obtain a so-called "Yellowstone Injunction," which, if granted, would stay the termination of the lease and allow the tenant to remain in possession of the property until the parties' dispute is resolved. If a licensee objects to an alleged default, and his or her time to cure the default under the terms of the license expires during the court proceeding, it may be removed immediately upon a finding of default, without an opportunity to cure. If it is later found (on appeal or otherwise) that the licensee was wrongfully removed, the licensee's only remedy will be to seek monetary damages for breach of contract.

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Traditionally, a key characteristic of a license is that it is freely revocable. However, the license may, by its terms, be for a definite period of time. Usually the time period is a year or less. If a license for a specific period of time is wrongfully terminated before the expiration of that term, again the licensee's only remedy is to bring an action for money damages on the contract. The licensee will not be granted an injunction to preserve or restore its occupation of the premises.

A tenant under a lease has other statutory rights that are not enjoyed by a licensee. For example, in New York City, a tenant (commercial or residential) who defaults on the payment of a monetary obligation, such as the payment of rent, taxes, or assessments, may stay the issuance of a warrant to evict or cause the eviction proceeding to be dismissed entirely by depositing with the court the amount allegedly owed, or by giving an undertaking that such amounts will be paid within ten days. If the default arises due to the tenant's insolvency or bankruptcy, the tenant may stay the issuance of such a warrant by giving an undertaking to the effect that he will pay rent when due. Outside New York City, similar rights are available to residential tenants at the discretion of the court. For a licensee, however, such rights of redemption are available only if they are negotiated and written into the agreement, and even then, a licensor's failure to recognize contractual rights of redemption would give rise only to a breach of contract claim. As another example, tenants also enjoy a statutory protection that deems certain terms void and unenforceable if found in a lease, such as a waiver of liability or an indemnity for injury arising from an owner's negligence; such terms can be enforceable in a license.

Since a lease is considered a conveyance of real property, it may be assigned, mortgaged,

or further sublet, absent terms in the lease to the contrary. In contrast, since a license merely conveys a personal privilege to do some act or acts on the land without possessing any interest therein a transfer of the license extinguishes it unless there is a specific transfer provision. If the licensor is not willing to enter a new agreement, the assignee must leave.

Financing by either the landlord/licensor or the occupant may also have an effect on the form of the arrangement. A lender will consider the lease as a valuable asset when considering whether to approve the landlord's application, and, if it approves the loan, the lease will be assigned as additional collateral. A license, however, is less secure. It can also be pledged as collateral for a loan, but it is treated as personal property. The lender must secure its interest in the license by filing a UCC Financing Statement for personal property. Although a license may be pledged as security, the common law limitations on the conveyance of a license make such a security arrangement precarious for the lender. Absent terms in the license allowing the licensor to convey its interest to the lender, the license may terminate the moment the lender attempted to exercise its lien by seizing the licensor's interest therein. For this reason, a license for space is of little value as collateral to a lender.

Outside agreements or regulations affecting the parties may influence the form of the agreement. The proposed landlord/licensor may be bound by an agreement or subject to laws that limit its ability to convey a leasehold interest. For example, the landlord/licensor may be the tenant under a ground lease or overlease. The overlease may have restrictions or consent requirements related to subleasing, but may not prohibit the licensing of space. In such a situation, the landlord/licensor may want to consider using a license, especially if the proposed occupancy is only for a short term or for a small amount of space. Another instance is where governmental

regulations place restrictions on the conveyance of real property by or to a religious or municipal organization.

Once the preferred form is chosen, the drafting attorney must incorporate the characteristics of the chosen form into the agreement itself. It is not sufficient to simply title the document "Lease" or "License." To be enforceable as the chosen form, the terms of the agreement must be consistent with the characteristics of the chosen form to be treated as such by a court. To be a lease, the agreement must convey exclusive possession of a definite space to a tenant who exercises sole and exclusive dominion over the space leased to the exclusion of all others, including the owner.

Under a license, on the other hand, the privilege may be non-exclusive; it may lack a description of specific space that may be used; the owner may retain supervisory power over the operations of the occupant; or the owner may be permitted to materially alter the space in which the occupant's operations are conducted without affecting the agreement.

In sum, there are advantages and disadvantages to using either a lease or license, and which is best for a particular circumstance will depend on the practical intentions of the parties and the limitations on the terms of the agreement in that circumstance. As a general rule, however, a lease affords greater rights to tenants and is typically more appropriate where the relationship is expected to last for a long period of time. In contrast, a license gives the owner of the property greater control over the occupant's use of the space and permits the owner to remove the occupant with greater ease. Extraneous agreements or regulations must be considered because such circumstances may place limitations on which form may be used. Once the best form is chosen with the assistance of your counsel, the agreement must be drafted carefully to reflect the characteristics of the chosen form because a court will interpret the agreement based on the practical intentions of the parties rather than on the terminology used in the agreement. For more information, please contact one of our partners.

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## USING UNDIVIDED REAL PROPERTY INTERESTS AS AN ESTATE PLANNING DEVICE

The concept of undivided real property interests is becoming more frequently used by estate planners as a way to reduce a client's estate. An estate tax planning technique exists for significantly decreasing the value of a client's home for estate tax purposes by creating a discount for a partial interest in property. It has become so often used that the current versions of the United States Estate and Gift Tax Return now asks whether a discount has been taken on the valuation of any of the client's property.

Couples customarily own their home jointly,

without considering other options. An alternate way of owning a home is as tenants in common. Each spouse owns a percentage interest in the home, normally 50%, but there is no automatic right of survival at the first spouse's death as there is with jointly owned property. An interest as a tenant in common is discounted for estate tax and gift tax valuation purposes. The value of an interest as a tenant in common in real property is entitled to discounts for lack of marketability and lack of majority interest. The lack of marketability argument can be summed up as fol-

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lows. Who would pay half of the value of the property to purchase your 50% interest in your home with your spouse? Of course, no one would pay half of the market value of the entire property for this interest. The hypothetical purchaser would pay something less.

The issue of how much less has increasingly been decided by the Tax Court in recent years. The customary discount, without blinking the eye of an estate tax attorney, is 15% to 20%. Tax cases during the last few years have indicated that perhaps a 25% or 30% discount may be sustained. What this means in real numbers is that if a couple owns a \$1,000,000 home jointly, at the survivor's death, the home would be valued at \$1,000,000 in the survivor's estate. If the title was changed so that each spouse owned a 50% interest as a tenant in common, assuming a 20% discount, each half interest would be entitled to a valuation discount in the survivor's estate of \$100,000. Without considering any other factors, if the estate is in the highest estate tax bracket of 50% combined for Federal and State, this could potentially generate an estate tax savings of \$50,000. To preserve these discounts at the survivor's death, further planning would be required.

Another advantage for spouses to own property as tenants in common is the ability to shift percentages of ownership between them without tax consequences, as long as they are both United States citizens. When a home is owned as tenants in common, it is usually presumed that each spouse owns a 50% interest in it. This presumption can be overcome by a short agreement between the spouses indicating that one owns a greater percentage of ownership than the other. This technique is especially useful when one spouse's assets are appreciably greater than the other. For example, an 80%-20% split may equalize the value of the spouses' estates.

Although this article is limited to discounts of interests in real property between spouses, discounts may also be taken for many other undivided interests. These can include discounts for interests between non-spouses, between more than two individuals, for interests in personal property, and even for partnership interests.

Please contact a Hofheimer Gartlir & Gross partner if you are interested in pursuing this tax-saving technique.

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## PREVENTING MEDICAID FRAUD

New York State, in conjunction with the federal government, now requires that medical providers deriving a substantial portion of their business from the Medicaid program have policies and procedures in place to detect and prevent Medicaid fraud.

Additionally, covered health care entities must now file a certificate of compliance attesting to the existence of such policies and procedures with the newly formed New York State Office of the Medicaid Inspector General. Failure to submit a certificate can result in sanctions and/or penalties.

Specifically, the new law requires that health care entities establish and disseminate to their employees, contractors and agents information regarding: (1) the health care entity's specific policies, procedures and mechanisms for detecting and preventing waste, fraud and abuse (2) the federal False Claims Act, (3) the New York State False Claims Act, (4) the provisions of section 1902(a)(68)(A) of the Social Security Act (the federal statutory provisions requiring the new policies), (5) whistleblower protections for employees who report fraud, and (6) other applicable state civil and crimi-

nal laws.

While not required to create one, if a health care provider has an existing employee handbook it must amend that handbook to include information about: (1) the state and federal false claims laws, (2) the protections afforded to whistleblowers, and (3) the provider's policies and procedures for detecting and preventing fraud, waste and abuse.

The certificate of compliance mentioned above requires the health care entity to certify that: (1) it maintains the required written policies, (2) that an employee handbook (if in existence) includes the required information, and (3) that the required information has been disseminated to employees, contractors and agents.

The disseminated information and policies may be in paper or electronic form, but need to be easily accessible by employees, contractors and agents. HGG recommends that health care providers not only disseminate the information and policies but also have their employees,

contractors and agents acknowledge receipt and review of the literature with a signature.

While the new regulation can certainly be viewed as an additional burden for honest health care providers who will never encounter issues of fraud, an increased emphasis on fraud prevention and a non-retaliatory system for employees to report fraud within the health care entity will create an atmosphere where any potential abuse is both detected and internally remedied before it becomes an external problem.

If you are not sure about whether your organization must comply with the new laws or for information about the specific provisions of the fraud prevention policies and procedures that need to be implemented please contact your HGG attorney and/or visit the New York State Office of the Medicaid Inspector General (<http://www.omig.state.ny.us>) and the United States Department of Health and Human Services, Center for Medicaid and Medicare services (<http://www.cms.hhs.gov/>).

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## CHARITABLE PLEDGE TO THE JEWISH MUSEUM

One of our firm's partners, who is a trustee for a sizeable charitable trust, has recently pledged one million dollars to The Jewish Museum so that the Museum can be open on Saturdays, free of charge to all visitors.

Knowing that the family that established the trust cared deeply about supporting Jewish cultural and educational institutions, the trustee contacted The Jewish Museum to arrange a visit and learn more about the Museum.

At 102 years old, The Jewish Museum is the largest and oldest Jewish museum in the United States, with one of the finest collections of its kind in the world. At the heart of New York City's Museum Mile, the Museum is located at Fifth Avenue and 92nd Street.

The opening of The Jewish Museum on Saturday has been done in close consultation with the Jewish Theological Seminary. In observance of the Jewish Sabbath, the shops and café will be closed, and exhibition audio guides will not be available.

## RECENT NEWS

- We are pleased to welcome Peter I. Reiter as our partner effective January 1, 2008. Peter has extensive experience in all types of major real estate transactions, including both office and retail leasing, acquisitions and dispositions, service agreements (e.g. architectural, engineering, design and construction contracts) and procurement related agreements.

In addition to his law firm experience Peter was Real Estate Counsel and Vice President at Gulf & Western for more than 12 years and more recently Vice President and Assistant General Counsel at JP Morgan Chase Bank for 17 years. Peter will enhance our growing real estate department.

- Jerry Rosenthal represented The Guardian Life Insurance Company in a sublease of office space at One Madison Avenue of over 100,000 square feet. Crain's New York covered the story. Crain's also found noteworthy a retail lease at 120 Wooster Street handled by Jerry Morganstern on behalf of the landlord. The new tenant is TSE Cashmere, which is reestablishing a New York flagship store. Jerry Morganstern also represented the landlord at the Torrington Fair Shopping Center, Torrington, CT, in a new lease with Circuit City. On Long Island, Jerry represented the Country Glen Center in Carle Place, NY in new leases with the Guitar Center, Cosi and Chipotle.
- On behalf of the retailer, Dollar Tree Stores, Inc., Scott Kipnis headed a team that successfully acquired in excess of 20 leases from 2 bankrupt entities, Hancock Fabrics, Inc., and The Rag Shops, in addition to leases from other entities which were going out of business or downsizing, having defeating numerous use restriction objections of several landlords and other tenants
- Partner Jerry Morganstern has been elected President of the B'nai Brith New York Real Estate Unit. Prominent real estate professionals speak at the group's monthly lunch meetings. If you would like to attend or want more information about upcoming meetings or speakers, please call Jerry at 212-897-7909.

- The firm held a luncheon on October 1 honoring Bernard Gartlir, who celebrated his 90th birthday. Bernie still has enough work to keep him busy three days a week, while enjoying golf the rest of the week.

- Our office manager, Carole Green, has been elected President of the Greater New York Chapter of the International Facilities Managers Association.

Thanks to Jerry Morganstern, our managing partner, and our attorneys Damon Osborne, Adam Hochhauser and Suzanne O'Malley for their contributions to this issue.

David L. Birch.—Editor

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### About Hofheimer Gartlir and Gross, LLP

The firm conducts a general commercial practice. Our principal practice areas are:

- real estate
- corporate and securities law
- general business and commercial law
- cooperative and condominium matters
- financial institutions (loan transactions, leasing, acquisitions, credit restructuring, workouts, foreclosures)
- estate planning
- trust and estate administration
- general litigation and alternate dispute resolution
- matrimonial and family law
- taxation
- bankruptcy and creditors' rights

**Clients of the firm range from major financial institutions and public corporations to closely-held businesses, individuals and families**