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MODEL INSURANCE REQUIREMENTS FOR A GROUND LEASE

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These Model Insurance Requirements for a Ground Lease (the "Model Insurance Requirements") consist of an extensive and detailed set of up-to-date insurance requirements suitable for use in a ground lease (a "Lease"). The Model Insurance Requirements appear in a separate exhibit so the parties can easily involve insurance advisers from the beginning of the transaction. That exhibit first presents a Base Case (the provisions one would ordinarily expect to see) followed by a collection of optional Bells & Whistles (extra measures one might use because of extra concerns or sensitivity or special circumstances).

This document is intended for a generic development Lease, in which Landlord owns vacant Land and Tenant will develop that Land by constructing a Building. These Model Insurance Requirements disregard any deal-specific elements and assume a generic development Lease that is typical and ordinary—nothing special or unusual. Of course, every commercial real estate transaction, however mundane, always has something atypical, extraordinarily, special, or unusual. These Model Insurance Requirements will require adjustment accordingly by a competent insurance adviser.

Although these Model Insurance Requirements relate to a Lease transaction, the requirements for a lending transaction will usually look rather similar, except that a lender will require endorsements and documentation different from those for a Landlord.

One can always say more about insurance. Joshua Stein's upcoming New Guide to Ground Leases will include an Encyclopedia of Ground Leases with an entry on Insurance, with additional comments. These Model Insurance Requirements, in slightly different form, will also appear in that New Guide. Consistent with the style sheet of that New Guide, terms typically defined in a Lease are capitalized in these Model Insurance Requirements and introductory cover notes. Anyone using these Model Insurance Requirements will need to check definitions.

INSURANCE PROCESS

As part of the closing process for any Lease, the parties need to deal with insurance, starting but not finishing with insurance requirements like those in these Model Insurance Requirements. Landlord's and Tenant's insurance advisers should review all insurance provisions in the Lease and Tenant's

insurance program, adjusting them as appropriate for the circumstances, including Tenant's development plans, the role of Subtenants, any connections with other nearby real property, requirements of other documents such as reciprocal easement agreements, and the parties' specific requirements.

That process takes time and should start when or before the legal work starts. It should take into account not only the insurance provisions themselves, but also other Lease provisions that directly or indirectly affect allocation and treatment of insurable risks, such as Rent abatement, Damage, Restoration, Indemnification,[1] Mortgages, maintenance and repair, termination rights, and waivers. An insurance adviser will want to see those sections, but these Model Insurance Requirements will constitute the main event.

COVERAGE TYPES AND AMOUNTS

These Model Insurance Requirements take into account these issues on insurance coverage types and amounts:

Coverage Limits, Generally

For all Required Insurance, Landlord and Tenant should determine minimum coverage requirements in consultation with insurance advisers. Those advisers typically suggest minimum coverage amounts, letting the clients decide whether to require more. As experts at recognizing risks, insurance advisers want to avoid the risk of "recommending" specific coverage amounts. No matter how high those amounts are, they could always turn out not to suffice when an actual large loss occurs. More coverage is always better. Any decision on higher coverage should also consider the incremental cost of the incremental coverage, which is often low.

CGL Coverage

Commercial general liability insurance typically has a coverage limit for each occurrence. It also has an aggregate limit that applies to all losses incurred in a year, at a single location or project. Sometimes that aggregate limit applies over the entire duration of a Construction project, so it might extend for several years. A multiyear duration is particularly likely in the case of a "controlled insurance program," which wraps Construction Period Insurance for Tenant and its (sub)contractors into a single policy.

Property Coverage

Property Insurance can be limited in two possible ways. First, it might provide a specific dollar amount of coverage for the insured Building. That limit typically applies on a "per occurrence" basis, with no aggregate limit. Second, Property Insurance might be written as part of a large blanket policy covering multiple locations. In that case, it would have a maximum per occurrence limit, again without an aggregate limit. A Building could sustain two or more property losses in a year. Each loss would potentially: (i) tap the entire coverage amount of the Property Insurance; and (ii) require the insured to pay a separate deductible amount. That is one of several reasons why it made a crucial difference whether the two airplane strikes on September 11, 2001, were one occurrence or two separate occurrences. To the extent it was determined the airplane strikes were two separate occurrences, each would have tapped into the full amount of Property Insurance coverage, so the carrier would have had to pay twice.

Construction Period Insurance

During Construction, special and more extensive/complex insurance requirements apply. Those requirements will often vary substantially from those which would otherwise apply, so much so that Construction Period Insurance is almost an entirely separate animal. The risks of Construction are fundamentally different in nature and magnitude than the risks of stabilized income-producing commercial real estate. And if particular Construction consists of Restoration after Damage, then Tenant's Subtenants may stop paying Subrent or may go away. Tenant's Property Insurance program will need to provide business interruption coverage to backstop that risk and assure Tenant can pay Rent during Restoration.

Downzoning Coverage

The Bells & Whistles say that if the Building ever becomes a legal nonconforming structure as the result of a future downzoning, then Tenant must maintain Property Insurance that will compensate for the resulting loss of value if major Damage occurs and the Building cannot be Restored. A typical insurance carrier may have trouble with that concept, as the carrier expects to pay only Actual Cash Value (replacement cost of the lost improvements less depreciation) in any circumstance when the insured does not promptly Restore.

Any existing Building of substantial size could at any time experience a downzoning, and hence become nonconforming. So any document that requires Property Insurance for any substantial Building should, in theory, probably include the requirement suggested in the preceding paragraph. But no one considers this issue unless they know the existing Building is already overbuilt. The special coverage for nonconforming structures can be quite expensive or even unavailable, just because it is unusual, it doesn't fit into the usual pigeonholes, and it varies from carriers' expectations on payment of Actual Cash Value if the damaged Building is not Restored.

Tenant may push back against the whole concept, arguing that any existing overbuilt Building that complies with code is highly unlikely to suffer so much Damage that it cannot legally be fully Restored. And even if it does suffer such Damage, Landlord should be just fine with a newly constructed and modern replacement Building using the maximum development potential available under then-current Law. The parties can certainly negotiate all of this further, perhaps with an appraisal process if major Damage occurs. Or Tenant might persuade Landlord to leave the issue to Tenant and its Institutional Leasehold Mortgagee—if the Institutional Leasehold Mortgagee doesn't care, then Landlord shouldn't either.

Here is sample language for Property Insurance that covers the risk of damage to a legal nonconforming structure. The blanks will need to be filled in based on the details of local codes and zoning.

Legal Nonconforming Structure

The structure located at _____ is a legal nonconforming structure. If this structure is damaged by either: (i) ____ percent or more of its replacement cost; or (ii) less than ____ percent of its replacement cost but the insured does not: (a) start such repair or reconstruction within ____ calendar days of that damage; or (b) complete such repair or reconstruction within ____ months after that damage and, as a result, its rights as a legal nonconforming structure are terminated (e.g., by operation of local zoning ordinances or other codes that prevent the insured from rebuilding the structure to its previous size), then this policy shall cover the diminution in fair market value of this location, without deduction for depreciation, up to an agreed amount cap for the diminution in fair market value of $_____. Diminution in fair market value means the difference between: (i) the fair market value of a newly repaired or reconstructed legal, nonconforming building as it existed before the damage, without deduction for depreciation; and (ii) the fair market value of the newly repaired or reconstructed building that complies with local zoning ordinances. That diminution shall be calculated as of the date of completion of all repairs and reconstruction of the conforming structure.

The extra insurance coverage just suggested for an overbuilt Building is not the same as traditional "ordinance or law" coverage, which instead covers only incremental costs that arise because current Law requires: (i) Restoration to meet a higher standard than the Damaged Building had to meet before the Damage; or (ii) demolition of the undamaged parts of the Building.

LANDLORD'S PROTECTION

Tenant's Required Insurance needs to protect Landlord and not just Tenant. That requires consideration of the following points, among others:

Additional Insured Status

For Liability Insurance, Landlord typically insists on being named as an Additional Insured on Tenant's

policy. In December 2019, the insurance industry changed the ISO Form CG 20 11 endorsement for Additional Insured parties. Those changes give Landlord less coverage than did the earlier April 2013 edition of that endorsement,[2] and more reason to maintain its own separate Liability Insurance policy independent of the Lease and Tenant's Required Insurance.

Even before those changes, careful Landlords hesitated to rely entirely on their Tenants' Liability Insurance. As a general principle, one should never rely exclusively on someone else's insurance. Insurance programs are often structured so the active party (Tenant or a contractor) must cover the passive party (typically Landlord) by endorsement as an Additional Insured. The December 2019 ISO Form CG 20 11 12 19 endorsement will not provide coverage if the only negligent party was someone other than Tenant or a party acting for Tenant. That circumstance is certainly conceivable. The December 2019 endorsement also does not cover construction activities.

Landlord will often try to cover construction activities by requiring Tenant's contractors to cover Landlord as an additional insured on the contractors' liability policies. That sounds good, but many Additional Insured endorsements protect only parties in privity of contract with the Named Insured Party. Landlord will flunk that test as it relates to Tenant's contractors. Again, the words of the policy are crucially important. Landlord and its insurance advisers should read the policy and not rely on insurance certificates.

Landlord may also face exposure if: (i) a particular accident did not arise from ownership, maintenance, or use of the Premises leased to Tenant; (ii) Tenant has let its Liability Insurance lapse; (iii) Tenant reduced the coverage limits; (iv) Tenant provided a less favorable Additional Insured endorsement than the Lease requires (e.g., Tenant provides an ISO Form CG 20 11 12 19 when the Lease requires an ISO Form CG 20 11 04 13); (v) Tenant simply failed to name Landlord as an Additional Insured as the Lease requires (and Landlord didn't notice and solve the problem); or (vi) the aggregate limits of liability have been exhausted.

Landlord can try to prevent that last problem by assuring that supplemental payments under the policy, such as attorneys' fees and other defense costs, remain outside the policy limits. In other words, the policy should require the carrier to make those payments in addition to payments for actual legal liability. This potential gap goes away if the policy directly covers Landlord as either an additional insured or a named insured, as its interest may appear. In that case, however, Landlord might find itself liable for premiums or deductible amounts.[3]

Landlord often obtains its own Liability Insurance, typically on an "excess only" basis. The Lease should require that Tenant's or some other party's (e.g., the contractor's) insurance be primary and non-contributory. The primary insurance will be called upon to pay before Landlord needs to rely on its own insurance. Underwriters deeply discount Landlord's insurance premium if Landlord, as Named Insured under Landlord's own policy, routinely requires Tenant and any contractors to provide primary and noncontributory Additional Insured coverage for Landlord.[4] Conversely, if Landlord doesn't do that, it may face a higher deductible amount.

Misconduct by Insured

The Conditions of Coverage in every Property Insurance policy say that if any insured party engages in misconduct—e.g., by misrepresenting any risks or material facts or falsifying a claim—this vitiates the entire policy. The only exception is the coverage for a Mortgagee named in the policy declarations. A Mortgagee is deemed an independent insured party, so its coverage is not vitiated by misconduct of other insured parties. In Landlord's perfect world, Landlord could conceivably try to persuade the carrier to endorse the policy to give Landlord coverage "as if" it were a Mortgagee. Although Leases occasionally require such an endorsement for Landlord, it is nonstandard. Tenant would typically object to it based on impossibility or at least great difficulty or expense. Perhaps a similar endorsement, if available,

for a Fee Mortgagee (rather than Landlord) might help bridge that gap.

LIABILITY INSURANCE IS DIFFERENT

Liability Insurance separates the insured parties. Misconduct by one vitiates the coverage for that party, but not for the others the policy covers. As long as the premium is paid, the coverage should attach. Liability Insurance carriers typically refuse, however, to commit to give notice of cancellation to anyone except the First Named Insured, i.e., Tenant. This imposes extra administrative burdens on Landlord and underscores the importance to Landlord of maintaining backup Liability Insurance.

GENERAL CONSIDERATIONS

In considering how to arrange Required Insurance for a particular Lease, the parties may also want to consider these issues of a more general nature:

Who Insures?

These Model Insurance Requirements, like the insurance provisions of most ground leases and many triple-net leases, require Tenant to obtain and maintain both Property Insurance and Liability Insurance.

For Liability Insurance, it is universally agreed that Tenant should obtain and administer the primary insurance policy. At a minimum, Liability Insurance should name Landlord as an Additional Insured. It may even identify Landlord as a named insured. Both designations are subject to some nuances and issues discussed below.

For Property Insurance, the typical case contemplates that Tenant must Restore, Rent does not abate upon Damage, and Tenant will use Property Insurance Proceeds to Restore before using them for anything else. In that case, Leases will typically require Tenant to maintain Property Insurance.

Even then, however, some insurance advisers and smart Landlords think Landlord should obtain and maintain the Property Insurance, in Landlord's and Tenant's names, as their interests may appear, and bill Tenant to prevent problems. That gives Landlord greater control, knowledge, and protection against surprises. It also spares Landlord from the need to police Tenant and review Tenant's policies for compliance, with occasional crises whenever an Insurance Impairment might occur. If Landlord obtains Property Insurance, though, Tenant and any Leasehold Mortgagee face much the same concerns in policing Landlord. Sensible allocation of these responsibilities will also depend on each party's size, sophistication, staffing, internal systems, and access to favorably priced blanket insurance coverage.

Usually it will make sense, and more "equitably" conform to the overall rights and obligations in the Lease and market expectations, for Tenant to maintain Property Insurance.

Indemnification vs Insurance

In any Lease, Tenant will Indemnify Landlord against a broad range of risks. Some of those risks are insurable. Some are not. Liability Insurance merely backstops Tenant's indemnity as it relates to risks covered by Tenant's Liability Insurance. Tenant remains liable for the insurable risks—or risks producing exposure beyond policy limits—as well as the uninsurable and uninsured ones. Tenant's exposure will, however, typically not exceed its equity in the Leasehold Estate. No creditworthy party backstops Tenant's Indemnity obligations, except perhaps during Construction.

Consider the possibility that Landlord can validly assert a huge Indemnity claim—far in excess of policy limits and Tenant's equity in its Leasehold Estate—for an Indemnified risk. Tenant's failure to pay that Indemnity claim creates a Monetary Default under the Lease. If Leasehold Mortgagee wants to preserve the Lease, Leasehold Mortgagee will need to cure the Monetary Default by paying Landlord's Indemnity claim. In contrast, a Fee Mortgagee would not face that risk and would take comfort that the Fee Mortgage comes ahead of tort judgments against Landlord.

Leasehold Mortgagees typically live with that risk. They don't use it as the basis for a new nonrecourse

carveout or for further fine-tuning the Leasehold Mortgagee Protections. This exposure does not seem to have produced substantial losses so far for Leasehold Mortgagees. It does, however, mean Leasehold Mortgagees should care more than Fee Mortgagees about having high levels of reliable insurance coverage.

Insurance Practices

Because a typical Lease continues for many years, these Model Insurance Requirements give each party a limited right to require changes in Required Insurance based on changes in Insurance Practices over time. Landlord will, however, worry that Tenant's changes will imperil Landlord, and conversely Tenant will worry that Landlord's changes will become onerous. So the suggested language limits each party's ability to require changes, with disagreements to be resolved by Expedited Arbitration, which would have to be defined elsewhere in the Lease. Tenant may also want to limit some insurance requirements so that, at all times from the Commencement Date, they apply only to the extent consistent with Insurance Practices, without the need to seek a change in those requirements. In general, though, the parties should satisfy themselves that all Required Insurance complies with Insurance Practices at least as of the Commencement Date.

MATTERS NOT COVERED

These Model Insurance Requirements do not cover any of these matters:

Business Personal Property Insurance

In general, Tenant is not required to insure its own business personal property such as inventory and equipment, as one might require of a store tenant.[5] Whether to obtain such coverage is left to Tenant's business judgment.[6] Some business personal property, such as fire extinguishers, will be legally required to operate the Building. So Landlord faces some contingent possibility of loss if that property is not insured.

To protect Landlord from Tenant claims resulting from damage to Tenant's business personal property, the Lease should include a broad waiver of all rights and claims that could have been insured by a "Causes of Loss – Special Form" policy of property insurance, with additional coverage for loss of business income. State law may limit Landlord's ability to enforce any such waiver.[7] That gives Landlord another reason to maintain its own backup Liability Insurance.

Construction Period Insurance, on the other hand, must address business personal property, to include construction equipment, materials, and temporary facilities such as scaffolding, forms, and field offices. These Model Insurance Requirements provide for that.

Environmental Insurance

These Model Insurance Requirements disregard environmental insurance for conditions that existed at the Commencement Date. That type of insurance mostly deals with environmental issues (not traditional insurance issues) and ties to environmental due diligence, site-specific history, risk allocation, and issues of environmental law. Policy wording will vary and require close scrutiny, even more so than for ordinary insurance coverage. Traditionally, most environmental insurance was written on a manuscript basis, tailored to reflect historical conditions. On the other hand, the industry has more recently figured out how to issue standardized pollution legal liability policies that insure against contamination that first arose after a particular date. Those policies are relatively inexpensive. These Model Insurance Requirements do require them. Although they have become more standardized, they still need a very close reading with help from environmental counsel and insurance advisers.

Separate Insurance

These Model Insurance Requirements seek only to define the insurance that Landlord and occasionally Tenant will typically require of the other. Most insurance advisers and smart Landlords recommend that Landlord carry its own backup Liability

Insurance to cover cases where either: (i) Tenant's policy lapses; or (ii) some legal quirk or Tenant's policy language limits Landlord's protection. Landlord may also want to maintain its own backup Property Insurance, protecting Landlord in cases where Tenant's Property Insurance somehow fails. That sort of backup coverage is not necessarily easy, standard, common, or cheap. Landlord will want to assure that Tenant's Property Insurance is primary, so that Landlord's Property Insurance, if any, responds only if Tenant's somehow fails. These Model Insurance Requirements contain language to that effect for any insurance Landlord decides to obtain. To the extent that Landlord obtains any insurance this paragraph suggests, Landlord may want to try to have Tenant reimburse the premiums, although that is not market standard.

Along similar lines, although these Model Insurance Requirements require Tenant to maintain certain Construction Period Insurance, those requirements consider only what Landlord requires to protect Landlord's interests. Tenant may very well require its Construction vendors to maintain more insurance and for longer periods, though Tenant will typically need to pay for it.

Assignment of Insurance Policies

Conceivably Landlord or Leasehold Mortgagee might want Tenant to assign (or collaterally assign) Required Insurance to that party. Any such assignment would go beyond the normal recognition of Landlord's and Leasehold Mortgagee's interests as contemplated by Insurance Documents issued for Required Insurance. It would be off market, might not be available, and is rarely or never seen.

Variations and Exceptions

State law may limit or require changes in these Model Insurance Requirements. Practices of particular insurance carriers may require Landlord to accept some variations or may drive the parties to find a different carrier. That process could take some time and is best not deferred to the last minute. Landlord can always waive any insurance requirement or any variation from Required Insurance. Therefore these Model Insurance Requirements never mention that possibility. It always applies automatically.

Self-Insurance and its Variations

If Tenant is (an Affiliate of) an institutional investor or some other creditworthy entity (e.g., a chain operator signing the Lease in its own name), Tenant may have a self-insurance, captive insurance carrier, or large self-insured retention program. In any such case, the parties will need to adapt and customize the Model Insurance Requirements to conform to the particular Tenant's program. Any resulting concessions and dilutions should apply only so long as the contemplated level of credit remains in place. Should the Lease be assigned in a way that removes the contemplated level of credit, or if Tenant's credit deteriorates, the original insurance requirements should once again apply.

A Different Approach?

One might think Landlord's insurance adviser could review and approve (or require changes in) Tenant's existing insurance program; the parties could memorialize Tenant's existing and satisfactory program in an exhibit to the Lease; Tenant could agree to maintain a substantially equivalent program (with the possibility of future changes based on future circumstances); and the parties could avoid saying much about Required Insurance. But insurance does not seem to work that way.

OTHER DOCUMENTS

These Model Insurance Requirements may need these exhibits, related documents or deliveries, additional information, conforming provisions in other documents, etc.:

Construction Contracts

Tenant must have its contractors and sub-contractors deliver certain Insurance Documents. Tenant will want to assure that its construction contracts align with those requirements and its contractors and subcontractors will be able to comply with them.

Flood

Although not specific to Leases, if either party obtains a Mortgage, the Mortgagee will need to obtain a flood zone certificate as an insurance-related part of the closing process. If the property is located in a flood zone, the Mortgagee must make various disclosures to the borrower and obtain the borrower's signature to acknowledge receipt of those disclosures. The Mortgagee must then maintain that paperwork in its permanent loan file. The bank regulators care a lot about all of this and take it very seriously.

Insurance Documents

Aside from the insurance requirements themselves within the Lease, there will also be an actual insurance policy or policies. Tenant will need to deliver appropriate Insurance Documents, which will, ideally, consist of the policy itself. Tenants often hesitate to share their actual policies, but might provide copies that exclude information about other locations. If Tenant refuses to provide any version of its actual policies, then Landlord may settle for some other evidence of coverage. For examples, see the possible definitions of Insurance Documents in these Model Insurance Requirements. There is no substitute for seeing the actual insurance policy with all endorsements before closing. A one-page "Certificate of Liability Insurance" or "Evidence of Commercial Property Insurance" is typically worse than worthless because it lulls the certificate holder into thinking it has coverage when it very well might not.[8] Either way, those deliveries should be treated as serious closing documents from the beginning of the transaction, not just as a last-minute trivial detail to be checked off on someone's clipboard. Landlord's insurance advisers should review these deliveries well before the last minute.

Names of Parties

Any Insurance Documents should identify the parties they benefit, e.g., Required Additional Insureds in the case of Liability Insurance. Traditionally, real estate transactions require absolute accuracy and precision, even regarding punctuation and abbreviation, in identifying those parties. Thus, early in the transaction, Landlord and Tenant should identify the exact names and addresses of all parties the Insurance Documents should initially name. That information should be checked against the appropriate Secretary of State websites. Then appropriate Insurance Documents should be prepared and carefully reviewed in draft, well before closing.

Replacement Cost Appraisal

An appraisal that separately states "replacement cost" is useful, but not conclusive. In the case of most high-value property, the parties will often obtain "agreed value" coverage for Property Insurance. It states the agreed value of certain objects or components and eliminates any coinsurance penalty or risk.

ADMINISTRATION

This document creates these and other issues and concerns for post-closing administration and follow-through. Some or all of these issues may justify an advice memo to the client after closing, to prevent problems or surprises.

Change of Address

If Landlord relocates, Landlord should update its contact information with the carriers and, of course, all other parties. Landlord should also file a change of address with the Secretary of State of the state where Landlord was formed, and with any corporate service company Landlord uses. Liability Insurance claims will often first appear when they are served on the Secretary of State. Landlord will want to make sure they are forwarded quickly and correctly.

Change of Use; Vacancy; Construction

If the Building experiences a change of use, vacancy of 31 percent or more of the Building for more than a very short time, or Construction (commencement, interruption, or completion), the parties should consider how this affects Required Insurance. In any of these cases, Landlord should either require assurances from the carrier (for vacancy), additional

coverages (for Construction or some changes of use), or other changes in Required Insurance, or obtain these assurances or coverages itself, whether or not at Tenant's expense. Otherwise, the change in circumstances may vitiate the insurance coverage. In some cases, that can happen automatically even without notice. Thus Landlord should keep its eyes and ears open for substantial changes in circumstances at the Building.

Claims Generally

If Landlord or Tenant becomes aware of a possible claim, this will require prompt action. If Tenant maintains insurance and Landlord receives a claim, Landlord should Notify Tenant quickly and in compliance with the Notice procedures in the Lease. Tenant (and perhaps Landlord as well) should formally Notify the insurance carrier. A nice conversation with the insurance broker will not suffice. Instead, Notice must potentially be given to a particular address, using a particular form, and enclosing certain required information. Any party giving such a Notice should comply to the letter with policy requirements. If Landlord maintains backup liability insurance, Landlord should give a similar Notice to its own carrier. After any party gives such a Notice, that party should try to obtain from the carrier written acknowledgment of receipt and formal confirmation that the carrier will defend.

Claims and Defense Costs

If Landlord files a claim under the policy as an Additional Insured, then costs of defense are typically not part of the indemnified loss, and thus do not erode the limit of coverage. That is one of many benefits to Landlord of being an Additional Insured. On the other hand, if Tenant's Liability Insurance responds to a claim against Tenant for contractual indemnity based on Tenant's Indemnities in the Lease (as opposed to a claim made directly by an Additional Insured), the costs of defense are typically part of the indemnified loss, and thus erode the limit of coverage. This is one reason a Landlord that is covered only as an Indemnitee should pay attention to the handling of any claim.

Expiration

Insurance coverage will expire periodically, typically annually. Both parties should stay on top of the renewal process and try to prevent a last-minute scramble. Those efforts will generally fail. The amount of available insurance may also change due to aggregate limits, claims experience, and shifts in the insurance market, which is often very volatile. When Tenant does renew or replace Required Insurance, Landlord should apply the same scrutiny to Tenant's deliveries that Landlord would at the original Lease closing. Landlord's diligence, and the involvement of its insurance professionals, should not end at closing but should instead continue through the Term.

Future Market Changes

As insurance markets change, Landlord's or Tenant's expectations on insurance may change. As a good example of that, industry expectations on deductibles can rise or fall over time. Depending on final wording of the insurance provisions, either party may have the right to require Tenant's insurance program to conform to those changes.

Historical Files

Insurance Documents cover a particular period, typically a year. The policy in place during that year will cover events that occur during that year, except in the unusual case of a "claims made" policy. If someone is injured during that year, they might not file suit right away. If and when they do file suit, Landlord will typically need to demand coverage under whatever insurance was in effect at the time of the injury. Thus, Landlord should keep its Insurance Documents in an organized way for at least several years, and not discard them merely because the period they cover has lapsed.

Notices

If the carrier agrees to give Landlord notices of possible Insurance Impairment, Landlord should watch for those notices and act quickly if it receives one. This may require placing replacement insurance on

an emergency basis. A Tenant's insurance policy does not itself automatically require the carrier to notify Landlord of possible Insurance Impairment, if Landlord is merely an Additional Insured. The policy will, however, require the carrier to give notice to the actual Named Insured and its designated Mortgagee. By specific endorsement, the carrier can conceivably (though it is not necessarily likely) also agree to give notice of cancellation to other specified parties, such as Landlord. The carrier's notice may warn that the policy will go away because of a change of circumstances. In that case, Landlord will need to understand and do something about what's happening. Merely getting notice of a problem doesn't solve it.

Policies

If the carrier does not issue actual insurance policies at closing, Tenant (and Landlord, because Landlord should ideally be entitled to copies of policies) should follow through to make sure the policies are issued promptly after closing. "Insurance Binders" are temporary policies and should be treated with great caution. Landlord's insurance adviser should review the policies to confirm they provide all Required Insurance.

Updates

If Landlord conveys the Fee Estate, Landlord should have Tenant reissue all required Insurance Documents in favor of the new Landlord. Ideally, but not typically, this will happen at the closing of the conveyance. Most Leases do not provide for it. Joshua Stein's Model Ground Lease offers such a requirement as a Bell & Whistle.

Notes

1 Tenant's Liability Insurance will not protect Landlord unless Tenant has agreed to Indemnify Landlord by written contract. Without such a written contract, "additional insured" or other status on Tenant's Liability Insurance doesn't help Landlord.

2 Sometimes Landlord can still require the old endorsement, ISO Form CG 20 11 04 13.

3 The insurance company will generally pay injured parties up to the coverage limits, regardless of deductibles. Often, the insured must then reimburse the carrier for the deductible.

4 Landlord's policy will describe the level of insurance documentation Landlord must obtain from Tenant and contractors. Often, certificates of insurance will suffice.

5 These Model Insurance Requirements do, however, require Tenant to insure its improvements and betterments, an insurance phrase with a meaning like fixtures.

6 In a space lease as opposed to a ground lease, this concern would lead Landlord to require insurance on Tenant's personal property.

7 See, e.g., New York General Obligations Law Section 5-321.

8 As a middle-ground approach that sometimes works, Landlord or its insurance adviser can review the declarations page of the policy as well as all endorsements the Lease specifically requires. Of course, this does not protect against modifications to the policy itself that trim coverage. These Model Insurance Requirements offer several possible definitions of Insurance Documents to accommodate different ways to handle this matter.

MODEL INSURANCE REQUIREMENTS FOR A GROUND LEASE

BASE CASE

EXHIBIT _____

Capitalized terms not defined in this Exhibit have the meanings: (i) in the Lease[1] to which this Exhibit is attached and of which it is part (the "Lease"); or, if not so defined; then (ii) that apply under Insurance Practices.

1. REQUIRED INSURANCE

1.1. PROPERTY INSURANCE. Tenant must maintain insurance for damage to or loss or destruction of the Building, Tenant's improvements and betterments, and Building Equipment (as this Exhibit more fully requires, "Property Insurance").[2] The Lease governs use of Property Insurance Proceeds regardless of terms of any Mortgage. These additional requirements apply to Property Insurance:

1.1.1. COVERAGE AMOUNT. Property Insurance must provide coverage for 100 percent of replacement cost (not actual cash value),[3] except excavations, foundations, and footings, without deduction for depreciation, and in an amount (or with an agreed value[4] endorsement) sufficient to prevent coinsurance.

1.1.2. LOSS PAYEES. Property Insurance must: (i) name as loss payee[5] each Mortgagee this Lease allows; and (ii) name as loss payee and additional insured Landlord as its interest may appear.

1.1.3. PERILS. Property Insurance must cover all losses caused by the perils covered by the broadest type of property insurance coverage available from time to time consistent with Insurance Practices. At the Commencement Date, this means an ISO Form CP 10 30 "Causes of Loss—Special Form" or other "open peril" policy form. Property Insurance must cover at least losses from fire, lightning, sprinkler or other water leakage, and wind. Property Insurance must also cover losses from these perils, which may be reasonably sublimited, subject to Landlord's reasonable approval: (i) earthquake, earth movement, and subsidence; (ii) Named Storm, including storm surge; and (iii) flood and rising water. If the Land is located in flood zone A or V, Tenant must

1 Conform this Exhibit to the nomenclature in the Lease.

2 Some real estate documents refer to "casualty insurance." In the world of insurance, the term "casualty" has special meaning, not limited to Property Insurance. These Model Insurance Requirements therefore refer to Property Insurance rather than casualty insurance.

3 Replacement cost coverage should pay to replace the Damaged Building with a comparable Building at the same location, with no deduction for depreciation, but only if Restoration occurs. In contrast, actual cash value coverage will reflect replacement cost of the Damaged Building, minus depreciation, hence will result in lower insurance proceeds. It will typically correlate with Tenant's not Restoring the Damaged Building. The carrier may also limit the recovery to actual cash value if Tenant does not complete Restoration within a stated period. The diminished award for actual cash value could fall short of the Mortgage balance. That's another reason to favor Restoration. If Tenant has built a larger Building than the Lease requires, Tenant might creatively argue that Property Insurance only needs to cover the cost to replace whatever Building the Lease actually required. Such a limitation does not typically appear.

4 Landlord may want the right to approve the agreed value. Such a right does not typically appear.

5 Multiple loss payees will result in joint checks payable to all loss payees. Tenant may object to recognizing Landlord as a loss payee if Tenant paid for and owns the Building or if the Lease allows Tenant or Leasehold Mortgagee to take the insurance proceeds and run.

maintain at least the maximum Flood insurance coverage available from the National Flood Insurance Program.[6] [Property Insurance must also cover losses from terrorism.][7]

1.1.4. SPECIFIC COVERAGE REQUIREMENTS. Property Insurance must cover, by endorsement or otherwise:[8] (i) equipment or mechanical breakdown, including explosion of steam and pressure boilers; (ii) debris removal, demolition, and increased cost of construction (ordinance or law coverage);[9] (iii) Waiver of Subrogation; (iv) civil authority; and (v) Loss of Business Income, and naming Landlord as an Additional Insured as its interest may appear under a form that, subject to Insurance Practices, provides no less coverage than that provided by ISO Form CP 15 30. Loss of Business Income coverage must cover continuing ordinary operating expenses, including Fixed Rent and Real Estate Taxes, for at least 12 months, with a 12-month[10] extended period of indemnity.[11] None of this coverage may be subject to co-insurance.

1.2. COMMERCIAL GENERAL LIABILITY INSURANCE. Tenant must maintain commercial general liability insurance[12] (CGL) against claims occurring on, in, or about the Premises or (to the extent consistent with Insurance Practices) adjoining sidewalks, streets, and passageways (CGL, with the additional types of liability insurance required below, collectively, "Liability Insurance") in compliance with these requirements:

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6 Depending on location and other circumstances, Landlord will require flood coverage beyond the National Flood Insurance Program. It covers only $500,000 of property loss and zero for business interruption.

7 The bracketed language will more likely appear for trophy or high visibility office buildings; buildings with high-profile tenants such as embassies or law enforcement organizations; projects near petrochemical facilities; and buildings that draw large crowds, such as major hotels and entertainment facilities. Tenant may wish to add: "to the extent consistent with Insurance Practices." If the federal backstop goes away, Tenant may want a separate cap on terrorism insurance premiums, e.g., no more than 200 percent of all other Property Insurance premiums.

8 Tenant might add: "to the extent consistent with Insurance Practices."

9 If a significant part of a building is Damaged, Law may require the owner to demolish the rest of the building, remove the resulting debris, and rebuild an equivalent building to current code. "Ordinance or law" coverage pays those extra costs and losses. Without it, the insured bears them. This coverage does not cover the risk that Development Law, at the time of Damage, would prevent full Restoration (a "legal nonconforming" structure). The latter risk often requires special manuscripted coverage, which can incur high premiums, as more fully discussed in the cover notes. Coverage for debris removal will typically not exceed 25 percent of the amounts payable for actual Damage. It also erodes coverage that may be needed to Restore. If Damage would create unusual amounts or types of debris, such as wrecked cars in a large underground parking garage, it may make sense to require extra coverage for debris removal (e.g., the ISO CP 04 15 endorsement). If Damage would cause a significant Hazardous Substance Discharge, the Building may need additional coverage for pollutant extraction, removal, and disposal.

10 Landlords will often want 24 months, sometimes even more. Before fighting over that issue, it makes sense to investigate the cost of that extra extension to coverage. The extended period of indemnity may cover Restoration time as well as delays in Restoration and, if Tenant relies on Subrent income, Tenant's re-leasing time, including re-leasing delays because of adverse conditions in the leasing market—but only for the duration of the extended period of indemnity.

11 If Rent doesn't abate—and it absolutely should not abate if Tenant must maintain Property Insurance—then in the coverage period (after the Damage), Tenant's coverage for loss of business income should cover Tenant's "continuing ordinary operating expenses," which would include Rent. In the rare case where Rent abates upon Damage, Landlord would maintain back-up Property Insurance coverage that includes coverage for loss of incoming Rent. The real question here is whether Landlord can be an Additional Insured on Tenant's business interruption coverage to the extent of the Rent portion of the continuing ordinary operating expenses. The answer is usually no.

12 This was once called "comprehensive" general liability insurance. The insurance industry renamed it in response to court decisions that interpreted "comprehensive" broadly, i.e., to mean "comprehensive." Today's Commercial General Liability coverage covers all causes of loss not excluded. But it never covers any forms of loss beyond Bodily Injury, Property Damage, and sometimes Personal and Advertising Injury. Some legal documents still call for Comprehensive Public Liability Insurance with the Broad Form Extended Property Coverage endorsement. The industry stopped using those policy forms in 1985.

1.2.1. COVERAGE AMOUNTS. CGL must provide for limits of liability[13] not less than $_____ for each occurrence and $_____ in general aggregate limit per annum, all on an "occurrence" (not a "claims made") basis.[14]

1.2.2. PROHIBITED PROVISIONS. CGL must not exclude or limit, by endorsement or otherwise, coverage for Abuse and Molestation; Assault and Battery; "Insured vs. Insured" except Named Insured vs. Named Insured; Punitive, Exemplary, or Multiplied Damages (except where Law allows); or subsidence or other earth movement. Liability Coverage must not be endorsed for Limitation to Designated Premises or Project (ISO Form CG 21 44) or include a Classification Risk Endorsement; Amendment of Insured Contract Definition (ISO Form CG 24 26); a Classification or Business Description limitation; or any other exclusion or limitation reasonably unacceptable to Landlord.

1.2.3. SCOPE. CGL must provide coverage in substance at least as broad (subject to Insurance Practices) as that supplied by ISO Form CG 00 01, including coverage for bodily injury, death, property damage, and personal and advertising injury. CGL must provide contractual liability coverage consistent with Tenant's Indemnity obligations under this Lease, to the extent insurable in accordance with Insurance Practices, treating this Lease as an insured contract. The policy may not, without Landlord approval, be endorsed to restrict the definition of an insured contract (in a manner that varies from any provision of this Lease) or to require that the insured occurrence arise out of operations or culpable conduct of any Named Insured.

1.3. ADDITIONAL LIABILITY INSURANCE. Tenant must also maintain (or, in the case of third parties, require maintenance of) this additional liability insurance (also part of "Liability Insurance") in conformity with Insurance Practices:

1.3.1. AUTOMOBILE INSURANCE. Tenant and Builder (and any other Person driving onto the Land or the Premises to perform services for Tenant[15]) must maintain automobile liability insurance on ISO Form CA 00 01, for all owned, non-owned,[16] leased, rented, or hired vehicles (and any mobile equipment subject to compulsory insurance or financial responsibility laws), providing coverage with a combined single limit of at least $1 million. This coverage must be endorsed to: (i) recognize Landlord and all Required Additional Insureds as Additional Insureds on ISO Form CA 20 48; (ii) provide primary and noncontributory liability coverage on ISO Form CA 04 49; and (iii) include a Waiver of Subrogation.

1.3.2. EMPLOYERS' LIABILITY INSURANCE. Tenant must maintain employer's liability insurance for all employees, with limits of at least $500,000.

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13 Ordinary Liability Insurance applies whether or not Construction is underway. During Construction, higher limits might apply as part of Construction Period Insurance. For any commercial real property, Liability Insurance will typically equal or exceed $1 million per occurrence and $2 million annual aggregate, supplemented by an umbrella policy providing total coverage of at least $10 million, or $5 million for smaller and lower-risk properties. Total coverage may substantially exceed $10,000,000 for large or high-risk properties. Tenant will typically provide much of that coverage through one or more umbrella policies, as this Insurance Exhibit permits.

14 Landlord or any other beneficiary of insurance will usually prefer coverage on an occurrence basis. In some cases, however, claims-made basis may make sense. This requires involvement of insurance advisers.

15 The parenthetical requires auto coverage from practically everyone working for Tenant. Insurance advisers say auto insurance claims are the fastest growing category of real estate-related insurance claims, so the parenthetical requirement is reasonable. In the real world, Tenant will not always fully comply. But Tenant or its property manager will typically engage service providers (e.g., the pest control company that drives onto the Premises) through a purchase order or other simple document, which can include terms and conditions that cover indemnification and insurance. A careful property manager will require an indemnification agreement and insurance from everyone working on the Premises.

16 "Non-owned" coverage applies to liability claims resulting from an employee's use of a personally owned vehicle for the business.

1.3.1. LIQUOR. If any alcoholic beverages are manufactured or sold on the Premises, then Tenant must maintain liquor sales and dram shop liability coverage, on an occurrence basis, in amounts as Landlord reasonably requires consistent with Insurance Practices, each on a per location basis with umbrella liability coverage consistent with that required for other Liability Insurance.[17]

1.3.2. POLLUTION LEGAL LIABILITY. Tenant must maintain pollution legal liability coverage for at least $1 million.[18]

1.3.3. WORKERS' COMPENSATION INSURANCE. Tenant must maintain workers' compensation and disability benefits insurance covering all Persons employed, as Law requires,[19] including (to the extent consistent with Insurance Practices and Law) a Waiver of Subrogation and compliance with all requirements for Liability Insurance.

1.4. REQUIREMENTS FOR ALL LIABILITY INSURANCE. All Liability Insurance must comply with these requirements:

1.4.1. NEGLIGENCE. No Liability Insurance shall exclude coverage for negligence of a Required Additional Insured. To the extent available under Insurance Practices, negligence on the part of the Named Insured or a person acting on its behalf must not be necessary for Liability Insurance coverage for a Required Additional Insured to attach.[20]

1.4.1. REQUIRED PROVISIONS. All Liability Insurance must: (i) apply to all Additional Insureds on the same basis and to the same extent as Named Insureds to the extent consistent with Insurance Practices; (ii) not exclude, limit, or restrict coverage for injuries to employees of any insured, New York Labor Law Section 240 or 241 or related or similar provisions, "third-party over" actions, or gravity-related injuries;[21] (iii) not exclude bodily injury or property damage contractual liability; and (iv) include a Waiver of Subrogation.

1.5. CONSTRUCTION PERIOD INSURANCE. During any Construction, including Preliminary Work,[22] and until the Completion Date or as this Exhibit otherwise requires, Tenant must (or must cause Builder to[23]) maintain this insurance ("Construction Period Insurance"), which does not limit any other Required Insurance except as expressly stated:

1.5.1. ADJACENT PROPERTY DAMAGE. Insurance against damage to property next to or near the Land caused by Construction, including excavation and construction of foundations and footings (and liability arising from

17 If the parties already know liquor will be served on the Premises, Landlord may want more detail.

18 This coverage is not yet universally required. Without it, Tenant's environmental indemnity stands on its own without insurance backing it up. If the Premises already suffer from known environmental conditions, that can entail separate environmental insurance beyond these Model Insurance Requirements.

19 In New York State, workers' compensation and employer's liability policies must generally be written without liability limits.

20 The December 2019 modifications to the Additional Insured endorsement cover Additional Insureds only if the Named Insured, or someone acting for it, is at least partially negligent. So Tenant may not be able to comply with this sentence. Hence the reference to Insurance Practices.

21 Clause (ii) recognizes some New York state-specific problems. Illinois has similar problems. So may other states. This definition will require adjustment outside New York.

22 Depending on circumstances and definitions, the parties may want this requirement to apply only in a Major Construction Period.

23 The Lease says once that Tenant can cause anyone else to perform any obligation the Lease imposes on Tenant. In reality, that is how Tenant will perform many of its obligations under the Lease, not just those on insurance. So the parenthetical language is unnecessary. Nevertheless it is universally expected in the worlds of construction and insurance.

crane operations, if applicable), in such amounts as Landlord reasonably requires and as Construction Easements or Permitted Exceptions require.

1.5.2. BUILDER'S RISK INSURANCE. Builder's risk insurance for 100 percent of completed value, on a replacement cost basis, including cost of debris removal and foundations covering Landlord and Tenant as their interests may appear. This insurance must: (i) contain a Waiver of Subrogation; (ii) grant permission to complete and occupy;[24] (iii) cover, for replacement cost, materials and equipment stored offsite (or in transit) for installation at the Premises;[25] (iv) insure against Building collapse during Construction; (v) cover products and completed operations; and (vi) continue for the Exposure Period Contractor's Liability Insurance.

1.5.3. CONTRACTOR'S CGL. Contractor's commercial general liability insurance for at least $_____ per occurrence (and at least $_____ annual aggregate) for bodily injury, death, and property damage, remaining in place for the entire Exposure Period, including: (i) products and completed operations coverage; (ii) contractor's protective liability for all subcontractors' operations; (iii) contractual liability, referring to the indemnity provisions of the construction contract (to the extent insurable) as an insured contract; (iv) premises-operations liability; (v) Waiver of Subrogation; (vi) coverage of all Required Additional Insureds consistent with ISO Form CG 20 10 10 01 and ISO Form CG 20 37 01 (for completed operations) on a primary and noncontributing basis; and (vii) to the extent consistent with Insurance Practices, compliance with all requirements that apply to Tenant's Liability Insurance.

1.5.4. CONTRACTOR'S POLLUTION LIABILITY INSURANCE. Contractor's Pollution Liability insurance, on ordinary and customary terms, with coverage in the amount of $_____, covering Landlord and Tenant for claims arising from any Hazardous Substance Discharge caused or exacerbated by Construction.[26] This coverage must be provided on a basis specific to the Premises. It must cover claims for third-party bodily injury, property damage, and environmental damage caused by Builder, including Clean-Up costs when required by Law or as a result of third-party claims.

1.5.5. DESIGN PROFESSIONALS E&O. For any provider of professional services, including architects and engineers, for Construction, professional liability insurance covering the professional services rendered (including errors and omissions coverage), providing coverage during the Exposure Period for that liability insurance. Coverage must equal at least $1 million per occurrence and $1 million aggregate. Architects and engineers must, however, provide at least $2 million aggregate. The retroactive date of that insurance must be no later than the date of the contract by which the professional in question was first engaged.[27]

1.5.6. COORDINATION. To the extent Required Insurance in place provides coverage at least equivalent in all respects to Construction Period Insurance, that insurance shall suffice and be deemed (part of) "Construction Period Insurance."

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24 If the policy does not grant this permission, then the builder's risk coverage may lapse automatically, instantly, and without notice if the policyholder takes beneficial occupancy of the Construction or any part of it. That lapse even affects a Mortgagee, so if a loss occurs the carrier would deny coverage and the Mortgagee might ultimately foreclose.

25 Coverage for building materials and equipment to be incorporated into the Construction is often sharply sublimited. It often excludes "materials and equipment of others." So, if the risk of loss does not rest with the named insured when a loss occurs, then the coverage may be inadequate. This is especially true when Builder is the named insured or if materials or equipment are not perfectly tendered. Construction contracts should try to shift risk of loss to whoever must maintain builder's risk coverage, even for materials and equipment that the purchaser has the right to reject (or to revoke acceptance), until and unless the vendee elects to reject them or to revoke acceptance for nonconformity.

26 Much more could be said here. For example, Hazardous Substances Discharge does not include mold. Landlord's insurance adviser may identify specific additional requirements.

27 If anyone asks to be added as an Additional Insured on this policy, the carrier's answer will usually be no.

1.6. GOVERNMENTAL REQUIREMENTS. If any Government requires any insurance related to the Premises, Tenant shall obtain and pay for it.

2. STANDARDS FOR ALL INSURANCE

All Required Insurance must meet these requirements, and contain these provisions, by endorsement or otherwise:

2.1. ADDITIONAL PROVISIONS. Policies must contain additional provisions as Landlord reasonably requires consistent with Insurance Practices.

2.2. CARRIERS. All carriers must: (i) have a policyholders' rating of A-/VII[28] or better, based on the latest rating publication of Property/Casualty Carriers by A.M. Best Company, Inc., or an equivalent rating if that rating ceases; and (ii) be licensed or otherwise authorized[29] to do business in the State.

2.3. DEDUCTIBLE/RETENTION. Any Required Insurance shall not have a deductible or self-insured retention amount above $25,000.[30] Named Storm, flood, earthquake, earth movement, and subsidence coverages may, however, have a higher deductible consistent with Insurance Practices.

2.4. LANDLORD PROTECTION. Landlord's interest and coverage must not be invalidated by any: (i) negligence of Tenant, Landlord, any Mortgagee, or any other person with any interest in the Premises; or (ii) Involuntary Transfer.[31]

2.5. NOTICE TO LANDLORD. Each policy must be endorsed to require the carrier to give Landlord 30 days (10 days for cancellation for nonpayment) prior Notice of any policy cancellation or nonrenewal.[32]

2.6. PRIMARY COVERAGE. All policies must be written as primary policies, without requiring contribution from (or providing coverage only in excess of) any other coverage (primary, umbrella, contingent, or excess) of any Additional Insured. If any Additional Insured obtains its own separate or additional coverage, then that coverage will be excess, secondary, and noncontributing.

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28 The letter grade reflects Best's Financial Strength Rating. "A-" means excellent. The roman numeral "Class" category reflects the carrier's financial size or policyholders' surplus, an insurance term that relates to financial strength. Class VII means a carrier has a policyholders' surplus between $50 million and $100 million. Many Government agencies accept Class VII, so these Model Insurance Requirements set it as a floor. Any Lease can require a higher or lower standard. Class VIII means a carrier has a policyholders' surplus between $100 million and $250 million. Class X means $500 million to $750 million. Leases and loan documents typically set minimum carrier criteria at the levels just mentioned in this footnote, sometimes lower if the carrier has a favorable reinsurance program. Class XIV, which some advisers recommend, means $1.5 billion to $2 billion of policyholders' surplus–a standard that only about a dozen carriers can meet. An insurance consultant can best advise on these matters.

29 The term "admitted" is narrower and is used only in non-excess-and-surplus lines. The term "authorized" allows more carriers. If a carrier is authorized but not admitted, it will not need to comply with all the same rules and regulations that apply to carriers admitted in the state. Landlord will typically allow carriers that are authorized even if they are not admitted. This should be discussed with insurance advisers.

30 This is a low number. For larger properties, portfolios, or substantial owners, an insurance adviser may recommend a higher deductible.

31 Landlord would like to go a step further, and have its Property Insurance immunized against any "act" of Tenant, such as Tenant's misrepresentations on an insured risk or claim, misconduct in placing coverage or handling claims, or occupancy for uses more hazardous than the policy allows. A Mortgagee would obtain that protection. Landlord typically cannot. This is an argument for Landlord to control Property Insurance and pass the premiums through to Tenant.

32 Landlord would also like notice of "any material change" in the policy. Carriers generally reject that. Carriers typically agree to give Landlord the notice described in text, at least for Property Insurance though not necessarily for Liability Insurance.

3. ADDITIONAL COVENANTS

3.1. ADDITIONAL INSUREDS. Wherever this Exhibit requires insurance covering Additional Insureds, that coverage must, to the extent consistent with Insurance Practices, be: (i) at least equivalent to that provided under ISO Form CG 20 11 01 96 or equivalent (in the case of Tenant's coverage) or ISO Form CG 20 37 10 01 and ISO Form CG 20 10 10 01 (in the case of insurance provided by contractors); and (ii) no less favorable to the Additional Insureds than the coverage provided to the Named Insureds.

3.2. CHANGED REQUIREMENTS. Either party may reasonably request an adjustment of any insurance requirements of this Exhibit to conform to changes in Insurance Practices. If Landlord's additional requirements conform to those of any [Leasehold] Mortgagee [that is an Institution], then they shall automatically be deemed reasonable, and Tenant shall comply with them.[33] A party exercising rights to adjust coverage under this section must: (i) do so no more than once every three years; and (ii) give at least six months prior Notice of the requested change.[34]

3.3. DISPUTES. The parties shall resolve through Expedited Arbitration any disagreement on Tenant's compliance with this Exhibit, Insurance Practices, or the scope of Required Insurance. Tenant shall nevertheless, even during Expedited Arbitration, maintain with Landlord all Insurance Documents this Exhibit expressly requires.

3.4. ENHANCED LIABILITY INSURANCE. If Tenant, its Builder, or anyone else with whom Tenant contracts carries liability insurance that is higher in amount or broader in scope than Required Insurance (that liability insurance, the "Enhanced Liability Insurance"), then: (i) the Required Additional Insureds must be named as (and shall be deemed to be) additional insureds for the Enhanced Liability Insurance; and (ii) the minimum Liability Insurance that Tenant, Builder, or Tenant's contractual counterparty must carry shall increase to match the Enhanced Liability Insurance, so long as it remains in effect.

3.5. INFLATION ADJUSTMENTS. Dollar figures in this Exhibit, including coverage and deductible amounts, shall be Inflation-Adjusted.[35] That does not apply to any insurance requirement that: (i) refers to value or a formula; or (ii) otherwise does not use a particular dollar figure.

3.6. LANDLORD'S INSURANCE. Landlord may, at its option, maintain for its benefit secondary, contingent, or backup insurance covering any of the same risks as Required Insurance, but responding only if Required Insurance has lapsed or become unavailable for any other reason. In no event will Landlord have any liability to Tenant if it does not maintain this coverage. Tenant will not be entitled to the benefits of any such insurance if Landlord maintains it.

3.7. NO REPRESENTATION OR OBLIGATION. Neither party represents that the forms, limits, scope, or terms of Required Insurance are adequate. Landlord has no obligation to enforce anything in this Insurance Exhibit or to confirm that Tenant's insurance program complies with Required Insurance. The requirements for Tenant's insurance program solely benefit Landlord and Fee Mortgagees.

33 Tenant might propose the converse: If an Institutional Leasehold Mortgagee accepts less than this Insurance Exhibit requires, Landlord must go along. See the Bells & Whistles for some language along these lines.

34 Landlord may prefer to: (i) say only Landlord can exercise rights under this paragraph; and (ii) delete the last sentence.

35 Inflation adjustments may not suffice. The Bells & Whistles would allow Landlord to adjust Required Insurance to match the standards of similar properties over time.

3.8. NO SEPARATE INSURANCE. Tenant shall not carry insurance (whether additional, separate, concurrent, or contributing) for any risk against which this Exhibit requires Tenant to insure, unless, for that insurance, Tenant has complied with all requirements of this Exhibit that apply to Required Insurance of the type in question.

3.9. POLICY ALTERNATIVES. Tenant may provide any Required Insurance through: (i) a combination of primary and excess liability or umbrella policies; (ii) a blanket insurance policy; or (iii) a risk purchasing group or similar cooperative insurance program. In each case, coverage must: (i) specify per-location limits for the Premises, consistent with this Exhibit, without potential reduction for any claim arising from any other location;[36] and (ii) follow the form of, have the same policy period as, and comply with all requirements for the primary coverage, including required carrier rating and Required Additional Insured coverages.

3.10. POLICY COMPLIANCE. Tenant shall comply with all: (i) conditions and requirements in Required Insurance; and (ii) orders, policies, recommendations, regulations, requirements, and rules of any board of fire underwriters, fire or insurance rating organization, or other body exercising similar functions that has or asserts jurisdiction over, or otherwise make rates or findings for, the Premises. Tenant shall do nothing that will or might cause an Insurance Impairment.

3.11. TENANT'S OBLIGATIONS. This Exhibit does not limit any obligation of Tenant under this Lease outside this Exhibit, including any Indemnity by Tenant. Tenant shall pay all deductible or self-insured retention amounts for claims under Required Insurance.

3.12. WAIVER OF SUBROGATION. To the extent [this Exhibit requires any party to maintain] [any party actually obtains][37] any insurance with a Waiver of Subrogation in favor of a party, the party required to maintain that insurance waives and releases the other party and its Related Persons (and in the case of Tenant's release of Landlord, also all Required Additional Insureds) from all claims and rights of recovery caused by or resulting from perils that such insurance covers (up to the policy limits) or would have covered (up to the policy limits) had it been obtained.[38]

4. DELIVERIES

4.1. CONTRACTORS. Tenant shall cause its contractors to give Landlord copies of: (i) Insurance Documents for any liability insurance that any Construction Document requires any such contractors (or if this Lease requires, sub-contractors) to maintain in favor of Landlord or Tenant; and (ii) copies of their liability insurance policies, from which details of other locations may be redacted, with proof of payment of premiums and endorsements adding all Required Additional Insureds[39] as additional insureds on a primary and noncontributory basis.[40]

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36 Large Tenants might not satisfy this requirement. Landlord may respond by requiring more umbrella liability coverage.

37 Choose one bracketed phrase and delete the other.

38 Joshua Stein's Model Ground Lease Base Case also includes Tenant's very broad waiver of claims against Landlord to the extent those claims were insured, or could have been insured, under the Property Insurance the Lease requires. The Model Ground Lease Base Case also includes Tenant's broad waiver of claims for damage to Tenant's personal property. But see N.Y. General Obligations Law Section 5-321, which invalidates waivers of Landlord's liability for negligence. The Model Ground Lease Base Case does not require Tenant to obtain insurance for that damage.

39 Many Additional Insured endorsements in Construction contracts limit Additional Insured status to the parties for whom the Named Insured performs Construction. Subcontractors do not work for Landlord. So the usual endorsement would not cover them.

40 Tenant may balk at the breadth of the requirements for insurance to be delivered by contractors and subcontractors. Nevertheless, many Landlords insist on those deliveries.

4.2. IMPAIRMENT. If Tenant receives notice of any actual or threatened Insurance Impairment, Tenant shall within two Business Days give Landlord a copy.[41]

4.3. INSURANCE DOCUMENTS. On the Commencement Date, and no later than 10[42] days before any expiration or cancellation of Required Insurance, Tenant must give Landlord Insurance Documents renewing or replacing the expiring or terminating Required Insurance, expiring at least one year from delivery.[43]

4.4. REQUIRED INSURANCE FAILURE. If Tenant fails to provide any Required Insurance or Insurance Documents, then Landlord, after giving Tenant two Business Days Notice,[44] may at its option arrange replacement insurance at Tenant's expense. Landlord must Notify Tenant promptly after doing so. Tenant must reimburse Landlord's Costs to obtain that insurance. When Tenant provides the Insurance Documents the absence of which triggered the replacement coverage, Landlord must, to the extent permissible, cancel any replacement insurance, for Tenant's account. Landlord's right to arrange replacement insurance at Tenant's expense does not: (i) excuse any insurance-related obligation of Tenant or any Default resulting from Tenant's failure to maintain Required Insurance or deliver Insurance Documents;[45] or (ii) limit any Landlord right or remedy under this Lease.

4.5. POLICIES. From time to time, in each case within five Business Days after Landlord's request, Tenant shall give Landlord copies of all insurance policies and endorsements this Exhibit requires, not limited to Insurance Documents.[46] Details of other locations may be redacted.

5. DEFINITIONS

These definitions apply in this Exhibit:

5.1. EXPOSURE PERIOD. The "Exposure Period" means, for Liability Insurance, a period that begins when this Lease first requires that Liability Insurance and ends when the statute of limitations and statute of repose have expired for all claims that it covers or would cover. For any Construction Period Insurance, except Liability Insurance, the Exposure Period: (i) begins when on-site Construction begins; and (ii) ends on the Completion Date for that Construction.

41 Landlord might try to: (i) obtain a similar commitment from Tenant's insurance broker; and (ii) trigger an automatic incurable Event of Default if Tenant fails to comply with this obligation. Both extra measures are unusual and would probably concern a Tenant.

42 Landlord would like to receive Insurance Documents for a renewal policy at least 30 days before expiration. But that just doesn't happen. Any renewal typically causes a last-minute scramble, with new Insurance Documents sometimes arriving the day before expiration, or later. It is reasonable to require new Insurance Documents 10 days before expiration, but Landlord should still recognize that it probably won't happen. Tenant may propose to deliver replacement Insurance Documents "as soon as practicable but in any event no later than the existing coverage expires." It still often won't happen.

43 Tenant might request the right to maintain insurance for less than a year, particularly at the beginning of the Term, to synchronize renewals with a larger insurance program. Tenant will typically reject any requirement to pay insurance premiums for a period of more than a month at a time.

44 Landlord might not want to give any Notice. Landlord would typically want to force-place first, talk later. Landlord can usually force-place insurance if Tenant is out of compliance with any Required Insurance, even if Tenant's noncompliance is minor. There is no substantial compliance cushion. This should of course be confirmed with insurance advisers.

45 See Thee Aguila Inc. v ERDM, Inc., B263005, 2016 WL 3029560 (Cal. Ct. App. May 19, 2016) (Landlord's right to force-place substitute insurance means Landlord cannot declare Lease default for Tenant's failure to insure). This is, however, a California case.

46 This requirement may be quite burdensome. Discuss with insurance adviser. It is important, though. It allows Landlord to confirm that Tenant's actual insurance complies with the Lease. The insurance may vary from the Insurance Documents Tenant delivered, depending on how the Lease defines Insurance Documents. See the comments accompanying that definition.

5.2. INSURANCE DOCUMENTS. The "Insurance Documents" means these documents, identifying Tenant as the insured and where appropriate as the First Named Insured and otherwise fully evidencing all Required Insurance: (i) ACORD 28 evidence of Commercial Property Insurance; (ii) ACORD 25 Certificates of Liability Insurance;[47] and (iii) a copy, certified by the carrier, of each policy constituting part of Required Insurance, including declaration pages, Schedule of Forms and Endorsements, and a full copy of all endorsements and other provisions that apply to Landlord or Fee Mortgagees, including recognition of all Required Additional Insureds,[48] all in ordinary and customary form reasonably satisfactory to Landlord. Details on locations other than the Premises may be redacted.[49]

5.3. INSURANCE IMPAIRMENT. An "Insurance Impairment" means any cancellation, modification, nonrenewal, premature termination, or premium increase for any Required Insurance.

5.4. INSURANCE PRACTICES. "Insurance Practices" means then-current, at the time of determination, ordinary, customary, and commercially reasonable insurance practices, requirements, and standards for buildings of a type, use, size, height, construction, location, and other characteristics generally similar to the Building.[50] Insurance Practices take into account, among other things, then-current Law and requirements of Mortgagees that are Institutions.

5.5. ISO. "ISO" means the Insurance Services Office, Inc., and its successor organizations. If no successor exists, then references to ISO shall refer instead to an insurance industry organization performing similar functions. Any dispute under this paragraph shall be resolved by Expedited Arbitration.

5.6. ISO FORM. Any reference to an "ISO Form" means, without modification: (i) unless a particular edition is specified, the then latest version of that form published by ISO, or any replacement, successor, or substantially equivalent form; and (ii) if a form is discontinued without replacement or if ISO no longer exists, then insurance coverage or endorsements on substantially the same terms as the last ISO version of the specified form,

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47 Tenant will ordinarily prefer to deliver only ACORD 25 and 28 documents. They state on their face that Landlord cannot rely on them. Case law confirms, and the certificates themselves go out of their way to announce, that certificates of insurance are legally worthless. Tenant's broker typically prepares them. But Landlord has no privity of contract with Tenant's broker or carrier, hence no claim for negligent misrepresentation. Even if a certificate is accurate as far as it goes, it often says so little as to be inadequate. It doesn't describe coverage exclusions. It doesn't say whether supplemental payments (e.g., attorneys' fees) erode coverage or are outside the policy limits. It omits conditions of coverage that make the insurance illusory. In practice, Landlord will often accept certificates of insurance, based on the high practical likelihood that they are accurate. That leaves open a perfectly preventable risk, which seems anomalous for a process that is supposed to reliably reallocate risks. There is no substitute for obtaining and carefully reviewing the actual policies of insurance.

48 The policy may automatically include as Additional Insureds Landlords and other parties that Tenant agrees by contract to name as additional insureds. If, however, Landlord can't see the policy itself, Landlord can't confirm it has that provision or actually provides the correct coverage. Even when the policy does provide for an "automatic" endorsement, Landlord's insurance advisers will want to see the exact language of the Additional Insured Endorsement, which often comes with limitations.

49 Tenant, especially if a large company, will often resist providing a copy of the entire insurance policy (clause "iii"). In that case, Landlord should try to obtain as many of the items listed below as possible. If Tenant delivers all these items, though, there isn't much left to hide, so Tenant may as well have delivered the entire policy:

(iii) policy declaration pages showing all Required Insurance; (iv) all endorsements evidencing Required Insurance (e.g., Waivers of Subrogation, Required Additional insureds, loss payee, obligations to notify Landlord or Additional Insureds, or otherwise relating to Landlord or Required Additional Insureds); (v) Schedule of Forms and Endorsements; (vi) each Coverage Form and, where pertinent, Causes of Loss form with declaration pages attached; (vii) Common Policy Declarations, Terms, and Conditions; and (viii) other insurance documentation sufficient to reasonably evidence that Tenant maintains all Required Insurance.

50 The parties could refer to a radius for similar properties, or the County, or limit the definition to buildings built or substantially redeveloped in the 10 years before the date of determination. Or they could live with the language in text, which seems reasonable.

to the extent consistent with Insurance Practices. Any ISO Form may be replaced by any other form providing equivalent coverage subject only restrictions and limitations equivalent to those in the ISO Form.[51]

5.7. REQUIRED ADDITIONAL INSUREDS. The "Required Additional Insureds" means Landlord and such additional or other Persons as Landlord designates from time to time by Notice to Tenant, consistent with Insurance Practices, such as managers and Fee Mortgagees. Landlord initially designates these Persons, at these addresses, as Required Additional Insureds: [list persons and addresses].[52]

5.8. REQUIRED INSURANCE. The "Required Insurance" means all insurance this Lease requires of Tenant.

5.9. WAIVER OF SUBROGATION. A "Waiver of Subrogation" means a provision in, or endorsement to, any Required Insurance,[53] by which the carrier: (i) allows the insured, before a loss or claim occurs, to waive its and the carrier's right to recover against parties responsible for that loss or claim; and (ii) waives all rights of recovery by way of subrogation or assignment against such party(ies) for any loss or claim the policy covers.[54]

MODEL INSURANCE REQUIREMENTS FOR A GROUND LEASE

BELLS & WHISTLES

1. ADDITIONAL AGREEMENTS ON INSURANCE

1.1. COORDINATION WITH MORTGAGE. Notwithstanding anything else in this Exhibit, Tenant shall be deemed to be in full compliance with this Exhibit if Tenant provides all insurance coverage required by a Leasehold Mortgagee that is an Institution and that coverage: (i) benefits Landlord and the Required Additional Insureds directly, in a manner consistent with Insurance Practices; and (ii) has been confirmed through Insurance Documents delivered to Landlord.[55]

1.2. COORDINATION WITH MORTGAGE. To the extent and only so long as a Leasehold Mortgagee requires Tenant to maintain any insurance coverage (or provide any insurance-related documents or deliveries) beyond Required Insurance, this Exhibit incorporates those additional requirements by reference as part of Required Insurance. Tenant shall comply with all those additional requirements, including delivery of corresponding Insurance Documents, for the benefit of Landlord and all Required Additional Insureds, in addition to all requirements of this Exhibit.

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51 Some insurance advisers disfavor the flexibility implied by the previous sentence.

52 Customarily the Required Additional Insureds must be identified with extreme accuracy and precision. Failure to identify them correctly may impair their insurance protection.

53 Waivers of Subrogation can sometimes cover Liability Insurance. More often, though, similar issues are handled through Additional Insured status.

54 Most Property Insurance policies have a Waiver of Subrogation. Leases and other transactional documents must still close the loop by having the parties waive claims against one another for property loss or damage. Because subrogation rights belong to insurance carriers and not to the contractual parties, any waivers of subrogation agreed between the contractual parties, but not the carrier, are generally ineffective. Other insurance types, such as workers' compensation coverage, don't always automatically include a Waiver of Subrogation. There, it must be specifically requested, which may lead to special requirements, including extra premiums. Some state Laws prohibit Waivers of Subrogation in workers' compensation coverage.

55 This paragraph is inconsistent with the next. Don't use both. Select and edit as appropriate.

1.3. EQUIPMENT BREAKDOWN. To the extent that Tenant's equipment breakdown coverage requires Tenant to obtain (or file with any Government) inspection reports, Tenant shall upon Landlord's request promptly give Landlord copies of all those reports.[56]

1.4. EXISTING INSURANCE PROGRAM. Landlord has approved Tenant's existing insurance program, a copy or summary of which appears as Exhibit ____ ("Existing Insurance"). To the extent that the Existing Insurance varies from Lease requirements, Landlord waives that noncompliance. [To the extent that Existing Insurance exceeds Lease requirements, Tenant agrees to maintain and continue that excess program so long as it conforms to Insurance Practices.] That does not limit either party's right to seek changes in Tenant's insurance program as this Exhibit otherwise allows.[57]

1.5. FINANCING. Tenant shall not finance any insurance premiums under any arrangement that could result in Insurance Impairment if Tenant fails to make payments due under the premium financing or otherwise.[58]

1.6. INDEMNITY. Neither this Article nor Tenant's Liability Insurance limits Tenant's Indemnity obligations under the Lease. If Tenant fails to maintain any Required Insurance, then Tenant shall pay all amounts that the Required Insurance would have paid if maintained.[59] Tenant's liability shall not be limited to the amount of premiums not paid. Landlord's right to arrange replacement insurance is intended only to benefit Landlord. The existence of that right shall not limit Tenant's liability, as described in this paragraph, for failure to maintain Required Insurance.

1.7. LANDLORD'S LIABILITY INSURANCE. Landlord shall [at Tenant's expense] maintain commercial general liability insurance against claims for bodily injury or property damage for which Landlord is legally responsible (and not covered by Tenant's Liability Insurance) occurring on or about the Premises or (to the extent consistent with Insurance Practices) adjoining sidewalks, streets, and passageways, with liability limit of $_____ for each occurrence and $_____ in aggregate per annum.[60]

1.8. LEGAL COMPLIANCE. To the extent any Law categorically prohibits carriers from providing any Required Insurance, the requirement for that insurance shall be deemed to have been limited accordingly.

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56 Mechanical breakdown coverage typically allows the carrier to inspect covered systems once or twice a year, typically matching local code requirements. In New York City, noncompliance may lead to violations and closures.

57 This paragraph effectively makes the detailed Required Insurance language in the Lease meaningless, replacing it with another perfectly reasonable but off market way to define Required Insurance, i.e., an exhibit that defines Actual Insurance based on what Tenant actually does. If the parties agree to it, they should consider the possible need for known future changes, such as when Tenant starts Construction.

58 This prohibition sometimes appears. Most Tenants do, however, want to finance insurance premiums and pay monthly. Carriers have learned that this form of financing creates a nice profit center. If Tenant misses a payment, the premium financier can cancel the policy. But the carrier must always give Landlord 10 days' notice of cancellation—at least for Property Insurance—so Landlord can act to prevent the cancellation. Landlord may, of course, prefer to avoid that drama entirely. Tenant may be sympathetic to Landlord's concerns but will argue that premium financing is quite ordinary and makes business sense for Tenant, so Landlord should live with it. In today's world, Tenant will typically prevail.

59 Some courts would limit Tenant's liability to the amount of unpaid premiums, even if a loss occurred that should have given rise to a substantial insurance claim. The language in text seeks to prevent that result.

60 Tenants sometimes request this coverage based on mutuality. Given Tenant's complete control of the Premises, Tenant probably has no basis to look to Landlord to provide insurance for any Premises-related risks, unless Landlord retains some possessory interest in the Premises or adjacent property. Landlord may, however, choose to maintain this coverage for its own benefit. Before agreeing to maintain the insurance described here, Landlord should confirm its availability. Tenant would like to be named as an Additional Insured, and to have Landlord's coverage identify this Lease as an insured contract, but the carriers will hesitate to do that.

1.9. NONCONFORMING BULK. To the extent that, at any time, Tenant could not legally Restore ZFA after Damage, Property Insurance shall require the carrier to pay Depository (for Landlord's benefit) the amount (less any permitted deductible) this Lease requires Tenant to pay Landlord as a result of that Damage. That requirement must be evidenced by an endorsement in form and substance reasonably satisfactory to Landlord.

1.10. PLATE GLASS. Tenant shall maintain plate glass insurance for the Premises consistent with Insurance Practices.

1.11. REIMBURSEMENT. Tenant shall reimburse Landlord's Costs to: (i) maintain any backup or secondary insurance covering risks comparable to those covered by Required Insurance,[61] but Landlord shall reasonably allocate those premiums across multiple properties if applicable; and (ii) review Insurance Documents to determine whether they comply with this Insurance Exhibit.

1.12. REPORTING. Tenant shall, from time to time as Landlord requests for any Required Insurance, give Landlord: (i) loss run reports evidencing that all outstanding claims have been lodged, reserved for, or paid; and (ii) such reasonably available evidence as Landlord reasonably requests to confirm that the carrier has acknowledged and is defending any claims for the benefit of Landlord. In the event of any claim, Tenant shall keep Landlord fully informed on Tenant's communications with the carrier and give Landlord such acknowledgments of claim and other confirmations from the carrier as Landlord reasonably request.

1.13. VACANT LAND. Notwithstanding anything else in this Exhibit, so long as the Premises consist entirely of vacant land, Tenant need not maintain Property Insurance.[62]

1.14. VERIFICATIONS. Landlord may at any time seek to verify directly with any carrier or broker the status of any Required Insurance. Tenant shall promptly sign any consent Landlord requests toward that end.

1.15. WRAP-UP INSURANCE. Tenant may provide Construction Period Insurance through a so-called "wrap-up program" ("Wrap-Up Program"). Any Wrap-Up Program must: (i) comply with all requirements for Construction Period Insurance, including on delivery of Insurance Documents and on Required Additional Insureds; (ii) provide coverage fully equivalent to Construction Period Insurance, for the entire Exposure Period; and (iii) have a general commercial liability limit of at least $_____ per occurrence and in aggregate and an excess liability limit of $_____. Tenant must comply with the carrier's requirements for security for large-deductible insurance policies. If paid or reserved claims have substantially diminished the amount of insurance remaining available, Tenant shall comply with Landlord's reasonable requests to increase the aggregate limits.

61 Adjust to reflect scope of any insurance for which Landlord seeks reimbursement. This Bell & Whistle does not commonly appear in Leases.

62 Although this paragraph sounds intuitively reasonable, Landlord should check it with insurance advisers for each specific transaction. Circumstances may justify some Property Insurance even for vacant land.

LOAN WORKOUT CONSIDERATIONS IN THE REAL ESTATE CAPITAL STACK

MICHELLE KELBAN, Global Co-Chair of the Real Estate Practice at Latham & Watkins LLP, advises on all aspects of commercial real estate law, with a particular concentration on highly structured capital raising and financing, acquisitions, joint venture recapitalizations, and workouts and restructurings for both borrowers and lenders. She represents capital providers in a range of real estate transactional structures and is a "skilled and extremely competent" lawyer who is "very knowledgeable and service oriented" according to The Legal 500 US. In 2020, Ms. Kelban was elected to the American College of Real Estate Lawyers, an invitation-only organization comprised of leading real estate lawyers across the US.

The author would like to thank Elizabeth Vinci for her contributions to this article.

While it is expected that vaccination rollouts and fiscal stimulus will provide relief across markets, the commercial real estate industry continues to feel the effects of COVID-19. This has played out through tenant vacancies, debt service delinquencies, debt maturity issues, and operational changes across asset classes.

As a lender, your place within the capital stack guides any analysis of a distressed real estate situation. Aligning your goals with your rights and obligations and then developing a strategy to reach those goals requires informed consideration of your borrower's and fellow lenders' interests. To think through the various issues posed by the following scenario, consider yourself in the second mezzanine position, within three layers of mezzanine debt, on an office property that used to have a safe risk profile but now is in trouble after key tenants were hit hard by the pandemic. Now, the borrower is heading for a default.

The first step to addressing a loan in distress is to determine the status of the loan, the other relevant loans in the capital stack, the borrower, the guarantors, and the collateral. Take these critical key steps to quickly gather as much information as possible:

File review

Dust off the deal files and find out early if the loan administration practice has deviated from the requirements of the loan documents. For example, has the cash management structure been respected? Have waivers consistently been granted (explicitly or not) regarding certain requirements? Have the lenders abided by the terms of the intercreditor agreement?

Collateral review

Order and review new searches of title, UCC and lien filings, bankruptcy filings, and litigations involving the borrower parties. Confirm the location and status of any possessory collateral (especially any notes and pledged equity certificates and powers). Also consider whether jurisdictional procedures or requirements exist based on the situs of the collateral and/or the governing law of your documents—such as one form of action rules.

Capital structure

Consider the rights and obligations of other members of the capital structure. Make sure you know of any horizontal parties (co-lenders) and any vertical parties (senior lenders, mezzanine lenders, and preferred equity holders) and the rights and obligations of each in relation to you and the borrower. Follow

every word of the intercreditor agreement to avoid potential forfeiture of your rights. Take this opportunity to confirm you and your counsel have the correct entity and contact information (including counsel) for other lenders and the borrower parties and that all parties have yours as well.

Changing regulatory backdrop

As the world grapples with COVID-19, multiple new regulatory schemes at the federal, state, and local levels address the economic fallout, and protective measures now exist, including moratoria on foreclosures, evictions, and other legal actions in various jurisdictions. Review and consider the obligations and options those provide to you, the other lenders, your borrower, and any tenants of the collateral property.

Begin formulating a strategy that accounts for the above information and any insight about the borrower's and other lenders' goals. In some situations, a lender may need to take control of the collateral. Before pursuing that route, consider whether you should (or even can) own and operate a property. Instead, pursuing prompt disposition of your interest in the loan may be the best course. Alternatively, pursuing a workout with the borrower that involves disposition of the mortgaged property or some other interim operating solution may be preferable. Coordination among lenders and with the borrower to stabilize the value of the collateral is in everyone's best interest.

In terms of shaping your strategy, think about the following:

Source

What is causing the problem? Has the loan historically been underperforming or is a change in market forces causing this issue? Is there a one-time problem at the heart of the pending default or has a new issue (perhaps COVID-19) exposed and accelerated an underlying weakness? Has the management team failed or would any group face the same challenges?

Future prospects

Understanding your position in the capital structure is critical when determining how to proceed during a distressed situation. Collateral needs to be preserved. If you are in the money, preserving your rights and interests typically requires less cash than if you are not in the money. In our example, you are faced with multiple creditors coming before you in line. Before determining whether to throw additional money at the problem (via curing senior loan defaults, purchasing more senior interests or otherwise investing or advancing additional funds), it is important to understand the property's realistic potential. Is bankruptcy a possibility? What does the "bad boy" guaranty cover and is there a credit-worthy entity or warm body behind it?

Other lenders' plans

The lenders will eventually need to make their intentions clear to each other, but this may not occur until any relevant deadline under the applicable intercreditor agreement. Often, much pontification occurs before you eventually understand each lender's underlying motives and position. Given the myriad opportunities for your plans (or the other lenders' plans) to go awry, you should plan and prepare to execute your preferred strategy as if you were the first person in line interested in doing so, while simultaneously making plans based on what the others may elect to do. Often lenders dual track their takeover plans, which, while potentially costly, is generally considered prudent in most cases to ensure your position is protected.

While working to gather information, balancing the desire to be constructive and negotiate effectively with the need to avoid fodder for litigation can be difficult. To reconcile these conflicting demands, most parties rely upon a prenegotiation agreement, which essentially provides that nothing either party says or discloses during workout negotiations may be used against that party in court. Be especially careful with email.

After a prenegotiation agreement is in place, the parties are generally free to craft a custom solution

for their situation. Some common deal elements that are often considered include the following:

Additional equity

An equity infusion from the borrower's parent may be enough to remedy the situation, although this is usually part of a larger cure package with additional structuring often required.

Additional loan disbursements

Putting additional money into a failing loan seems counterintuitive, however it may be worth funding through a default if additional capital would increase the value of the collateral significantly (e.g., by finishing construction to allow for a new tenant to take possession) or prevent further decreases in value (e.g., by completing necessary capital improvements). As part of any funding or senior loan cure decision, you must consider whether you are in the money or out of the money and how desirous you are of protecting your current investment.

Additional security

A guarantor or borrower parent may be able to supplement the collateral package in order to buy more time to rectify a problem asset.

Leadership change

If the management team seems problematic, you and the other lenders might consider negotiating a change without requiring a sale of the property. For example, the developer or property manager may be replaced or the managing member of a joint venture borrower could be removed.

Reductions or discounts

Something is better than nothing, especially when you are not in a position to own a property or otherwise dispose of collateral for a profit. In such circumstances, you might consider offering a discount or reduction in principal and/or interest payments or implementing PIK interest. At times this is paired with an equity kicker or a larger fee at the end of the relationship as lenders try to maximize the value they can recoup.

Deed in lieu, settlement, and release of personal liability

A negotiated transfer of the property from borrower to lender/lender group, which sometimes includes upside protection for a borrower in the event of a later sale of the property, is always an option and can be structured in a multitude of ways. If property ownership does change, often borrowers (or guarantors) request a release from liability, if it was not already part of the documentation. Be prepared for this issue to be raised. Due diligence as to current property status will help you ascertain what is appropriate.

Although a good workout plan sets up the borrower to avoid future problems, that is not always the final result. You should keep in mind the increased likelihood of more issues while crafting the revisions. Typically, lenders tie a second chance to a tighter covenant package, with more requirements and lower thresholds for lender action. For example, a higher debt service coverage ratio or a cash trap and/or cash sweep can mitigate the damage by alerting the team earlier in the event of future problems.

Consulting with counsel at the first signs of loan distress is critical to working through a strategic plan and to protecting yourself through each step of the process. In these situations, preparation is key. So, act quickly to gather information internally and obtain sound legal advice before taking action to ensure you advance toward your long-term goal.

FORUM SELECTION CLAUSES: WAIVER OF THE RIGHT TO REMOVE AND RELATED DRAFTING PITFALLS

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The views and opinions set forth in this article are the personal views or opinions of the authors and do not necessarily reflect views or opinions of the law firm with which they are associated.

Forum selection clauses are commonplace in real estate, construction, and other commercial contracts. A forum selection clause allows parties to agree that any disputes will be litigated in a particular forum, whether it be a specific court or geographical location. A forum selection clause can be an important provision, especially on construction projects involving participants from multiple jurisdictions, whether different states or countries. A party may desire to have disputes resolved in a designated forum for a whole host of reasons, including convenience and cost, experience in the forum, or the belief that the named forum will be less parochial than other potential forums. While a number of potential legal restrictions may apply to the enforceability of forum selection clauses, a properly drafted forum selection clause brings predictability to the parties in the event a dispute later arises.[1]

Unfortunately, all too often parties treat a forum selection clause as boilerplate and recycle a clause from a prior agreement without serious thought as to whether it achieves the intended purpose. This can result in a court interpreting the clause in a manner different than intended and parties litigating a dispute in a different forum than the one identified in the forum selection clause. In particular, where a forum selection clause specifies state court as the chosen forum, there is an interplay between the forum selection clause and whether a defendant is precluded from exercising its statutory right to remove a case to federal court where federal jurisdiction exists.[2] This interplay is frequently overlooked when drafting contracts. A properly drafted forum selection clause designating state court as the chosen forum may support remand to state court or dismissal of a case removed to or filed in federal court.[3] As the case law highlights, however, when it comes time to enforce a forum selection clause, drafting errors can lead to unintended consequences and court decisions that are often difficult to harmonize. All is not lost. The antidote for this malaise is clear drafting that overcomes the incongruity in the case law.

To that end, this article addresses how words matter in a forum selection clause when courts are asked to decide whether the parties waived their right to remove a case to federal court or file in federal court in the first place. As discussed below, some federal courts refuse to remand a case to state court where a

forum selection clause specifies that disputes shall be filed in state court unless there is an express waiver of the right to remove. A simple statement that the "parties waive their right to remove to federal court" is enough for an express waiver, but frequently no such statement is found in forum selection clauses. This and other language is critical when choosing state court as the forum, which places a premium on precision in drafting forum selection clauses.

SCOPE OF FORUM SELECTION CLAUSE: "ARISING FROM" v. "RELATED TO"

The threshold consideration for determining whether a forum selection clause specifying state court as the chosen forum waives the right to remove to federal court is the scope of disputes subject to the forum selection clause. For example, if the forum selection clause is narrow and only applies to breach of contract claims, the clause may not preclude filing a tort claim in federal court or removing to federal court a lawsuit filed in state court that does not assert a breach of contract claim. The question of whether the asserted claims fall within the scope of the forum selection clause is a threshold issue because a party cannot waive its right to remove a dispute through a forum selection clause if the type of claim itself falls outside the scope of the clause. Parties commonly agree to forum selection clauses that broadly apply to any "claims or disputes arising out of or related to" the agreement. This or similar language is likely to capture any disputes involving the validity, terms, or performance of the contract. But forum selection clauses contain scope language as varied as the imaginations of the lawyers who draft them, often creating ambiguities for the courts to resolve. Thus, parties and their counsel must have a basic understanding of the typical scope language and how such language is construed by courts.

Forum selection clauses that apply to any dispute "related to" or "in connection" with the contract are typically interpreted to include contract, tort, and statutory claims. In Roby v. Corp. of Lloyd's, the Second Circuit found that a forum selection clause encompassing all claims "related to" the Agreement included tort claims, finding "no substantive difference in the present context between the phrases 'relating to,' 'in connection with' or 'arising from.'"[4] As one court has aptly summarized, "[w]hen 'arising out of,' 'relating to,' or similar words appear in a forum selection clause, such language is regularly construed to encompass … tort claims associated with the underlying contract."[5] Hence, parties seeking to increase the chances that their forum selection clause will be construed to apply to contract, tort, and statutory claims may use "arising from, related to, or in connection with" language.

Despite the Roby court's observation that there frequently is no difference between the phrase "related to" and "arising from," many courts generally view a forum selection clause that only uses the phrase "arising under" the contract to be much narrower than a clause using "related to." The Second Circuit has commented that "we do not understand the words 'arise out of' as encompassing all claims that have some possible relationship with the contract, including claims that may only 'relate to,' be 'associated with,' or 'arise in connection with' the contract."[6] In the context of construing the scope of arbitration clauses, the Ninth Circuit has also given "relating to" a much broader interpretation than "arising out of" or similar language.[7] Accordingly, parties using only the phrase "arising under" in their forum selection clause should be mindful that it may be construed to exclude tort or statutory claims "related to" the contract.

Parties should also be aware that even if they use "arising hereunder" or other narrow language in their forum selection clause, some courts may still apply the clause to tort or statutory claims. By way of illustration, in Manetti-Farrow, Inc. v. Gucci America, Inc., the forum selection clause applied to disputes regarding the "interpretation" or "fulfillment" of the contract.[8] Yet, the Manetti court found the tort claims at issue to be within the scope of the forum selection clause because "[t]he claims cannot be adjudicated without analyzing whether the parties were in compliance with the contract[,]" which includes a "'conflict over the interpretation'" of the contract."[9] As another court summarized in Graham Technology Solutions v. Thinking Pictures, "forum selection clauses can be equally applied to contractual and tort causes of action where resolution of the tort claims relates to the interpretation of the contract."[10]

Practice pointer 1: Use the right language

The first lesson from these cases for the lawyer drafting a forum selection clause is to be mindful of the language used to establish the type of disputes subject to the clause. Using the phrase "arising from or related to" the contract will ordinarily extend to contract, tort, and statutory claims. To eliminate any doubt, the clause can be expanded by inserting the phrase "whether a contract, tort, or statutory claim or claim based on any other legal theory." Use of the phrase "arising from" the contract will often, but not always, be interpreted to apply only to claims for breach of contract. In the rare situation where a party intends for the forum selection clause to only apply to breach of contract claims, the clause should specify that it applies "only to claims for breach of contract and not to tort or statutory claims." Counsel drafting a forum selection clause should obviously research the law in the relevant jurisdiction to see how courts interpret the chosen language as courts have reached different results.

MANDATORY v. PERMISSIVE FORUM SELECTION CLAUSES

Use of the words "shall," "will," and "may"

If the dispute falls within the terms of the forum selection clause, the next question is whether the clause is permissive or mandatory. If it is mandatory, then the forum selection clause requires the parties to litigate their dispute in the specified forum to the exclusion of others and may preclude removal to federal court where state court is the designated forum. However, as discussed below, some courts simply hold that, notwithstanding the use of otherwise mandatory language, there must be an express waiver of the right to remove to preclude removal from state to federal court. If the forum selection clause is viewed as permissive, the clause will not preclude removal to federal court. Thus, it is important to understand what contractual language courts view as making a forum selection clause mandatory (and exclusive) rather than permissive (and optional).

A mandatory forum selection clause will typically use mandatory language like "shall," "must," "only," "solely," or "exclusively." Courts construing a forum selection clause as mandatory often point to the use of the word "shall" or similar terms that mandate compliance as opposed to establishing a permissible option. For example, in DeRoy v. Carnival Corporation, the Eleventh Circuit was tasked with interpreting a clause providing that "all disputes … shall be litigated, if at all, before the United States District Court for the Southern District of Florida in Miami."[11] The DeRoy court found the use of the word "shall" signified that the "clause is a mandatory one that requires a litigant to sue in Miami federal district court."[12]

Context is key, so the mere use of mandatory terms like "shall" may not always result in a finding that the forum selection clause is mandatory.[13] For instance, in Hunt Wesson Foods, Inc. v. Supreme Oil Company, the Ninth Circuit was asked to construe the following forum selection clause: "The courts of California, County of Orange, shall have jurisdiction over the parties in any action at law relating to the subject matter or the interpretation of this contract."[14] When the plaintiff filed in California state court, the defendant removed the case to federal court. The plaintiff filed a motion to remand, arguing that Orange County state court had exclusive jurisdiction, which the trial court granted. The Ninth Circuit reversed, finding that "the forum selection clause in this case is permissive rather than mandatory."[15] The Ninth Circuit reasoned:

> The language says nothing about the Orange County [state] courts having exclusive jurisdiction. The effect of the language is merely that the parties consent to the jurisdiction of the Orange County [state] courts. Although the word "shall" is a mandatory term, here it mandates nothing more than that the Orange County courts have jurisdiction. Thus, [defendant] cannot object to litigation in the Orange County Superior Court on the ground that the court lacks personal jurisdiction. Such consent to jurisdiction, however, does not mean that the same subject matter cannot be litigated in any other court.[16]

The Hunt decision underscores how closely courts will scrutinize every word in a forum selection clause despite seemingly mandatory language, and how such scrutiny can affect whether a case can be

removed to federal court. The plaintiff in Hunt easily could have avoided litigating in federal court by inserting language making clear that Orange County state courts were the exclusive or sole forum for the parties to resolve their disputes and that the parties waived the right to remove to federal court.

The Ninth Circuit reached a different conclusion in Docksider, Ltd. v. Sea Technology, Ltd., which involved a forum selection clause with additional venue language beyond what could be viewed as a mere consent to jurisdiction.[17] In Docksider, the forum selection clause provided that "Licensee hereby agrees and consents to the jurisdiction of the courts of the State of Virginia. Venue of any action brought hereunder shall be deemed to be in Gloucester County, Virginia."[18] The Ninth Circuit affirmed dismissal because, unlike in Hunt, the clause went beyond a mere consent to jurisdiction and required venue in a specific forum. The Ninth Circuit found that the added "mandatory language makes clear that venue, the place of suit, lies exclusively in the designated county. Thus, whether or not several states might otherwise have jurisdiction over actions stemming from the agreement, all actions must be filed and prosecuted in Virginia."[19]

As the Docksider case illustrates, a forum selection clause specifying a specific court or venue, rather than a mere consent to jurisdiction, will generally be viewed as mandatory. For example, in Phillips v. Audio Active Ltd., the court interpreted as mandatory a forum selection clause requiring cases "to be brought" in England.[20] Similarly, in Slater v. Energy Services Group Intern., Inc., the Eleventh Circuit found that a forum selection clause, which provided "'that all claims or causes of action relating to or arising from this Agreement shall be brought in a court in the City of Richmond, Virginia'," was mandatory because the "the term 'shall' is one of requirement."[21]

As these cases demonstrate, forum selection clauses are more likely to be viewed as mandatory if they refer to a specific court, rather than just consent to jurisdiction, and include "shall" or other mandatory language. Any language that merely allows litigation in a particular forum could be viewed as permissive rather than mandatory. Examples of clauses a court might find to be permissive include those stating that a particular court "shall have jurisdiction" (as in Hunt), the parties "consent to venue" in a particular forum, or litigation may be filed in a particular court.[22]

Practice pointer 2: Clarify intent

Parties need to be clear on whether the specified forum is mandatory and exclusive or permissive and optional. Depending on the wording of the clause, some courts may hold that words like "shall," which ordinarily convey a mandate, do not create an exclusive forum and instead dictate that the forum is proper but not exclusive. To avoid the risk that a court might view as permissive a clause intended to be "mandatory," a forum selection clause can indicate both that disputes "shall" be filed and resolved in the specified forum (i.e., mandatory) and that the forum is the "sole and exclusive" forum for resolution of disputes (i.e., exclusive). While inserting both "mandatory" and "exclusive" language in a forum selection clause identifying a state court as the chosen forum increases the chances that any ensuing litigation will be resolved in state court, certain federal courts nonetheless require an express reference of the right to remove a case to federal court and a waiver of that right.

REMOVAL TO FEDERAL COURT

When drafting a forum selection clause requiring disputes to be resolved in state court, not federal court, consideration must be given to whether the right to remove based on diversity can defeat the intent of the clause depending on how a court might later construe the language. Unintended consequences can arise when the language is unclear.

Some forum selection clauses identify the forum by reference to a geographical area, such as a state or county, rather than a specific court. Designating a geographical location like a state or county may create ambiguity and more drafting precision may be required to effectuate the intended purpose. Simple words like "of" or "in" can lead to much different outcomes when linked to a geographical location. Take for example a forum selection clause that provides "any dispute arising under this Agreement

must be resolved in the courts of County of Los Angeles." Most courts would agree that the word "in" as used in that phrase includes both state and federal courts "in" Los Angeles County. Replacing the word "in" with the word "of," however, will likely result in a different outcome, as most courts view a forum selection clause designating the "courts of County Los Angeles" to refer only to state courts in the County. Thus, using the word "of" may signify only state courts, while the word "in" may signify both state and federal courts.

The law in the Ninth Circuit exemplifies how courts generally treat "in" and "of" when construing forum selection clauses and whether cases may be resolved in only state court or in both state and federal court. In Doe 1 v. AOL, LLC, the Ninth Circuit found that a forum selection clause designating the "courts of Virginia" only encompassed Virginia state courts, reasoning that Black's Law Dictionary definition of the term "of" in the phrase "courts 'of' Virginia" refers to courts proceeding from, with their origin in, Virginia—i.e., the state courts of Virginia. Federal district courts, in contrast, proceed from, and find their origin in, the federal government."[23] On the other hand, the Ninth Circuit construes "in" to include federal courts:

> [A] forum selection clause referring to "courts in" a state imposes a geographic limitation, not one of sovereignty.… Hence the phrase "courts in" a state includes any court within the physical boundaries of the state, even if the court does not derive its power and authority from the sovereignty of the state. In short, the rule … is that a forum selection clause that specifies "courts of" a state limits jurisdiction to state courts, but specification of "courts in" a state includes both state and federal courts.[24]

The majority of courts agree that "of" a state or county waives the right to remove. A few courts, including the Eleventh Circuit, have found that the phrase "of" includes both state and federal courts.[25]

Similarly, in Excell, Inc. v. Sterling Boiler & Mechanical, Inc., the Tenth Circuit was asked to determine whether a forum selection clause stating that "venue shall lie in the County of El Paso" precluded removal to federal court.[26] The Tenth Circuit concluded that while defendant "argues the clause can be reasonably interpreted to allow removal of the case to federal district court that sits in El Paso County, we reject this argument. For federal court purposes, venue is not stated in terms of 'counties.' Rather, it is stated in terms of 'judicial districts.'"[27] Both the Ninth Circuit and Fifth Circuit have rejected this reasoning.[28]

Notably, if "in" a county is chosen for the forum selection clause on the assumption that either state or federal court is acceptable, counsel should confirm that there is a federal court in the designated county. In City of Albany v. CH2M Hill, Inc, the Ninth Circuit found that a forum selection clause stating that "[v]enue for litigation shall be in Linn County, Oregon" required the case be tried in state court because there was no federal court in Linn County.[29]

Consideration should also be given to whether the phrase "filed in" or similar language can result in a party litigating in federal court rather than its preferred state court. In Green v. Moore, the forum selection clause provided, in part, that "[a]ny lawsuit arising from this Agreement must be filed in Whatcom County Superior Court, Bellingham, Washington, USA."[30] The defendant removed the case and the plaintiff filed a motion to remand on the basis that Whatcom County Superior Court was the exclusive forum. The court rejected this argument and concluded that "the clause requires only filing, not litigation, in Whatcom County. If plaintiff had intended for Whatcom County to have exclusive jurisdiction, he could have included that language in the Agreement."[31]

The court in Guenther v. Crosscheck, Inc. reached a different result with seemingly similar language. In Guenther, the forum selection clause appeared in a paragraph entitled "VENUE" and provided that "[t]he parties agree that any action arising out of the negotiation, execution or performance of the terms and conditions of this agreement shall be brought in the courts of Sonoma County, California."[32] In granting the plaintiff's motion to remand, the court rejected the defendant's argument that "brought" was effectively the same as "filed," thus only requiring the

case to be "brought" in state court but allowing the case to be subsequently removed to federal court. The court rejected the argument that "brought" just meant that the case must be initially filed in state court and not litigated there, relying in particular on the "venue" designation as the Ninth Circuit did in the Docksider case discussed above.

The case law can be all over the map and difficult to reconcile depending on the phraseology used in the forum selection clause. Terms like "filed" and "brought," which may appear similar, have been treated differently by many courts. Other terms like "commenced" have been viewed by some courts as more similar to "filed" than "brought," while other courts have reached a contrary conclusion.[33] Some courts have found state court to be the exclusive forum and remanded based on a clause providing that "[a]ny proceeding shall be initiated in the courts of the State of New York."[34] The best approach to avoid any surprise of being required to litigate in federal court is to research the applicable law, use mandatory language identifying a state court as the exclusive venue, and expressly waive the right to remove to federal court.

Practice pointer 3: Identify the State

When the intent is to make state court mandatory and exclusive, the forum selection clause should identify state court in simple and plain language. A party desiring to keep all disputes in state court should identify the state court specifically, make clear the state court is the "exclusive" or "sole" forum for resolving disputes, and expressly waive the right to remove disputes to federal court. This language avoids the ambiguity that can arise when a clause relies on the difference between courts "in" or "of" a state and the subtleties between the words "filed," "brought," "commenced," and the like. While this Practice pointer overlaps with Practice pointer 2, it is worth emphasizing. Further, those charged with drafting forum selection clauses specifying a state court as the forum for resolution of disputes need not master the hodgepodge of case law by following these Practice pointers.

STANDARD FOR DETERMINING WAIVER OF THE RIGHT TO REMOVE TO FEDERAL COURT

Waiver of the right to remove to federal court can arise in two different ways. First, a forum selection clause can waive the right to remove. Second, a defendant can waive the right to remove by litigation conduct in state court that is inconsistent with removal. Virtually all courts interpret forum selection clauses like any other contract provision in determining whether the parties intended to preclude removal, though some courts apply a stricter standard.[35] In contrast, the Ninth Circuit has held that waiver based on litigation conduct taken in state court must be "clear and unequivocal."[36] The Ninth Circuit has not applied this "clear and unequivocal" waiver standard in determining whether a forum selection clause waives the right to remove.[37] Like the Ninth Circuit, the Third and Eleventh Circuits apply the clear and unequivocal standard only to litigation based waivers and apply the general canons of contract interpretation to determine whether a forum selection clause waives the right to remove.[38]

But a minority of courts, including the Sixth Circuit, require "clear and unequivocal" language in the forum selection clause to preclude removal.[39] In Cadle Co. v. Reiner, Reiner & Bendett, P.C., the Sixth Circuit held that the parties did not waive the right to remove where the forum selection clause provided, in part, that "[a]ll disputes.…shall be resolved in the Newton Falls, Ohio Municipal Court or the Trumbull County, Ohio Common Pleas Court."[40] Most parties would instinctively view this clause as sufficient to waive removal given it includes mandatory "shall be resolved" language and identifies a specific court. However, the Sixth Circuit took a different view because "the forum selection clause at issue here neither mentions removal nor sets forth an explicit waiver of that right by [Defendant]."[41] Thus, under the Sixth Circuit standard, a forum selection is not clear and explicit unless the right to remove is expressly mentioned and expressly waived.[42] In essence, the forum selection clause must expressly state that the parties waive the right to remove in order for the clause to prevent litigating in federal court.

Practice pointer 4: Be clear about the right to remove

If parties intend to resolve their disputes in state court, not federal court, they need to be mindful of the different standards for removal and the requirement in the Sixth Circuit that there be an express reference to removal and the waiver of the right to remove. In view of the divergence in approaches among the circuits, a party can avoid any issues by the simple expedient of inserting a clause stating that "the Parties waive their right of removal to federal court." This would satisfy the approach of those courts applying general principles of contract interpretation to determine whether a forum selection clause results in waiver of the right to remove as well as the more exacting "clear and unequivocal" standard followed by the Sixth Circuit and other courts. When the recommended clause is joined with language indicating that disputes "shall" be resolved in state court and that state court is the "sole and exclusive" forum as discussed in Practice pointers 2 and 3, absent other considerations, it would be difficult for a court not to conclude that such a clause did not waive the right to remove.

CONCLUSION

Parties drafting a forum selection clause that is intended to require litigation take place in state court, not federal court, need to be mindful of several drafting pitfalls that can frustrate the intent of the parties. This is especially so when it comes to the relationship between requiring litigation in state court and a party's right to remove a case to federal court where there is diversity or concurrent federal question subject matter jurisdiction. The following language should accomplish this goal:

> Any litigation between the parties arising out of or related to the contract, whether a contract, tort, or statutory claim or claim based on any other legal theory, shall be initiated and maintained in the Superior Court for the County of Los Angeles, such court shall have sole and exclusive jurisdiction over such litigation, and the Parties waive their right of removal to federal court.

This language takes into account each of the four practice pointers discussed above and, most importantly, expressly waives the right to remove to federal court.

Notes

1 One example of a legal restriction on the enforceability of forum selection clauses is "home rule" laws that apply to construction projects, which are in place in more than half of the states. These home rules typically provide that a contract clause requiring that disputes be resolved in a state other than where the project is located is voidable by the party who performed the work. These rules are typically designed to protect local contractors and subcontractors hired by an out-of-state owner or general contractors who may be deterred from seeking relief where arbitration or litigation must take place in a faraway jurisdiction. But the result may be different for arbitration where a project involves interstate commerce—the parties can enforce their agreement to arbitrate in a state other than where the project is located in spite of a home rule because the Federal Arbitration Act (FAA) preempts home rules. See OPE Int'l. LP v. Chet Morrison Contractors, Inc., 258 F.3d 443, 447 (5th Cir. 2001) (finding that Louisiana construction dispute venue statute that conditioned the enforceability of arbitration agreement on the selection of a Louisiana forum was preempted by Section 2 of the FAA).

2 The general removal statute is 28 U.S.C. § 1441. There are a number of procedural requirements governing the right to remove, including time limits within which removal must be sought. See, e.g., 28 U.S.C. § 1446(b)(1) (providing that removal must be sought within 30 days of service of the complaint). A cross defendant may not remove a case to federal court. See Home Depot U.S.A., Inc. v Jackson, 139 S. Ct. 1743, 1749 (2019) (holding that "Congress did not intend for the phrase 'the defendant or the defendants' in § 1441(a) to include third-party counterclaim defendants.").

3 Docksider, Ltd. v. Sea Technology, Ltd., 875 F.2d 762, 763–64 (9th Cir. 1989) (affirming dismissal of federal case based on forum-selection clause designating state court as the chosen forum); Guenther v. Crosscheck, Inc., No. C 09-01106 WHA, 2009 WL 1248107, at *5–6 (N.D. Cal. April 30, 2009) (remanding case from federal court to state court based on forum-selection clause).

4 996 F.2d 1353, 1361 (2d Cir. 1993).

5 Credit Suisse Sec. (USA) LLC v. Hilliard, 469 F. Supp. 2d 103, 107 (S.D.N.Y. 2007).

6 Phillips v. Audio Active, Ltd., 494 F.3d 378, 389 (2d Cir. 2007).

7 See, e.g., Cape Flattery Ltd. v. Titan Mar., LLC, 647 F.3d 914, 921–23 (9th Cir. 2011) (concluding that the phrase "arising out of" is narrower than the phrase "arising out of or relating to" in arbitration context); Mediterranean Enters.,

Inc. v. Ssangyong Corp., 708 F.2d 1458, 1464 (9th Cir. 1983) (holding that arbitration clauses omitting the "relating to" language are "intended to cover a much narrower scope of disputes, i.e., only those relating to the interpretation and performance of the contract itself.").

8 858 F.2d 509, 514 (9th Cir. 1988).

9 Id.

10 949 F. Supp. 1427, 1432 (N.D. Cal. 1997).

11 963 F.3d 1302, 1308, 1315–16 (2020) (emphasis added); see also Terra Intern., Inc. v. Mississippi Chem. Corp., 922 F. Supp. 1334, 1373 (N.D. Iowa 1996) (observing that "will" as used in forum selection clause is not permissive; immaterial that parties did not use "shall" or "must," or "only" or "exclusively").

12 DeRoy, supra, 963 F.3d at 1315.

13 "Typically, words such as 'must', 'only', or 'shall' are indicators of mandatory clauses, but the presence of [these] words alone does not foreclose the possibility that venue would be permissible in an unnamed locale." Stanley Smith Drywall, Inc. v. Munlake Contractors, Inc., 906 F. Supp. 2d 588, 592 (S.D. Miss. 2011) (citations omitted).

14 817 F.2d 75, 76 (9th Cir. 1987).

15 Id. at 77.

16 Id.

17 875 F.2d 762 (9th Cir. 1989).

18 Id. at 763 (emphasis added).

19 Id. at 764.

20 494 F.3d 378, 386 (2d Cir. 2007).

21 634 F.3d 1326, 1328–30 (11th Cir. 2011); see also Verdugo v. Alliantgroup, L.P., 237 Cal. App. 4th 141, 145-150 (2015). Statements that a claim "must" be brought in a particular forum or that it may "only" be brought in that forum also may suffice. Rivera v. Centro Médico de Turabo, Inc., 575 F.3d 10, 17 n.5 (1st Cir. 2009).

22 See, e.g., Animal Film, LLC v. D.E.J. Prods., Inc., 193 Cal. App. 4th 466, 470 (2011) (finding that the following forum-selection clause was permissive: "The parties hereto submit and consent to the jurisdiction of the courts present in the state of Texas in any action brought to enforce (or otherwise relating to) this agreement." (emphasis omitted)).

23 552 F.3d 1077, 1081–82 (9th Cir. 2009).

24 Simonoff v. Expedia, Inc., 643 F.3d 1202, 1205–06 (9th Cir. 2011) (internal citations omitted).

25 See Stateline Power Corp. v. Kremer, 148 Fed. App'x 770, 771 (11th Cir. 2005) (concluding that the phrase "the courts of the State of Florida" was ambiguous and construing the phrase against the drafter to include both state and federal courts).

26 106 F.3d 318, 321 (10th Cir. 1997) (emphasis added).

27 Id. (citing 28 U.S.C. § 1391).

28 Alliance Health Grp., LLC v. Bridging Health Options, LLC, 553 F.3d 397, 400–01 (5th Cir. 2008) (observing that the reasoning that reference to a county in a forum selection clause does not encompass a federal court located in the county "would be more persuasive were the federal courts organized in total disregard of state counties; if, for instance, federal judicial districts were defined by metes and bounds…. [Instead, these federal] "districts and their divisions are defined by specific reference to the counties they encompass."); Simonoff, 643 F.3d at 1206 (finding the Excell case discussed above to be "at odds with our precedent").

29 924 F.3d 1306, 1307 (9th Cir. 2019); see also id. at 1309 ("In short, the venue-selection clause at issue here precludes litigation in federal court because no federal courthouse is located in Linn County. Accordingly, the only way to effectuate the parties' agreement is to limit venue for litigation to the state court in Linn County."); Bartels ex rel. Bartels v. Saber Healthcare Grp., LLC, 880 F.3d 668, 676 (4th Cir. 2018) ("Because there is no federal court in Franklin County, the plain language of the forum-selection clause precludes removal.").

30 No. C06-553RSL, 2006 WL 1638282, at *1 (W.D. Wash. June 9, 2006).

31 Id. at *2.

32 No. C 09-01106 WHA, 2009 WL 1248107, at *1 (N.D. Cal. April 30, 2009) (emphasis omitted).

33 John's Insulation v. Siska Constr. Co., 671 F. Supp. 289, 291, 297 (S.D.N.Y. 1987) (ordering remand based on a clause providing that "any action hereunder shall be commenced in the Supreme Court of the State of New York"); Karl Koch Erecting Co., Inc. v. N.Y. Convention Ctr. Dev. Corp., 838 F.2d 656, 659 (2d Cir. 1998) (finding lawsuit in federal court expressly forbidden because relevant provision stated "[n] o action or proceeding shall be commenced by [Plaintiff] against [Defendant] except in the Supreme Court of the State of New York").

34 Phoenix Glob. Ventures, Inc. v. Phoenix Hotel Assocs., Ltd., No. 04 CIV. 4991RJH, 2004 WL 2360033, at *6 (S.D.N.Y. Oct. 19, 2004), aff'd sub nom. Phoenix Glob. Ventures, LLC v. Phoenix Hotel Assocs., Ltd., 422 F.3d 72 (2d Cir. 2005).

35 Bastami v. Semiconductor Components Indus., LLC, No. 17-CV-00407-LHK, 2017 WL 1354148, at *4–5 (N.D. Cal. April 13, 2017).

36 Id. at *4 (citing Resolution Trust Corp. v. Bayside Developers, 43 F.3d 1230, 1240 (9th Cir. 1994)).

37 Resolution Trust Corp., 43 F.3d at 1240.

38 Snapper, Inc. v. Redan, 171 F.3d 1249, 1261 (11th Cir. 1999) ("[L]itigation-based waivers must be distinguished from … contractual waivers[.]"); Foster v. Chesapeake Ins. Co., Ltd., 933 F.2d 1207, 1217 n.15 (3d Cir. 1991) (same).

39 See, e.g., Milk 'N' More, Inc. v. Beavert, 963 F.2d 1342, 1346 (10th Cir. 1992) ("We are mindful that a waiver of one's statutory right to remove a case from a state to a federal court must be 'clear and unequivocal.'"); Weltman v. Silna, 879 F.2d 425, 427 (8th Cir. 1989) ("Waiver of the right to remove must be 'clear and unequivocal'" (internal citation omitted)).

40 307 Fed. App'x 884, 885–88 (6th Cir. 2009).

41 Id. at 888.

42 See, e.g., Zehentbauer Family Land LP v. Chesapeake Exploration LLC, No. 4:15CV2449, 2016 WL 3903391, at *4 (N.D. Ohio July 19, 2016) (holding that forum-selection clause stating that "[a]ny and all disputes must be resolved in a common pleas court located solely in the State of Ohio" did not waive removal rights).

INVERSE CONDEMNATION: STANDARDS AND BURDENS OF PROOF

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INVERSE CONDEMNATION: WHAT IT IS AND HOW TO RAISE IT[1]

Generally speaking, inverse condemnation is a cause of action against a public entity when a taking of private property has occurred without a formal exercise of the eminent domain power.[2] The proper way to raise that cause of action varies from state to state. The majority of states allow separate claims to be brought for inverse condemnation, though the statutes of limitation vary greatly.[3] Some states allow inverse claims to be brought as counterclaims,[4] and others either require or allow the affected property owner to file a mandamus action for the government to institute condemnation proceedings.[5] Generally, most inverse condemnation claims are based in state constitutions and therefore are not barred by statutory notice provisions or sovereign immunity.[6]

Some jurisdictions have fee-shifting provisions that apply in the event of a successful inverse condemnation claim.[7] These statutes can lessen the burden on an individual property owner to file an inverse condemnation action.

BURDENS OF PROOF

While most states recognize inverse condemnation claims for both taking and damage claims,[8] a minority of states only allow inverse condemnation claims when there is a physical invasion.[9] Most require some affirmative action from the government that leads to the damage claimed.[10] What types of damages are compensable remain varied. For instance, some states recognize damages for impaired access,[11] while others do not. Damages must be proved by the property owner, and are generally established by the loss in fair market value before the action constituting inverse condemnation and after.[12] Some states also allow damages for expenses incurred in mitigating damages,[13] or for pre-condemnation damages that accrued before the condemnation was filed.[14] Inverse condemnation can be a powerful tool for property owners whose properties are damaged. For example, in a 2019 unpublished opinion, the Michigan Court of Appeals held that inverse condemnation was a proper claim for Flint property owners who had received contaminated water.[15]

REGULATORY CLAIMS

Inverse condemnation is also used as a tool against excessive local government action. Property owners can bring inverse condemnation claims for "regulatory takings"—when a regulation goes "too far" and deprives an owner of some right or rights in their property.[16] Usually, the regulations at issue are zoning ordinances. The majority of states require that property owners first seek variances or other remedies before claiming an inverse condemnation.[17] Additionally, many states require the property owner to be deprived of all or substantially all of the economic advantages of ownership of the property.[18] While most states offer three options for regulatory inverse condemnation claims—damages, an injunction, or invalidation of the regulation,[19] states such as New York, California, and Hawaii have held that the only available remedy is the invalidation of the regulation at issue.[20]

FLOODING CASES

Many states also recognize inverse condemnation claims related to condemnor actions that result in the flooding of properties. Federally, however, the bar that property owners have to jump over may be lower than in some states. The United States Supreme Court has recognized that flooding, even temporary flooding, can give rise to a takings claim under the Fifth Amendment.[21] Some states disagree. Analyzing each of the jurisdictions that the authors practice in, we can see just how differently inverse condemnation claims for flooding of property are evolving.

Georgia

Georgia allows inverse condemnations for flooding of a property based on both direct actions by condemnors and by continuing nuisances, such as a failure to maintain stormwater systems.[22] Georgia differs from the federal standard in that the nuisance must be continuing, and that single instances are not sufficient to create a claim for inverse condemnation[23] unless those instances can be tied to the condemnor's failure to maintain proper drainage structures.[24] Additionally, direct actions by condemnors can include the diversion of water onto the property[25] or when construction of a nearby project causes flooding onto the property.[26]

North Carolina

North Carolina allows claims for flooding when the flooding is a foreseeable, direct result of government action or construction, and is not attributable to "an act of God."[27] Additionally, the flooding must be recurring for permanent liability to attach.[28] When such flooding occurs, property owners can seek an inverse condemnation action for an "easement for flooding" and all related damages.[29]

Texas

A property owner can file an inverse condemnation petition under Art. I, § 17 of the Texas Constitution with the court of competent jurisdiction for a taking, damaging, or destruction of his or her property. In Texas, the recurrence of flooding onto a property may be a probative factor in determining whether there is a taking rising to the level of inverse condemnation.[30] Single flood events do not rise to the level of a taking.[31] Instead, a property owner must show that the damage claimed is a repeated and

recurring injury.[32] Additionally, released water that unnaturally erodes a substantial amount of a downstream owner's land can also rise to the level of inverse condemnation.[33]

The Texas Supreme Court dictates three essential elements for a finding of inverse condemnation: (i) intent, (ii) causation, and (iii) public use. All three elements were present in Tarrant Reg'l Water Dist. v. Gragg.[34] In this case, a ranch had seventeen miles of river frontage and was used for cattle grazing, particularly for young cattle.[35] Although the ranch experienced regular flooding, it was relatively easy to move the cattle around seasonally and the regular, slow flooding also meant the ranchland was quite fertile.[36] But in "March 1990, extremely heavy rains caused extensive flooding throughout the Trinity Basin, and the [Water Control] District released water through the reservoir's floodgates for the first time. For the first time in its history, the Gragg Ranch suffered extensive flood damage."[37] The Tarrant Regional Water District argued that the landowner, Gragg "failed to adduce any competent or reliable evidence that the reservoir's construction and operation caused the flood damage that the Ranch experienced. Second, if Gragg established causation, the District claim[ed] that its actions were merely negligent and d[id] not, as a matter of law, constitute a taking."[38]

The Court found that all three elements were present, especially focusing on causation and intent. On causation, "Gragg was required to prove that the same damaging floods would not have occurred under the same heavy rainfall conditions had the dam not been constructed."[39] It was not enough merely for the landowner to trace the damage back to the dam release. He had to prove that the damage would not have occurred but for the dam's construction. This heavy burden was met by the Gragg family at the trial court level, and the Court did not overturn it. As to intent, the Court emphasized the difference between a negligent taking and an intent to take the property. The element of intent may be proven by circumstantial evidence, and can be based on evidence that "a governmental entity knows that a specific act is causing identifiable harm or knows that the harm is substantially certain to result."[40]

In contrast to the Gragg case, the recent flooding within the San Jacinto Regional Water District's territory has led to some failed inverse condemnation claims by plaintiffs after Hurricane Harvey.[41]

Virginia

Virginia follows the federal standard in holding that a single occurrence of flooding may give rise to an inverse condemnation claim.[42] It also allows a property owner to bring a new inverse claim for each instance of flooding where the government's operation of a public improvement leads to that flooding.[43] Recently, however, Virginia courts have focused more on whether the alleged taking is for a public use—focusing on purposeful acts or failures to act instead of negligence.[44]

Federal

If the federal government took a property owner's real property without first undergoing the statutory condemnation procedures that are required, she should file a Complaint in the Court of Federal Claims. This Article I court was originally created by Congress in 1855 (then called the Court of Claims) and given national jurisdiction to hear individual monetary claims against the federal government based upon the Constitution, federal statutes, executive regulations, or contracts.[45]

Alleging and proving a federal inverse condemnation claim draws from a storied history of United States Supreme Court cases analyzing whether certain conditions rise to the level of a taking. The "polestar" case to determine whether a governmental action rises to the level of a taking is Penn Central Transportation Co. v. City of New York.[46] The Supreme Court outlined several factors (nicknamed the Penn Central factors) for determining whether a taking has occurred: (i) "[t]he economic impact of the regulation on the claimant," (ii) "the extent to which the regulation has interfered with distinct investment-backed expectations," and (iii) "the character of the governmental action. . . . [wherein a] 'taking' may more readily be found when the interference

with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good."[47]

Over decades of referring to this line of cases, the Court's opinion on whether or not a particular government action is a taking has become clear as mud.

> For reasons that probably owe more to case-by-case pragmatism than any concern for doctrinal clarity, the Supreme Court's Takings Clause jurisprudence has divided into two broad categories, commonly referred to as regulatory and physical takings, respectively. Regulatory takings typically occur when legal restrictions on the use of private property "go too far," depriving the owner of essential attributes of ownership. Physical takings result from incursions onto private property (normally referred to in quasi-military terms as "invasions" or "occupations") by the government or by parties acting under governmental authority.[48]

One of the higher-profile takings cases in recent years has been the In re Addicks and Barker (Texas) Flood-Control Reservoirs cases, colloquially referred to as the Harvey cases or Harvey takings cases. In late August 2017, Hurricane Harvey decimated the Texas Gulf Coast, dumping approximately 40+ inches of rain in the Houston area alone. Yet many of the people who flooded were high and dry during the hurricane event, only to be flooded days and weeks after the storm had passed. On the western side of Houston exist two dry reservoir dams, Addicks and Barker, which operate to store and release water during heavy rain events. Out of this factual background came two separate, but related, takings claims.

The Upstream plaintiffs claimed that when the federal government (through the U.S. Army Corps of Engineers) impounded water within the confines of the reservoirs but onto private lands, the government took their property.[49] In other words, like backfilling a bathtub, the government failed to buy out all of the land within the outer edges of the bowl of the reservoirs, much of which had been turned into largely single-family residential housing.[50]

The Downstream plaintiffs claimed that when the government eventually released all that water at approximately midnight between Sunday, August 27th and Monday, August 28th, it took Downstream plaintiffs' property by inundating their properties with water from days to weeks.[51] Interestingly, during discovery it turned out that the Corps knew precisely which properties would flood based on the rate of release and internal mapping.

To handle such an unprecedented docket, then-Chief Judge Braden of the Court of Federal Claims created a Master Docket (1:17-cv-3000) and split that docket into an Upstream sub-docket (1:17-cv-9001) and a Downstream sub-docket (1:17-cv-9002). The judges in each case organized the thousands of cases by appointing leadership counsel and designating test property plaintiffs. The test property plaintiffs were intended to be akin to bellwether plaintiffs, whose different fact scenarios were to test out governmental takings liability for each.

The Upstream cases went to trial in early 2019, with an affirmative liability finding of a flowage easement by Judge Lettow in December of 2019. In that opinion, Judge Lettow held: "The government's suggestion that this flooding is not a compensable taking because it was temporary and confined to a single flood event carries no water. . . . The flooding that occurred was the direct result of calculated planning."[52] The Upstream cases now face a trial on damages, expected to occur in the fall of 2021.

Downstream plaintiffs were not so fortunate. After Judge Braden took senior status, Judge Smith took up the Downstream sub-docket and pushed all case deadlines back a year. He held a hearing on the government's Motion to Dismiss and the parties' cross-Motions for Summary Judgment. Without a liability trial, Judge Smith granted the government's Motion to Dismiss and their Motion for Summary Judgment in full in February 2020, and dismissed the downstream cases in September 2021.[53] The downstream plaintiffs filed their notices of appeal in

November 2020 and their appellate briefs were filed on March 8, 2021. [54]

For the Downstream cases, Judge Smith ruled specifically that "[t]he closing and later opening of the gates under the Corps' induced Surcharge operation does nothing to make the water 'government water', as opposed to 'flood waters' as articulated in Central Green. 531 U.S. 425."[55] The opinion focused on two points: (i) defining that the alleged property interest at issue was a right to be free from flood waters, and finding no such property right exists under Texas state law or federal common law, and (ii) the character of the waters that flooded the property were not federal waters, but Act-of-God waters. Indeed, Judge Smith made his opinion clear from the first phrasing of the issue: "Do plaintiffs have a . . . property interest in perfect flood control . . . when a government-owned [dam] . . . fails to completely mitigate against flooding created by an Act of God?"[56]

How to reconcile these inconsistent liability rulings? No doubt this will be the primary subject of the (inevitable) appeals to the Federal Circuit.

PLEADING AND TRIAL STRATEGY

The authors of this outline have found it advisable to be as detailed as possible in pleading an inverse condemnation action, as they are often the target of motions to dismiss or state law equivalents targeted at ending the litigation even before discovery. On the whole, trial courts are generally more familiar with tort claims, and owners are encouraged to provide a comprehensive recitation of factual claims and a thorough explanation of the applicable law governing inverse condemnation claims, so as to educate the trial judge from the outset of the litigation.

Inverse condemnation trials often focus on narrow determinations of fact, especially relating to whether the condemnor *intended* to damage private property for a public use or whether it was merely negligent in its acts. Although these are tort law principles—and inverse condemnation claims are not tort claims—trial courts may nonetheless apply them as they focus on the public use requirement and consider whether the condemnor could have filed a *de jure* condemnation action to take or damage the property rights it is claimed to have *de facto* taken or damaged. Practitioners should be thorough in producing evidence in support of their inverse condemnation claim at trial, to ensure that the trier of fact is fully apprised of the scope of the alleged taking and can fairly render a verdict in favor of the aggrieved property owner.

Notes

1 The authors would like to recognize and thank Ashlynn Hutton, an attorney with Parker Poe Adams & Bernstein LLP, for her substantial contribution to researching and writing this article.

2 *§* 21:43 Inverse condemnation, 3 Local Government Law § 21:43 (Oct. 2020).

3 See, e.g., N.C. Gen. Stat. Ann. §§ 40A-51, 136-111 (2011) (24 months); Tomasek v. State, 196 Or. 120 (1952) (six years without notice requirement); White Pine Lumber Co. v. City of Reno, 801 P.2d 1370 (Nev. 1990) (fifteen years).

4 See, e.g., North Carolina Dep't. of Transp. v. Cromartie, 214 N.C. App. 307 (2011); State of Texas v. Whataburger, Inc., 60 S.W.3d 256 (Tex. Ct. App. 2001); Herring v. Gulick, 5 Haw. 57 (1883) (it is not decided whether an inverse claim must be made in the condemnation action or may be brought as a separate action).

5 See, e.g., Nolan and Nolan v. City of Eagen, 673 N.W.2d 487 (2003) (Minnesota inverse claims are petitions for writ of mandamus seeking the condemnor to commence inverse condemnation proceedings); Kruse v. Village of Chagrin Falls, 74 F.3d 694 (6th Cir. 1966) (Ohio inverse claims can be brought as own action or through petitions for writ of mandamus); State ex rel. Henson v. West Virginia Dep't. of Transp., 203 W. Va. 229 (1998); Mapes v. Madison Cnty., 252 Iowa 395 (1961).

6 *§* 27:30 Notice of claim; statute of limitations, 4 Local Government Law § 27:30 (Oct. 2020); compare, Hise v. State of Tennessee, 968 S.W.2d 852 (Tenn. Ct. App. 1997) (claims only against counties, not the state).

7 See, e.g., Va. Code Ann. § 25.1-420.

8 See The Law of Eminent Domain: Fifty-State Survey, American Bar Association Condemnation, Zoning & Land Use Committee (2012).

9 See, e.g., Robinson v. City of Ashdown, 301 Ark. 226 (1990); O'Brien v. City of Syracuse, 54 N.Y.2d 353 (1981).

10 See, e.g., Christ v. Metro St. Louis Sewer Dist., 287 S.W.3d 709 (Mo. Ct. App. 2009).

11 See, e.g., Third & Catalina Assocs. v. City of Phoenix, 182 Ariz. 203 (App. 1994).

12 See, e.g., A Tumbling-T Ranches v. Flood Control Dist. of Maricopa Cnty., 222 Ariz. 515 (App. 2009); Fulton Cnty. v. Baranan, 240 Ga. 837 (1978).

13 See, e.g., Cuna Mut. Life Ins. Co. v. Los Angeles Cnty. Metro. Transp. Auth., 108 Cal. App. 4th 382 (2003).

14 See, e.g., Klopping v. City of Whittier, 8 Cal. 3d 39 (1972); Clay Cnty. Realty Co. v. City of Gladstone, 254 S.W.3d 859 (Mo. 2008); Buzz Stew, LLC v. City of N. Las Vegas, 181 P.3d 670 (Nev. 2008).

15 Gulla v. State of Michigan, No. 340017, 2019 WL 320531 (Mich. Ct. App. Jan. 24, 2019).

16 See, federally, Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978) (recognizing three criteria for a federal regulatory taking inverse claim).

17 See, e.g., The City of Coeur d'Alene v. Simpson, 142 Idaho 839 (2006); Molo Oil Co. v. The City of Dubuque, 692 N.W.2d 686 (Iowa 2005).

18 See, e.g., Homeward Bound, Inc. v. Anchorage Sch. Dist., 791 P.2d 610 (Alaska, 1990); Tim Thompson, Inc. v. Village of Hinsdale, 247 Ill.App.3d 863 (2nd Dist. 1993); Gove v. Zoning Bd. of Appeals of Chatham, 831 N.E.2d 865 (Mass. 2005); Bayside Warehouse Co. v. City of Memphis, 470 S.W.2d 375 (Tenn. Ct. App. 1971).

19 See, e.g., *§* 21:43 Inverse condemnation, 3 Local Government Law *§* 21:43 (Oct. 2020).

20 See Fred F. French Investing Co. v. City of New York, 39 N.Y.2d 587 (1976); Agins v. City of Tiburon, 598 P.2d 25 (Cal. 1979); Allen v. City & Cnty. of Honolulu, 58 Haw. 432 (1977).

21 Arkansas Game & Fish Comm'n v. United States, 568 U.S. 23, 34 (2012) ("Because government-induced flooding can constitute a taking of property, and because a taking need not be permanent to be compensable, our precedent indicates that government-induced flooding of limited duration may be compensable.")

22 See, e.g., Hayman v. Paulding Cnty., 349 Ga. App. 77 (2019).

23 See, e.g., DeKalb Cnty v. Orwig, 261 Ga. 137, 139 (1991).

24 See Hayman, 349 Ga. App. 77.

25 See, e.g., Reid v. Gwinnett Cnty., 242 Ga. 88 (1978); McFarland v. DeKalb Cnty., 224 Ga. 618 (1968).

26 See, e.g., Dep't. of Transp. v. Ballard, 208 Ga. App. 474 (1993).

27 See Lea Co. v. North Carolina Bd. of Transp., 308 N.C. 603 (1983).

28 Or it must be shown that the property will be subject to inevitably recurring flooding. See id.

29 See id.

30 See, e.g., Kopplow Development, Inc. v. City of San Antonio, 399 S.W.3d 532 (Tex. 2013); Tarrant Reg'l Water Dist. v. Gragg, 151 S.W.3d 546 (Tex. 2004).

31 See id.

32 See City of Van Alstyne v. Young, 146 S.W.3d 846 (Tex. App. 2004).

33 See Sloan Creek II, L.L.C. v. N. Texas Tollway Auth., 472 S.W.3d 906, 911 (Tex. App. 2015).

34 151 S.W.3d 546 (Tex. 2004).

35 Id. at 549.

36 Id.

37 Id. at 550.

38 Id. at 551.

39 Id. at 554.

40 Id. at 555.

41 See generally San Jacinto River Auth. v. Burney, No. 01-18-00365-CV, 2018 WL 6318506 (Tex. App.—Houston [1st Dist.] Dec. 4, 2018, no pet. h.).

42 See Livingston v. Virginia Dep't of Transp., 284 Va. 140, 152 (2012) ("our case law holds that a single occurrence of flooding can support an inverse condemnation claim.")

43 See id. at 152; 161.

44 See AGCS Marine Ins. Co. v. Arlington Cnty., 293 Va. 469, 479-83 (2017).

45 See United States Court of Federal Claims, https://www.uscfc.uscourts.gov/ (last visited March 12, 2021).

46 438 U.S. 104 (1978). See Tahoe-Sierra Preservation Council, Inc. v. Tahoe Reg'l Plan. Agency, 535 U.S. 302, 336 (2002) (quoting "polestar" language approvingly); Palazzolo v. Rhode Island, 533 U.S. 606, 633 (2001) (O'Connor, J., concurring) ("Our polestar . . . remains the principles set forth in Penn Central itself and our other cases that govern partial regulatory takings.").

47 Penn Cent., 438 U.S. at 124 (citations omitted).

48 Brian T. Hodges, Will Arkansas Game & Fish Commission v. United States Provide a Permanent Fix for Temporary Takings?, 41 B.C. ENVTL. AFF. L. REV. 365, 366 (2014); see also generally Richard A. Epstein, Physical and Regulatory Takings: One Distinction Too Many, 64 STAN. L. REV. ONLINE 99 (2012) (acknowledging the separate analyses for physical and regulatory takings, and arguing for stronger regulatory takings protections); Josh Patashnik, Physical Takings, Regulatory Takings, and Water Rights, 51 SANTA CLARA L. REV. 365 (2011) (same, for water-rights takings).

49 See generally Amended Individual Upstream Master Complaint, In re Upstream Addicks and Barker (Texas) Flood-Control Reservoirs, Cause No. 1:17-cv-9001-CFL, Doc. 17 (Filed January 16, 2018).

50 Id.

51 In re Downstream Addicks and Barker (Texas) Flood-Control Reservoirs, Cause No. 1:17-cv-9002-SGB, Doc. 23 (Filed January 16, 2018).

52 In re Upstream Addicks and Barker (Texas) Flood-Control Reservoirs, 146 Fed. Cl. 219, 252.

53 In re Downstream Addicks and Barker (Texas) Flood-Control Reservoirs, 147 Fed. Cl. 566.

54 In re Downstream Addicks and Barker (Texas) Flood-Control Reservoirs, Cause No. 1:17-cv-9002-SGB, Doc. 243-247 (Filed Nov. 4, 2020); see also Taking – Addicks & Barkers Res.; Milton, et al. vs. United States, Docket No. 21-1131, Doc. No. 34 (Filed March 8, 2021).

55 147 Fed. Cl. at 583.

56 Id. at 576.

PREROGATIVES PROVISIONS AND EFFORTS COVENANTS IN COMMERCIAL REAL ESTATE FINANCE

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This article addresses prerogatives provisions and efforts covenants in commercial real estate transactions, primarily under New York law. Two of the more ubiquitous and interesting widgets of contracting technology, they play roles throughout the commercial world.

Since our practice focuses on commercial real estate, and especially commercial mortgage finance, we'll tend to use examples from that arena (with a few useful detours). It so happens that prerogatives provisions are extremely common in mortgage loan documents, but efforts covenants much less so. By comparison, efforts covenants are a lot more common in commercial leases, sale/purchase agreements, joint ventures, and certain other transaction categories, both in the real estate world and beyond, as we'll touch on below.

WHAT ARE PREROGATIVES PROVISIONS?

So — what are prerogatives provisions? A prerogative is simply any right, power, or privilege, and in real estate deal-making, typical examples of prerogatives provisions are those pursuant to which:

- Party A's consent is to be given (or not given) to Party B's action (e.g., a lender's consent to a borrower's execution of a lease).
- Party A has the power to make a determination of law, fact, and/or contract interpretation (e.g., an interest rate formula, financial ratio or loan balancing calculation, a funding shortfall, substantial completion of a project, qualification of a replacement guarantor or property manager, satisfaction of funding conditions, etc.).
- Party A has the power to approve a deliverable (e.g., a rate cap agreement, a legal opinion, a budget, a title policy endorsement) as to matters of form and/or substance.
- Party A has the power to choose whether to enforce or waive a right, option, or remedy.
- Party A has the power to choose whether to perform or not perform an action (e.g., a lender's decision to fund or not fund a construction advance, or a protective advance).

As the list suggests, one of the remarkable things about prerogatives provisions is how many of them there are and what a wide range of circumstances they touch on and concern in a commercial (and particularly a real estate finance) context.

Another is how much they vary in impact. Some concern routine, immaterial procedural determinations, while many others — if exercised to their fullest — can confer on lenders life-or-death powers over borrowers. People tend to think of consent provisions as a placeholder for this category of concepts, but prerogatives provisions cover a lot more ground.

Prerogatives are commonly expressed either as being exercised "in good faith," "reasonably" or "in the holder's discretion," or some variant or combination of the three. (Commercial custom, plain language definitions, and the New York courts all seem to generally agree on the meanings and therefore the functions of these seemingly vague terms, as we will discuss below.)

What are efforts covenants?

Efforts covenants are those pursuant to which one party has an obligation to use a certain level of effort in furtherance of satisfying or achieving a condition, state of facts, other result that is vague, uncertain, and/or partially or potentially out of that party's hands. In the real estate finance context, one sees obligations on the borrower's part to use "reasonable," "commercially reasonable," or "best" efforts (or some variant thereof) toward a wide range of uncertain and contingent outcomes including:

- Completing a project by a target date;
- Enforcing the contractual obligations of a tenant, property manager, construction manager, or other counterparty;
- Causing specified rentable space to be leased on market terms or in accordance with specified parameters;
- Obtaining specified insurance policy clauses or endorsements that may or may not be available;
- Obtaining an estoppel from a tenant or other counterparty not required to provide one;
- Obtaining specified licenses, permits, approvals, or the like;
- Ensuring that the lender's lien is not adversely affected by a potential future license or franchise expiration/replacement process;
- Ensuring a favorable and speedy disposition of a theoretical future contested injunction against construction; or
- Cooperating with a loan sale process.

One also occasionally sees efforts obligations binding on lenders. For example, a loan application might obligate the lender to use reasonable efforts to close the loan by a specified target date, or a loan agreement might obligate the lender to use good faith efforts to fund a draw request on the requested date. Finally, a borrower's ability to receive a refund of a good faith deposit might hinge on its having exercised commercially reasonable efforts to perform its obligations under the application.

Having described and illustrated our terms with a few examples, let's next articulate how they're typically constituted and formulated, sticking with our commercial mortgage lending context.

How are prerogatives provisions built?

Focusing first on prerogatives provisions, the fundamental topic for debate — whether the context relates to a lender's right to grant or withhold a consent, make a determination, approve a deliverable, enforce or waive a right, and perform or withhold an action — is almost universally the standards that will apply to the lender's exercise of its right. What are they? And *are* there any?

And lenders, in their standard form lending documentation, typically make use of shorthand language — up to and including "in lender's sole, absolute, and unfettered discretion" — to describe the standard; whereas in the course of transactions, borrowers sometimes successfully negotiate for some form of reasonableness standard instead.

How are efforts covenants built?

Next, let's consider how efforts covenants are typically constructed.

Whenever loan documents obligate a borrower to act in furtherance of an outcome that it can't fully control, the basic question implied is always, "What standards will apply to the borrower's performance of its obligation?" By way of opening bid, lenders' standard form loan documents typically use phrasing up to and including, "Borrower shall use its best efforts" to describe the standard in shorthand, whereas, again, borrowers sometimes successfully (just how successfully, we will return to consider) negotiate for some form of reasonableness standard instead.

WHAT DO THE PARTIES THINK THESE CONSTRUCTS MEAN OPERATIONALLY?

Of course, all of this is just the start. These widgets fit into many different niches and play many different roles within our world of complex contracting technology. Sometimes they stand alone, and may by themselves constitute major deal points, and other times they play silent or supporting roles.

With all their versatility, it's not surprising that both of these constructs are renowned for the degree of negotiation that goes on around them — to such an extent that one not infrequently hears expressions of weariness about it all.

In fact, given all the vagueness of the terms and the complexity and variability of their roles, what is surprising is that people seem to have such strongly held ideas about what's at stake with the negotiations.

In other words, there seem to be well-established expectations and a broad degree of agreement in the marketplace as to how the terms, once settled by negotiation, actually function to govern borrowers' operational conduct.

WHAT HAPPENS IN COURT?

How does all of this play out if a dispute over someone's exercise of a prerogative, or failure to exercise sufficient efforts, puts these concepts to the test in litigation?

New York's case law supports the conventional wisdom among parties and counsel regarding the application of prerogatives provisions but confounds the conventional wisdom as to the application of efforts clauses.

Prerogatives

Whenever Party A makes a choice that it has the right to make in its sole discretion, and Party B is aggrieved by that choice, one of Party B's most typical arguments is that state law implies a covenant of good faith and fair dealing on Party A's part, and that Party A's choice violates that covenant. In some states and under certain conditions, this argument has prevailed, but in New York it doesn't seem to be viable, at least within the limited scope of situations described in the opinions.

New York's courts have consistently shielded sole discretion-based prerogatives provisions from implied covenant attack to such an extent that such provisions lend certainty and therefore stability to real estate transactions: People know what they mean and act accordingly. Certainly, some of those who subject themselves by contract to discretionary prerogatives end up aggrieved when the prerogative holder succumbs to moral hazard and abuses the leverage built into the prerogative. In those cases, the line is bright — there is no implied consent-based relief to be expected from New York courts.

Exceptions are made perhaps for certain cases of unfair asymmetry in bargaining power or some other equitable reason, but generally speaking, people able to fend for themselves in the commercial marketplace know where they stand with "sole discretion" and know what they have to do in order to avoid it — either successfully bargain for a reasonableness standard (such as "consent will not be unreasonably withheld") or do not proceed with the transaction.

For example, in Transit Funding, LLC v Capital One Equipment Finance Corp.,[1] a commercial line-of-credit loan case, the loan agreement gave the lender the right to decline any request for a loan advance in its "sole and absolute discretion," the court held that the implied covenant of good faith and fair dealing was no basis to force the lender to make an advance, and also not a basis for a damage claim by the borrower. In the court's words, "motivation…is irrelevant."[2]

There is some indication in the case law that the implied covenant of good faith and fair dealing requires the acting party not to act arbitrarily or irrationally, but that does not stop the acting party from acting selfishly — even to the destruction of the counterparty. For example, several cases stand for the proposition that a lender does not have an "implied covenant problem" just because it conditions a consent to a loan assumption on raising the interest rate to a level consistent with the current market rate.

On the other hand, in Silver v. Rochester Savings Bank, a lender was obligated by its loan agreement not to unreasonably withhold its consent to a loan assumption, a New York court held that by conditioning its consent to a loan assumption on raising the interest rate to a level consistent with the current market rate, the lender did violate its reasonableness obligation.[3]

In short, the courts are aligned with the marketplace understanding of the functional difference between "discretionary" prerogatives and those which must be exercised "reasonably" — the former are absolute, the latter are not.

Efforts

What about the best efforts versus reasonable efforts debate? In some jurisdictions, notably Delaware, best efforts means something more than reasonable efforts — but it may surprise some to learn that (broadly speaking) that is not the case under New York's case law.[4]

Essentially, New York seems to compress all the variants of this theme into one, so that best, reasonable, and good faith are more or less synonymous — and on a least common denominator basis, i.e., in the face of a naked efforts clause, New York courts will not bestir themselves to make best mean anything more than reasonable, or to make reasonable mean anything more than good faith, regardless of plain language and market usage arguments to the contrary. (And New York is far from alone in taking this seemingly quirky posture.)

Why this result? In a word, the concept of efforts seems to be too situation-specific for courts to develop a one-size-fits-all definition or means of applying it, absent context in the documents or in the specific industry, market, asset, or parties. In fact, the New York (and other) courts have historically been inclined to find the concept void for vagueness, only to relent as the volume of transacting parties using them has continuously grown.

In addition to its vagueness (lack of operational meaning without context), efforts has an element of

ambiguity to it, in that by its dictionary definition it has two very different senses — an objective sense reflected in visible activity and a subjective sense reflected by invisible states of mind. This seemingly academic distinction is actually a practical one, for two reasons: (i) some courts actually recognize the distinction between an objective version and a subjective version of efforts, in which reasonable efforts are subjective and commercially reasonable efforts are objective; (ii) second, parol evidence is admissible in some courts in case of ambiguous provisions, but not necessarily vague provisions under New York law.

SETTING THE CONTEXT

In the present environment, more pressure is certainly coming to bear on any number of transaction-based relationships in commercial real estate, so more litigants will likely test the shorthand in courts. But we see no reason for the courts to change their approach as a result of the added volume.

It's probably smart to pause now, in a time of ongoing uncertainty in politics, the economy, and public health, to be on guard and recognize that many contracting parties may feel heightened pressure these days to leave things unsaid, uncharacterized, or unspecified about relevant contingencies and their respective responses to it.

Picture the broad range of commercial real estate transactions and ongoing contractual relationships — from purchase/sales, to debt and/or equity financing arrangements, ground and space leases, and construction, management, and/or operational/franchising agreements. One thing they all have in common is that no one expects the documentation to cover every eventuality, much less to articulate the party's detailed understandings about how each eventuality (should it actually occur) would be addressed.

In order to avoid costly and time-consuming negotiation, based on assumptions and calculations that might not be well-founded, parties often use shorthand language — sometimes even mere buzzwords — rather than spelling things out in detail. In law as in life, it's bound to happen when we try to govern complex relationships in uncertain environments with limited transaction budgets and limited time to focus beyond today's problems.

All of this means there are gaps, gray areas, and vagueness in every contract. Some of this is mitigated by generic yet detailed further assurance clauses, cooperation covenants, and certain other boilerplate provisions. These are not shorthand. They are fully articulated sets of interlocking covenants that address post-closing cleanup and other similar concerns, and do it generically.

And some of the vaguest, grayest gaps are never filled, clarified, or specified at all. In that case, one party might not have given the matter any consideration — or might have simply reckoned that (for whatever reason) any time, effort, or money spent to address it would be wasted. The other party, perhaps, thought it best to remain silent on the subject. Cost-benefit analysis is easy to do if you don't sweat the long term too much, or, on the other hand, if you think you know better than your counterparty what the long term will really bring.

But real estate transactions are also, and frequently, characterized by much more specific (yet still extremely flexible) bits of technology for providing some form of guidance on a given concept or topic, while avoiding a detailed road map.

And prerogatives provisions and efforts clauses? They are probably among the most popular of these technologies. For principals and their lawyers alike, there are times when it's worth a closer look at these two ubiquitous yet tricky standbys of the contracting toolkit.

In non-lending contexts, efforts provisions are particularly common in purchase and sale agreements, where the seller or buyer each may have one or more efforts obligations to perform in support of clearing specified conditions precedent to the closing. In this case, the entire deal hinges on the efforts clause. Outside of real estate, efforts provisions are staples of certain kinds of contracts such as merger/acquisition agreements and exclusive marketing and distribution agreements. Here again, efforts clauses are

fundamental, in this case because they relate to one party's obligation to generate contingent proceeds using the other party's good will, intellectual property, or merchandise, the amount of which then determines the amount of the principal's net profits or the selling party's deferred purchase price.

One thing that is pretty obvious when thinking about efforts clauses is that — especially in the high-stakes sale/purchase and merger/marketing contexts — they tend to be accompanied by a specific kind of moral hazard: the risk that during the contract period, one of the two contracting parties might get cold feet or become distracted for whatever reason. If the party that regrets entering into the contract or allocating resources to it is also an "efforts obligor," then there is a conflict of interest.

What's more, the efforts party often has some level of plausible deniability about its motivations. The very fact that the condition precedent in question is partly or potentially out of its hands provides cover and camouflage for it to argue that any failure of the condition to be satisfied is due not to the insufficiency of its efforts but to other causes outside its control.

As a result, it should not be too surprising that many of the leading cases (in New York at least) on efforts clauses do involve parties who have effectively torpedoed the very same transaction in which they have committed themselves to make best efforts or commercially reasonable efforts to consummate.

And some of the New York courts do sometimes get mired in the complications that this moral hazard problem can cause. You often see efforts parties engaged in flagrant, even flamboyant, sabotage of the very goal of the contract that they are supposed to be expending efforts to help achieve. And that has been a distraction for the courts.

Equally clearly, prerogatives provisions are also inherently prone to moral hazard. When no one can call a person's decision into question, you are essentially saying that nothing is out of bounds, nothing is wrong, the person can do no wrong — and that can't be right, or so it would intuitively seem.

There is a particularly strong feedback loop between the front-end contracting process and the back-end enforcement process built into these tools, because they are both in essence mechanisms for deferring much of the process (and thus the cost) of specifying contract obligations to the future (including by the courts) but only to an unpredictable future in which a dispute has arisen. That cost deferral (and hopefully cost elimination) function is what makes them as popular as they are.

WHAT DOES IT ALL MEAN?

To get to the bottom of all this, it helps to recognize that prerogatives and efforts are very different creatures.

When contracting parties delegate a discretionary prerogative exclusively to one of the parties, they enact a governance rule between them covering a specified situation. It's a low-cost bright line everyone can understand. If nuance is needed, one can add conditions, exceptions, or other qualifications — or replace discretion with reasonableness and then qualify that. But if we want no gray areas, we have a simple effective tool to avoid them.

The story's different with efforts clauses, which serve a different function. They speak not to the task of setting up simple binary decision-making algorithms, but that of defining performance where uncertainty of one form or another precludes precise characterization of the performance. It's all very complicated and subjective.

In that context, the word 'best' (or any qualifier) has impossibly too much work to do and one could say that New York courts have put us all on notice of that reality. As such, wise borrowers and lenders (and their counsel) will want to think twice about using the efforts concept at all. It helps that the nature of mortgage lending allows for a limited level of reliance on the concept. There are industries much more susceptible to the concern — for example, New York's leading efforts case related to the acquisition of a beer distributorship business's goodwill and distribution network and the buyer's obligation to use efforts to monetize those assets.[5]

So maintain awareness of how the courts treat these terms. Whether a loan application is being negotiated or a set of master loan documents is being created, it may be worth screening for them and confirming that principal and counsel are on the same page about what happens if it should come to litigation. And of course, since litigation is rare, and the market believes what it believes, one might conclude that no change is needed because the incentives are, ultimately, what the parties think they are.

CONCLUSION

This discussion of prerogatives and efforts provisions should reinforce two truisms. First, in commercial real estate, there are always tactical approaches to negotiation and drafting. Second, if the parties don't take the time and effort to articulate their intentions clearly, courts won't be particularly eager to allocate their time and resources to filling in the gaps. You can always prevent this situation by being very careful in commercial real estate drafting — not just with prerogatives and efforts provisions, but with all provisions of your documents.

Notes

1 Transit Funding, LLC v Capital One Equipment Finance Corp., 48 N.Y.S. 3d 110 (N.Y. App. Div.2017).

2 Id. at 114.

3 Silver v. Rochester Savings Bank, 4 N.Y.S.2d 945 (N.Y. App. Div. 1980).

4 See, e.g., Holland Loader Company LLC v. FL Smidth A/S, 313 F. Supp. 3d 440 (S.D.N.Y 2018) ("When interpreting the meaning of a reasonable efforts clause, "New York courts use the term 'reasonable efforts' interchangeably with 'best efforts'").

5 Bloor v. Falstaff Brewing Corp., 454 F. Supp. 258 (S.D.N.Y. 1978).

THE APPLICABILITY OF THE AMERICANS WITH DISABILITIES ACT TO SHORT TERM RENTAL FACILITIES

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The Covid-19 Pandemic has changed our world as we know it. One of the most significant changes has been the prevalence of remote work, a trend that many agree will become a permanent part of our lives long after the pandemic has (hopefully) ended.

The acceptance of remote work and the increased concern for safety and privacy as a result of the pandemic has been a boon for the short-term rental industry. With many people now having the flexibility to work while spending months at a time away from their primary residence, expect the short term-rental industry to continue growing.

This article will discuss the potential obligations of operators of short-term rental facilities under the Americans With Disabilities Act (ADA) and the potential impact on landlords which lease to those operators. Any landlord who leases a building or part of a building to an operator of a short-term rental facility needs to be familiar with the ADA accessibility requirements, especially for older buildings that were built prior to the ADA's enactment.

Title III of the ADA prohibits discrimination on the basis of disability in activities or places of public accommodation and requires newly constructed or altered places of public accommodation—as well as commercial facilities—to comply with the ADA Standards.[1]

Importantly for landlords, the ADA regulations hold the landlord who owns a building that houses a place of public accommodation and the tenant who leases the building and operates a place of public accommodation equally responsible for complying with the ADA.[2]However, "allocation of responsibility for complying with the obligations … may be determined by lease or other contract."[3]As such, leases with operators of short-term rental facilities must be drafted with the ADA requirements in mind.

The initial question is whether a short-term rental would be considered a "place of public accommodation." The Code of Federal Regulations defines a "place of public accommodation" as a facility operated by a private entity whose operations affect

commerce and fall within at least one of twelve categories."[4]One of the twelve categories is a "place of lodging" which is defined as:

> An inn, hotel, or motel; or
>
> A facility that –
>
> (A) Provides guest rooms for sleeping for stays that primarily are short-term in nature (generally 30 days or less) where the occupant does not have the right to return to a specific room or unit after the conclusion of his or her stay; and
>
> (B) Provides guest rooms under conditions and with amenitiessimilar to a hotel, motel, or inn, including the following —
>
> (1) On- or off-site management and reservations service;
>
> (2) Rooms available on a walk-up or call-in basis;
>
> (3) Availability of housekeeping or linen service; and
>
> (4) Acceptance of reservations for a guest room type without guaranteeing a particular unit or room until check-in, and without a prior lease or security deposit.[5]

As such, if the short-term rental provides "guest rooms for sleeping" for short-term stays where the occupant does not have the right to return after the conclusion of his or her stay and offers hotel-like conditions or amenities such as the ones described above, it could qualify as a "place of public accommodation" to which the ADA applies.

The regulation does provide an exception for "an establishment located within a facility that contains not more than five rooms for rent or hire and that actually is occupied by the proprietor of the establishment as the residence of the proprietor." Thus, a short-term rental is not required to be ADA compliant if it does not contain more than five rooms for rent *and* is occupied by the owner of the establishment as his residence. If the short-term rental is not owner-occupied or there are more than five rooms, the aforementioned analysis must be applied to determine if the short-term rental would be considered a place of lodging subject to the ADA.

The ADA requirement to make the facility accessible is dependent upon whether the short-term rental is located within a new construction or an existing facility. A new construction must be ADA-accessible. An existing building is required to remove architectural barriers, including communication barriers that are structural in nature, where such removal is readily achievable, i.e., easily accomplishable and able to be carried out without much difficulty or expense.[6]

Section 36.304(b) provides examples of steps to remove barriers which include, but are not limited to, the following actions:

> (1) Installing ramps;
>
> (2) Making curb cuts in sidewalks and entrances;
>
> (3) Repositioning shelves;
>
> (4) Rearranging tables, chairs, vending machines, display racks, and other furniture;
>
> (5) Repositioning telephones;
>
> (6) Adding raised markings on elevator control buttons;
>
> (7) Installing flashing alarm lights;
>
> (8) Widening doors;
>
> (9) Installing offset hinges to widen doorways;
>
> (10) Eliminating a turnstile or providing an alternative accessible path;
>
> (11) Installing accessible door hardware;
>
> (12) Installing grab bars in toilet stalls;
>
> (13) Rearranging toilet partitions to increase maneuvering space;

(14) Insulating lavatory pipes under sinks to prevent burns;

(15) Installing a raised toilet seat;

(16) Installing a full-length bathroom mirror;

(17) Repositioning the paper towel dispenser in a bathroom;

(18) Creating designated accessible parking spaces;

(19) Installing an accessible paper cup dispenser at an existing inaccessible water fountain;

(20) Removing high pile, low density carpeting; or

(21) Installing vehicle hand controls.

The aforementioned is not an exhaustive list of potential barrier removals that might be required. The Department of Justice website has a Checklist for Readily Achievable Barrier Removal which is intended to be used when surveying an existing facility for barriers to accessibility.[7]It is organized by the priorities stated in the regulations and includes possible solutions to accessibility barriers.

Furthermore, under the ADA Accessibility Standards issued by the Department of Justice and the Department of Transportation, the requirement of accessibility applied to new construction is triggered whenever there is an "addition" or "alteration" to an existing building.

An "addition" is defined as "[a]n expansion, extension, or increase in the gross floor area or height of a building or facility."[8]

An "alteration" is defined as "[a] change to a building or facility that affects or could affect the usability of the building or facility or portion thereof."[9]The definition of alteration is broad and could potentially include remodeling, renovation, rehabilitation, reconstruction, historic restoration, resurfacing of circulation paths or vehicular ways, changes or rearrangement of the structural parts or elements, and changes or rearrangement in the plan configuration of walls and full-height partitions. Where compliance with applicable requirements is technically infeasible, the alteration shall comply with the requirements to the maximum extent feasible. Normal maintenance, reroofing, painting or wallpapering, or changes to mechanical and electrical systems are *not* alterations unless they affect the usability of the building or facility.

In addition to potential structural modifications, Section 36.302(e)(1) requires a public accommodation that owns, leases (or leases to), or operates a place of lodging to (i) modify its policies, practices, or procedures to ensure that individuals with disabilities can make reservations for accessible guest rooms in the same manner as individuals who do not need accessible rooms and to identify and (ii) describe the accessible features in the hotels and guest rooms offered through its reservations service in enough detail to reasonably permit individuals with disabilities to assess independently whether a given hotel or guest room meets his or her accessibility needs.

Additionally, Section 36.302(e)(1)(iii) requires a public accommodation to ensure that accessible guest rooms are held for use by individuals with disabilities until all other guest rooms of that type have been rented and the accessible room requested is the only remaining room of that type and to guarantee specific accessible guest rooms that are reserved through a reservations service to the same extent that it guarantees rooms that are not accessible.

When a public accommodation does guarantee room reservations, it must provide the same guarantee for accessible guest rooms as it makes for other rooms, except that it must apply that guarantee to the specific room reserved and blocked, even if in other situations, its guarantee policy only guarantees that a room of a specific type will be available at the guaranteed price.[10]

Taking into account these requirements, a lease between a landlord and the operator of a short-term rental facility that could qualify as a place of public accommodation must be carefully drafted

to knowingly allocate responsibility for ADA compliance.

An attorney representing a landlord should seek the best terms possible to place responsibility upon the tenant-operator for removing architectural barriers and making the building otherwise accessible if the building has been, or will be, altered or expanded. Likewise, it would be important to include provisions in the lease, making the tenant-operator explicitly responsible for the contents of any advertisements of the short-term rental, including advertisement on social media and third-party platforms such as Travelocity, AirBnB and Orbitz, and for making accessible rooms available to the disabled in a non-discriminatory manner.

Conversely, an attorney representing the tenant-operator should attempt to place as much responsibility upon the landlord for making structural repairs to remove architectural barriers and making the building otherwise accessible if the building has been, or will be, altered or expanded.

As people continue to utilize short-term rentals in greater numbers, we will inevitably see additional guidance from the courts as to the application of the ADA to such short-term rentals.

Notes

1 42 U.S. Code § 12182.

2 See 28 CFR § 36.201(b).

3 Id.

4 28 CFR § 36.104.

5 Id.

6 See 28 CFR § 36.304(a).

7 Checklist for Readily Achievable Barrier Removal, Information and Technical Assistance on the Americans with Disabilities Act, available at https://www.ada.gov/checkweb.htm

8 U.S. Dept. of Justice 2010 ADA Standards for Accessible Design, § 202.2, available at http://www.ada.gov/regs2010/2010ADAStandards/2010ADAStandards.pdf.

9 Id. at §202.3

10 28 CFR § 36.302(e)(1)(v).

FARM LEASES: TWELVE IMPORTANT THINGS TO CONSIDER

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The following checklist is meant to act as a guide to various lease terms and provisions specific to farm leases. However, each lease is specific to the parties involved; accordingly, some of the items addressed below may not be relevant to a given lease. Similarly, the below list does not attempt to address all matters that may be addressed in a given farm leasing arrangement.

1. Description of the farm

- ❑ Do you have an accurate survey or legal description? Is there an USDA/FSA number associated with the farm?
- ❑ Is the rent being charged by "cropland" acres?
- ❑ If so, do you have an accurate survey of the cropland acres? (Who decides what is cropland?)

2. Length of the lease

- ❑ Is this an annual lease?
- ❑ Multi-year lease?
- ❑ Does the tenant have the right to renew the lease?

Note that leases involving permanent crops are often for longer terms (tied to the growth cycle of the permanent crops); leases involving row crops or pastureland are often one year in length.

Practice tip: In order to make a farmland development arrangement economically viable for permanent crop tenants, lease arrangements often have terms that address the timeline necessary to plant the crops and install any initial irrigation infrastructure. Further, depending on the type of crop, the lease term will correspond to the viable life of the crop (noting that certain permanent crops have harvest lives ranging from 25 to 50 years). Extension rights allow a tenant to continue to harvest should the orchard or vineyard continue viability beyond the initial contemplated life of the crop.

3. Land use

- ❑ Is the tenant required to submit a cropping plan? Does the landlord have approval rights over the cropping plan?
- ❑ Also, is the tenant required to maintain a fertilizer plan to address soil fertility?
- ❑ Does the landlord require conservation or low-till practices?
- ❑ Farming on the contour?

Practice tip: Similar to a commercial ground lease, a ground lease will provide for permitted (or prohibited) uses. A farm lease may restrict types of crops (e.g., no cannabis, wine grapes, or tobacco); alternately, it may allow a type of crop (e.g., any orchard crop; any row crops).

4. Rent

- ❑ Is this a cash rent lease, in which the landlord gets paid once or twice a year (usually on a dollar/acre basis)?

- ❑ Is this a flex rent lease, where the landlord may receive rent tied to certain yield factors or other performance metrics?
- ❑ Is this a crop-share lease, where the landlord is to receive rent in the form of crops?
- ❑ If this is a crop-share lease, consider how to detail the various cost obligations for both parties (and the resulting percentage of crop that is to be shared by each party following harvest); also consider if the tenant is to deliver the landlord's crop to a certain grain elevator or produce facility in performance of "paying" its rent obligation.

5. Grain bins, storage buildings, and other structures

- ❑ Does the leased premises include any storage facilities, grain bins, shops, or other buildings?
- ❑ If so, what obligation does the tenant (or landlord) have to maintain these buildings?

With respect to grain bins, these have specific safety concerns and may warrant a separate lease specific to the tenant's maintenance and operation obligations.

- ❑ Consider whether or not the tenant may be allowed to store its crop on a short-term basis following harvest (even after the term of the lease expires, perhaps on a license).
- ❑ Consider, further, whether a new tenant has to accommodate a prior tenant's right to store crops following harvest (usually for a short time frame).

Finally, if the grain bins (or other buildings) are not included in the farm lease, make sure to carve those out of the legal description. Be mindful that any residential structure on the property should be separately leased (co-terminus with the farm lease), to provide for residential landlord/tenant provisions.

6. Operator duties and obligations

Here is a sample provision setting forth tenant obligations or duties during the term:

Tenant shall:

1. Operate the Property in an efficient and workmanlike manner, and cultivate and maintain the Property at all times in accordance with practices of good husbandry generally common to farming operations of this type, and possess at Tenant's expense the essential farming machinery needed to plant and harvest the Property.
2. Control weeds in fields, fencerows, road ditches, building lots, and all areas of the Property by mowing or spraying and do all things reasonably necessary to prevent the introduction of any noxious or undesirable weeds.
3. Protect all desirable vegetation, such as grass, field borders, grass waterways, shrubs, and trees; also not to plow or otherwise disturb pastureland or permanent vegetation without the written consent of Landlord.
4. Keep the Property in a neat and tidy condition and in as good condition as reasonable use will permit.
5. Not commit waste nor permit waste to occur to or on the Property.
6. Perform labor necessary in making minor repairs and improvements.
7. Perform labor necessary to maintain and repair fences at the direction of Landlord.
8. Remove no forage or crop residues, including straw and stalks, grown on the Property, nor sell or burn it except by written permission of Landlord.
9. Assist with erosion control and maintenance and establishment of grass waterways, including not plowing or disking through grass waterways or other low places that would permit open ditches eroding across fields.
10. Not permit the obstruction of drainage ditches or watercourses.
11. Incur no expense for or on account of Landlord without first obtaining Landlord's written consent.

12. Permit no livestock to trample soft fields or allow no hogs to root in fields or lots.
13. Investigate broken or inoperative tile and report same to Landlord. Provide labor for minor repairs to broken tile and keep intakes and outlets open.
14. In the event of damage to crops, buildings, or improvements by any natural or man-made disaster, notify Landlord by telephone or in writing within 24 hours of Tenant's knowledge of such damage.
15. Not store any fertilizer, pesticide, or other hazardous substance on the Property except in compliance with all applicable laws and regulations and in an amount not to exceed that contemplated to be used on the Property.
16. Not dump, abandon, or bury any chemicals, trash, containers, or machinery on the Property.
17. Not erect or permit to be erected any structure, sign, well/pump, or building.
18. Not add electrical wiring, plumbing, or heating to any building.
19. Not reside, or permit or encourage any other person to reside on any portion of the Property (except as otherwise provided in a separate written rental agreement, entered into between Landlord and such resident).
20. Not engage in any trade or business, or permit any other person to engage in any trade or business on the Property, other than farming and related activities.
21. Not cut or harvest trees without Landlord's prior written approval.
22. Not suffer, permit, encourage, and/or invite any other person to use any part or all of the Property for any purpose or activity not directly related to its use for agricultural production.
23. Not house or store vehicles on the Property.
24. Comply, and cause all Tenant's employees, agents and contractors to comply, with all local, state, and federal laws and regulations in the use and operation of the Property, including those pertaining to groundwater contamination and agricultural chemical, pesticide, petroleum and/or hazardous waste storage or disposal and to follow label directions in the handling and application of all chemicals used on the Property.
25. Pay all electrical bills, and any other utility bills payable due to Tenant's activities on the Property.
26. Not take any action that might cause a mechanics' lien or other lien to be imposed on the Property.
27. Control rats and other rodents in and around buildings by baiting.
28. Not permit or cause any nuisance to exist on the Property.
29. Read, understand, and follow the stewardship requirements, including applicable refuge requirements for insect resistance management, for the biotechnology traits expressed in the seed planted on the Property.
30. Except as otherwise specifically provided herein, have sole responsibility for all costs associated with the farming operation on the Property including, but not limited to, all labor, machinery, and operating expenses necessary to properly plant, cultivate, grow, irrigate, harvest, store, and market crops on the Property.

7. Government programs

- ❑ Does the tenant have the option to participate in various government farming programs?
- ❑ Can the landlord require the tenant to participate in certain programs (for example, programs that promote certain conservation or environmental concerns)?
- ❑ Finally, is the farm enrolled in certain programs that require the tenant to conduct its farming operations in a certain way (or risk causing the landlord to lose program qualifications)? For example, certain programs create acreage bases or set-aside areas that affect long-term crop planning for the applicable farm.

Practice tip: Consider whether the tenant is planning to raise cannabis or other regulated crops. In the event the tenant defaults in the lease, then the landlord has a crop on the property that cannot be cultivated without a legal license. These licenses generally are not transferable; the landlord cannot simply continue the cultivation and harvest of the regulated crop.

8. GPS/yield input and data

- ❑ Does the landlord have the right to require the tenant to use precision agricultural practices?
- ❑ Does the tenant have to share that data with the landlord?
- ❑ Is the tenant allowed some control on the sharing and dissemination of the data? For example, can the landlord share that data with potential purchasers of the property, to show historic yields and soil conditions?

9. Irrigation

- ❑ Is the property irrigated?
- ❑ If so, make sure to clearly define the maintenance, repair, and replacement obligations for irrigation equipment.
- ❑ Also, state whether the tenant has the right to install its own equipment (and if so, track the equipment by serial number and GPS location should tenant have the right to remove post-term; otherwise, it will be hard to segregate the landowner's equipment from the tenant's equipment).

Finally, if this is a term for years (perhaps for permanent crops), consider how capital improvements are to be shared by the parties:

- ❑ Does the tenant pay a portion of the cost for any new wells or irrigation systems?
- ❑ Is the landlord obligated to make certain capital expenditures during the lease term?

Also, if the property obtains water from a water district, irrigation company, or other third party, consider whether:

- ❑ The "utility" cost for the water is to be paid directly by the landlord (presumably recovered in the cost of the rent) or is to be paid by the tenant;
- ❑ If the tenant pays, make sure to address the landlord's cure rights for any non-payment (to preserve its water rights and good standing with the water district).

10. Natural resources

- ❑ The landlord should consider disclaiming any guaranty of a continuous or adequate water supply.
- ❑ Also, the landlord should address any third-party mineral operators (and provide that the tenant will cooperate with any surface use terms or agreements); consider also having the landlord expressly exclude any mineral rights from the leasehold interest.

Finally, given that many farms often provide hunting, fishing, or other recreational opportunities:

- ❑ The landlord should clearly state whether the tenant has such hunting, fishing, or other recreational rights (including camping);
- ❑ If not, then the landlord should expressly exclude those activities from the lease.
- ❑ If the landlord elects to separately enter into hunting or fishing leases with third parties, address the rights of access for those third parties in the farm lease (i.e., shared road, non-exclusive rights to use surface water ponds or lakes, etc.).

11. Landlord's lien

In many states, landlords have a statutory lien right over tenant crops. This lien right acts as security for rent (and in certain states, security for other tenant acts or obligations). Additionally, landlords may

elect to file UCC liens with respect to their interest in tenant's proceeds from the sale of crops grown on the farm.

- ❑ The farm lease should reference landlord's security interest and right to lien.

Practice tip: In order for a tenant to get financing for its improvements (crops, irrigation infrastructure, etc.), the tenant will likely need to obtain financing. It is not uncommon for tenants to ask landlords to subordinate their landlord lien in the crops; also, for longer-term leases, for landlords to allow the tenant to obtain leasehold mortgages.

12. End of term

Consider what rights (or obligations) the tenant has to remove improvements made to the farm.

- ❑ For example, certain permanent crops such as grapevines will have structures and supports; if the lease ends prior to the end of the life-cycle for certain permanent plantings, the landlord will likely want the tenant to leave the support structures in place for the next operator.
- ❑ The lease should also address whether the tenant will get any credit or refund for soil inputs or amendments that have a carry-over effect into the season (or seasons) following the end of the lease term.
- ❑ For example, will the tenant get any refund for fertilizer carry over at the end of the term?
- ❑ Will the tenant get credit for lime application (if so, is there a rate of reimbursement that accounts for the rate of depletion during the term of the lease)?

Practice tip: If the landlord is planning to develop the land for commercial (non-agricultural) use, then the landlord should consider how to protect the long term value of the property once it ceases farmland production. For example, consider whether the tenant should be required to remove any underground irrigation infrastructure; alternately, consider whether the tenant should be required to install sleeves over the irrigation pipelines that would allow for roadways over the pipeline. Also, for any pipelines that may be abandoned or left in place, consider a minimum depth to have the pipes installed (to allow for later surface development).

THE FIRST QUARTER OF 2021 IS OVER: WHERE ARE WE IN NEW YORK?

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Like every other aspect of life in New York over the past year, real property leasing, lending, and sales have been turned upside-down by the Covid-19 pandemic. Countless tenants and property owners have failed to pay full rent or mortgage payments, but have been protected from immediate dispossession through at least August 31, 2021 by a combination of executive orders and legislation.[1] While trials have resumed in New York City, a growing backload of foreclosures and evictions continue to be held in abeyance.[2] Many offices and commercial establishments that emptied out as a result of closure orders, job losses, work-from-home arrangements and rising vacancy rates, raised questions about lasting changes to New York's office stock and streetscapes.[3] Commercial real estate lawyers are anxiously wondering what the coming months will hold in store. This article will briefly examine some recent developments on the legislative and litigation fronts that may be consequential for the commercial real estate law bar.

On the legislative front, as of this writing, the Governor has signed a $212 billion budget bill for the 2022 fiscal year (the "2022 budget").[4] This budget, criticized by some as a "tax-and-spend boondoggle,"[5] nevertheless failed to implement several measures that had been dreaded in many real estate circles:

- First, the 2022 budget does not include the so-called mezzanine recording tax. This tax, the latest incarnation of which was introduced

in the State legislature earlier this year,[6] would create a new section 291-k of the Real Property Law that would require the recording of a mezzanine loan or preferred equity investment (in the latter case, if there is a special, preferred or accelerated rate of return) concurrently with the recording of a mortgage on the subject real property located in New York. This legislation would also require the payment of a mortgage recording tax (on the amount of the loan or investment) at the same rate as applicable to the recording of a mortgage on the property (under a new proposed section 253(4) of the Tax Law). Failure to record and pay the tax may mean that the lender would not have a perfected security interest and would not have the right to enforce its lien on the collateral (under UCC section 9-601(h)). The mezzanine recording tax, in its current and former iterations, has been widely criticized as unworkable by the real estate law bar, and fiercely opposed by industry groups.[7]

- The 2022 budget also left out an extension and increase to the state capital base tax which had been inadvertently included in the Senate and Assembly budget proposals.[8]
- Also omitted was the pied-a-terre tax, which had been included in the original Senate and Assembly budget proposals. Such a tax, under consideration for at least seven years, had been advancing in Albany earlier this year.[9]
- Notably, the 2022 budget also failed to pick up a new short-term rental sales tax requirement that was included in Governor Cuomo's executive budget proposal.[10] The proposal was opposed by Mayor DeBlasio and others on the basis that it would legitimize activity that is currently illegal under the Multiple Dwelling Law.[11]

Nonetheless, the 2022 budget increases income tax rates, even in the face of better-than-expected revenues from tax collections and federal aid.[12] Given the State legislature's current inclination to increase tax revenues, the real estate industry's collective sigh of relief as to the absence of the above-described taxes from the budget could very well prove fleeting.

In Albany, other legislation is in the works to address rising commercial vacancy rates. The Housing Our Neighbors with Dignity Act, in committee in both the Senate and Assembly, would permit building owners to sell their properties to the State with the purchase price being funded with federal monies, and the State would then operate them as affordable housing managed by housing nonprofits and similar organizations.[13] The 2022 budget did not include anything close to what is proposed in this bill, but did include $100 million in funding for an Adaptive Reuse Affordable Housing Program, the monies for which will not be used until a program for buying and converting distressed commercial properties in New York City is established.[14] How the program will ultimately be structured (if at all) remains to be seen.

Other recent proposed legislation has been aimed at helping small businesses affected by the pandemic. The Save our Storefronts Act, introduced in the summer of 2020, would reduce the rent of qualifying small business tenants to the lesser of 20 percent of actual income or one-third of the contractual rent.[15] Other legislation would be aimed at limiting defaulting commercial tenants' liability by requiring landlords to mitigate damages.[16] In New York City, in coming months, we may very well see increasing calls[17] to enact the Small Business Jobs Survival Act [18] and/or the so-called Commercial Rent Stabilization Act,[19] which have been referred to, individually and collectively, as commercial rent control (approvingly or derisively, depending on the speaker). [20]

On the practical side, a bill pending in Albany would authorize the use of video and audio conference technology to identify individuals for electronic notarization.[21] This legislation would, in effect, make permanent some temporary measures implemented during the pandemic. This bill is still in committee in the Assembly, but it has passed in the Senate. Federal legislation permitting remote and electronic notarization (the Securing and Enabling Commerce Using Remote and Electronic (SECURE) Notarization Act of 2020) is also pending in Washington, D.C.[22] All such legislation is being closely monitored by title insurance companies and other interested constituents.

Shifting now to litigation, the proverbial elephant in the room is, of course, the deluge of eviction and foreclosure actions that is expected after the expiration of the moratoria.[23] It remains to be seen to what extent the substantial federal and state aid expected to be made available to affected tenants and owners will ultimately protect these individuals and entities from dispossession, money judgments, and lasting negative credit consequences.

Over the past year, tenants, licensees, purchasers, and other parties adversely affected by the pandemic have sought relief from their performance obligations through the doctrines of force majeure, impossibility of performance, frustration of purpose, failure of consideration, constructive eviction, and even on the basis that the pandemic constitutes a casualty event or regulatory taking. To date, these efforts have met with limited success in the federal and state courts.[24] However, there is presently scant guidance from the courts as to the impact of these doctrines on loan enforcement proceedings, and little to no guidance at the appellate level as to their applicability in any context. As time goes on, the Appellate Divisions and other appellate courts may have the opportunity to adjudicate these issues, and clearer parameters for the applicability of these doctrines may emerge.

In recent months, we have also seen the resolution of legal challenges to legislation enacted by the New York City Council in 2020 to ameliorate the effect of the pandemic on commercial and residential tenants and lease guarantors. [25] In November 2020, in Melendez v. City of New York, [26] the Southern District of New York rejected the constitutional challenges to Local Laws No. 56-2020, No. 53-2020, and No. 55-2020, a suite of legislation passed by the City Council in May, 2020 prohibiting landlords from harassing "person[s] impacted by COVID-19" out of their lawfully occupied space, and permanently limiting the ability of commercial landlords to enforce "personal guaranties" by natural persons of payments accrued between March 7, 2020 and June 30, 2021 contained in leases with certain tenants (the "guaranty law").[27] An appeal is pending in the Second Circuit. Still unresolved is the question of whether the courts will interpret the guaranty law to limit the enforcement of standalone guaranties which are not, strictly speaking, in "a commercial lease or other rental agreement."[28] In January 2021, the Supreme Court of New York County permitted Saks, Inc.'s landlord to enforce a lease guaranty, confirming that the 2020 Local Law does not limit a landlord's remedies against non-natural person guarantors.[29]

Any discussion of Covid-19-related real estate litigation would be incomplete without saying a word about the wealth of disputes between property owners, lessors, and their insurers about whether or not commercial property policies (including business interruption and civil authority coverages contained therein) cover pandemic-related losses. The defenses to such coverage raised by insurers have included the requirement of direct physical loss and, if applicable, virus exclusions.[30] Insurers' incentives to settle pandemic-related claims may grow in view of legislation pending in the at the state[31] and federal[32] levels which, if passed, would require certain pandemic-related perils to be covered under business interruption policies or would reimburse insurers for voluntary payments of pandemic-related losses. These pandemic-related insurance suits may be consolidated or continue to be litigated separately.[33] Also under consideration is the Pandemic Risk Insurance Act of 2020,[34] which, using an approach analogous to the Terrorism Risk Insurance Act of 2002,[35] would create a federal Pandemic Risk Insurance Program providing coverage to insurers that incur losses as a result of coverage related to pandemics and the outbreaks of disease on or after January 1, 2021.

In light of the moratoria on the commencement of commercial mortgage foreclosure actions, lenders are exploring other potential remedies. One that has been utilized is an action (and application therein, albeit on notice) for the appointment of a receiver for the mortgaged property pursuant to Article 64 of the Civil Practice Law and Rules.[36] There are many implications (including the impact of New York's election of remedies) that must be considered before a lender may invoke this remedy. In a

recent federal case, the court appointed a receiver for the income-producing mortgaged property, in the absence of a mortgage foreclosure action, concluding "the elimination of rental income is a direct impairment of the lender's collateral."[37] In addition, mezzanine lenders may proceed with UCC foreclosures notwithstanding the moratoria;[38] however, establishing the commercial reasonableness of such sales during a pandemic may be complicated. [39]

Lastly, and perhaps overshadowed by the Covid-19 emergency, is 2019's Climate Mobilization Act,[40] which deals with greenhouse gas emissions mitigation, adaptation, and finance. Notably, the 2022 budget failed to include a so-called climate law workaround for which many in the real estate industry had lobbied and which had been included in Governor Cuomo's executive budget.[41] While the January 1, 2024 compliance date is less than two years away, building owners claiming "adjustments" to the emissions limitations had to do so by July 1, 2021.[42] Affected real estate owners and their advisors should promptly access the Act and navigate its compliance requirements as best they can. While comprehensive rules are not yet in place, there is a wealth of law firm client advisories, webinars, and continuing legal education programs that may help provide guidance. Owners, users, and their respective legal counsel will need to negotiate compliance cost allocations. Environmental experts, construction companies, and related consultants will need to be enlisted to help guide compliance. Brokers and bankers will need to evaluate how the Act will affect both the future value of real estate and its cash flows. Regulators will need to fill in any remaining gaps in the Act.

Covid-19 has changed our world, including real estate in New York. The extent to which its effects will continue to be felt in years to come remains to be seen. Much will depend on epidemiology (including the emergence of variants and long-term efficacy of vaccines), economics (overall economic growth and the effect of stimulus monies), changes in work habits (less reliance on use of physical office space), and politics (in particular, the outcome of the gubernatorial election on November 8, 2022 and, in New York City, the mayoral election on November 2, 2021).

Notes

1 See N.Y. Exec. Order No. 202 (Mar. 7, 2020) (the Executive Order; together with its successors, collectively, the Executive Orders). The moratoria on commercial evictions, foreclosures and tax sales previously mandated by the Executive Orders were codified in a modified form on March 9, 2021 in the COVID-19 Emergency Protect Our Small Businesses Act of 2021, Assemb. B. 3207, 2021-2022 Leg. Sess. (N.Y. 2021); S.B. 471-A, 2021-2022 Leg. Sess. (N.Y. 2021), as extended by Assemb. B. A7175-A, 2021-22 Leg. Sess. (N.Y. 2021); S.B. S6362-A, 2021-22 Leg. Sess. (N.Y. 2021). It establishes hardship declarations for owners of commercial real property and a temporary stay.

Currently, small businesses with 50 employees or less are eligible for the eviction moratorium, and properties of 10 units or less are eligible for the foreclosure moratorium. It seems possible that these protections will be expanded to include additional business owners and landlords suffering financial hardship in the coming months. See Press Release, Andrew Cuomo, Governor, New York State, Governor Signs the COVID-19 Emergency Protect Our Small Businesses Act of 2021 Establishing Eviction and Foreclosure Protections for Small Business (Mar. 9, 2021), https://www.governor.ny.gov/news/governor-cuomo-signs-covid-19-emergency-protect-our-small-businesses-act-2021-establishing.

Since the pandemic began, residential tenants and mortgagors have been protected from dispossession by operation of the Executive Orders and, since December 28, 2020, the COVID-19 Emergency Eviction and Foreclosure Prevention Act of 2020, Assemb. B. 11181, 2019-2020 Leg. Sess. (N.Y. 2020); S.B. 9114, 2019-2020 Leg. Sess. (N.Y. 2020). This enactment stays all evictions for residential tenants experiencing a financial hardship due to COVID-19 until August 31, 2021. See also Coronavirus Aid, Relief, and Economic Security Act of 2020. Pub. L. No. 116-136, 134; Temporary Halt in Residential Evictions to Prevent the Further Spread of COVID-19, 85 Fed. Reg. 55,292 (Sept. 4, 2020), as extended by Consolidated Appropriations Act of 2021, Pub. L. No. 116-260, § 502, as further extended by Temporary Halt in Residential Evictions to Prevent the Further Spread of COVID-19, 86 Fed. Reg. 8,020, 8,021 (Feb. 3, 2021).

2 See Coronavirus and the New York State Courts, https://www.nycourts.gov/covid-archive.shtml (last visited Mar. 10, 2021); Eviction Moratoria and Courthouse Operations, N.Y.C. Mayor's Office to Protect Tenants, https://www1.nyc.gov/content/tenantresourceportal/pages/eviction-moratorium-and-courthouse-closures (last visited Mar. 18, 2021); Will Parker, New York Renters Owe More Than $1 Billion in Unpaid Rent, Survey Finds, Wall St. J. (Jan.

14, 2021), https://www.wsj.com/articles/new-york-city-renters-owe-more-than-1-billion-in-unpaid-rent-survey-finds-11610622000.

3 See, e.g., Matthew Haag, Remote Work is Here to Stay. Manhattan May Never Be the Same, N.Y. Times (March 29, 2021), https://www.nytimes.com/2021/03/29/nyregion/remote-work-coronavirus-pandemic.html.

4 The 2022 budget is embodied in more than 10 bills passed in each legislative chamber, all of which are available at https://www.budget.ny.gov/pubs/archive/fy22/#en.

The 2022 budget was signed by the Governor on April 19, 2021. Press Release, Governor Andrew M. Cuomo, Governor Cuomo Signs FY 2022 Budget and Announces Continuation of Middle-Class Tax Cuts to Help New Yorkers Recover from Economic Hardship During the COVID-19 Pandemic (April 19, 2021), https://www.governor.ny.gov/news/governor-cuomo-signs-fy-2022-budget-and-announces-continuation-middle-class-tax-cuts-help-new.

5 See Press Release, New York Republican State Committee, Statement from NYGOP Chairman Nick Langworthy on the 2022 State Budget (April 7, 2021), https://nygop.org/statement-from-nygop-chairman-nick-langworthy-on-the-2022-state-budget/.

6 Assemb. B. A3139, 2020-2021 Leg. Sess. (N.Y. 2021); S.B. S3074, 2020-2021 Leg. Sess. (N.Y. 2021). This legislation is a new version of legislation introduced in 2020. See Assemb. B. 9041-A, 2019-2020 Leg. Sess. (N.Y. 2020); S.B. 7231-A, 2019-2020 Leg. Sess. (N.Y. 2020).

7 See, e.g., Meghan O'Reilly and Rachel M. Orbach, Potential Implications of Proposed Mezzanine Tax: Consequences for Lenders and Developers (January 2020), https://www.herrick.com/publications/potential-implications-of-proposed-mezzanine-tax-consequences-for-lenders-and-developers/.

8 See Erin Hudson, Legislators Accidentally Propose Huge Tax Hike for Co-ops, The Real Deal (Mar. 26. 2021), https://therealdeal.com/2021/03/26/legislators-accidentally-propose-huge-tax-hike-for-co-ops/

9 Assemb. B. 9041-A, 2021-2022 Leg. Sess. (N.Y. 2021); S.B. 4199, 2021-2022 Leg. Sess. (N.Y. 2021).

10 See Jimmy Vielkind, Cuomo Proposes Airbnb Collect Sales Tax on New York Stays, Wall St. J. (Jan. 25, 2021), https://www.wsj.com/articles/cuomo-proposes-airbnb-collect-sales-tax-on-new-york-stays-11611579661.

11 See MDL § 4(8)(a). See also Ryan Deffenbaugh, Lawmakers Fear Trojan Horse in Cuomo's Airbnb Tax Proposal, Crain's N.Y. Bus. (Mar. 18, 2021), https://www.crainsnewyork.com/hospitality-tourism/lawmakers-fear-trojan-horse-cuomos-airbnb-tax-proposal.

12 See Carl Campanile, COVID Stimulus Eliminates Need for NY Tax Hikes, Experts Say, N.Y. Post (Mar. 10, 2021), https://nypost.com/2021/03/10/covid-19-stimulus-eliminates-need-for-ny-tax-hikes-expert-says/.

13 Assemb. B. 6593, 2021-2022 Leg. Sess. (N.Y. 2021); S.B. 5257, 2021-2022 Leg. Sess. (N.Y. 2021); See Katie Honan, New York Could Turn Hotels, Office Buildings Into Affordable Housing Under State Senate Bill, Wall St. J. (Mar. 2, 2021), https://www.wsj.com/articles/new-york-could-turn-hotels-office-buildings-into-affordable-housing-under-state-senate-bill-11614723512.

14 See supra note 4.

15 Assemb. B. A-10901, 2019-2020 Leg. Sess. (N.Y. 2020); S.B. 8865, 2019-2020 Leg. Sess. (N.Y. 2020). This legislation would, inter alia, cancel the contractual rent of qualifying small business tenants during the state of emergency to the extent it exceeds the lesser of 20 percent of actual income or 1/3 of the contractual rent, landlords would waive 20 percent of the contractual rent, and an interim commercial rent relief program of up to $500 million of federal monies will be set up to help compensate landlords for the differential. This legislation is a commercial adaptation of the Rent and Mortgage Cancellation Act, proposed earlier in 2020. Assemb. B. A-10826, 2019-2020 Leg. Sess. (N.Y. 2020); S.B. 8802, 2019-2020 Leg. Sess. (N.Y. 2020).

16 Assemb. B. A8482, 2019-2020 Leg. Sess. (N.Y. 2019); S.B. S1129, 2021-2022 Leg. Sess. (N.Y. 2021) (passed by the Assembly and introduced in the Senate in January 2021).

17 In fact, some small business advocates have already renewed their calls for this legislation; See Bridget Bartolini, City's Small Businesses Need Rent Stabilization to Survive COVID-19, Advocates Say, City Limits (Apr. 6, 2020), https://citylimits.org/2020/04/06/citys-small-businesses-need-rent-stabilization-to-survive-covid-19-advocates-say/.

18 N.Y. City Council Int. No. 737A (2018) (would establish conditions and requirements for commercial lease renewals).

19 N.Y. City Council Int. No. 1796 (2019) (would establish conditions and requirements for commercial lease renewals). (would cap annual rent increases for certain commercial tenants at amounts determined by a City Council-appointed board).

20 These bills seek to regulate the commercial landlord-tenant relationship in a manner not seen in over half a century. See N.Y. Unconsol. Laws §§ 8521-38 (Consol. 1945) (expired 1963);

see also N.Y. Unconsol. Laws §§ 8521-67 (Consol. 1945) (expired 1963). We expect that all such legislation will continue to be vociferously opposed, on constitutional and other grounds, by the Real Estate Board of New York and other industry groups.

21 Assemb. B. 4076-B, 2019-2020 Leg. Sess. (N.Y. 2020); S.B. S4352B, 2019-2020 Leg. Sess. (N.Y. 2020).

22 S.B. 3533, 116th Cong. (2020) currently before the Senate Judiciary Committee); H.R. 6364, 116th Cong. (2020) (currently before the House Energy and Commerce and House Judiciary Committees).

23 See supra note 1.

24 Some courts have been persuaded to apply these doctrines excusing performance. See, e.g., In re Hitz Rest. Grp., 616 B.R. 374 (Bankr. N.D. Ill. 2020); Gap, Inc. v. 170 Broadway Retail Owner, LLC, No. 652732/2020 (Sup. Ct., N.Y. Co. Oct. 30, 2020), rev'd on other grounds;

Gap, Inc. v. 44-45 Broadway Leasing Co., LLC, No. 2020-03361 (1st Dep't Feb. 16, 2021);

UMNV 205-207 Newbury, LLC v. Caffé Nero Americas Inc., No. 2084CV01493-BLS2 (Mass. Super. Ct. Feb. 8, 2021) (partial summary judgment order);

188 Ave A Take Out Food Corp. v. Lucky Jab Realty Corp., No. 653967/2020 (Sup. Ct., N.Y. Co. Dec. 21, 2020) (Yellowstone injunction motion).

However, courts seem to reject the applicability of these doctrines in most reported decisions. See, e.g., Martorella v. Rapp, 20 Misc. 000153 (MDV) (Mass. Land Ct. June 1, 2020);

FTC v. A.S. Research, LLC, No. 19-CV-03423-PAB-KMT (D. Colo. July 21, 2020);

Future St. Ltd. v. Big Belly Solar, LLC, No. 20-cv-11020-DJC (D. Mass. July 31, 2020);

Victoria's Secret Stores, LLC v. Herald Sq. Owner LLC, 70 Misc. 3d 1206(A), 136 N.Y.S.3d 697 (Sup. Ct., N.Y. Co. 2020); Lantino v. Clay LLC, No. 1:18-cv-12247 (SDA) (S.D.N.Y. May 8, 2020);

Backal Hosp. Grp. LLC v. 627 W. 42nd Retail LLC, No. 154141/2020 (Sup. Ct., N.Y. Co. Aug. 3, 2020);

BKNY 1, Inc. v. 132 Capulet Holdings, LLC, No. 508647/16, 2020 N.Y. (Sup. Ct., Kings Co. Sept. 23, 2020);

Dr. Smood N.Y. LLC v. Orchard Houston, LLC, No. 652812/2020 (Sup. Ct., N.Y. Co. Sept. 29, 2020);

E. 16th St. Owner LLC v. Union 16 Parking LLC, No. 653839/2020 (Sup. Ct., N.Y. Co. Jan. 15, 2021);

Atlantic Garage Mgmt. LLC v. Boerum Commercial LLC, No. 512250/2020 (Sup. Ct., Kings Co. Dec. 2, 2020);

35 East 75th Street Corporation v. Christian Louboutin L.L.C., No.154883, slip op. (Sup. Ct., N.Y. Co. Dec. 9, 2020).

25 N.Y. City Local Laws Nos. 56-2020, 53-2020, and 55-2020; See also Press Release, N.Y.C. Council, Council Votes to Provide Relief to Small Businesses and Restaurants Impacted by COVID-19 Pandemic (Aug. 27, 2020), https://council.nyc.gov/press/2020/08/27/2012/.

26 Melendez v. City of New York, No. 20-CV-5301 (RA) (S.D.N.Y. Nov. 25, 2020), appeal docketed, No. 20-4238 (2d Cir. Dec. 22, 2020).

27 N.Y. City Local Law No. 55-2020. The prohibition on enforcement originally expired on March 31, 2021, but on March 25, 2021, the date was extended to June 30, 2021. See Natalie Sachmechi, City Council Extends Protections for Small Businesses, Crain's N.Y. Business (March 25, 2021), https://www.crainsnewyork.com/commercial-real-estate/city-council-extends-protections-small-businesses.

28 See Mark S. Edelstein, Jeffrey J. Temple and Bozena Sarsynska, Morrison Foerster Client Alert: NYC Enacts Law Prohibiting Enforcement of Personal Liability Provisions for COVID-19-Impacted Commercial Tenants (May 29, 2020), https://www.mofo.com/resources/insights/200529-nyc-law-personal-liability-covid-commercial-tenants.html.

29 135 East 57th Street, LLC v. Saks Inc., No. 155234/2020 (Sup. Ct., N.Y. Co. Jan. 29, 2021).

30 See, e.g., Soundview Cinemas Inc. v. Great Am. Ins. Grp., No. 605985-20 (Sup. Ct., N.Y. Co. Feb. 8, 2021); Social Life Magazine, Inc. v. Sentinel Insurance Co., Ltd., No. 20 Civ. 3311 (VEC) (S.D.N.Y. May 14, 2020).

31 Assemb. B. A-10226B, 2019-2020 Leg. Sess. (N.Y. 2020).

32 Business Interruption Relief Act of 2020, H.R. 7412, 116th Cong. (introduced on June 29, 2020) (establishes a Business Interruption Relief Program to provide benefits to insurers that choose to join the program and voluntarily pay benefits for Covid-19 related losses).

33 See Storm Wilkins, Commercial Property and Business Interruption Insurance Coverage Issues: The Next COVID-19 Hotspot?, 49 Real Est. Rev. J., no. 1, 2020, at 7.

34 H.R. 7011, 116th Cong. (2020).

35 Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, 116 Stat. 2322 (codified as amended at 15 U.S.C. § 6701 (2002)).

36 CPLR 6401.

37 Wilmington Tr., Nat'l Ass'n v. Winta Asset Mgmt. LLC, No. 20-CV-5309 (JGK) (S.D.N.Y. Sept. 28, 2020).

38 See, e.g., 1248 Associates Mezz II LLC v. 12E48 Mezz II LLC, Index No. 651812/2020 (Sup. Ct., N.Y. Co. May 18, 2020) (order vacating TRO); 893 4th Ave. Lofts LLC v. 5AIF Nutmeg, LLC, 2020-08886, 511942/2020 (2d Dep't Jan. 20, 2021).

39 UCC § 9-610(b) requires that "[e]very aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable." Pandemic-related disruptions have affected courts' assessment of the commercial reasonableness of UCC sales. See D2 Mark LLC v. OREI VI Invests., LLC, Index No. 652259/2020 (Sup. Ct., N.Y. Co. June 23, 2020) ("what is reasonable during normal business times, may not be reasonable during a pandemic").

40 N.Y. City Local Law Nos. 92 and 94–97.

41 The proposed executive budget would have allowed building owners to meet emissions targets by buying credits for renewable energy produced in New York. N.Y. State Div. of the Budget, FY 2022 New York State Executive Budget (2021), https://www.budget.ny.gov/pubs/archive/fy22/ex/artvii/ted-bill.pdf.

42 See Raymond "Rusty" Pomeroy II, Brian Diamond, Karen Scanna, Ross F. Moskowitz and Joseph B. Giminaro, The NYC Climate Mobilization Act: How to Prepare and What You Need to Know, Stroock Special Bulletin (Jan. 16, 2020), https://www.stroock.com/news-and-insights/new-york-city-climate-mobilization-act.

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