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Sandy, One Year Later: Issues Facing Property Owners

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Real estate lawyers have been and will be the leaders of the rebuilding process of our storm-torn city. One of our most important functions is to prepare for the next storm or potential casualty. In order to improve our lawyering it is essential that we learn the lessons from the storm. For this we turn to the Sandy-related real estate cases on commercial leasing, insurance coverage and other related issues.

There are, in total, five reported real estate decisions that have come down in the aftermath of Superstorm Sandy, two of them landlord-tenant, one of them regarding negligence liability for a fallen crane, one for utility liability for failed power, and one for construction of an insurance policy. Additionally there are some seven complaints on file, six of them construing insurance policies and one suing a landlord for alleged negligence. These suits, both completed and pending, can provide useful instruction for the kinds of actions a landowner must take to prepare for the next natural or civil disaster to afflict New York City.

Landlord-Tenant Litigation

In landlord-tenant litigation resulting from storm damage, focus comes first on Real Property Law §227, a provision that overrides the common law so as to allow a tenant to break a lease or tenancy and surrender the premises in the event of disaster. This provision comes into play relatively rarely as, by its terms, it is waivable if the parties arrive at some other agreement. All standard form leases waive this provision and so do nearly all hand-crafted attorney drawn commercial leases. The statute therefore has only a very small body of modern case law. Instead, the case law focuses on the so-called casualty clauses of modern leases.

The most widely available commercial lease forms, those of the Real Estate Board of New York (REBNY), have a common law construing their casualty clause found at Article 9, stating "Destruction, Fire and Other Casualty… If damaged by fire or other casualty...Tenant shall give immediate notice thereof to Owner and lease shall continue in full force and effect except..." New York's leading case Vermont Teddy Bear v. 538 Madison Realty,1 construes Article 9 and its complex mechanism for suspending the rent or terminating the lease in the event of casualty. However, neither Article 9, Vermont Teddy Bear, nor any other New York case defines just what a casualty is. Rather, under the structures of Article 9, there is no casualty at least until one of the parties to the lease declares there to have been one.

What Is a Casualty?

In 4261 Realty v. DB Real Estate,2 Sandy substantially damaged the premises. 4261's major focus was on the question of giving notice under Article 9. The notice the tenant gave to the landlord conformed to the lease requirements except as to being "return receipt requested." 4261 excused that deficiency and held the notice sufficient under the circumstances. The landlord was shown to have actually received the notice and the court also spoke of exigent notice being allowed in exigent circumstances.

However, long before Sandy, Milltown Park v. American Felt& Filter, 180 A.D.2d 235, 584 N.Y.S.2d 927 (Third Dept. 1992), had required the notice precisely as defined by the lease in spite of tenant's claim that the landlord had actual knowledge. Thus, the ruling in 4261 is questionable.

The other focus in 4261 centered around landlord's claim that the premises never became wholly unusable so as to trigger a rent abatement and the tenant's claim to the contrary. If the premises were merely rendered partly unusable, then, according to the court, the tenant would be entitled to no abatement. The decision in 4261 denies summary judgment, the court finding a triable issue of fact on whether or not the premises were rendered wholly unusable or merely partially so.

Maiden Lane Properties v. Just Salad Partners3 is also a case construing Article 9 of the REBNY lease where the tenant gave no Article 9 notice at all, but still claimed the benefits of Article 9's rent abatement allowances.4 Even more damning to the tenant's position in Just Salad, the tenant's claim was entirely based on loss of electricity, tenant's exclusive responsibility under the lease. Weeks of no public utility-provided electricity inspired the tenant to claim an abatement of the rent. Core to the tenant's claim was that as the landlord had supplied (via free standing generators) electricity to its residential tenants, it should also have provided electricity to its commercial tenant, Just Salad.

Given the absolute absence of notice under Article 9, together with the lease's specific exculpation of the landlord from responsibility for electricity, the tenant's loss in a suit focused entirely on failure to provide electricity was essentially inevitable. The lease in question even released the landlord for liability for its own failures to provide electricity except in cases of gross negligence or willful misconduct.

Constructive Eviction

In Just Salad, the tenant sought to have the rent abated by reason of "constructive eviction," a situation in which the landlord's upkeep of the premises is so badly performed that the tenant is compelled to abandon all or part of the premises. Key to the concept of constructive eviction, however, is fault on the part of the landlord. Mere happenstance is not fault. In Barash v. Pennsylvania Terminal Real Estate,5 the Court of Appeals set the standard for constructive eviction, writing, "On the other hand, constructive eviction exists where, although there has been no physical ex-

pulsion or exclusion of the tenant, the landlord's wrongful acts substantially and materially deprive the tenant of the beneficial use and enjoyment of the premises."

Thus, for a tenant to claim constructive eviction, mere casualty to the premises is insufficient. There must also be proof of the landlord's wrongful acts. Thus, the Just Salad court saw no need even to mention constructive eviction in its decision.

Reasonable Preparation

While there have been no Sandy-related decisions that have come down on what a landlord should do to prepare for a storm, one complaint that has been filed shows the kind of claims that landlords have to face on the subject.

In Manfra, Tordella & Brookes v. 90 Broad Owner,6 plaintiff-tenant's theory is that the landlord was liable for neglecting to take supposedly reasonable precautions against flooding caused by Superstorm Sandy such as window boarding and sandbagging.

Among the allegations of the complaint were:

> 32. "Because of its history of flooding and location in low lying Zone A, Defendant was well aware that 90 Broad in general, and MTB's offices in Particular, were highly susceptible to flooding and would likely experience severe flooding in the event of a major storm, such as Hurricane Sandy."
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> 37. Defendant was thus fully aware, and warned of the potential flooding that would occur as soon as Sandy made landfall. Despite this knowledge, and expectation of storm related flooding, Ms. Arce's email did not include any information regarding any steps Defendant took or would take to prevent or at the very least, mitigate, the potential damage to the Building from storm related flooding.

Some of the preparations our clients have made or are in the process of making include moving facilities higher, encapsulating utilities and lines with waterproof materials, and upgrading their facilities to be more storm resistant or building a barrier preventing water from entering the building. Of course, all of this has been accomplished as a result of Sandy.

Insurance Litigation

Cashew Holdings v. Canopius U.S. Insurance,7 the only reported decision in Sandy-based insurance law, started in Queens Supreme Court. The case was removed to the Federal District Court where the insured sought a preliminary injunction requiring payment on the insurance policy as a result of Superstorm Sandy and holding the insurance policy in place.

The court found lack of irreparable injury precluded issuance of a preliminary injunction and a lack of likelihood of success as the policy excluded damage due to flood or other causes linked to water. While the policy covered wind damage, that defined the limits of the insurer's liability. Thus, the court denied the plaintiff a preliminary injunction.

Aside from the preliminary injunction issues, the decision was very much a battle of the experts as to whether plaintiff suffered its damages from the water or the wind. Since typically insurance policies cover for wind, but not for water, that determination is crucial. However, in Cashew Holding the decision was on a preliminary finding of lack of probable success and therefore did not ultimately determine for the case whether the theories of water or wind would eventually prevail.

The court also found that the insurer was under no obligation to renew the insurance policy. The lesson from this case is that the consumer or business should not only be extremely careful in selecting insurance policies, but should be prepared for vastly larger premiums in order to purchase more exotic policies once there is a recovery on insurance because of damage from a large scale storm.

Since Cashew Holding is the only reported Sandy decision on the subject of insurance, there is value in looking at the reported complaints on the subject. Of course, anyone can plead anything, but examination of these complaints is nonetheless instructive in the kinds of issues we can expect to see in the aftermath of a major storm. In Neptune Food v. Federal Insurance,8 for example, an insured sued for business losses caused by Superstorm Sandy. The controversy of the case centers around clauses in the insurance policy dealing with covered perils worsened by uncovered perils. Here, the covered peril is wind and the uncovered peril, water.

In Bamundo v. Sentinel,9 a law firm sought to collect on its loss of business insurance on the theory that its business was shut down by civil authorities who ordered transportation systems shut down and refused the employees of the firm access to their offices. The insurance companies disclaimed coverage, finding that it was not civil authority that shut down the business, but loss of electricity.

In Lester Schwab v. Great Northern,10 (see complaint), Newman Myers v. Great Northern,11 and Shapiro v. National Fire,12 various law firms allege that their respective insurance carrier breached their insurance policies. Each plaintiff entered into an insurance policy with each respective defendant, insuring the plaintiff against any loss of business income it may sustain and against any extra expenses it may incur as the result of a loss to the subject premises by a "covered peril." In these three otherwise unrelated cases, plaintiffs seek to recover for the loss of electricity on the theory that it was caused not by water, but by the explosion at the ConEd plant. Each insurer is claiming that the loss of electricity was due not to the explosion, but to the flooding that destroyed the electrical infrastructure.

Loss of electricity was also the issue in Just Salad, supra, but there the lease specifically cast all responsibility for the electricity on the tenant. The court therefore rejected the Just Salad tenant's purported defense to rent based on the loss of electricity. Underlying all this was the understanding that the tenant should have insured against this loss instead of looking to the landlord.

Utilities

Utilities have always enjoyed special legal protections. This is no more evident than in Balacki v. Long Island Power Authority,13 a small claims case in which the claimant sued in small claims court for loss of food due to loss of refrigeration due to the extended loss of power in the aftermath of Superstorm Sandy. The court found clear evidence that the Power Authority was negligent. However, prevailing case law exempts a power utility from liability for loss of electricity if the published rates claim such an exemption for mere negligence, as opposed to gross negligence.

Quoting the Moreland Commission that had investigated what went wrong with Sandy and why, the court wrote, "Hurricane Sandy was a unique storm which caused an unprecedented interruption of service to Lipa customers." The resulting "power outage" was "inevitable" and was on a scale which would take days for restoration under optimal conditions."

According to the court, it was unable to find gross negligence because under its reading of the case law, "gross negligence" entails the failure to exercise even slight care. Holding that the entirely inadequate precautions of the utility did not rise to that level, it dismissed the complaint.

Conclusion

Impossible to know precisely what the risks will be, attorneys drafting the necessary documents must use both the experience of the past and imaginings of the future to prepare for the worst.

For the landlord, long term preparation for

a storm of any kind must include careful drafting of the lease so as to allocate the risks of the storm to the tenant. For the tenant who typically must accept most of the lease as written, the chief corresponding preparation is getting appropriate insurance policies, covering both the costs of doing physical repairs to the premises and the loss of business that can be occasioned by forces entirely exterior to the premises such as loss of electricity, Internet, or potable water.

Adam Leitman Bailey is the founding partner and Dov Treiman a partner of Adam Leitman Bailey, P.C. The firm represented the prevailing party in the 'Just Salad' trial.

1. 1 N.Y.3d 470 (2004).
2. 2013 WL 4437198.
3. 056312/13, NYLJ 1202598292879, at *1 (Civ NY Schecter).
4. The authors were petitioner's counsel in this case.
5. 26 NY2d 77 (1970).
6. 2013 WL 373327.
7. 2013 WL 4735645 (EDNY 2013).
8. 2013 WL 3423065 (E.D.N.Y.).
9. NY County Index #157622/2013.
10. NY County Index #652708/2013.
11. NY County Index #151774/2013.
12. NY County Index #650037/2013.
13. 40 Misc.3d 1220 (Dist. Nas. 2013).