



ANews

President's Message

It's a raw and gloomy day in Chicago, but in Tucson, the skies are bright blue, and the air is balmy. Many of you, like me, must be longing for a change, because the registration for our March meeting at Loews Ventana Canyon Resort is breaking records! If you haven't already, register today.

Plans for the meeting include our first-ever public policy forum on water policy, programs on construction, professionalism and a host of other topics, and the chance to attend spring training or NCAA basketball games, enjoy our golf and tennis tournaments, go horseback riding, mountain biking or on a jeep tour of the desert, or kick back and relax in the resort's newly renovated spa. Ann Saegert and our Programs Committee, and Kathy Murphy and our Meetings Committee, have done a terrific job with the planning. You don't want to miss this meeting!

Our high-energy working groups for 2005 are off to a great start. Their work is focused on professionalism (Kevin Shepherd, Chair), member selection standards and procedures (Joe Fries, Chair), collegiality (Susan Talley, Chair), smart growth (Greg Hummel, Chair) and public policy forums (Ira Waldman, Chair). You'll hear more about

their work in Tucson, but in the meantime, feel free to share your ideas with leadership of the various groups.

Susan Reid and the Member Selection Committee are working hard to complete their recommended slate of new members for presentation to the Board of Governors in March. We had 49 nominations for new members, from 27 states, plus DC and the Virgin Islands. We received 550 online votes cast by 250 members, together with a number of paper ballots. Clearly, interest in College membership remains high, and we owe a debt of gratitude to David Gordon and the Member Development Committee for generating increased participation in the nominating process on behalf of younger, more diverse nominees, as well as nominees from under-represented states.

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Those historians among you will notice that this newsletter is coming to you earlier than usual in the calendar year. Many thanks to our energetic editors, Chuck Edwards and Jack Murray, and to all of our contributing writers, who have responded prolifically to our calls for copy.

In this message, one thought should be coming through loud and clear. There are a lot of people working hard to ensure that the

“State of the College” is vital and strong. I encourage you to join them and to become an active participant in our many programs and initiatives.

See you in Tucson!



Portia Morrison

www.acrel.org

Check the ACREL website for the latest committee information, meeting registration materials and other College news.

To log on, direct your browser to www.acrel.org, click on "Private Home Page" and enter your user id and password. Forgot your password? If you try to log on, the system will offer to email your password to you. Or, you may email Jill or Henri at the ACREL office (jhpace@acrel.org or hkeller4501@acrel.org), or send a message to webmaster@acrel.org, or call us at 301-816-9811 for help.

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Taking Title to Servient Tenements

by Roger Bernhardt, Golden Gate University, San Francisco, CA and Joyce Palomar, University of Oklahoma College of Law, Norman, OK

[Roger Bernhardt, Editor of the California Real Property Law Reporter, invited Joyce Palomar, author of Palomar on Title Insurance Law, to comment on two recent California cases involving nonwritten easements. In Larsson v Grabach (2004) 121 CA4th 1147, 18 CR3d 136, an easement by implication was held to arise upon the death of an owner of three connected parcels of property that were distributed to his heirs in probate that were connected by a road at the time of his death because the road was reasonably necessary for the beneficial enjoyment of the property, despite the fact that nothing could be said about the deceased owner's intent. In Felgenhauer v Soni (2004) 121 CA4th 445, 17, CR3d 135, a prescriptive easement was upheld, even though there was no evidence that the user had believed that he was legally entitled to use of easement; a use must be open and notorious, adverse, continuous and uninterrupted for the statutory period "under a claim of right" but "claim of right" does not require a belief or claim that the use is legally justified, merely that the property was used without permission of the owner.]

Roger Bernhardt: It is so rare to see two cases on unwritten easements appear in the same time period that I could not refrain from writing a column on them. For the most part, neither implied nor prescriptive easements offer much opportunity for real estate attorneys to do much planning for their clients. Most people engaged in acquiring a prescriptive easement do not consult attorneys about how to succeed at it. Generally, either they are unaware that they are trespassing or they expect to be stopped at some point before the 5-year statutory limitations period runs; in any event, it is probably easier to purchase the easement from the servient tenant than to litigate a prescriptive claim against her.

Likewise for people who receive an easement by implication: The doctrine behind it is that, had the parties only thought about the matter at the time of a lot split, they would have said something explicit about the easement, and the court is only making up for their failure to do that thinking. Those assumptions make it inconceivable for anyone to come into your office asking "How do I get (or give) an implied easement?" since the obvious response would be: "Don't. Create an express one instead."

On the servient side, there is the possibility that a client may someday ask you what to do about the neighbor who keeps walking across her property without consent. If the limitations period has not yet elapsed, you can suggest that your client ask the neighbor to agree to accept a license to continue, or else get fenced off or sued if he refuses. But the owner whose property may be subject to an implied easement is not going to see an attorney until it is too late to undo the facts that established the implication in the first place.

However, what I noticed in both *Larsson* and *Felgenhauer*, was that the party whose land was held to be subject to an easement—the servient tenant—was someone who had acquired the property long after the easement had been created. In *Larsson*, a probate lot split was held to have created an easement by implication in 1942, but the servient estate was not sold to the Grabachs until 1998, 56 years later. In *Felgenhauer*, the prescriber adversely used the servient property from 1982 to 1988, but the Sonis did not acquire the property until ten years later, also in 1998.

And, in both cases, things had changed before the defendants had acquired

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their parcels. A cabin had been built in *Larsson*, and a fence constructed in *Felgenhauer*. Thus, the facts on the ground when the parties purchased might not necessarily have told them about what had happened before.

Although there was some evidence of actual knowledge in both cases, I would rather consider the matters as if that had not been so. And whether there was anything actually happening on the surface to warn those two buyers of the existence of easements would not matter anyway: For there to be an easement by implied creation in *Larsson*, the court had to conclude that there existed in 1942 an unpaved road that was "so obviously and apparently permanent that the parties should have known of the use" back then; and for there to be a prescriptive easement in *Felgenhauer*, an "open and notorious use" had to have existed between 1982 and 1988. In each case, once the easement was created, those essential characteristics were no longer required: At the time the defendants acquired their parcels in 1988, there was no need for the *Larsson* implied easement to be obvious and apparent, or for the *Felgenhauer* prescriptive easement to be open and notorious. Whether or not they knew about the easements or had reason to know about them, the Grabachs and the Sonis took title to properties burdened with preexisting easements.

Which, finally, gets me to the theme of this column: how to protect clients who are acquiring property from taking it subject to easements that may not be recorded and may not be evident from the current physical appearance of the property. The obvious solution is to have them get title insurance, but that advice is no help if the policy excludes those risks. And that means the attorney's job is to make sure that the coverage is appropriate.

To see how effective title coverage is, I turned to Joyce Palomar, whose book *Title Insurance Law* is the reigning authority in this area (and whose other book, *Patton & Palomar on Land Titles*, gives her similar stature on easement matters). I asked her to read both cases and give us Californians some advice as to what title policies the Grabachs and Sonis might have wished they'd had, in retrospect, after they lost their cases against their neighbors. My questions and her answers follow.

RB: Joyce, if these defendants have standard CLTA policies, do you think they can recover against their insurers? Would you reach a different conclusion if they had ALTA policies?

JP: In either a standard CLTA (1990) or ALTA (1992) owner's policy, insuring clauses covering encumbrances on the title and unmarketability of the title would cover loss due to unrecorded easements. And, in either of these policies, the preprinted exclusions do not expressly exclude unrecorded easements from coverage.

Traditionally, however, a "general exception" for "unrecorded easements and claims of easements" has been included as one of four or five standard exceptions in Part I of Schedule B of both CLTA and ALTA policies. *Palomar, Title Insurance Law* §§7:1, 7:2, 7:12 (2004 ed Thomson*West). Assuming this preprinted standard exception to coverage appeared in Schedule B of their standard owner's policies, the Grabachs and Sonis would have had no title insurance claim.

The purpose of this standard Schedule B exception is to insulate title insurers from losses resulting from easements that were created as a matter of law by prescription or implication and that cannot be discovered by searching the public records. A title insurer

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typically does not go onto the land to look for indicia of someone's use.

Nevertheless, in most states, the title insurance applicant can pay an additional premium to receive an "extended coverage policy" which omits all the Schedule B general exceptions, including the exception for "unrecorded easements and claims of easements." *Title Insurance Law* §§7:1, 7:2, 7:12. If the Grabachs' and Sonis' policies omitted the general Schedule B exceptions, then they will have a claim against their title insurance policies.

RB: Do you think their carriers could defend on the ground that these easements were known or should have been known to them?

JP: You state that there was some evidence of actual knowledge in both cases. The insurers surely would attempt to prove that knowledge and assert the general exclusion from coverage for matters known to the insured and not disclosed to the insurer, which is preprinted in both CLTA and ALTA policies. *Title Insurance Law* §§6:14–6:16. Nevertheless, insureds are not charged with actual knowledge of a title defect or adverse claim from the mere existence of physical structures or activities on the property, unless the presence of such structures or activities unambiguously indicates an adverse interest. A billboard on the insured land that advertised a neighbor's cave tours was held not to give actual notice that the neighbor claimed an interest in the insured's land. An insured's knowledge of an irrigation ditch on the land did not imply that the insured knew that another party had a right of entry onto the insured land to maintain the ditch. The court ruled that the title insurer may not assume that the insured has specialized knowledge of easements.

In comparison, when, prior to purchasing, the insureds had seen (1) a paved

roadway on the western border of the property, (2) a recorded plat which showed the road, and (3) the lender's title policy which contained an exception for the road, the court held that the insureds clearly knew of the presence of the road at closing and had received the bargained-for property. The policy exclusion therefore applied to the insureds' claim. See cases cited in *Title Insurance Law* §6:15.

RB: Do you think the insureds' carriers could defend on the ground that these were interests that a survey would disclose?

JP: A general exception for what an accurate survey would reveal is another of the standard exceptions that is preprinted in Part I of Schedule B of standard CLTA and ALTA owner's title insurance policies. Like most of the general exceptions set forth in Schedule B, the exception for matters which would be disclosed by an accurate survey or inspection is intended to protect the title insurer from matters that may affect the title but that cannot be discovered via an examination of the public land records. Title insurers have no duty to obtain a survey in connection with the issuance of a title insurance policy. The choice of whether or not to obtain a survey belongs to the insured. *Title Insurance Law* §7:8.

If the insureds paid for extended coverage and their policies omitted this general exception, as discussed above, that defense would not be available to the title insurer. If the general exception does appear in their policies' Schedule B, then it is a question of fact whether an accurate survey would have disclosed the easements.

RB: Do you think the carriers could defend on the ground that the insureds succeed to the rights of parties in possession?

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JP: While the language of exception is a little different in CLTA and ALTA owner's policies, both include in Part I of Schedule B standard language excepting facts or rights that could be ascertained by an inspection of the land or that may be asserted by parties in possession. The analysis would be the same as under the exception for unrecorded easements and claims thereof, discussed above.

RB: Do you think any particular endorsements would have made a difference?

JP: Yes. First, as discussed, the title insurance applicant can pay an additional premium to receive an "extended coverage policy," which omits all the Schedule B general exceptions.

Second, a title insurance applicant may be able to provide the insurer with a survey rendered by an accredited surveyor and receive a "Survey Endorsement." A Survey Endorsement, also called a "Same As Survey Endorsement," assures that the "land" the insured is getting is the same as the survey shows. Encroachments, including easements, not shown in the survey then would be covered.

If the title insurer agrees to delete or endorse over the survey exception, the title insurer cannot thereafter avoid coverage of matters an accurate survey could have revealed by asserting the general exceptions discussed above. *Title Insurance Law §7:8.*

Neither CLTA Endorsement 100 nor ALTA Endorsement 9—i.e., "Restrictions, Encroachments, Minerals"—would have helped the insureds in these cases, however. These standard endorsement forms provide some coverage against loss as a result of improvements on the insured land encroaching on easements, but they apply only to easements discovered by the insurer and listed in the policy's Schedule B, so these

endorsements would not help in the case of easements created by prescription or implication.

Finally, I will note that some express casualty coverage for loss resulting from unrecorded easements is available in both the CLTA and ALTA Homeowner's Policies. These policies would not have been available in the two cases you discuss here, however, because the properties insured were not one-to-four-family residences. ■

Meetings Calendar

March 17-20, 2005

Loews Ventana Canyon Resort
Tucson, AZ

October 20-23, 2005

Waldorf=Astoria
New York, NY

March 16-19, 2006

The Sanctuary
Kiawah, SC

October 4-9, 2006

Grand Hyatt
Seattle, WA

ALTA Revising Loan Policy

by Harvey L. Temkin, Reinhart Boerner Van Deuren, SC, Madison, WI ©2005

One of the roles of ACREL's Title Insurance Committee (the "ACREL Committee") is to keep current on promulgation of new title insurance products and review and comment on revisions that the American Land Title Association ("ALTA") proposes to make to its forms. When ALTA recently revised its leasehold endorsement to the ALTA loan and owner's policies, the ACREL Committee was heavily involved in providing input into the endorsement.

Most recently, ALTA has begun working on a rewrite of the Lender's Title Insurance Policy. This process has been ongoing for about two years, and ALTA has requested ACREL input on the various drafts ALTA has promulgated. The ACREL Committee has responded with several memoranda to ALTA, the most recent being one dated July 22, 2004, which reflected ACREL's comments on the March 17, 2004, draft ALTA Loan Policy. In general, ALTA has been very interested in and receptive to ACREL's input. In July, one of our members, Paul McNamara, appeared in front of ALTA's Forms Committee and presented ACREL's position on the March 17, 2004 draft.

The ALTA Forms Committee issued a revised loan policy draft dated October 5, 2004 (the "Draft") just prior to ACREL's Annual Meeting in Denver. The Draft and all previous drafts of the loan policy and ACREL's July 17, 2004 Memorandum can be found on the Title Insurance Committee page of the ACREL website.

While ALTA has included many ACREL suggestions in its rewrites of the policy, many significant issues remain. The purpose of this article is to alert members to some of those issues and some of the changes

that ALTA has or intends to include in its rewrite of the loan policy. It will also highlight areas in which ALTA has requested further input from ACREL. The ACREL Committee would also appreciate any further insights or suggestions from ACREL members that may help improve the final product. Dean Rogeness (dean@rogeness.com) and I (htemkin@reinhartlaw.com) are principally responsible for compiling comments so we would appreciate receiving any of our Member's thoughts. Some of the significant issues that ACREL has commented on include the following:

1. The Draft provides for what appears to be enhanced coverage for certain matters such as losses due to the enforcement of laws, ordinances, permits or governmental regulation (including those relating to building and zoning), as well as enforcement actions based on the exercise of a governmental police power not covered by the foregoing, but only when a notice given by the governmental body and describing the land is recorded in the Public Records at the date of policy and then, only to the extent the violation or enforcement is referred to in that notice. While the Draft appears to broaden coverage of these matters, the definition of Public Records is critical to understanding the extent of the coverage.

Currently, the Draft defines public records as "records established under state statutes at date of policy for the purpose of imparting constructive notice of matters relating to real property for value and without knowledge." The ACREL Committee commented that it did not know whether the Draft intended to limit those notices to matters that would appear in a register or recorder of deeds office, or whether the Draft

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also intended to include matters that might appear in other governmental records. While ACREL requested a broader definition to clarify that Public Records would include any governmental records, ALTA has indicated that it intends the term to restrict coverage to the public records systems of land recording in the various states. It appears that what is intended is that, if an enforcement agency records a notice of violation with the register or recorder of deeds, then the title company will be liable if it misses that notice. If, on the other hand, a notice exists in another government office, the insured is not covered. This substantially limits, if not eliminates, any additional coverage from that which is currently provided.

1. ALTA has requested further input from the ACREL Committee on how to better define "Public Records." The ACREL Committee is currently debating how best to define the term. Members have suggested including in the definition federal and bankruptcy courts, as well as building and zoning code files of the municipality in which the property is located.

2. The Draft creates significant confusion as to how and when an insured lender would file a claim. Under one provision of the Draft, the lender would need to notify the title company promptly of any claim of title or interest which might cause loss or damage for which the company may be liable. Under another provision, the lender would need to furnish the title company with the proof of loss or damage within 90 days after the lender has ascertained the facts giving rise to the loss or damage. One issue that is not clear, however, is when the insured suffers loss or damage.

The following example poses the possible dilemma. The lender, while the loan is still current, is advised that an easement has been discovered that traverses the insured parcel. The lender has determined that the easement's existence diminishes the parcel's value by 20%. Presumably, there would not be any actual loss yet suffered by the insured under this example (although the lender is damaged in that the value of its collateral is less), unless the lender declared the loan in default due to a breach of warranty of title typically contained in a mortgage or deed of trust. The Draft, however, while apparently requiring prompt notice of the title defect, is not clear as to whether the 90 day notice period has begun to run. The Draft is also not clear as to whether the lender could, at that time, demand payment of damages even if the loan otherwise remained current.

The ACREL Committee has suggested that the final policy be more specific as to the insured's rights, remedies and notice obligations. For example, we have proposed that the loan policy might require that the title company be advised within 90 days after a defect in title is uncovered. At that time, the title company ought to acknowledge coverage and either clear the title defect or acknowledge that, if the loan goes into default, and if the lender is not made whole on its loan, the title company will provide coverage for any diminution in the value of the property caused by the title defect.

When the ACREL Committee presented this issue to ALTA, ALTA in principle agreed that the notice and damage requirements should be more clearly spelled out and this is another area where ALTA has asked for ACREL's assistance.

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3. In addition to expressing concern over the notice and damage provisions contained in the Draft, the ACREL Committee also expressed concern about the timing of the payment of any losses. Under the terms of the Draft, the insurer controls any litigation involving a title matter that the insured may have uncovered and disclosed to the insurer. This control includes the insurer deciding when and whether to appeal an adverse ruling and when it might settle the title claim.

An example of what might occur in this situation highlights the problem. Assume that a lender has lent \$1,000,000 to its borrower, and has obtained a lender's title insurance policy in the principal amount of \$1,000,000. A title defect is discovered and the borrower defaults when there is still a principal balance of \$950,000 owing under the loan. Under paragraph 8.(b), the Draft provides that the company can fight the title defect and not pay the insured lender until final adjudication by a court of competent jurisdiction, as well as disposition of all appeals. If we assume that this process takes two years and, if the loan is in default, the lender may be accruing interest under its loan (unless it perhaps has exercised other remedies under its loan documents), which means that the loan balance due at the end of such two year period will undoubtedly be well in excess of the \$1,000,000 policy limit. The title company can, however, avoid settling with the insured lender and thereby increase the insured's loss (and minimize the insurer's loss by using the time value of money). The ACREL Committee believes that the limit on recovery should be increased above the \$1,000,000 policy limit if the increased coverage is needed to cover a loss that the insured lender may suffer because of the title company's election to pursue the title claim,

rather than pay the lender. In the case of a partial loss, interest also continues to accrue, and when payment is made in an amount that includes that accrued interest, the limits of coverage remaining under the policy based on the Draft's current language are effectively reduced.

The timing of the payment of a claim, which remains under the insurer's control, can, therefore, substantially affect coverage under the policy and the ultimate recovery that the insured will receive. The ACREL Committee has proposed other ways of handling the problem which might include a mechanism in the loan policy providing for the deposit or other posting of collateral by the insurer bearing interest at the rate payable under the loan while the matter proceeds in court. Payment would be made to the insured from the deposited collateral, including the interest earned on the collateral, without regard to the base policy amount. The insured would then be assured of receiving the amount of its loss, including interest, even if such amount exceeded the policy limit if such excess amount resulted from the insurer's decision to appeal. The matter could also be handled for both full and partial losses, by simply allowing the policy limits to be raised by the amount of the accruing interest without regard to the policy limit while the insurer pursues its court actions. ALTA acknowledged the ACREL Committee's concern and has requested further input on proposed resolution of the issue.

4. Fraudulent conveyances or transfers and their coverage under the Draft are also concerns of the ACREL Committee. In particular, paragraph 16 of Covered Risks insures over fraudulent or preferential transfers occurring prior to the transaction

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creating the lien of the insured mortgage, whereas paragraph 6(a) of the Exclusions from coverage provides that the policy does not provide coverage if the transaction creating the lien of the insured mortgage was a fraudulent conveyance or a fraudulent transfer.

As a preliminary matter, the ACREL Committee believes that the loan policy should cover fraudulent transfers. While we understand the reluctance of the title insurance industry to provide blanket coverage for fraudulent transfers under an owner's policy, when a lender's policy is involved, the ACREL Committee believes that the title company should make itself comfortable that the loan transaction does not constitute a fraudulent transfer. Most knowledgeable traditional mortgage lenders will insist on this coverage and so it is only those less sophisticated lenders who may be left without coverage if coverage is not included as part of the standard policy.

Secondly, the ACREL Committee expressed concern as to how the policy would be applied in practice. For example, if a borrower/bonafide purchaser acquires property from a third party in what would otherwise be a fraudulent transfer (e.g., the transfer is for less than reasonably equivalent value), but, rather than financing the property at the time of the transfer the borrower delays the loan closing for several days, the insurer is arguably covering any fraudulent transfer claim arising out of the initial transaction. On the other hand, while the ACREL Committee does not believe that it is free from doubt, if the loan was a purchase money mortgage, the question arises as to whether, under those facts, the insurer could argue that it is not insuring the loan since the loan arose out of a

fraudulent transfer. This distinction seems to be confusing and creates anomalous results. The ACREL Committee has suggested that the provisions be clarified. While ALTA has taken the position that the loan policy is not to cover fraudulent conveyances or transfers in a universal framework, it agreed to look further at the Draft's language.

The ACREL Committee has raised numerous other more technical drafting issues concerning the rewrite of the Loan Policy. Many of these issues are covered in the July 17, 2004 Memorandum which the ACREL Committee forwarded to ALTA.

ALTA's rewriting of its title insurance policies has a major impact on the practice of all lawyers practicing real estate in the United States. The relationship that the ACREL Committee has forged with ALTA has provided an excellent opportunity for the real estate bar to have input into the rewriting of these policies. While the ACREL Committee is pleased to undertake the lion's share of the work on behalf of the real estate bar, if other ACREL members have issues that should be raised at this critical time, we would once again appreciate if you would let either Dean Rogeness (dean@rogeness.com) or me (htemkin@reinhardt.com) know. ■

New York Extremes: Attacking Big Forfeitures, Big Lobby Searches and Big Buildings

Tenant Complains About Intrusive Building Security

by Harris Ominsky, Blank Rome, LLP, Philadelphia, PA

Building tenants may be victimized, not only by terrorism, but also by anti-terrorism measures. In a recent case, a New York restaurant owner sought a preliminary injunction to bar a landlord from implementing its proposed security measures. *Cipriani Fifth Avenue, LLC v. RPCI Landmark Properties, LLC*, 2004 W.L. 1514339 (N.Y. Supp)

Searches and Metal Detectors

Cipriani Fifth Avenue operates a famous restaurant in New York City, the Rainbow Room, which is located on the top floors of the tallest building in Rockefeller Center. The landlord seeks to install metal detectors as part of recommended security procedures. Cipriani alleges that its guests will be then subjected to intrusive personal searches and unreasonable delays in using the elevators.

Therefore, Cipriani petitioned for a preliminary injunction to bar the landlord from implementing its plans. Cipriani submitted affidavits from party planners that they would hesitate to recommend the Rainbow Room if the security measures were instituted, and that these measures would discourage customers. Cipriani alleged that it had invested more than \$6 million in improving the Rainbow Room to maintain its reputation, and that up to 83% of its business comes from large parties that draw hundreds of guests at dinnertime.

The landlord countered that the restaurant's allegations were entirely speculative, and that in the current environment guests would not object to security checks to insure their safety. Further, it argued that it could suffer overwhelming damages if security measures were not implemented and a terrorist or other criminal attack should occur.

In discussing the equities of the arguments on both sides, the court acknowledged that using metal detectors and frisking guests was not only "inappropriate" to guests "who throughout the Rainbow Room's stellar history are known for exhibiting only maturity, elegance and grace." Also, that would constitute rather ineffective security.

However, the court went on to say: "The terrible burden of post-9/11 history counters that weight and justifies owners, in the exercise of their discretion and judgment, undertaking extraordinary precautions." One element in this analysis will be the likelihood of an attack because of the visibility of the restaurant located on the top floor of the tallest building in Rockefeller Center.

The Lease

The court denied the injunction because in reviewing the lease it concluded that Cipriani had not yet demonstrated the probability of success in a lawsuit to the standard that is necessary for a court to issue

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a preliminary injunction. It decided that the issues should be decided at a trial based on the evidence and analysis of the lease provisions. One of these provisions gives the landlord the right to make any alterations to the security system in the public portion of the building, including elevator banks. The court opined that metal detectors would ordinarily fall within the security system that the landlord has the right to offer. However, the trial court will have to determine whether the proposed system would amount to a denial of Cipriani's "access to the premises" and whether the landlord would be enforcing its operating rules against the restaurant in a discriminatory fashion, violating an expressed provision in the lease.

This is one of the first cases to deal with the impact of anti-terrorism measures on a tenant's rights under a lease. Many tenants still fail to focus on these issues when they are negotiating their leases. The irony of these efforts by landlords in a post-9/11 world is that some landlords, and tenants, think that enhanced security should make a high-rise building more attractive to prospective tenants. On the other hand, as in the case of *Cipriani Fifth Avenue*, many tenants will resent such perceived improvements.

Who Pays?

One of the issues, which is not discussed in the case, but frequently arises, is the issue of who pays for metal detectors, new installations and extra security personnel. In some leases, improving building security becomes a major cost of operating the building, and if the lease requires tenants to share increased operating costs, the tenants will wind up paying for an unanticipated rent increase. Even if such costs involve capital improvements which are spread out over the term of the lease, the costs could still prove to be a significant increase in rental costs during the term of a lease.

This case should serve as a warning to tenants that they must deal with the issue of building security when they negotiate their leases. For some tenants it will be important to specify what approval or consultation rights they will have in the landlords' decisions about future security plans. In addition, they may want to specifically focus on the cost of those measures and who will pay for them. If all other things are equal and the tenant has a choice of two buildings, one of which already has a satisfactory security system installed, and the other of which does not, some tenants would prefer the building where the landlord will not charge the tenants for the cost of future intrusive, and perhaps expensive systems intended to prevent attacks.

Landlords' Liability for Crime

In *Cipriani Fifth Avenue* the court cited two New York security cases that tended to counter the landlord's argument that its failure to implement these types of security measures would expose it to substantial damages. In the case of *Gross v. Empire State Building*, the Empire State Building was sued as a result of a tragic incident in 1997 where a deranged man armed with a semi-automatic pistol went to the 86th floor observation deck and, without warning, indiscriminately shot one tourist to death and seriously injured six others before committing suicide with the same weapon.

Although there had been only a minimal showing of criminal activity within the building before that incident, there was evidence of violence in adjoining stores and sidewalks, and bomb threats to the building. Despite that, the Appellate Division, First Department, reversed a lower court decision and ordered the action summarily dismissed. In March of last year, that court held that the owners could not have reasonably foreseen the events in question, and therefore owed no duty to visitors to employ x-ray machines,

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metal detectors and scanners. The court acknowledged the proliferation of metal detectors and other security measures in the aftermath of the attacks of September 11, 2001. However, the court reiterated the principle that owners are not insurers of the safety of those who use their property. It described a building owner's common-law duty to take on only "minimal precautions" to protect tenants and visitors from foreseeable harm, including foreseeable criminal acts.

The second case cited was *Djurkovic v. Good Fellows, Inc.*, a 2003 case which involved a nightclub with a reputation and clientele quite different from that of the Rainbow Room. That case illustrated that even metal detectors proved to be "no safe harbor or prophylactic against either violence or lawsuits." In that case, metal detectors operated by state-licensed security guards who conducted pat-downs at the entrance of the club, did not prevent a box-cutter-wielding assailant from injuring another patron.

The court observed that "[a]dmittedly, the detectors were not set at a level sensitive enough to detect small objects, such as keys, and so it would appear box-cutters." Nevertheless the court held, as a matter of law, that even though the anticipated presence of large crowds of young people consuming alcohol at a "hip-hop" club in the early

morning hours made the particular criminal act foreseeable, the injured plaintiff failed to establish any breach in the owner's duty to take reasonable security measures to minimize the danger of such a criminal attack. The *Cipriani* court viewed the *Djurkovic* case as support for Cipriani's argument that imposition of metal detectors and frisking guests is not only inappropriate, and ill-advised, but also rather ineffective security.

All over the country, our courts are struggling with standards for landlords' liability for intruders' crimes. The Pennsylvania rule seems to be that landlords have no general duty to protect tenants against criminal conduct unless the landlord has established or advertised a so-called "program of security" that is "neglected and not fully implemented." Under this rule the *Djurkovic* case might have been decided differently because the argument might have been made that the security guards and the detectors constitute a "program of security" that was "not fully implemented." The *Djurkovic* decision had noted that the detectors were not set at a level sensitive enough to detect box cutters. See *Harris Ominsky, Real Estate Practice, Breaking New Ground, Landlords Blamed For Intruder's Crimes*, 296-303 (PBI 2000).

Trump "Trumps" Turks on 25% Termination Damages

by Harris Ominsky, Blank Rome, LLP, Philadelphia, PA

Donald Trump is still making news. He has done it again in *Cem Uzan v. 845 UN Limited Partnership*, 778. N.Y.S. 2d 171 (Supreme Court Supp. Ct., App. Division 2004), which involved a dispute over the forfeiture of a 25% down payment on the purchase of four luxury condominium units in New York City. The somewhat unusual facts

read as though they could be the basis of another TV series.

Battle of Billionaires

The scenario features a battle between billionaires, "The Donald" against two brothers, Turkish billionaires, who as a result

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of an unrelated fraud action, are allegedly subject to arrest if they attempt to enter the United States. Also, it's about the purchase of luxury condominiums on the top floors of the Trump World Tower, described as the tallest residential building in the world.

The buyers and their attorneys had negotiated agreements of sale during a two month period, and wound up exchanging at least four extensively marked-up drafts of the purchase agreements. The final negotiated agreements set a price of approximately \$32 million, a reduction of more than \$7 million from the list price in the offering plan, and obligated the buyers to make a 25% down payment. Other significant changes to the standard purchase agreement included granting the buyers the right to advertise the units for resale before closing, and a conditional right to assign the agreements to a third party.

The agreements were signed in April 1999 and the seller projected that the first closing on the building would occur nearly two years later. The total down payment of approximately \$8 million was paid into escrow in installments over a period of about 1 1/2 years.

Terrorist Attack

On September 11, 2001 terrorists attacked the World Trade Center, the city's two tallest buildings, murdering thousands of people. Apparently, that attack was a factor in changing the buyers' minds. They defaulted on the agreements and claimed that they were entitled to rescind the agreements because of the attack.

They claimed that they were concerned that the top floors in a "trophy" building, described as the tallest residential building in the world, would be an attractive terrorist target. Also, that the risk would be

further aggravated by the fact that the building bears the name of Donald Trump, perhaps the most widely known symbol of American capitalism.

In their complaint the buyers alleged that Trump had prior special knowledge that certain tall buildings, such as Trump World Tower, were potential targets for terrorists, and that the building did not have adequate protection for the residents of the upper floors of the building. They argued that the owners failed to advise prospective purchasers of the specific risks of a terrorist attack on Trump World, and to describe these risks. Some of these issues sound remarkably like the charges sometimes leveled at the Bush administration by their detractors, and investigated by Congressional committees.

25% Down Payment

The court's opinion did not discuss the charges of fraud and deceptive sales practices. Rather, the decision dealt with another charge of the buyers, that is, that the forfeiture of the down payment was an unenforceable "penalty."

The agreement of sale had made clear that the deposits constituted a non-refundable down payment and were payable to the owners if the buyers defaulted. Despite that, the buyers sought a declaratory judgment that they were entitled to return of the deposit because a 25% down payment was an "unconscionable illegal and unenforceable penalty."

Trump World Towers attempted to make the case that the sum was reasonable. It submitted an estimate of its damages, and substantial evidence of the common usage of the 20% to 25% down payment in the pre-construction luxury condominium market of New York. Trump World Towers stated that 25% was needed because of the substantial

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length of time between contract signing and closing during which it had to keep the units off the market; and because of the obvious risks. Also, it noted that in new construction condominium projects purchasers often speculate on the market, and if the market value increases they will then follow through and attempt to make a profit. If the market price has dropped they might then walk away from their down payment. It also presented a witness who discussed the volatility of the market and the risk factors specific to newly-constructed luxury condominium projects.

The witness concluded that from the sponsor's perspective, future competition is largely unknown, requiring an educated guess of the appropriate level of services and amenities to be provided at the building. She also stated that the demographic profile of potential purchasers of those types of units includes many foreign nationals who are inherently risky purchasers because their incomes and assets are often difficult to measure, and to reach. She alleged that the volatility of these real estate transactions increases with the size of the unit and that price swings for three and four bedroom units, such as the penthouse units in question, were greater than for smaller apartments.

All of this information tended to support Trump's position that the down payment was reasonably related to the loss that Trump Towers would expect to suffer if buyers defaulted under their purchase agreements.

The Law

The court ruled in favor of Trump, reversed the order of the Supreme Court of New York County, and held that Trump Towers was entitled to retain the full 25% down payments. However, in reaching that conclusion, the court did not even seem to require that damages bear a reasonable

relationship to the probable loss caused by the breach. It apparently ruled that way because the 25% down payment was a specifically negotiated element of the contracts negotiated between sophisticated business people, represented by counsel, who spent two months at the bargaining table before executing the final purchase agreements. It stated:

Finally, there was no evidence of a disparity of bargaining power, or of duress, fraud, illegality or mutual mistake by the parties in drafting the down payment clause of the purchase agreements. The detailed provision concerning the non-refundable deposit was integral to the transaction. If plaintiffs were dissatisfied with the 25% non-refundable down payment provision in the purchase agreements, the time to have voiced objection was at the bargaining table....Because they chose to accept it, they are committed to its terms. Thus, upon plaintiff's default and failure to cure, defendant was entitled to retain the full 25% down payments.

Sellers seeking to retain a 25% deposit will undoubtedly face more difficult hurdles in some other states. It is customary in many areas of the country to provide for forfeiture of a 10% deposit on a buyer's default, and it is likely that other courts will apply a test of "reasonableness" as the amount of forfeiture increases above that percentage.

On the other hand, the concept of reasonableness is often viewed at the time the parties entered into the contract. Courts will even uphold forfeitures of deposits when the seller hasn't suffered damages from the default. For example, the Massachusetts Supreme Court permitted a forfeiture even though the seller was able to sell the property for more than the original price. That court

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refused to apply the so-called “second look” doctrine that would require the parties to look at what really happened after the buyer defaulted. *Harris Ominsky, Real Estate Practice, Breaking New Ground*, pages 56-58 (PBI Press 2000).

Where a seller is trying to support a large forfeiture, it might improve its chances of success by structuring an agreement of sale

as an option agreement. The parties could agree that the buyer pays the agreed sum as a non-returnable price for the option, as with stock or commodity options. While it is not clear that that strategy would save a 15% or 25% forfeiture in some states, that type of transaction may leave the seller with a stronger position if the forfeiture is ever challenged as a penalty. ■

ACRELades

The *Washington Business Journal* honored top lawyers in metro DC in 10 substantive areas. In the category for Real Estate Transactions, **Jay Epstien** was selected as the “top Lawyer.” **Phil Horowitz** was one of the three finalists in this category. In addition, special mention was made of **Roger Winston** for his work with condominiums and homeowner associations, and **Earl Segal**, who in the words of the *WBJ* received the largest number of nominations, earning him the title of “Best Loved Real Estate Lawyer.” **Stef Tucker** also was a co-winner in the Tax Law category.

Professors Steve Bender, **Celeste Hammond**, **Michael Madison** and **Robert Zinman** have published *Modern Real Estate Finance and Land Transfer – A Transactional Approach*, 3rd ed. (Aspen), and recommend the casebook to those teaching Real Estate Transactions, Land Development and Real Estate Finance Courses.

Fred Joseph received a special plaque for his service as Chairman of the

Planning Committee and Moderator for the University of Kentucky CLE Bicentennial Real Estate and Practice Institute from 1988-2004.

Harold Lubell was awarded the New York State Bar Association Real Property Section Lifetime Professionalism Award. “Among those in the Section, the award is considered a Nobel Prize in Real Estate,” reports **Matthew Leeds**.

The ABA’s Excellence in Writing Awards for *Probate & Property Magazine* 2004 gave **Jack Murray** the “Best Overall Articles: Real Property” award, and **Marvin Leon** the award for “Best Cutting Edge Articles.”

The ABA Forum on the Construction Industry has issued a new publication, *The Construction Contracts Book: Negotiating Design and Construction Clauses*. **Stan Sklar** is a contributing author for the chapter on Dispute Resolution.