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Phone (646) 728-3800

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In Depth

From Canada

California Seeks to Rein In Frivolous ADA Lawsuits

*Matthew P. Seeberger**
Cox, Castle & Nicholson
Los Angeles, CA

On September 19, 2012, California Governor Jerry Brown signed into law Senate Bill 1186 ("SB 1186") to address the situation that many owners and tenants of commercial property have been confronted with for some time—effectively being forced, in order to avoid a costly lawsuit, to pay demands for settlement and "attorney fees" to plaintiffs (and their lawyers) who raise arguably specious allegations under the federal Americans with Disabilities Act ("ADA").

Background

In California, statutory remedies for violations of the ADA have often been used by plaintiffs and their lawyers in a manner that many feel to be abusive and counter to the intent of the law. The facts in these situations have a fairly common theme: An attorney, in some cases a group of attorneys, seeks and sends disabled persons to all forms of retail establishments (and other places of "public accommodation"), both large and small, with the goal of finding violations of the accessibility requirements of the ADA. Even when these violations are minor in nature, such as a mirror being a few inches too high, the attorneys (as concerned representatives of their "plaintiffs") send demand letters stating that their client was denied access and that the property is in violation of the ADA. The typical demand is for $4,000, which represents the minimum fine under the *Unruh Act* (California's civil rights statute) for a single violation, plus an additional demand for attorney fees ranging from $2,000 to $4,000; however, the demands sometimes involved much higher amounts (where, for example, multiple violations were claimed, based on repeated visits to a property).

Unfortunately, in many situations, the actual accessibility issue was not remedied, often because the funds that could have been used to make the property accessible to disabled persons instead went to the plaintiff and its legal counsel.

While most owners and tenants would prefer to fight these demands, it is almost always cheaper to pay than to litigate the claim because violations of the ADA are relatively simple to prove and the litigation is expensive. Since attorney fees are awarded to the prevailing party but not to the defendant, frequently the sound business decision is to make the payment (regardless of how frivolous the claim is) rather than engage in a costly legal action. Small business owners, who often lack either the resources to fight unfair claims or the sophistication as to what the law actually provides, seemed to be particularly vulnerable to these tactics.

This business model became quite lucrative for a number of attorneys, in some cases representing an attorney's entire practice. A few attorneys were so aggressive in pursuing such claims that they were disciplined by the State Bar of California. After years of efforts by a number of interest groups, spearheaded by the California Business Properties Association ("CBPA"), the California State government has stepped in to remedy the worst abuses.

SB 1186

SB 1186 (portions of which go into effect immediately, the remainder of which go into effect as of January 1, 2013) addresses many of these concerns. The legislation itself is lengthy and complex. A brief summary of the most significant changes follows.

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Reduction in Damages. SB 1186 dramatically changed the statutory damages obtainable in a lawsuit for ADA violations. Previously, § 55.56 of the California Civil Code (the "Civil Code") sets forth the circumstances under which damages may be awarded for a construction-related accessibility claim (a "Claim"), defined in Civil Code § 55.3(a)(2) as a claim of violation of a construction-related accessibility standard (a "Standard"), which is defined in Civil Code § 55.52(a)(6) as a provision, standard or regulation under state or federal law requiring compliance with standards for making new construction or existing facilities accessible to disabled persons, requiring that a complainant be denied full and equal access (subsection (a)), which is satisfied if the complainant encountered the violation on a particular occasion or was deterred from access on a particular occasion (subsection (b)). Personally encountering the violation occurs if the plaintiff experienced difficulty, discomfort or embarrassment because of the violation, while deterrence occurs if the plaintiff had actual knowledge of the violation(s) that dissuaded the person from accessing the property (subsection (c)) *and* the plaintiff would have actually been denied full and equal access (subsection (d)). Damages are to be assessed based on each particular occasion that full and equal access was denied, not on the number of violations of Standards identified at the property, although if a property has distinct facilities that offer distinct services, damages may be assessed on each distinct facility where full and equal access is denied (subsection (e)).

SB 1186 revised §55.56 by adding subsections (f) and (h).

(a) Subsection (f), which became effective as of September 19, 2012, but is not retroactive (see subdivision (5)) reduces a defendant's minimum liability for statutory damages under certain circumstances. Subdivision (1) provides some protection for a defendant by reducing the minimum fine for a single violation from $4,000 to $1,000 *if* the defendant can demonstrate (i) that it has corrected all construction-related violations which constituted the basis for a Claim within 60 days of being served with the complaint *and* (ii) one of the following occurred prior to the occasion on which the plaintiff alleges access was denied: (A) that the violation area was inspected by a Certified Access Specialist (referred to as a "CASp") and met the applicable standards for accessibility, and to the best of the defendant's knowledge no changes had been completed or commenced after such inspection that would have affected compliance; (B) that the violation area was inspected by a CASp but the determination of accessibility is pending and the defendant either implemented reasonable measures to correct the alleged violation or was in the process of doing so; (C) if the Claim is filed prior to January 1, 2018, that the violation area was new construction or an improvement approved by, and which passed inspection by, the local building department on or after January 1, 2008, and before January 1, 2016, and to the best of the defendant's knowledge no changes had been completed or commenced after such inspection that would have impacted compliance; or (D) the violation area was new construction or an improvement approved by, and which passed inspection by, a local building department official who is also a CASp, and to the best of the defendant's knowledge no changes had been completed or commenced after such inspection that would have impacted compliance.

In a similar vein, subsection (f)(2) provides some protection for small businesses by reducing the minimum statutory damages from $4,000 to $2,000 if the defendant demonstrates that (i) it has corrected all construction-related violations which constituted the basis for a Claim within 30 days of being served with the complaint *and* (ii) it is a small business (A) employing fewer than 25 employees on average and (B) averaging less than $3,500,000 (subject to adjustment for the California Consumer Price Index) in annual gross receipts, in each case for the prior three years (or less, if the defendant has not been in business for three years).

Note that § 55.56(f)'s reductions in damages do not apply where the violation is intentional (subsection (f)(3)), nor does § 55.56(f) affect the awarding of actual damages or treble actual damages (subsection (f)(4)).

(b) Section 55.56(h), which became effective on September 19, 2012, provides that in assessing liability under § 55.56(d) where multiple Claims are alleged for the same construction-related accessibility violation based on different occasions, a court shall consider the reasonableness of the plaintiff's conduct in light of the plaintiff's obligation, if any, to mitigate damages. This is in response to the tactic of sending plaintiffs back to the same property on more than one occasion and claiming denial of accessibility on each visit, sometimes on the same day, creating multiple claims for violations under the ADA (this is referred to as "stacking"). Thus, after reviewing the facts of a particular Claim, a court may rule that multiple claimed violations encountered on the same day or on separate visits be considered a single violation, such as where a plaintiff repeatedly visits a restaurant that the plaintiff claims violates the ADA. (One of the most egregious examples involved a plaintiff who asserted 30 violations at the same property over a period of less than 30 days, and then sought $120,000 in statutory damages.) If the plaintiff encountered a violation on the first visit, any visits thereafter are not necessary (no one has to eat at the same restaurant), and could have been avoided, thus mitigating damages. However, SB 1186 specifically states that § 55.31(h) does not mean that such behavior is automatically excessive, since if the plaintiff had a reasonable explanation for multiple visits where there is a known barrier, which constituted the basis for claims for repeated violations may be appropriate, such as where a disabled person has to attend medical appointments on a regular basis at the same doctor's or therapist's office.

Based on the foregoing, there are three ways to obtain the benefit of SB 1186's reductions in minimum statutory damages: (1) Having the property inspected by a CASp; (2) a small business, or until January 1, 2018; (3) Having completed construction of the alleged violation area after January 1, 2008, which was approved by, and which passed inspection by, the local building department. However, § 55.53(f) states that neither a property owner nor a tenant is required to hire a CASp, and that the failure to hire one is not admissible to prove lack of intent to comply with the law.

Qualified Defendant. A major feature of SB 1186 was its extensive amendments to Civil Code § 55.54 regarding post-filing rights of defendants who have been served with a summons and complaint regarding a Claim, which amendments became effective as of September 19, 2012. SB 1186 added to the definition of a "qualified defendant" a party who meets the criteria set forth in Civil Code § 55.56(f)(1)(B), (C) or (D) or (f)(2). (See discussion above regarding these provisions under the "Reduction in Damages" heading of this article.) Being classified as a qualified defendant entitles such defendant to apply for (i) an immediate 90-day stay of the action (subject to extensions not to exceed an additional 90 days) (unless the plaintiff has filed a temporary restraining order) and (ii) an early evaluation conference to be held within 70 days after filing the application (existing law [§ 55.52(a)(8)] had limited qualified defendant status to one whose property had been inspected by a CASp). In addition, attorneys must, concurrently with the service of the complaint, give such defendants an advisory regarding their rights under § 55.56 (similar to the advisory in a demand letter). If a defendant decides to apply for a stay and conference, SB 1186 requires the defendant to follow certain procedures, including a signed declaration stating the reasons the defendant is entitled to the stay and conference. Note, though, that SB 1186 is not retroactive, and thus does not apply to demands for money sent or complaints filed prior to September 19, 2012 (see Civil Code § 55.54(o)).

Even though a defendant may not qualify for an early evaluation conference or choose not to seek one, SB 1186 added § 55.545 to the Civil Code, which will become effective as of January 1, 2013, and which allows any defendant to seek a mandatory evaluation conference regarding any Claims. If a defendant does not do so, § 55.545 also allows the plaintiff to request a mandatory evaluation conference. If a mandatory evaluation conference is requested, it must be held no later than 180 days after the date of the request or application, and no earlier than 120 days after the filing of the request or application.

Owner/Lessor Responsibilities. An important provision of SB 1186 is the addition of § 1938 to the Civil Code, which requires an owner or lessor of real property to state, in every lease form or rental agreement executed on or after July 1, 2013, whether the property being leased or rented has undergone an inspection by a CASp and, if so, whether the property has or has not been determined to meet all applicable construction-related accessibility standards pursuant to § 55.53 of the Civil Code. (Property owners and lessors are also nominally affected by SB 1186's adding § 4467 to the California Government Code (the "Govt. Code"), which provides that during the period commencing January 1, 2014, and ending December 31, 2018, any new or renewal applicant for a local business license or equivalent instrument or permit must pay an additional $1 to the city or county to help fund local CASp services, oversee the CASp program, and reduce costs of CASp testing and certification.)

Demands. Prior to SB 1186, California law allowed an attorney to send a written document, referred to as a "demand for money," to an owner or tenant, or its agent or employee, containing a request for money based on one or more construction-related disability claims, whether or not the attorney intended to file, or eventually filed, a complaint. This was intended to open a dialogue between an owner or a tenant, on the one hand, and a disabled person who believed that he or she had been denied access in violation of the ADA, on the other hand, to work out a resolution without resorting to the courts. However, it has frequently been used as a threat to make sizable damage claims in a lawsuit while offering to forego litigation if the owner or tenant agrees to pay a lesser sum in lieu of a complaint being filed.

The distinction is one of the critical aspects of SB 1186, as discussed below.

SB 1186 added § 55.31 to the Civil Code, which will become effective as of January 1, 2013, to specifically address pre-litigation demands. Subsection (c) prohibits an attorney, or a person acting at the direction of an attorney, from sending a demand for money. Now, only "demand letters" are permitted, which subsection (b) provides may offer pre-litigation settlement negotiations, but shall not include a request or demand for money or an offer or agreement to accept money. Instead, the demand letter can only state that the owner or tenant may be liable for damages for a violation of a construction-related accessibility requirement. Significantly, since SB 1186 includes oral statements in the definition of a demand for money, a telephone call or an in-person conversation could constitute a violation of § 55.31(c). However, § 55.31(d)(1) provides that if—following a demand letter—the owner or tenant, or its *authorized* agent or employee, requests a settlement figure or specification of damages, an attorney may present such information.

Note, however, that § 55.31(c) does not (i) apply to pre-litigation settlement discussion of liability for damages and attorney fees occurring after a written or oral agreement is reached between the parties for correction of the alleged violation(s) of a Standard (§ 55.31(e)) or (ii) a claim involving physical injury and resulting special damages (§ 55.31(f)). In addition, § 55.31(d)(1) provides that a violation of either § 55.31(b) or (c) may constitute cause for imposition of discipline on an attorney (see the "Attorney Conduct" heading of this article, below, for additional discussion).

Section 55.31(a) provides that a demand letter must state facts that are sufficient to allow a reasonable person to identify the basis of the violation supporting the Claim, including all of the following: (1) a plain language explanation of the specific access barrier the complainant encountered, or by which he or she was deterred, with information about the location of the barrier to identify it; (2) how the barrier interfered with the complainant's access, or how it deterred the complainant, on each occasion; and (3) the date of each occasion. These requirements are also set forth in California Code of Civil Procedure § 425.50, which SB 1186 added, to be effective as of January 1, 2013, which governs allegations of Claims in a complaint, and which in subsection (b) thereof provides that any lawsuit alleging a Claim must be verified by the plaintiff. SB 1186's legislative history states that two of the primary purposes of these provisions are to (i) deter the use of form demand letters and complaints by attorneys, who often would use the same form for many different types of Claims without identifying the alleged violation, and thus not having to spend time on due diligence regarding the alleged violations (these attorneys' offices were sometimes referred to as "ADA mills") and (ii) to prevent "stacking" (see discussion in part (b) or under the "Reduction in Damages" heading of this article regarding Civil Code § 55.56(h)).

Attorney Conduct. With respect to the role of attorneys in this process, SB 1186 added § 55.32 to the Civil Code, which will become effective as of January 1, 2013 (and which will be slightly revised as of January 1, 2016, as discussed below), which sets forth certain obligations of an attorney who sends a demand letter or serves a complaint. Subsection (a) requires such attorney to include his or her California State Bar license number in the demand letter and, within five business days after sending the letter or serving the complaint, to send a copy of the letter or complaint to the California Commission on Disability Access and, until December 31, 2015, to the State Bar of California's Professional Competence section. Note that § 55.32(h) (to be 55.32(i) as of January 1, 2016) exempts from § 55.32 demand letters and complaints sent or filed by an attorney employed or retained by a qualified legal services project or a qualified support center (both as defined in the California Business & Professions Code § 6213).

SB 1186 further addressed the impact of an attorney's violation of some of the foregoing provisions, adding § 6106.2(b) to the California Business & Professions Code, which commencing as of January 1, 2013, makes it cause for imposition of discipline if an attorney violates (i) § 55.31(b) or (c) of the Civil Code (which govern the content of demands [—see discussion of § 55.31(d)(1) at the end of the third paragraph under the "Demands" heading of this article) or (ii) § 55.32(a)(3), 55.32(b) or 55.32(c) (as 55.32(c) relates to § 55.32(a)(2)) (such subsections require an attorney who provides a demand letter or serves a complaint to send a copy of the letter or complaint to the California Commission on Disability Access and the State Bar of California) (as noted above, § 55.32(c), as it relates to § 55.32(a)(2) [which requires an attorney to send a copy of a demand letter to the state bar association] will cease to be effective as of January 1, 2016).

Note that § 55.32(d) states that copies of subsequent demand letters or amended complaints need not be sent regarding the same dispute following the initial demand letter or complaint, unless a new Claim is alleged.

Advisory. In addition to creating the distinction between a demand letter and a demand for money, SB 1186 also revised § 55.3(b) of the Civil Code, effective as of September 19, 2012, to require certain additional information in the written advisory, which an attorney is required to provide with each demand letter sent or complaint served upon a potential defendant or defendant, respectively, expanding the statement of rights of the owner or tenant of the property by stating that a demand letter may not ask for money or an offer or agreement to take money, that the owner or tenant will have the right to make its case of no violation or that the violation has been corrected or correction has been commenced, and the owner or tenant is not required to pay any money unless and until a court makes a finding liability. (The initial form of the advisory is prescribed in § 55.3, but the California Judicial Council is required, on or before July 1, 2013, to update such form.) Note that the advisory requirement applies only to demand letters or complaints made by attorneys, and § 55.3 does not affect the right to file a civil complaint under any other law or regulation regarding access for the disabled, nor does it require a party to provide or send a demand letter prior to filing a civil complaint (subsection (d)). Finally, subsection (b) states that an advisory is not required in subsequent communications following the initial demand letter or complaint, unless a new Claim is asserted.

Additional Provisions. Finally, SB 1186 added provisions regarding the CASp certification process (amended Civil Code §§ 55.52 and 55.53 and Govt. Code § 4459.8, all effective as of September 19, 2012), disability access, education and outreach, and compilation and reporting of information on demand letters and complaints (new Govt. Code §§ 4465, 4467, 4469 and 4470 and amended Govt. Code §§ 8299.05, 8299.06, 8299.07 and 8299.08, effective as of September 19, 2012), and compliance with Standards in connection with the upcoming adoption of the 2013 California Building Standards Code (new Govt. Code § 18944.15, effective as of January 1, 2013; however, this provision sunsets December 31, 2015).

Summary

Hopefully, the new legislation will protect owners and tenants from claims that are driven more by the desire to extract payments than by legitimate concerns over access and use. However, it is not clear whether the federal ADA, which is expected to have changes go into effect in 2013, will conflict with and/or pre-empt some of the provisions of SB 1186.

In addition, disabled persons' supporters and advocacy groups have expressed their intent to fight the provisions of SB 1186, which they consider to be most egregious—particularly, the reduction in minimum statutory damages. They are concerned that this may slow the progress of removing barriers to access for the disabled by severely weakening one of the primary weapons against violators, thus diminishing the incentive of owners and tenants to voluntarily bring their properties into compliance with the ADA. Further, some advocacy groups have stated their belief that (i) SB 1186 itself discriminates against disabled persons by making it more difficult to seek redress for violations than for other groups protected under the Unruh Act, and (ii) SB 1186's ban on demands for money may violate the First Amendment's protection of free speech.

Stay tuned.

*__Matthew P. Seeberger__ is a Partner in the Los Angeles office of Cox, Castle and Nicholson. He is actively involved in ICSC and BOMA ("Building Owners Managers Association"), has written for a variety of publications regarding real estate issues and has lectured on retail, office and commercial leasing matters.

It's About Time: Appellate Court Excuses Missed Contract Deadline Because Time Was Not of the Essence

*Eric D. Rapkin**
Akerman Senterfitt
Ft. Lauderdale, FL

*L. Joseph Shaheen, Jr.***
*Chaila D. Restall****
Akerman Senterfitt
Tampa, FL

"Time is of the essence of this Agreement." As real estate and other transactional attorneys know, this is often one of the myriad boilerplate clauses found somewhere near the end of an agreement, typically in a section entitled "Miscellaneous." Attorneys all too often gloss over "Miscellaneous" without stopping to consider what clauses are not included but could be critical to the interpretation of the agreement. But even if a time is of the essence clause is included in a contract, does that mean that any missed deadline results in the loss of a right or possible forfeiture of the entire contract?

In a recent Florida appellate case (successfully argued on appeal by authors, Mr. Shaheen and Ms. Restall), the contract at issue did not contain a time is of the essence clause, and the court upheld a purchaser's right to seek a post closing purchase price adjustment despite the purchaser's missing the deadline in the purchase agreement to seek the adjustment.

In *Command Security Corporation v. John A. Moffa,* 37 Fla. L. Weekly D679a (Fla. 4th DCA 2012), Eagle International Group, LLC ("Eagle") did an assignment for the benefit of creditors (a state law proceeding similar to a Chapter 7 liquidation under the bankruptcy code). John A. Moffa ("Moffa"), as the assignee, entered into an asset purchase agreement ("APA") and an escrow agreement in order to sell Eagle's assets to Command Security Corporation ("Command"). The APA provided that Command could seek an adjustment in the purchase price if the purchased assets "underperformed." According to the APA:

> Within 45 days after the end of the Measurement Period (the last day of the Measurement Period is referred to herein as the "<u>Measurement Date</u>"), the Purchaser shall deliver to the Assignee a proposed statement (the "<u>Proposed Statement</u>") that sets forth the Purchaser's determination of the Measurement Period Actual Revenues…. The Assignee shall have the right, exercisable within 15 days following its receipt of the Proposed Statement, to deliver to the Purchaser a detailed statement (a "<u>Proposed Statement Challenge</u>") describing all of its objections (if any) thereto including a reasonably detailed explanation of such objections. If the Purchaser has not received a Proposed Statement Challenge within 15 days following the receipt by the Assignee of the Proposed Statement, the Assignee shall be deemed for all intents and purposes to have accepted and agreed in full to the Proposed Statement. If, however, the Purchaser shall have received a Proposed Statement, there shall be no Purchase Price Adjustment in respect of the Measurement Period until resolution of the disagreement between the Assignee and the Purchaser in accordance with <u>Section 2.08</u> hereof, and the Escrow Agent shall make no disbursement of the Escrow Fund until such dispute has been resolved…. [I]f the Purchaser shall fail to deliver to the Assignee, the Seller or the Assignee the Proposed Statement within 45 days after the Measurement Date, then the Assignee shall have the right in its sole discretion to declare that the Measurement Period Actual Revenues have exceeded the Measurement Period Target Revenues, which declaration shall be final and binding upon the Purchaser and the Escrow Agent.

"Measurement Period" was defined as "the last full calendar month immediately preceding the first anniversary of the Closing Date. For example, if the Closing Date is September 15, 2008, then the Measurement Period shall be the entire calendar month of August 2009." The closing date was September 12, 2008, with the measurement period being the calendar month of August 2009.

Forty five days after the end of the measurement period was October 15, 2009. Pursuant to the APA, by that date Command was to deliver the "Proposed Statement," which would set forth the actual revenues for the Measurement Period. Command, however, did not send a letter claiming that revenues were less than target revenues until November 6, 2009, and claimed entitlement to all of the funds in escrow.

In response, Moffa sent Command a letter dated November 12, 2009, seeking to exercise its "sole discretion" under the APA to "declare that the Measurement Period Actual Revenues have exceeded the Measurement Period Target Revenues" due to the fact that Command failed to "deliver… the Proposed Statement within 45 days after the Measurement Date." Thereafter, Moffa filed a complaint against Command, seeking a declaratory judgment as to who was entitled to the funds held in escrow. Command also sought a declaratory judgment that it was entitled to the disputed funds held in escrow. The trial court found Moffa rightfully entitled to the money held in escrow, and Command appealed.

According to the appellate court, the main point of contention was the fact that Command failed to meet the October 15 deadline and, instead, sent the notification letter 22 days later, on November 6.

The court stated: "this case revolves on whether time was of the essence and what result best supports the intent of the parties, as determined by the language of the contract. If time is not of the essence then the parties would have a 'reasonable time in which to tender performance after the specified date.' *ADC Orange, Inc. v. Coyote Acres, Inc.,* 857 N.E.2d 513, 516 (N.Y. 2006)."

According to the court, the law is clear that generally:

> time is considered to be of the essence where an agreement specifies, or where such may be determined from the nature of the subject matter of the contract, or where treating time as non essential would produce a hardship, or where notice has been given to the defaulting party requiring that the contract be performed within a stated time, which must be a reasonable time according to the circumstances.
>
> *Sublime, Inc. v. Boardman's Inc.,* 849 So. 2d 470, 471 (Fla. 4th DCA 2003).

The court went on to state that:

> [w]here one claims that time is an essential provision, the party is "bound, before he can support such a claim, to serve a clear, distinct and unequivocal notice fixing a reasonable time within which the thing must be done." *Ballen v. Potter*, 167 N.E. 424, 425 (N.Y. 1929). Placing in the contract "the mere designation of a particular date upon which a thing is to be done does not result in making that date the essence of the contract." *Id.* See also *Nippon Life Ins. Co. of Am. v. One Source Mgmt., Ltd.,* 2011 WL 1782089 (Ohio Ct. App. May 6, 2011) (finding that time was not of the essence, even though agreement set forth specific date for performance, absent a showing that a reasonable delay would have constituted a material breach or that appellant suffered a significant injury due to delay in performance); *Centurion Air Cargo, Inc. v. United Parcel Serv. Co.,* 420 F.3d 1146, 1151 (11th Cir. 2005) (stating that failure to make a payment on time does not constitute per se a material breach of contract; rather, to constitute a material breach, late payment must occur where time is of the essence); ….

The court noted that, in the present case, the contract does not specify that time is of the essence. There was no evidence of hardship in the record due to the 22-day delay in which Command notified Moffa, pursuant to the APA. Nor was there evidence of any notice given to the alleged defaulting party to perform pursuant to the contractual section within a "reasonable time." Finally, there was no evidence in the record that the nature of the subject matter would inform the parties that time is of the essence. The court stated: "In this case, the assets had already been purchased, the money was already placed in escrow, and appellee was not prejudiced by appellant's delay of twenty two days. The contract contained only a date for performance, which, standing alone, is insufficient to make time of the essence."

In support of its decision, the court cited its earlier decision in *Atlanta Jet v. Liberty Aircraft Services, Inc.,* 866 So. 2d 148 (Fla. 4th DCA 2004), in which the failure to close on a sale by the contractually set closing date of April 15 did not entitle a party to terminate the contract since the non-performance did not "go to the essence of the contract." In *Atlanta Jet,* the contract did not specify that time was of the essence, nor were there penalties for delay; nor was it apparent that the purchaser suffered any undue hardship due to the delay. Finally, the purchaser never gave express notice requesting the contract to be performed within a stated reasonable time. Therefore, the court held that time was not of the essence.

The court also found *Beeler v. Katz Enterprises (Minnesota), Inc.,* 2001 WL 410342 (Minn. Ct. App. Apr. 24, 2001), to be very instructive. In *Beeler,* the purchase price under a purchase and sale agreement was also subject to post closing adjustments. The contract provided that the purchaser was to supply the calculations within 45 days of closing, but the calculations were provided 35 days late. The trial court found that the purchaser waived the right to any reduction in price by allowing the 45-day deadline to pass. On appeal, however, the appellate court concluded that the 45-day time limit was not material to the contract and thus reversed the trial court. "Even if a contract contains a specified date for performance, when the contract does not specify that time is of the essence, a delay will not necessarily invalidate the provision." Id. The contract had no provision stating that time was of the essence, nor did the contract list any consequences for failure to abide by the listed date for submitting calculations. Thus, the appellate court reversed to allow the purchaser to submit the calculations, which would essentially reduce the purchase price. Thus, the *Command Security* court held that "in the present case with similar facts, [Command] should be allowed to submit the calculations demonstrating that the revenues during the measurement period were less than the target numbers, and as such, would result in [Command] retaining the monies held in escrow."

The court went on to conclude that:

> time was not of the essence in this contract, [Command's] twenty two day delay in tendering the calculations was not material, and we should give effect to the intent of the parties by considering the calculations as stated in [Command's] letter. We, therefore, reverse and remand for the trial court to enter summary judgment in favor of [Command].

Practitioners would be incorrect in assuming that by simply including a time is of the essence provision, Command would have automatically lost the case. In fact, there are many decisions holding that not every breach will justify a forfeiture of a right due to a delay—even if the agreement in question contains a time is of the essence clause. See Catherine M.A.

McCauliff, *Corbin on Contracts,* Chapter 37 (Joseph M. Perillo, ed., Revised Edition 1999, Supp. 2006). For example, in the commercial leasing context, in *Foundation Dev. Corp. v. Loehmann's, Inc.,* 163 Ariz. 438, 788 P.2d 1189 (Ariz., 1990), a landlord brought a forcible detainer action against the tenant due to the tenant's delay in paying a common area charge. The court held that a two day delay in payment was a trivial breach that did not justify forfeiture even though the lease contained a time is of the essence clause.

Similarly, in *J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc.*, 42 N.Y.2d 392, 397 N.Y.S.2d 958, 366 N.E.2d 1313 (N.Y., 1977), the tenant failed to exercise a renewal option within the time required by the lease. Nonetheless, equitable relief was granted to the tenant because there was no prejudice to the landlord.

But see *Arvilla Motel, Inc. v. Shriver,* 889 So. 2d 887 (Fla. 2nd DCA 2004) (in analyzing the facts and circumstances surrounding a buyer's failure to appear for closing on the scheduled closing date, the court enforced the time of the essence clause against the buyer); *Nadeau v. Beers,* 440 P.2d 164 (Wash., 1968) (enforcing a clause expressly making closing on time of essence). *See also* Milton R. Friedman and Patrick A. Randolph, Jr., *Friedman on Leases,* § 14:2.1 (Patrick A. Randolph, Jr., ed., Fifth Edition 2004, Supp. 2006) and the cases cited therein.

Particularly for commercial lease negotiators, the question arises whether to always include a time is of the essence clause in leases. Even if it is included in a lease, the clause will typically be contradicted by the customary *force majeure* provision in the lease, and could also lead to unintended consequences, such as penalizing a landlord for late delivery of the space. *See* Mark A. Senn, *Commercial Real Estate Leases Preparation, Negotiation, and Forms*, § 33.06, 3rd Ed. (2000), Supp. 2006. For this reason, "… the real estate professional may conclude that [a time is of the essence] provision should be used sparingly and only with reference to the particular obligation to which it is relevant. The general applicability of this provision may have unforeseen and undesirable results." *Id.* Additionally, if time is made of the essence with respect to a particular obligation, practitioners might also consider specifying the consequence of failure to timely comply.

*__Eric D. Rapkin__ is a Shareholder in the firm's Fort Lauderdale, FL, office. erapkin@akerman.com

**__L. Joseph Shaheen, JR.,__ is a Shareholder in the firm's Tampa, FL, office. joseph.shaheen@akerman.com

***__Chaila D. Restall__ is a Shareholder in the firm's Tampa, FL, office. chaila.restall@akerman.com

No Current Investment: No Equitable Relief

*Kevin P. Groarke**
SNR Denton US LLP
New York, NY

Recently, the New York Court of Appeals (the highest state court) revisited, and by doing so clarified, its 1977 landmark decision in *J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc.*[1] ("*JNA*"). In the *JNA* decision, the court held that equity will relieve a tenant that failed to timely exercise a renewal option in a lease—that is, where the tenant's delay in doing so is due to "excusable default," the tenant would suffer a forfeiture if the lease was not renewed—and the landlord was not prejudiced by the tenant's delay. Since 1977, the *JNA* case has been followed in New York and in other states.

In May, the Court of Appeals decided *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey*[2] ("*Baygold*") in which the court was presented with this central issue: whether an out-of-possession tenant under a long-term lease, which had made improvements to the premises more than 20 years before, was entitled to equitable relief under the *JNA* decision to relieve the tenant from its inadvertent failure to exercise its renewal option within the time prescribed under the lease. The court held that such equitable relief was not available to the tenant under the circumstances.

The Distinction Between *JNA* and *Baygold*

In JNA, the lease for a restaurant was for an initial term of 10 years. The lease granted the tenant an option to renew and extend the lease for an additional 24 years, provided the tenant gave written notice to the landlord of its exercise of the option six months prior to the last day of the initial term. Due to its own admitted negligence, the tenant failed to notify the landlord of its intention to exercise the renewal option until more than four months after the specified deadline and after the landlord had notified the tenant that the renewal option had lapsed, and the lease would expire at the end of the initial term. The landlord refused to recognize the tenant's late exercise notice and commenced proceedings to recover possession of the premises, claiming the lease had expired. The tenant asked for equity to relieve it from its default and the resulting forfeiture of its lease.

The court ruled in the tenant's favor, making it clear that failure to timely exercise the option in and of itself does not result in a forfeiture because the tenant has no legal interest in the renewal period until the required notice is given. "But when a tenant in possession under an existing lease has neglected to exercise an option to renew, he might suffer a forfeiture if he has made valuable improvements on the property"[3] in good faith in contemplation of renewing the lease, and if the landlord is not harmed by the delay in giving the notice. The court found that the tenant in the *JNA* case would suffer a forfeiture if equity did not intervene since the trial record showed the tenant had made considerable investments in leasehold improvements during the lease term, at least part of which had been expended within six months of the expiration of the initial term, after the renewal option had purportedly expired. The court noted that "the tenant was at fault, but not in a culpable sense…. There would be a forfeiture and the gravity of the loss is certainly out of all proportion to the gravity of the fault."[4] In addition, the court recognized that "if the location was lost, the restaurant would undoubtedly lose a considerable amount of its customer goodwill."[5]

The *Baygold* Decision

The three-pronged criteria for the granting of equitable relief under the *JNA* decision was summarized by the Court of Appeals in the *Baygold* decision, as follows:

> equity will intervene to relieve a commercial tenant's failure to timely exercise an option to renew a lease where (1) such failure was the result of "inadvertence", "negligence" or "honest mistake", (2) the non-renewal would result in a "forfeiture" by the tenant; and (3) the landlord would not be prejudiced by the tenant's failure to send, or its delay in sending, the renewal notice.[6]

The Court of Appeals determined that the tenant in the Baygold case failed to meet the second prong of the JNA test.

The tenant, Baygold, had a lease for an initial term of 10 years with options to renew the lease term for four additional 10-year periods, provided the tenant gave written notice to the landlord no later than 270 days before the expiration of each term or extended term. Baygold subleased the entire premises to an affiliate, which operated the premises as a nursing home. The trial record showed that the affiliated subtenant made investments in the property in the amount of approximately $1 million during the period from 1976 through 1985. In January 1985, with the landlord's consent, the premises were further subleased to a non-affiliate, Israel Orzel, who continued to operate the premises as a nursing home. In August 1985, Baygold renewed the lease for two additional 10-year periods. During Orzel's tenancy, Orzel made improvements to the premises. Baygold made none. Orzel paid the rent reserved under the lease directly to the landlord and paid Baygold, as sublandlord, rent under the sublease over and above the rent under the direct lease of approximately $200,000 per year during the first 10-year period and $240,000 per year during the second 10-year term of the sublease. In July 2007, the landlord entered into a contract of sale for the premises with the defendant in the Baygold case, Congregation Yetez Lev of Monsey, Inc. ("Congregation"). The landlord's counsel sent a set notice to Baygold's counsel, apprising him of the pending sale and the landlord's position that the lease was to expire on September 30, 2007, the last day of the current term. Evidently in response, Baygold's counsel produced a copy of a letter dated November 1, 2005, which purported to exercise the extension option; but counsel was unable to produce a certified mail receipt, return receipt or other evidence that the notice had, in fact, been sent by Baygold and received by the landlord (as the lease required). Thus, whether the extension notice was given timely and in compliance with the lease was disputed. The landlord refused to honor Baygold's purported exercise of the renewal option. Baygold commenced an action against the landlord (Congregation, which purchased the premises after the action commenced, was substituted as defendant), asking for declaratory relief.

After a bench trial, the trial court held that the lease had not been properly renewed because Baygold failed to establish that notice was sent in compliance with the lease terms. The court also rejected Baygold's request for equitable relief. The court concluded that Baygold's counsel failed to allege any mistake at all; rather, Baygold's counsel only testified that he actually complied with the renewal provision. Thus, Baygold failed to establish that the failure to renew was the result of an excusable default—that is, inadvertence, negligence or honest mistake.

The appellate division, which is the intermediate appellate court, found record support for the trial court's conclusion that Baygold failed to comply with the renewal provision. The appellate division also concluded that the trial court properly denied Baygold's request for equitable relief, holding that Baygold, unlike the tenant in the *JNA* case, failed to demonstrate that it made improvements of a substantial character in anticipation of renewing the lease.

The Court of Appeals assumed, for the purpose of the appeal, that Baygold's failure to comply with the lease renewal provisions was the result of an excusable default. This focused the issue on appeal: whether the non-renewal would result in a forfeiture to Baygold. The Court of Appeals held that Baygold had failed to establish that it would suffer a forfeiture, noting that:

> Baygold concedes that it has not made any improvements to the premises since 1985, but claims that it made $1 million in improvements between 1972 and 1985 with the expectation that it would derive revenue from possessing a 50-year lease. Unlike the tenant in J.N.A. Realty, however, neither Baygold nor any of its affiliates was a tenant in possession of the premises at the time of the failure to comply with the lease renewal provision. Nor can it be said that Baygold, having profited from its sublease with Orzel since 1985 while having expended no monies on improvements, would incur a substantial loss should the lease not be renewed, as Baygold has undoubtedly reaped the benefit of any initial expenditure [citation omitted]. The forfeiture rule was crafted to protect tenants in possession who make improvements of a "substantial character" with an eye toward renewing a lease, not to protect the revenue stream of an out-of-possession tenant like Baygold."[7]

The court of appeals rejected Baygold's contention that the improvements it made over 20 years earlier, when it was a tenant in possession, could be said to have been made with a view toward the subject renewal of the lease. The court also rejected Baygold's attempt to rely on the improvements made by subtenant Orzel between 1985 and 2007.

In doing so the court noted:

> But our holding in J.N.A. Realty is restricted to tenants who made "considerable investment in improvements" "to the premises in anticipation of the lease renewal or would 'lose a considerable amount of…' customer good will" should the lease not be renewed. This narrow equitable doctrine was never intended [citation omitted] to apply in a circumstance like this, where the out-of-possession tenant fails to make any improvements in anticipation of renewal and does not possess any good will in a going concern."[8]

The Court of Appeals' decision did not refer to any facts that may have been adduced at trial (so perhaps there were none in the record) about whether the contract of sale of the building to Congregation by the landlord at the time the renewal option should have been exercised contemplated delivery of the building to Congregation vacant and clear of tenancies. Plainly, such additional factors, if applicable, would have supported additional grounds for denying Baygold equitable relief—that is, the landlord relied on the impending expiration of the lease in framing the terms of the sale (due to the tenant's failure to renew the lease timely) and would have been prejudiced if the tenant's failure was excused.

Conclusion

In practice, most landlords and tenants take necessary precautions to ensure that renewal rights and other valuable options are not jeopardized by the inadvertent failure to exercise such rights on a timely basis. As a further practical matter, most tenants would not make significant capital expenditures in leased space toward the end of the lease term, even in contemplation of renewing the lease, without discussions with the landlord. Nevertheless, these cases illustrate that the problem does occur in the real world. Baygold serves to poignantly illustrate the circumstances when a tenant will be disqualified from relying on equity to relieve it of such a mistake.

***Kevin P. Groarke,** a Partner in real estate and finance in the New York office of SNR Denton US LLP in New York, NY, specializes in leasing, acquisitions and dispositions, and the financing of commercial properties.

[1] *J.N.A. Realty Corp v. Cross Bay Chelsea, Inc.,* 42 N.Y.2d 392, 397 N.Y.S.2d 958 (1977).

[2] *Baygold Associates, Inc. v. Congregation Yetev Lev of Monsey, Inc.,* 19 N.Y.3d 223, 947 N.Y.S.2d 794, 2012 N.Y. LEXIS 940, 2012 Slip Opinion 03472 (May 3, 2012).

[3] 42 N.Y.2 398.

[4] *Id.* at 399-400.

[5] *Id.* at 400.

[6] *Baygold* Slip Opn at 2.

[7] *Baygold* Slip Opn at 6.

[8] *Baygold* Slip Opn at 8.

Be Careful What You Wish For: *Super Nova 330 LLC v. Gazes* and the Termination of Leases by Warrants of Eviction Under New York Law

*Douglas B. Rosner**
*Timothy J. Carter***
Goulston & Storrs, P.C.
Boston, MA

In August, the Second Circuit Court of Appeals held, in *Super Nova 330 LLC v. Gazes (In re Association of Graphic Communications, Inc.)*, 2012 WL 3125241 (2d Cir. August 2, 2012), that a commercial real property lease is "unexpired" for purposes of § 365(d)(3) of the Bankruptcy Code when the tenant under the lease has the power to revive the lease pursuant to applicable state law. More specifically, the Second Circuit found that under New York law a tenant's interest in a lease is extinguished only by the execution of a warrant of eviction and is not extinguished when the warrant is issued. Accordingly, even when a landlord obtains a warrant of eviction prior to a tenant's bankruptcy filing, the debtor-tenant retains an interest in the leasehold until the warrant is executed.

On the one hand, this means that a landlord may be entitled to payment of post-petition rent obligations as administrative expenses under § 365(d)(3) of the Bankruptcy Code until a warrant of eviction is executed or the lease is rejected. On the other hand, this decision may result in landlords being stuck in their tenants' bankruptcy cases, even when a landlord has already contractually terminated the lease and obtained a judgment and warrant of eviction.

Somewhat surprisingly, the landlord was the appellant in *Super Nova 330*, arguing that the lease remained unexpired until the warrant of eviction was executed. Although there may have been a limited economic benefit from this outcome in the short run, in the long run the decision serves as a cautionary reminder: Be careful what you wish for. At least in New York, landlords will now be exposed to the delays, the uncertainties, the inability to mitigate and the costs associated with a bankruptcy of its tenant, notwithstanding a yeoman's effort pre-petition to regain control of the premises.

This article discusses the Second Circuit's *Super Nova 330* decision and, along the way, summarizes the key provisions and mechanisms of bankruptcy law and New York property law relevant to the decision.

Background

Section 365(d)(3) of the United States Bankruptcy Code requires a debtor that is a tenant under an unexpired lease of non-residential real property to timely perform its obligations under the lease until the lease is assumed or rejected in the debtor's bankruptcy case. Courts hold that a lessor is entitled at least to administrative expense treatment for the amounts required to be paid under § 365(d)(3). The Bankruptcy Code does not define the term "unexpired," nor is the meaning of the term made clear by the legislative history of the Bankruptcy Code. Rather, bankruptcy courts look to state law to determine whether a non-residential real property lease is unexpired.

The facts of *Super Nova 330* are as follows. A tenant under a non-residential lease of real property failed to make certain payments of rent. Its landlord demanded payment and, unsatisfied, began a non-payment proceeding in New York City Civil Court. The tenant did not defend the non-payment proceeding, and the court granted the landlord a default judgment of possession and issued a warrant of eviction. The day after issuance of the warrant of eviction, and before the warrant was executed, the tenant filed a voluntary Chapter 7 bankruptcy petition.

Section 362 of the Bankruptcy Code provides for an automatic stay, protecting a debtor that files a petition under any chapter of the Bankruptcy Code. The automatic stay generally prohibits the commencement or continuation of litigation, lien enforcement and other actions that attempt to enforce or collect pre-petition claims. Section 362 also stays most actions that would affect or interfere with the property of the debtor or its estate. One notable exception to the automatic stay is the eviction of a debtor under a lease of non-residential real property that had terminated by the expiration of the stated term of the lease.

In *Super Nova 330*, the automatic stay prevented the landlord from executing its warrant of eviction once the tenant had filed for bankruptcy. Given the ultimate holding that the lease remained unexpired, the above-described exception to the stay did not apply. In order to execute the warrant, the landlord filed an unopposed motion before the bankruptcy court to lift the stay. The court granted the motion; the landlord executed the warrant almost three months after the warrant had been issued and the tenant had commenced its bankruptcy proceeding.

The landlord moved for payment of rent, attorney fees and pre-judgment interest pursuant to § 365(d)(3) for the period between the tenant's bankruptcy petition filing and the eviction date. The trustee for the debtor's bankruptcy estate opposed the motion. After discovery, the trustee moved for summary judgment, arguing that the lease had been terminated pre-petition when the warrant of eviction was issued and that, accordingly, the lease was not "unexpired" as required for relief under § 365(d)(3).

The bankruptcy court granted summary judgment for the trustee, concluding that the pre-petition issuance of the warrant of eviction terminated the landlord-tenant relationship such that there was no "unexpired" lease and therefore no right to payment under § 365(d)(3). On appeal the district court agreed that the lease was not unexpired, and affirmed the bankruptcy court's decision. On subsequent appeal, the Second Circuit vacated the lower courts' decisions.

Analysis

The Second Circuit began by noting that, because property interests are created and defined by state law, bankruptcy courts should look to state law to determine a debtor's interests in property, including leasehold interests. On the subject of warrants of eviction, § 749(3), New York Real Property Acts Law, provides:

> The issuing of a warrant for the removal of a tenant cancels the agreement under which the person removed held the premises, and annuls the relationship of landlord and tenant, but nothing contained herein shall deprive the court of the power to vacate such warrant for good cause shown prior to the execution thereof.

Interpreting this provision of New York property law, the Second Circuit found that, while the issuance of a warrant of eviction cancels any existing lease, the tenant retains a residual interest in the lease until execution of the warrant. The residual interest is apparent in the fact that, prior to execution of a warrant of eviction, the state court may vacate the warrant for good cause and thereby reinstate the lease.

The court went on to compare New York law regarding lease terminations with Vermont law, as applied in its prior decisions in *Brattleboro Hous. Auth. v. Stoltz (In re Stoltz)*, 197 F.3d 625 (2d Cir. 1999), and *Canney v. Merchants Bank (In re Canney),* 284 F.3d 362 (2d Cir. 2002). Under Vermont law, a debtor may redeem and avoid ejectment up until the issuance of a writ of possession in an ejectment proceeding; however, once issued, the writ extinguishes the debtor's right to redeem. In contrast, New York law provides that a tenant may obtain *vacatur* of a warrant after it is issued and before its execution. The court noted that the automatic stay preserves a tenant's right to pursue its state court statutory remedy in the period between issuance and execution of a warrant of eviction: It effectively prevents a landlord from executing a warrant of eviction without bankruptcy court approval once a tenant files for bankruptcy.

Thus, the Second Circuit followed *Stoltz* and *Canney* in holding that a lease is "unexpired" for purposes of § 365(d)(3) when the tenant has the power to revive the lease under applicable state law. The court continued:

> Because in New York it is the execution and not the issuance of the warrant of eviction that extinguishes the tenant's interest in the lease, the lease is "unexpired" as that term is used in § 365(d)(3), until the warrant is executed.

Having found that a lease is unexpired until a warrant of eviction is executed, the court went on to note that it does not necessarily follow that the landlord was entitled to the rental payments and other costs it sought. Section 365(d)(3) states:

> The trustee shall timely perform all the obligations of the debtor … arising from and after the order for relief under any unexpired lease of non-residential real property, *until such lease is assumed or rejected*. (emphasis added)

Also, § 365(c) states that a lease cannot be assumed or assigned by the trustee if it is terminated under state law.

Accordingly, the Second Circuit raised the question of whether a "terminated" yet "unexpired" lease should be treated as presumptively rejected by the trustee or whether the court should require the trustee to affirmatively reject it in order to avoid liability for rent and other costs.

While noting that this issue was one of law and, therefore, could be decided by the Second Circuit as part of its resolution of the instant appeal, the Second Circuit instead remanded the issue for briefing and argument before the bankruptcy court, deferring to the bankruptcy court's specialized knowledge. Query, though, how a lease could possibly be treated as presumptively rejected and at the same time unexpired, as the Second Circuit held. The Second Circuit also vacated the bankruptcy court's finding that the tenant was not in possession of the space because both sides presented dramatically divergent accounts as to whether the landlord or tenant was in possession of the property in the months leading up to the eviction proceeding and bankruptcy filing. The Second Circuit noted that summary judgment was inappropriate where the two sides' accounts of the material facts were at odds.

Conclusion

The *Super Nova 330* decision clarifies that, under New York law, a lease is unexpired and a tenant retains a residual interest in the lease up until a warrant of eviction is executed. This holding provides protection for tenants who may file bankruptcy at any point prior to the execution of a warrant of eviction and be assured both that the automatic stay will prevent the landlord from taking further action to execute the warrant without court approval and that its leasehold may remain subject to assumption and assignment. Landlords, such as the landlord who won the appeal in the *Super Nova 330* decision, may also benefit, in that they can argue that they are entitled to administrative rent up until a warrant of eviction is actually executed or the lease is rejected. The better result for landlords, however, may have been a finding that the tenant's interest in the lease terminated upon issuance of the warrant of eviction. That outcome could be more beneficial going forward because it would give landlords control of their premises and the ability to re-let and mitigate damages. For many landlords, control of the premises is more beneficial than the ability to preserve a claim for post-bankruptcy rent. Under the *Super Nova 330* decision, however, landlords must now wait until execution of a warrant of eviction or rejection of a lease in bankruptcy before knowing they are free of a delinquent tenant.

*__Douglas B. Rosner__ is a Director at Goulston & Storrs, P.C., resident in the firm's Boston office.

**__Timothy J. Carter__ is an Associate at Goulston & Storrs, P.C., resident in the firm's Boston office.

Premises Liability May Not Be So Foreseeable

*J. Yost Conner, Jr.**
*Stephen J. Kott***
Patton Boggs
Washington, DC

With reported incidents of violent crimes occurring at public sites increasing, it is imperative that business owners, commercial property managers, landlords and operators understand the legal standards and ramifications of premises liability for third-party criminal acts. This article provides an overview of premises liability for third-party crime and examines the prevalent "foreseeability" and duty-of-care standards utilized by various courts and jurisdictions.

The Basics of Premises Liability for Injuries Caused by Third-Party Acts

It is well established that business owners, landlords and enterprises open to the public have an affirmative duty to protect patrons and tenants against unreasonable risks of physical harm. The most recognized and widely acknowledged premises liability standard for third-party criminal acts is found in § 344 of the Restatement (Second) of Torts (1965), which states:

> A possessor of land who holds it open to the public for entry for his business purposes is subject to liability to members of the public while they are upon the land for such a purpose, for physical harm caused by the accidental, negligent, or intentionally harmful acts of third persons or animals, and by the failure of the possessor to exercise reasonable care to
>
> (a) Discover that such acts are being done or are likely to be done, or
> (b) Give a warning adequate to enable the visitors to avoid the harm, or otherwise protect them against it.
>
> Comment (f): Duty to police premises. Since the possessor is not an insurer of the visitors' safety, he is ordinarily under no duty to exercise any care until he knows or has reason to know that the acts of the third person are occurring, or are about to occur. He may, however, know or have reason to know from past experience, that there is a likelihood of conduct on the part of third persons in general which is likely to endanger the safety of the visitor, even though he has no reason to expect it on the part of any particular individual. If the place or character of his business, or his past experiences, is such that he should reasonably anticipate careless or criminal conduct on the part of third persons, either generally or at some particular time, he may be under a duty to take precautions against it, and to provide a reasonably sufficient number of servants to afford a reasonable protection.

Accordingly, premises liability for the criminal acts of third parties arises only where the owner knew, or should have known, of the likelihood of dangerous third-party conduct that could reasonably be anticipated to endanger the safety of patrons or occupants. The standard of care/duty of diligence that business and commercial property owners, managers, landlords and operators owe to guests, occupants and invitees is directly related to the reasonable foreseeability of the risk of harm posed by third-party actors. The greater the risk of harm presented by third-party actors, the greater the steps, precautions or security measures that commercial property owners and managers must implement. Increasingly, claimants have seized upon this sliding scale and sought to impose liability for injuries caused by third-party criminal acts by challenging the existence and adequacy of such protective/security measures implemented, including but not limited to the adequacy of lighting, the adequacy of protective barriers (fences/speed bumps), the presence of video surveillance, the provision of security personnel, and the posting of signs and warning notices.

The focal point of these challenges, however, remains foreseeability. Claimants must establish that the criminal act in question was one that the premises owner should have foreseen. Generally, to meet this requirement, courts look at the following factors: a prior pattern of criminal activity, the proximity of the prior criminal activities to the property and the similarity of the prior criminal behavior to the criminal act in question.

Over the course of the past 30 years, two distinct analytical approaches have emerged. The first approach, known as the "similar acts" approach, attaches liability only in those instances where the property owner possessed a high degree of actual knowledge based upon the occurrence of the same or substantially similar type of prior criminal activity. Under this approach, in assessing whether a crime committed by a third party was foreseeable, courts focus on the following factors:

1) Geographic and Temporal Proximity—Did the prior crimes occur on or near the premises, and did they occur within a reasonably recent time period?
2) Frequency—How often had prior criminal activities occurred and been reported in the local media? and
3) Substantial Similarity—Was the nature, extent and severity of the prior crimes the same as or substantially similar to the criminal act in question?

The alternative approach, known as the "totality of the circumstances," is far broader and extends liability where the totality of the circumstances demonstrates that the property owner should have known that there was reasonable basis to foresee the risk of third-party criminal harm. Under this approach, all factual circumstances such as the condition, location and use of the property are taken into consideration. While the number, nature and location of prior similar criminal acts are factors, they are not determinative. This more expansive foreseeability approach provides a basis for dissimilar, off-premises and less recent crimes to be considered in establishing foreseeability.

Discussed below are several illustrative cases that highlight the disparate risk management impacts of these two approaches.

Similar Acts

The more conservative "similar acts" approach is present in *Inger v. PCK Dev. Co., LLC.*[1] In *Inger*, a co-worker stabbed and killed the night manager of a restaurant that leased premises inside a regional mall. The crime occurred inside the restaurant when the co-worker returned after-hours. The plaintiff argued that the landlord owed the decedent a duty of protection in part because the crime was foreseeable due to past criminal activity at the mall—particularly, an indiscriminate shooting the year before the stabbing. The defendant asserted that it was not liable for damages related to the murder because (1) a night security officer at the mall did not notice any unusual activity and (2) there had been no prior similar incident at this restaurant. Holding for the defendant, the court reiterated the threshold test of a landlord's liability: Did the landlord take "at least minimal precautions to protect tenants from foreseeable harm?"[2]

The plaintiff argued that the overall history of crime at the mall made the attack in *Inger* foreseeable and that the landlord should be charged with doing more than it did.[3] The plaintiff noted (without comparison to other malls) that, at the time of the murder, the mall was generating an average of two calls to police each day and about 9 arrests each month. With one exception, the plaintiff did not allege that any of those calls or arrests was or were for violent crimes; however, the one previous violent crime was notable. The prior year, a gunman entered a large store at the mall through the store's exterior customer entrance. Once inside, the gunman fired a high-capacity rifle indiscriminately as he passed through the store and into the mall's main concourse. When he had expended all his ammunition, mall personnel subdued him in the concourse.[4]

The landlord argued that the shooting and the stabbing were materially different kinds of events and that the occurrence of the shooting did not make the stabbing foreseeable: "… nothing in the history of the tenancy of the [restaurant] gave the appellant any reason to anticipate that an assault on an employee would occur in the restaurant by a co-employee."[5]

After acknowledging the landlord's obligations to maintain the mall and its exterior in a safe condition and to keep the mall, sidewalks and parking lots (but not the tenant's premises) in a secure state, the court took up the plaintiff's allegation that failure to provide security cameras near the restaurant's entrance breached the obligation. The court said that harm was foreseeable only if there was "evidence that the attack on decedent was reasonably predictable based upon prior occurrences of the same or similar criminal activity at the mall."[6] Without an extended discussion of the similarities and differences between the shooting and the stabbing, the court held that the indiscriminate daytime shooting by a non-employee inside different premises did not make the after-hours stabbing of one co-worker by another inside different premises foreseeable. The court also specifically noted the landlord's security officer's affidavit, which stated that there had not been any prior incidents similar to the stabbing in any leased areas at the mall. The court concluded that, as a matter of law, the landlord owed no duty beyond the security guard's routine patrols. The court granted the defendant's motion for summary judgment.

The result in *Inger* reflected the result in an earlier New York case. In *Charleen F. v. Cord Meyer Dev. Corp.*,[7] a mall owner obtained summary judgment in a case brought by an employee of a store in the mall who was raped inside the premises during a robbery. Applying a narrow standard of foreseeability, the court held: "the plaintiff failed to establish that the defendants had reason to know from past experience that a store employee or customer would be attacked by a third party or would be endangered."[8] Like the *Inger* case, the *Charleen F.* court noted that the landlord did not have responsibility for security inside the tenant's premises. It also noted that there was a specific disclaimer of obligations to third parties in the lease, so the only remaining analysis related to foreseeability, and the court found nothing that fit the narrow "prior acts" standard.

Totality of the Circumstances

Some courts take a broader view. In *Shaeffer v. Vera Wang Bridal House, Ltd.*,[9] a bride and her parents, the Shaeffers, were visiting a bridal salon on Madison Avenue in New York. Visits to the salon were by appointment only. Two men without an appointment obtained entry to the premises. After failing in a series of ruses to convince the receptionist to allow them to proceed to the second-floor sales area, the men produced a gun and forced their way upstairs. There, they robbed the Shaeffers of cash and jewelry and shot Mr. and Mrs. Shaeffer before escaping from the premises.

This particular salon had not previously experienced any serious crime, although some incidents had occurred in the area in which it was located. There had been several violent crimes within a block of the salon during the previous year. In the three years leading up to the incident, there had been a series of similar robberies on the Upper East Side of Manhattan. In each case, well-dressed men accosted older women and stole large diamond rings. Unlike the salon incident, however, most of the prior robberies had not taken place inside retail premises. Following the fourth such robbery, police contacted media about the spree, and several media outlets covered it. The security director for the salon's landlord also distributed "wanted" posters to the retail businesses in the property.

Plaintiffs brought negligent security suits against both the landlord and the salon. The landlord settled with the plaintiffs, but the suit against the salon proceeded. In denying the defendant's motion for summary judgment, the trial court acknowledged the absence of prior serious crime at the salon. It also acknowledged that since the salon was not a cash business, it was not a likely robbery target. The court noted, however, the robbery spree and the other crimes in the area near the salon and the publicity generated by the robberies. The court concluded that a reasonable jury could decide that these facts made the robbery and shooting at the salon foreseeable.

Similarly, in *Isaacs v. Huntington Memorial Hospital*,[10] California adopted totality of the circumstances. In *Isaacs*, an assailant shot a doctor in the parking lot of a private hospital. Although there had been assaults at the nearby emergency room, the doctor presented no evidence of prior assaults in the particular parking lot where he was attacked. Under a narrow prior acts standard, the doctor's suit against the hospital might have failed. The California Supreme Court, however, refused to apply the narrow standard. Instead, the court held that the happening of prior acts is but one component of an analysis that should take many circumstances into account. Under this standard, the court concluded, the doctor's case should have gone before a jury.

After taking some criticism for *Isaacs*, the California Supreme Court seized the opportunity to re-examine the standard in *Ann M. v. Pacific Plaza Shopping Center*.[11] The plaintiff was an employee of a retail store in a shopping center. Shortly after the store opened for the day, an assailant raped the plaintiff and robbed the store. Like the leases in *Inger* and *Charleen F.*, the lease in *Ann M.* left, to the tenant, responsibility for security inside the store; but the plaintiff alleged that the landlord should have done more to secure the common areas and prevent the assailant's entry.

Although the record suggested that there had been prior criminal activity at the shopping center—including a bank robbery and an incident of a man "pantsing" a woman—the court said that there was no evidence of the landlord's awareness of these incidents. The plaintiff presented evidence that employees of the retailers at the shopping center were concerned for their safety because of loitering transients at the center. In one case involving the plaintiff's employer, a co-worker had even called the police on two occasions because she felt threatened. Tenants had conveyed their concerns to the merchants' association at the mall. The association commissioned a security study, but did not hire the walking patrols suggested by the expert. Instead, the association added drive-by patrols, operating three to four times per day. These facts would have appeared to satisfy a totality of the circumstances analysis, but the trial court granted and the appellate court upheld summary judgment for the landlord.

Given the ultimate holding, the ruling could have stood, but the California Supreme Court seemed eager to use *Ann M.* as its opportunity to revisit the rule announced in *Isaacs*. The court enunciated a "refinement" of the rule that essentially returned to a prior acts standard.[12] The court focused on the concept that the burden of increased security must be balanced against the foreseeability of potential harm—the higher the burden, the greater must be the foreseeability of the harm. It concluded that a high degree of foreseeability "rarely, if ever, can be proven in the absence of prior similar incidents of violent crime on the landowner's premises."[13] The court upheld summary judgment for the landlord.

Conclusion

The interplay of duty of care and foreseeability in the context of premises liability for third-party criminal acts is unsettled and evolving. As the cases discussed above demonstrate, courts from the very same jurisdiction often reach inconsistent results, depending on the foreseeability approach they adopt. Commercial property owners, operators and managers must be cognizant of their respective duties to evaluate the likelihood of criminal activity and to take reasonable measures to protect the safety of people on their premises.

Below is a list of steps/considerations that commercial property risk managers should consider in order to reduce their liability exposure for third-party criminal conduct:

- Determine the level/nature of crimes committed in the business operating area.
- Assess security risks based upon the criminal history of the surrounding community; the nature of the business operations; the nature of the patrons, visitors and guests; and site conditions.
- Have regular contact with law enforcement and other local businesses regarding incidents of criminal behavior.
- Develop site-specific protective measures (i.e., appropriate lighting, warning signs and notices, security video cameras, or patrols.
- Train employees on policing and securing the premises.
- Review/Assess commercial liability insurance policy and umbrella coverage.
- Consider the advice of counsel and other professional consultants.

*__J. Yost Conner,__ a Partner in the Washington, DC, office of Patton Boggs, represents clients in complex, multi-stage and multi-party projects throughout the United States and in other areas of the world.

**__Steve Kott,__ also a Partner in the Washington, DC, office of Patton Boggs, maintains a comprehensive commercial litigation and regulatory counseling practice.

[1] *Inger v. PCK Dev. Co., LLC*, No. 514215, slip op. 05376 (N.Y. App. Div. July 5, 2012).

[2] *Id.* [citing *Burgos v. Aqueduct Realty Corp.*, 92 NY2d 544, 548 (1998); *Jacqueline S. v. City of New York*, 81 NY2d 288, 293-94 (1993)].

[3] *See* Brief of Plaintiff-Respondent 20-24, *Inger v. PCK Dev. Co., LLC*, No. 514215, slip op. 05376 (N.Y. App. Div. July 5, 2012).

[4] *See Shooter Wounds Two at New York Mall*, CNN, Feb. 13, 2005, http://articles.cnn.com/2005-02-13/us/mall.shooting_1_mall-employee-ulster-police-opening-fire?_s=PM:US.

[5] Brief of Defendant-Appellant 10, *Inger v. PCK Dev. Co., LLC*, No. 514215, slip op. 05376 (N.Y. App. Div. July 5, 2012).

[6] *Inger v. PCK Dev. Co., LLC*, No. 514215, slip op. 05376 (N.Y. App. Div. July 5, 2012) (*citing Six Anonymous Plaintiffs v. Gehres*, 68 AD3d 1177, 1178 (2009), *lv denied* 14 NY3d 710 (2010)).

[7] *Charleen F. v. Cord Meyer Development Corp.*, 622 N.Y.S.2d 555 (1995).

[8] *Id.* at 556.

[9] *Shaeffer v. Vera Wang Bridal House, Ltd.*, 64 F. Supp 2d 286 (S.D.N.Y. 1999).

[10] *Isaacs v. Huntington Memorial Hosp.*, 695 P.2d 653 (1985).

[11] *Ann M. v. Pacific Plaza Shopping Center*, 863 P.2d 207 (Cal. 1993).

[12] *Id.* at 216 (Mosk, J. dissenting).

[13] *Id.* at 215.

Cases

Assumption of Non-Operating Anchor Store Lease in Bankruptcy

*Michael P. Kuppersmith**

The U.S. District Court for the Southern District of New York upholds an assumption of lease by a non-operating grocery anchor tenant. *In re The Great Atlantic & Pacific Tea Company, Inc.*, 472 B.R. 666 (2012).

A recent decision by the U.S. District Court for the Southern District of New York (the "Court") highlights the issues a landlord faces when it attempts to regain control of vacant anchor space by challenging a non-operating anchor tenant's election to assume its lease in a Chapter 11 proceeding under the United States Bankruptcy Code (the "Code").

In 1986, Super Markets General Corporation, a predecessor to Pathmark Stores, Inc. ("Tenant" or "Pathmark"), entered into a lease ("Lease") of anchor space (the "Premises") in a retail center (the "Center") known as Allaire Village Plaza, in Wall Township, NJ, which provided for a term of 25 years, plus extensions, and the payment of fixed rent plus pass-throughs, but not percentage rent. The Lease obligated the tenant to open for business to the public as a supermarket, but did not obligate the tenant to remain open.

In 2007, The Great Atlantic & Pacific Tea Company, Inc. ("A&P"), acquired Pathmark. A&P operated a competing A&P store across the street from the Center and, in 2009, caused Pathmark to close its store in the Center. A&P subsequently filed a voluntary petition as a debtor under Chapter 11 of the Code with the Bankruptcy Court for the Southern District of New York ("Bankruptcy Court"). At the time of the filing, Pathmark was in default under the Lease, owing Androse Associates of Allaire, LLC ("Landlord"), $42,000.00. In July of 2011, the Bankruptcy Court, over the Landlord's objections, granted A&P's motion to assume certain leases (including the Lease) under § 365 of the Code. The Landlord subsequently appealed the Bankruptcy Court's decision allowing A&P to assume the Lease, contending that (i) A&P's decision was not based on good business judgment; and (ii) A&P did not provide adequate assurances that it would cure existing Lease defaults or of future performance.

Under § 365 of the Code, subject to the approval of the Bankruptcy Court, a debtor in a Chapter 11 proceeding may assume or reject an unexpired lease. The question of whether a lease can be assumed is one of business judgment. The Landlord argued that A&P's decision to assume the Lease was not a good business judgment because (i) Pathmark was not operating in the Premises and would remain obligated to pay approximately $700,000.00 per year in rent, and thus the assumption would not enhance A&P's profitability; (ii) A&P had not demonstrated that the Lease had value for the bankruptcy estate; and (iii) assuming the Lease to protect the operation of A&P's store across the street was not a good business judgment.

The court disagreed, finding that (i) A&P and its advisors had gone through a thorough review of all of its leases to determine which leases to assume (a factor the court found was evidence of good business judgment); (ii) the Landlord had previously offered the Tenant approximately $1,250,000.00 to terminate the Lease (thus demonstrating the Lease had value); and (iii) the strategic benefits of the assumption to A&P, including helping to preserve the profitability of A&P's store across the street, could constitute a good business judgment.

Even if the assumption of a lease constitutes a good business judgment, under § 365(b)(i) of the Code, a debtor cannot assume the lease unless it: (i) cures existing defaults or provides adequate assurance that it will cure existing defaults and (ii) provides adequate assurance of future performance. Although A&P did not specifically address its ability to cure existing defaults under the Lease or future performance under the Lease (instead, addressing those matters on a global basis for all if its assumed leases), A&P did offer evidence that it had $300 million in cash and $800 million in debtor in possession financing available and that the Lease was a valuable asset (as evidenced by the Landlord's offer to buy out the Lease), and the court confirmed that this was sufficient to meet the adequate assurance requirements of § 365(b)(i) of the Code.

The court also addressed the additional protections afforded shopping center landlords under § 365(b)(3) of the Code, which requires a debtor that assumes a lease in a shopping center to provide additional assurances: (i) of the source of payment of rent under the lease and, in the case of an assignment, that the operations and financial condition of the assignee are similar to that of the debtor at the time it entered into the lease; (ii) that percentage rent will not decline substantially; (iii) that the assumption is subject to all of the terms of the lease and will not violate other leases or agreements; and (iv) that the assumption or assignment will not disrupt any tenant mix or balance. The court found that A&P had satisfied these requirements, holding that (A) since the Lease was assumed and not assigned, the Tenant only needed to provide adequate assurance that existing defaults would be cured and of future performance under § 365(b)(i) of the Code; (B) the test in (ii) was irrelevant since Pathmark paid no percentage rent; (C) the test in (iii) was met since Pathmark remained subject to all of the provisions of the Lease; and (D) the assumption did not disrupt the "tenant mix" of the center since Pathmark had stopped operating prior to the bankruptcy proceeding (and any disruptions to tenant mix had already occurred *prior* to the bankruptcy, and were permitted by the terms of the Lease).

The *A&P* case demonstrates that it is difficult for a landlord to challenge a non-operating anchor's election in a Chapter 11 proceeding to assume its lease, even though the failure to operate may be detrimental to the center. The Landlord in *A&P* could perhaps have obtained a more favorable result for the center if the Lease contained a termination right/buy-out, which was triggered by Pathmark going dark.

Constitutional and RICO Claims Against a Municipality

*Peter Friedman**

The U.S. District Court for the Northern District of Illinois lets stand constitutional due process and equal protection claims, but dismisses a RICO claim brought by a shopping center owner against a municipality. *Glenwood Halsted LLC v. Village of Glenwood*, __ F. Supp. 2d __, 2012 WL 1108414 (N.D. Ill) (April 2, 2012).

The U.S. District Court for the Northern District of Illinois recently let stand equal protection and substantive due process claims brought by an existing shopping center against an Illinois municipality. The court dismissed the shopping center's attempt to allege a claim based on the Racketeer Influenced and Corrupt Organizations Act ("RICO").

Glenwood Halsted, LLC ("Glenwood") owned a shopping center complex in the Village of Glenwood, IL. The shopping center had between 24 and 30 units available to rent. According to the complaint, in 2008, the Village (and its mayor and building inspector) ("Village") commenced an effort to force Glenwood to sell the center to the Village or to the Village's chosen purchaser at a price well below market. The complaint alleges that that these efforts included (i) telling prospective tenants that the Village was going to condemn the property, that the Village would not support the tenants and that the center was going into foreclosure; (ii) denying business licenses to tenants; (iii) issuing false or exaggerated building code violations to the center; (iv) requesting "public relations" efforts (i.e., campaign contributions) and rent-free space in the center for the mayor's election campaign; (v) stating that "two cheap Greeks own" the center— thus, "Why should we give them the money?"; and (vi) offering to buy the center at well below fair market value and threatening condemnation if Glenwood did not agree within 60 days.

Glenwood sued the Village in federal district court, asserting federal equal protection, substantive due process and RICO claims.

The equal protection claim was based on Glenwood's allegations that the Village intentionally treated it differently from other commercial shopping centers in Glenwood (class-of-one theory) or those not owned by persons of Greek descent (suspect class theory). The Village argued that the claim should be dismissed because Glenwood had not specifically identified any other shopping centers that were similarly situated. The district court disagreed and let the claim stand, holding, in reliance on *Labella Winnetka, Inc. v. Village of Winnetka,* 628 F.3d 937, 942 (7th Cir. 2010), that Glenwood was not required in the complaint to specifically name the similarly situated entities that were treated more favorably.

The Village argued that the substantive due process claim should be dismissed because it was not a distinct constitutional claim from the equal protection claim. The court disagreed and denied the motion on that claim. The court explained, "the equal protection clause prohibits class and differential treatment of an individual from others similarly situated, whereas the due process clause forbids arbitrary action irrespective of an individual's membership in a protected class or the government's more favorable treatment of similarly situated individuals."

The court agreed with the defendant and dismissed the RICO claim against the Village. The court found that the plaintiff did not sufficiently plead the elements of a RICO claim, specifically the requirement that the Village engaged in a pattern of racketeering activity consisting of at least two predicate acts committed within a ten-year period, related to each other and posing a threat of continued criminal activity. While the court agreed that the demand for campaign contributions and rent-free space were two predicate acts, the court nevertheless found that the predicate acts "lack in number and variety, relate to only one scheme, affect no other victim, and cause no distinct injuries," and thus do not establish closed-ended continuity required to maintain the RICO actions.

Exculpatory Releases

*Colleen M. Leonard**

The Court of Special Appeals of Maryland holds that a parent may not contractually waive a minor child's future negligence claim against a commercial enterprise. *Rosen v. BJ's Wholesale Club, Inc.*, ___A.3d.___, 2012 WL 2764517 (Md. Ct. Spec.App.).

The Court of Special Appeals of Maryland joined the "majority view" in an issue of first impression that is particularly relevant to a retailer that caters to children or provides a child play area within the premises.

Russell and Beiley Rosen brought a negligence action against BJ's Wholesale Club, a membership warehouse store, seeking damages for the life-threatening injuries suffered by their son when he fell head-first off of a play apparatus onto an unpadded area of the floor in the BJ's child play area. Mr. Rosen, prior to the incident, signed the standard release agreement, which BJ's required to be signed before a child could enter the play area. The BJ's release contained an exculpatory clause in which the Rosens agreed that neither they, nor their child, would bring a claim or cause of action against BJ's, which arose from their son's use of the play area. The release also required that the Rosens indemnify BJ's against any liability of any kind arising from their son's use of the play area. In response to the Rosens' complaint, BJ's filed a counterclaim alleging that the Rosens breached the exculpatory provision and indemnity in the release agreement, and moved for summary judgment. The lower court granted summary judgment in favor of BJ's, and the Rosens appealed to the Court of Special Appeals of Maryland.

The appellate court reversed the lower court's decision, holding that a parent may not contractually waive a minor child's future negligence claim against a commercial enterprise. The court explained that "commercial enterprise" meant a for-profit, commercial entity primarily serving private interests. Because Maryland case law offered no precedent on point, the appellate court reviewed case law from appellate courts in various other states. The majority of states presented with this issue held that a pre-injury release agreement executed by an adult on behalf of a child is unenforceable and invalid. Courts taking this majority-view position based their findings on one or more the following grounds: (i) the rationale that the statutory law in the state in which the case was brought prohibited a parent from releasing a child's pre-injury claim; (ii) the reasoning that where exculpatory provisions are permissible, the party being released has less incentive to act with reasonable care; (iii) the principle that the owner or operator of a commercial business is in a better position to eliminate, and insure against, hazards than a minor child who is using the apparatus or play area; and (iv) the public policy justification that a state has a duty to act in the best interest of the child.

Because there was no clear Maryland statutory law prohibiting a parent from releasing its child's pre-injury claims, the *Rosen* court turned to the latter three rationales in determining its holding. The court cited its well-founded public policy of protecting the best interests of children, who are typically less capable of looking out for themselves. The *Rosen* court also focused on the need to incentivize commercial enterprises, which derive economic benefit from their services, to use reasonable care in maintaining their premises in a safe manner, to train their employees to do the same, and to protect against liability by insuring against harm caused to minors as a result of the operator's or its employees' negligence.

The *Rosen* court also held that the indemnification clause in the release agreement was similarly unenforceable based on public policy grounds. The court refused to allow BJ's to use the indemnity as a shield from its own liability since to do so would undercut the policy protecting minor children who are unable to protect themselves by shifting the liability to the child's parent. Enforcing such a provision could result in diminished motivation for a parent to zealously advocate its child's claim on behalf of the child.

While the *Rosen* court considered the minority-view cases that upheld the same type of exculpatory release agreement, it found that each such case involved claims against a governmental or public entity rather than a commercial enterprise.

The *Rosen* court's holding could have significant consequences to restaurants, grocery stores, skating rinks, ski resorts and other commercial enterprises that provide services to minor children. Such enterprises should be aware that the majority rule burdens the commercial enterprise with the obligation to use reasonable care in providing such services and to properly insure for against potential liability.

Exclusive Covenants

*Julia E. Lane**

The U. S. District Court for the Southern District of Florida denies a national grocer's claim for damages for alleged violations of exclusivity clauses. *Winn-Dixie Stores Inc. v. Big Lots Stores, Inc. et al.*, ___ F.Supp.2d. ___, 2012 WL 3292001 (S.D.Fla.).

Winn-Dixie Stores, Inc., ("Winn-Dixie") filed a class-action lawsuit against Big Lots Stores, Inc. ("Big Lots"), Dolgencorp, LLC ("Dollar General"), and Dollar Tree Stores, Inc. ("Dollar Tree"), for alleged violations of Winn-Dixie's "grocery exclusive" in 97 of its leases for stores that co-located in the same shopping center as one or more of the defendant parties in Florida, Georgia, Alabama, Mississippi and Louisiana. Winn-Dixie sought both damages and injunctive relief in each instance.

The operative grocery exclusive language in nearly all of the leases at issue provides:

> Landlord further covenants and agrees not to permit or suffer any property located within the shopping center to be used for or occupied by any business dealing in or which shall keep in stock or sell for off-premises consumption any staple or fancy groceries, meats, fish, vegetables, fruits, bakery goods, dairy products or frozen foods without written permission of the Tenant; except the sale of such items not to exceed the lesser of 500 square feet of sales area or 10% of the square foot area of any storeroom within the shopping center, as [an] incidental only to the conduct of another business … shall not be deemed a violation hereof.

In determining whether there was a violation of the exclusive covenant, the court first determined which items were to be considered included in the definition of "staple or fancy groceries." While Winn-Dixie drew upon previous case law in Florida to support its argument that the definition included both non-food items and traditional food items in the definition of groceries, the defendants argued for a narrower interpretation excluding non-food items, beverages, snacks and candy. Under Florida law, the exclusive covenant should be construed "in favor of the free and unrestricted use of the property, but … where the provisions are ambiguous, the court will enforce such restrictions, according to the intent of the parties." The court concluded that the intent of the parties was not capable of being determined and the court held that, as a matter of law, the definition of staple or fancy groceries should be interpreted to mean food items only. During trial, the court also determined that "beverages, including but not limited to, bottled water, soda, and energy and coffee drinks, but excluding alcoholic beverages," are included in the definition of staple or fancy groceries. Dollar General conceded that snacks, candy and beverages are included in their calculation of square footage for grocery items.

The court then turned to the issue of how the 500 sq. ft. of "sales area" was to be measured. The plaintiff argued that one-half of the area of the aisle in front of the display of the restricted items should be included in the 500 sq. ft. of sales area. The court held that because the leases did not define "sales area," nor does the dictionary define it, then that the term should be construed to include only the "footprint of the display unit, excluding aisle space."

Finally, the court struck down the plaintiff's argument that the "incidental" clause be construed as an additional limitation on the defendants' sale of restricted items, concluding that where a bright line test has already been provided, the additional language should be construed as "coextensive with or an extension of the other clauses." The court concluded that the "incidental clause" could not be practically enforced as an independent covenant and must be considered synonymous with the preceding language in the plaintiff's grocery store exclusive.

The court held that in the instances where a defendant store had used more than 500 sq. ft. of its sales area, excluding aisle space, or more than 10% of its sales area, for the sale of staple or fancy groceries, the restrictive covenant should be enforced and the plaintiff was entitled to an injunction, but not damages. The court concluded that the facts presented at trial were insufficient to calculate any damages to the plaintiff. (An appeal was filed on August 28, 2012.)

*MICHAEL P. KUPPERSMITH and PETER FRIEDMAN are Partners in the Real Estate section in the Chicago office of Holland & Knight, LLP. COLLEEN M. LEONARD and JULIA E. LANE are Associates in the Real Estate section in the Washington, DC, office of Holland & Knight, LLP.

The Perils of Poor Drafting: Ambiguity in Commercial Lease Agreements

*Blair Rebane**
Borden Ladner Gervais LLP
Vancouver, BC

Introduction

A large number of commercial leasing disputes are the result of poor drafting. As landlords and tenants will naturally have different, and sometimes conflicting, interests and objectives, it is critical for both of them to ensure that their respective rights and obligations are described clearly and precisely in the lease and any related agreements. Failure to do so can be a costly mistake, resulting in unnecessary disputes, litigation and loss of revenue. The recent case of *Emtwo Properties Inc. v. Cineplex (Western Canada) Inc.*, 2011 BCSC 1072 ["*Emtwo Properties*"], serves as a cautionary tale regarding the perils of poor drafting and the consequences of failing to ensure that commercial lease agreements are free from ambiguity.

Background

The basis of the dispute in *Emtwo Properties* concerned the proper interpretation of a provision in a lease agreement for the Granville Cinema, which was located in Vancouver, BC. The provision, which was referred to as the "radius clause," appeared in the lease as follows:

> It is understood and agreed and it is a condition precedent to the execution of this Lease by the Landlord, that the Tenant acknowledges that the income of the Landlord is dependent upon the attraction of customers to the Leased Premises and the Shopping Centre. Therefore, the Tenant agrees that throughout the Term:
>
> (a) it shall not, and
> (b) it shall not suffer or permit any Person under its control ~~or connected or affiliated with it~~; whether as partner, shareholder (of five percent (5%) or more of the issued and outstanding shares of the Tenant), lender (unless such lender is a recognized public financial institution), employee or otherwise, to
>
> engage directly or indirectly in, or furnish any financial assistance to, any business which is the same as or similar to, or in competition with, the Tenant's business in the Leased Premises within any building or building complex, any portion of which is located within a radius of … ~~two (2) miles~~ *1200 feet* from any point on the perimeter of the Leased Premises …
>
> To give effect to the foregoing, if the Tenant shall breach the foregoing covenant, or if another business as described in this Section is operated within the radius aforesaid, the Landlord, in addition to any other remedy available to it, is entitled to require that the gross revenue (calculated in the same manner as Gross Revenue) from and in respect of any such other business be included in the computation of Gross Revenue hereunder, as though such gross revenue had actually been made from the Leased Premises ….

In summary, under the radius clause, the tenant—Cineplex Odeon Canada, which later assigned the lease to a subsidiary, Cineplex (Western Canada) Inc. ("Cineplex Western")—agreed not to operate a competing business within 1,200 feet of the Granville Cinema. If it did, or if certain other entities did, the tenant agreed that the gross revenue from the competing business would be included in the calculation of the tenant's gross revenue for the purposes of determining percentage rent payable to the landlord.

Twenty years after the lease was signed, Cineplex Western's new parent company, Cineplex Entertainment Limited Partnership ("CELP"), acquired the nearby Scotiabank Theatre on Burrard Street in Vancouver, BC, which the parties agreed fell within the 1,200-foot radius of the Granville Cinema. As part of the acquisition, CELP entered into a consent arrangement with the Competition Commissioner to divest itself of certain theatres, one of which was the Granville Cinema. Accordingly, the lease was transferred to an unrelated company.

The landlords brought an action against Cineplex Western and CELP, seeking payment of $3,464,398.12 in percentage rent that, they claimed, they were owed from the time of the acquisition. They also sought a declaration that the defendants were liable on the same terms until the expiration of the lease in 2016.

The principal issue at trial was whether, pursuant to the radius clause, Cineplex Western was obliged to include the revenue from CELP's operation of the Scotiabank Theatre in the calculation of its percentage rent under the lease. If so, a second issue arose as to whether CELP was also liable to the landlord on the basis that Cineplex Western was merely its alter ego. The claim against CELP was necessitated by the fact that Cineplex Western was without assets. Thus, in order to be successful, the landlords had to win on both issues.

Positions of the Parties

The landlords claimed the radius clause was triggered because CELP, as the sole shareholder of Cineplex Western, was obviously a shareholder of 5% or more of the shares of the tenant under the terms of the lease. The landlords argued that although control by the tenant was generally the governing principle regarding the application of the clause, the references to a partner, a shareholder of 5% or more, a lender and an employee operated as deeming provisions—establishing specific instances in which the clause would also apply. According to the landlords, this was the only interpretation capable of giving effect to the language of the clause as a whole.

The defendants argued that, on the plain meaning of the words in the radius clause, control by the tenant was the sole consideration. The defendants submitted that the roles listed in the remainder of the clause merely described various capacities in which a person may be found to be under the tenant's control, provided that control could be established in the first place. The defendants further argued that, as Cineplex Western's parent company, CELP could hardly be considered to be under its control.

In light of the obvious tension between the seemingly inconsistent requirements of the radius clause, the defendants argued that the clause was ambiguous and should therefore be strictly construed in their favour.

The Decision

After considering the language of the radius clause in light of the relevant principles of contractual interpretation, the court concluded that neither construction proposed by the parties was entirely satisfactory. Rather, it found that the clause was ambiguous. The ambiguity, it said, arose from the words "shareholder [of five percent (5%) or more of the issued and outstanding shares of the Tenant]" in juxtaposition to the apparent requirement that the competitor be "under [the tenant's] control." The court noted that it would be unusual for a shareholder of a company to be under that company's control, and found on the evidence that such was not the case here. On the contrary, it was the other way around.

Notably, the court rejected the defendants' submission that the radius clause should be interpreted narrowly on the basis that it creates a covenant in restraint of trade. Given that the agreement had been negotiated by sophisticated commercial entities, Sigurdson J. declined to resort to this approach here.

The court also rejected the landlords' submission that the reference to a shareholder of 5% or more in the radius clause amounted to a deeming provision. In the absence of express language to this effect, the court was not persuaded that this was a commercially reasonable interpretation. Instead, the court found that the only way to give meaning to both the requirement of control and the roles enumerated in the rest of the clause was to treat these roles as examples of relationships that would be captured by the clause as long as control by the tenant was established.

In view of the language of the provision as a whole, the court held that the use of the words "that the tenant shall not suffer or permit" suggested the parties intended the prohibition to be applicable only to matters that were within the tenant's control. In the court's view, it would be inconsistent with the words chosen if the clause could be triggered where a person owning another theatre in the area acquired a small interest in the shares of the tenant. Simply put, the tenant could not suffer or permit something it had no ability to control. Further, the court found that deletion of the words "or connected or affiliated with it" was indicative of a common intention to adopt a more restrictive version of the clause than was initially drafted.

The court concluded at para. 85:

> In all of the circumstances, I find that the interpretation of this ambiguous provision, from an objective consideration of all of the words of the contract, is that the parties intended that [the radius clause] requires control to be operative. Here, as the parent is not under the control of the subsidiary, the activities of the parent CELP in operating a competitive theatre do not trigger the radius clause requiring inclusion of the competitor's revenue to calculate additional rent.

Accordingly, the landlords' claim against Cineplex Western was dismissed. As there could be no liability to CELP in the absence of any liability to Cineplex Western, this result was sufficient to dispose of the action as a whole, leaving the landlords empty-handed and liable for the defendants' costs.

Key Takeaway

As the decision in *Emtwo Properties* plainly illustrates, the importance of using clear language and careful drafting in commercial lease agreements cannot be overstated. In particular, from the landlord's perspective, if your intention is to restrict the tenant's ability to do business, you must be especially careful to ensure that the language you select is precise and unambiguous. Although the court declined to follow this approach here, restrictive covenants are often interpreted narrowly and, as a result, can be difficult to enforce.

A well drafted lease could have avoided many of the problems with respect to interpretation and application that were experienced here. Had the lease expressly stated that the operation of a competing business by a shareholder of 5% or more of the shares of the tenant would require the payment of additional percentage rent, the dispute and resulting litigation could have been avoided altogether. Instead, the ambiguous wording and apparently inconsistent requirements of the radius clause resulted in there being more than one possible interpretation of the circumstances in which the tenant would be required to pay additional percentage rent; the court was left to determine the parties' intention, based on the words they used and with reference to general commercial principles. The outcome serves as a valuable lesson for landlords and tenants alike.

Anyone drafting or negotiating a commercial lease agreement is well advised to turn their mind to these issues at the earliest opportunity. Depending on the nature of the business, the lease could be one of the most important agreements you will ever sign. Accordingly, it is in your interest to spend the time and effort necessary to ensure that the lease accurately captures and clearly expresses your understanding of your rights and obligations.

*Blair A. Rebane is a Partner and National Leader of Borden Ladner Gervais LLP's Franchise and Distribution Group, as well as the Vancouver Regional Leader of the firm's Auto Industry Group. He practises franchise and distribution law as well as commercial litigation with a focus on commercial leasing disputes. Mr. Rebane has appeared as counsel in court on a large number of franchise and commercial leasing matters and acts for a number of Canada's most significant franchisors, manufacturers, retailers and landlords.