

# HG&G UPDATE

Hofheimer Gartlir & Gross, LLP

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## COMMERCIAL LEASES IN THE CURRENT ECONOMY

By Gerald H. Morganstern

Landlords are actively looking for Tenants, sometimes not caring about the tenants' real long-term prospects. Tenants are looking for deals. New strategies are being used as well as reinvigorated old ones.

The "kick-out" provision has renewed importance in retail and other leases. It may provide that if a certain sales figure is not reached within the first few years, the retail tenant can terminate the lease. Office tenants may be given a cancellation right, too, but usually the landlord will require a penalty of several months rent.

Landlords, especially those of trophy buildings, are loathe to offer new leases at rents substantially lower than they achieved in the past or are currently asking. In boom times they not only increased the rent per square footage, but also the rentable square feet. Now, one strategy is to keep the rental rate as high as possible by

reducing the rentable square feet for a space.

Good guy guaranties are now ubiquitous whenever a full guaranty cannot be obtained. They are becoming more onerous, requiring two or more months prior notice of surrender and landlord recovery of some leasing expenses if a very early termination. Often more than one principal and their spouses must sign the guaranty. It is important that multiple guarantors in such instance sign a cross-indemnity agreement so that one of them is not singled out for all the liability.

Options to renew are in contrast to the kick-out clauses. Rather than a long-term lease, Landlords prefer a short term with a renewal option. The renewal rent for a small tenant is often set by the landlord at the time of renewal. Tenants with some clout will get a renewal at fair market value rather than at 95% of fair market value as in the past. An arbitration clause may still be sought by the tenant.

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Landlords have also become more flexible in permitting assignments to any entity continuing a going business. Moreover, in this market, good tenants may be able to negotiate a release if the lease is assigned to a creditworthy entity. Subletting is frowned on since sublets compete with vacancies in buildings and malls not fully rented.

Any tenant seeking an improvement allowance must now show a much greater financial responsibility than previously. Landlords may indicate they desire to help tenants create new space, but unless the changes are easily converted to use by another tenant, they will want assurance that this expense will be recovered. It may be a large plus to a tenant that a landlord will give a work allowance, eliminating or reducing tenant's need to seek bank financing. Parties are proceeding cautiously and transactions are being consummated, but each lease is subject to much more negotiation further slowing the pace of transactions.

In shopping centers and malls, the co-tenancy clause has finally had a reason for its existence. This clause give tenants rights and benefits in the event an anchor tenant closes. The closing of big name retailers has triggered these clauses enabling tenants having this lease provision to pay reduced rents. In new leases this clause is sought by tenants that rely on anchor stores for their draw. Tenants that never considered it for their leases are now considering it. Even if not in their leases, tenants are using the loss of an anchor as a basis to claim a rent reduction.

We are told the recession has bottomed; however, leasing is expected to be a tenant's market for the immediate future. Tenants can look for properties where the owner is upgrading the building to reduce operating costs, as well as provide better services and amenities. For further discussion, please contact Jerry Morganstern or one of the real estate partners at the firm.

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## PROTECTING A BROKER'S COMMISSION

By Damon T. Osborne

In New York, real estate brokers have some specific but limited statutory resources to help in the resolution and collection of amounts they are owed. New York Real Property Law ("RPL") §294-b applies to a "duly licensed real estate broker who asserts that he or she has produced a person who was ready, able and willing to purchase or lease all or any part of a parcel of real property or any interest in a cooperative apartment pursuant to a written or oral contract of brokerage employment...." If that person subsequently either contracts to purchase or lease or, in fact, purchases or leases the property, the broker is entitled to file an "affidavit of entitlement to commission" in the county recorder's office. Although the availability of relief for a broker set forth in RPL § 294-b is designed to expedite the resolution of a dispute over unpaid broker commissions, the statute's effect is limited because it does not create a lien on the property.

However, the statute was enhanced effective in 2009 when a claim under a brokerage agreement pertains to residential property (including condominiums and co-ops) of not more than four

dwellings. In such cases, if the agreement contains a legislatively prescribed notice, then once the broker's affidavit is docketed, the broker may serve a copy on the defaulting party, and the defaulting party must deposit the disputed sum with the county recorder's office pending resolution of the dispute. The statute describes in detail the procedure that must be followed by the broker to exercise his or her rights. Still, there is no lien, and even in these limited circumstances in which a deposit may be required, the effectiveness of the statute is unproven. Title companies tell us that filings of the requisite affidavit are rare.

One might inquire whether a notice of pendency can be used to secure the broker's interest in the proceeds from the sale of the property, but New York courts have responded in the negative. A notice of pendency in general can be used to secure payment of unpaid amounts where the aggrieved party commences an action in which the judgment demanded would affect the title to real property. In cases where this applies, any person taking

an interest in the property after a notice of pendency is filed takes title subject to the notice of pendency. Unfortunately for brokers, a notice of pendency cannot be used to secure payment of unpaid commissions. To do so, as stated by at least one court, would be an attempt to circumvent the restrictions imposed on real estate brokers in RPL §294-b.

However, and again in limited situations, New York's Lien Law provides relief for brokers in certain commercial leasehold transactions. The statute permits a broker who has a written agreement from a non-residential lessor leasing space for a term in excess of three years to file a mechanic's lien against the property which, like a notice of pendency, would be enforceable against any subsequent transferee of the property. The rights provided to leasehold brokers under the Lien

Law arise from the definition of "improvements" found in Lien Law §2(4), which includes "the performance of real estate brokerage services in obtaining a lessee for a term of more than three years of all or any part of real property to be used for other than residential purposes pursuant to a written contract of brokerage employment or compensation."

Therefore, if a broker with a written agreement files a lien arising out of a commercial lease in excess of three years, the owner would be unable to sell or finance the property without the encumbrance of the lien, which should help in the settlement of the claim. Absent such settlement, the broker may pursue his or her claim in the same manner as if it were a lien for a contractor's labor and material, by commencing an action, including a foreclosure action, to recover the unpaid amount.

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## BANKRUPTCY UPDATE: IN RE GENERAL GROWTH PROPERTIES, INC.

By: Nicholas B. Malito & Allen M. Levine

General Growth Properties, Inc., a publicly traded real estate investment trust, is the ultimate parent of approximately 750 wholly owned subsidiaries, joint venture subsidiaries, and affiliates (collectively, "GGP"). GGP's primary business is shopping center ownership and management; the company owns or manages over 200 shopping centers in 44 states across the country. As of April 16, 2009, GGP is also party to the largest-ever real estate bankruptcy case, in which 388 of its entities filed for chapter 11 bankruptcy protection, including more than 160 bankruptcy-remote special purpose entities ("SPEs").

At the time of the filing, GGP operated at a profit and its income from shopping mall operations was on the rise. GGP has typically satisfied its capital needs through mortgage loans, increasingly through commercial mortgage-backed securities, and its business plan was premised upon its ability to refinance this debt prior to its maturation. Although solvent at the time of the filing, GGP nonetheless had billions of dollars in loans that were due to mature or hyper-amortize over the next several years. Many of these loans were guaranteed

by various entities throughout the corporate structure, including SPEs. Some of the loans guaranteed by SPEs were in default at the time of the filing. The bankruptcy filings were precipitated by the recent collapse of the credit markets through which GGP financed its operations and its belief that it would be unable to obtain refinancing before the loans matured or hyper-amortized over the next several years.

Soon after the bankruptcy filing, several secured lenders with outstanding loans to the SPEs moved to dismiss the individual bankruptcy cases of several SPEs. The movants argued, generally, that the SPE bankruptcy cases were improper and filed in "bad faith" because the SPEs were not insolvent, were not facing the imminent maturity of their debt obligations, and did not benefit from bankruptcy protection. In a recent ruling, the U.S. Bankruptcy Court for the Southern District of New York denied these motions to dismiss the SPE bankruptcy cases.

The principle that a chapter 11 bankruptcy case can be dismissed as a bad faith filing is a judge-

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made doctrine and is articulated as follows: A bankruptcy petition will be dismissed if both objective futility of the reorganization process and subjective bad faith in filing the petition are found. Courts examine the totality of the circumstances, rather than any single factor, in determining whether good faith exists. Petitions are generally dismissed for lack of good faith only sparingly and with great caution. Additionally, it is important to note that it is well established that the Bankruptcy Code does not require a debtor to be insolvent prior to filing.

In support of their contention that the SPE bankruptcy cases were premature, and thus objectively futile, the movants relied on well established case law in which courts dismissed bankruptcy cases of debtors that were not in financial distress at the time of filing, but rather had been commenced due to speculative liability arising from ongoing litigation. The Court distinguished those cases because the financial difficulty faced by the SPEs due to maturing mortgage debt over the next several years was neither contingent nor speculative. The Court further found that it was not unreasonable for the SPEs to conclude that they would not be able to refinance their mortgage debt in the coming years given the state of current market conditions.

The movants further argued that the SPEs were created in such a way as to make them bankruptcy-remote by providing that “independent directors and managers can satisfy their fiduciary duties by voting, to the creditors’ benefit, against any bankruptcy filing. The goal was to insulate the financial position of each SPE from its parents and affiliates. The Court rejected this argument holding that the movants should have known, given the large and integrated corporate structure of GGP, that the financial situation of the parent would affect its subsidiaries. GGP was justified in considering the interests of the group as well as the interests of the individual debtor in its decision to seek bankruptcy protection for the SPEs. Moreover, the Court stated

that the directors and managers of the individual SPEs were required to consider the interests of the parent company and the creditors, as well as adhere to applicable state law—in this case Delaware corporate law. Delaware corporate law provides that directors and managers owe their duties to the corporation and, ordinarily, to the shareholders. This shifts to the creditors when the corporation is insolvent. As a result, the Court held that the directors, including the “independent” directors and managers, had a duty to the SPEs’ shareholders, rather than to the SPEs’ creditors, because there was no contention that the SPEs were insolvent.

In support of their contention that the SPEs acted in subjective bad faith, the movants contended, inter alia, that the SPEs failed to negotiate with their creditors prior to the bankruptcy filing. The Court found that the Bankruptcy Code does not require a debtor to negotiate with its creditors prior to filing for bankruptcy. The Court further stated that although bankruptcy may inconvenience creditors, that is not a reason to dismiss a chapter 11 case.

The Court’s decision not to dismiss the bankruptcy cases and its reasoning is likely to have several implications. First, the Court’s decision that directors and managers of SPEs must consider the interests of shareholders when deciding whether to file for bankruptcy will likely make it more difficult to structure SPEs so that they are fully isolated from their parents and bankruptcy remote. Second, corporate groups may consider the interests of the group as well as the interests of the individual debtor when deciding which entities to thrust into bankruptcy. Finally, other similarly situated commercial real estate companies may seek bankruptcy protection, while solvent, in anticipation of the maturation of debt obligations, especially in the wake of current market conditions.

## CONVERTING TO A ROTH IRA

In 2010 you may be able to convert your IRA to a Roth IRA. Here are some considerations:

1. The amount you can convert is not limited by your income.
2. You will have to pay federal and state income taxes on the amount converted, but will no longer have to pay taxes on the amount in the Roth IRA or its earnings.
3. It may be beneficial to use idle cash earning less than 1% per year to pay the income taxes.
4. If you believe income tax rates will go up in the future converting could be a savings.
5. If you think you will actually be in a lower tax bracket when you must start making IRA withdrawals, the conversion could be beneficial.
6. In a Roth IRA you will no longer have the IRS mandating how much has to be withdrawn and when the withdrawal has to take place.

Our partners are available to discuss the pros and cons with you and your accountant.

### 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**

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## RECENT NEWS

In recognition of his loyalty and devoted service to The American Law Institute, our trusts and estates partner, Edward S. Schlesinger, was named a "Life Member" this year.

Douglas Gross, Gerald Morganstern and Edward Schlesinger have been named by New York Super Lawyers magazine as top attorneys in their respective fields of litigation, real estate and trusts and estates.

Our partner, Peter Reiter, has represented EdisonLearning in a number of leases throughout the country.

Our partner, David L. Birch, successfully argued Gletzer v. Harris, 12 N.Y.3d 468 in the New York Court of Appeals. The case clarified the law concerning the priority of a recorded mortgage over a judgment whose lien had expired

and was in the uncompleted process of being renewed.

HGG's bankruptcy practice continues to be vibrant. Recently, we have represented the interests of Dollar Tree Stores, Inc., a member of the Official Committee of Unsecured Creditors, in the bankruptcy case of In re First Republic Group Realty, LLC and have achieved a successful recovery of Dollar Tree's claims against the debtor. We have also represented Dollar Tree, as well as several landlords, in the bankruptcy case of In re Circuit City Stores, Inc. where we have vigorously defended our clients' interests. In the area of bankruptcy litigation, we have successfully settled or won motions to dismiss avoidance actions that sought the disgorgement of monies paid to our clients prior to the debtors' filing for bankruptcy.

Jerry Rosenthal is leaving the firm to join the law department at Fidelity National Title Co. We will miss his counsel and wry humor.

If you have questions about any matter Jerry handled feel free to contact him through HG&G. His email and phone will remain operative indefinitely. Jerry will respond together with (if appropriate) a real estate partner of the firm.

We wish Jerry all the best in his new career path

Thanks to Jerry Morganstern, our Managing Partner, Arthur Michaelson, Damon Osborne, Nicholas Malito and Allen Levine for their contributions to this issue. - David L. Birch, Editor

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