Nochumson Speaks About New Developments In Landlord-Tenant Law

Alan Nochumson, Esquire served as a faculty speaker at a Continuing Legal Education (CLE) seminar entitled *Landlord-Tenant Law: Surviving In A Difficult Economy* which was sponsored by Sterling Education Services, Inc.

During the seminar, Nochumson spoke about the legal and practical aspects of leasing real estate in Pennsylvania.

Vertical Position 100%

Eastern District Upholds Ordinance Requiring Rental Property Inspections

The Fourth Amendment to the U.S. Constitution protects citizens from unreasonable search and seizures along with a need for a warrant judicially supported by probable cause.

In *Marcavage v. Borough of Lansdowne*, the U.S. District Court for the Eastern District of Pennsylvania delved into whether a borough ordinance requiring the inspection of a rental property to obtain a rental license violates the Fourth Amendment.

According to the court’s opinion, in 2003, the borough of Lansdowne adopted Ordinance 1188, which made it unlawful for

property owners to lease property within borough limits without first acquiring a rental license issued by the borough's Code Enforcement Division. In order to obtain a license, a property owner had to arrange for a rental license inspection by the division. Under Ordinance 1188, such an inspection even applied to any owner-occupied portion of a rental property.

In the event of a violation, Ordinance 1188 instructed the borough's code enforcement officer to issue a notice of violation and empowered the officer to use any appropriate means to prevent any act or use constituting such violation.

According to the opinion, Michael Marcavage owned a couple of multi-unit apartment houses located in the borough, living in one of the units while leasing the remaining units. Although Marcavage received annual notices from the borough directing him to obtain rental licenses for his properties, he never allowed for property inspections to take place, as per Ordinance 1188. Instead, he contacted the borough on multiple occasions to express his objections with the rental inspection process, chiefly because of the lack of a warrant requirement for such inspections.

In late 2009, Marcavage received notices from the borough regarding both of his properties, declaring each of the properties an "unlawful rental property" for failure to obtain a rental license and prohibiting him from collecting rent, using or occupying the properties until he obtains a rental license. Neither of the notices informed Marcavage of how to appeal or contest the borough's decision.

Marcavage filed suit, along with a motion seeking a temporary restraining order, in order to prevent the borough from enforcing the notices or commencing any process against him for residing at his home. The borough agreed to refrain from taking any further action against Marcavage under Ordinance 1188 while the litigation was pending.

In early 2010, while the litigation was still pending, the borough enacted Ordinance 1251 that amended Ordinance 1188. Ordinance 1251 clarified certain rights and remedies of property owners and occupants of any property subject to the rental inspection requirement. Ordinance 1251 allows the property owner to deny entry to a code enforcement officer for the purposes of complying with the ordinance, but the code enforcement officer is allowed to ask for permission to enter the property for inspection and to seek a search warrant based upon probable cause or to enter the property in emergent situations.

After the passage of Ordinance 1251, Marcavage filed an amended complaint in the pending litigation, claiming that Ordinance 1251 was unconstitutional based upon, among other things, the Fourth Amendment.

The district court first addressed whether Marcavage had standing to assert alleged violations under the Fourth Amendment with respect to his rental units or on behalf of his tenants. Since Marcavage lived in one of his units, the federal district court concluded that a privacy interest in his own residence did arise, and therefore he had standing to challenge the constitutionality of the borough ordinance.

The federal district court then analyzed whether the borough ordinance violated his privacy interest. Marcavage based his argument primarily upon the U.S. Supreme Court's ruling in *Camara v. Municipal Court of City and County of S.F.*

In *Camara*, a couple of San Francisco ordinances were at issue. The first ordinance permitted city inspectors to enter any building for purposes of inspection and the second ordinance set out criminal penalties for property owners who refused to permit city inspectors to enter a building to perform an inspection. The plaintiff in *Camara* was a San Francisco property owner who was prosecuted for failure to allow an inspector to enter his property and who challenged the

constitutionality of the ordinances based upon Fourth Amendment grounds.

The Supreme Court in *Camara* held that the ordinances that authorized warrantless searches were in violation of the Fourth Amendment. Marcavage argued Ordinance 1251 was similarly unconstitutional.

The district court in *Marcavage* disagreed. According to the court, the ordinances in *Camara* allowed government employees to enter premises in the name of an inspection, subject to no limitations and criminal prosecution. In other words, the government in Camara had unregulated discretion to enter any unit, property owners were powerless to stop the government and the Supreme Court, in issuing its ruling, emphasized that this discretion was problematic.

Unlike the ordinances in *Camara*, the district court noted that Ordinance 1251 does not afford the borough unfettered discretion in entering a unit and there are no criminal penalties attached to a property owner's refusal to consent to a search. Rather, as pointed out by the federal district court, Ordinance 1251 provides that a property owner has "the right to deny entry to any unit or property by a code enforcement officer," and if the property owner does so deny permission, the borough may only enter the property by seeking a search warrant based upon probable cause or in the case of emergency.

The district court then discussed the U.S. Supreme Court's ruling in *Wyman v. James*, which was decided several years after *Camara*, where the Supreme Court upheld an ordinance that required a home inspection in order to investigate safety conditions for children on welfare because "the visitation in itself [wa]s not forced or compelled" and the only consequence of refusing to consent to an inspection was the loss of welfare funding.

Similar to the ordinance in *Wyman*, the federal district court believed that Ordinance 1251 does not force or compel an inspection, because the only consequence of failing to consent to a search is the denial of a rental license. As such, the issuance of monetary fines and criminal prosecution are only possible under Ordinance 1251 if a property owner, after having failed to obtain a rental license, leases his property to a third party or represents to the public that his property is for rent, use or occupancy.

LESSONS LEARNED

In upholding ordinances of this ilk, courts have placed the onus upon the property owner. The property owner, for the most part, will not be compelled to allow the government to inspect the property. However, as an end run around, the government is authorized to limit the usage of the property if the property owner so refuses access to the property. This nuance should not go unnoticed by property owners throughout the commonwealth.

Alan Nochumson

Vertical Position 100%

Nochumson Speaks About

Handling Landlord-Tenant Disputes In Philadelphia

Alan Nochumson taught a Continuing Legal Education (CLE) program entitled *Litigating Landlord-Tenant Disputes In Philadelphia County* which took place at Jenkins Law Library in Philadelphia, Pennsylvania.

During the program, Nochumson spoke about the notice requirements due to a tenant under state law, the defenses a tenant has to non-payment of rent, the rationale for filing a complaint in The Philadelphia Municipal Court or the Court of Common Pleas, and much, much more.

Vertical Position 100%

Landlord Fails To Properly Terminate Lease, Violating Automatic Stay

When a landlord enters into a lease with a tenant, the lease will generally grant the landlord the power to terminate the lease and evict the tenant from the leased premises if the rent due under the lease is not paid within the specified time period provided in the lease. In order to exercise this power, however, the landlord must comply with the terms of the lease and any relevant law specifying the required procedure for termination and eviction.

A recent decision by the U.S. Bankruptcy Court for the Eastern District of Pennsylvania, *In re Ice Treats One Inc.*,

illustrates why a landlord must strictly adhere to the terms of a lease, and to the laws of the governing jurisdiction, prior to initiating eviction proceedings.

In *Ice Treats*, related entities entered into separate leases to rent properties from the landlord for the purpose of operating Rita's Water Ice stores located in Philadelphia.

Under each of the leases, the tenant is responsible for paying rent on the first day of each month, and, if the tenant fails to pay rent within five days after receiving written notice from the landlord, the landlord may terminate the lease but only upon 10 days' written notice to the tenant.

After the tenant failed to make timely payment for rent under each of the leases, the landlord sent letters of default to the tenant, stating that the tenant would be in default under the terms of the leases unless the landlord received payment, in full, of the rent within 10 days from the date of the letters, the opinion said.

According to the opinion, two days later, after the letters of default were mailed to the tenant, the landlord filed in the Philadelphia Municipal Court separate landlord-tenant complaints against the tenant in order to evict the tenant from each of the leased premises. In the complaints, the landlord represented to the court that, on the day of the court filing, the landlord had provided the tenant with a "Notice to Quit," or, in other words, the landlord advised the tenant, in writing, to vacate from each of the leased premises in accordance with the Landlord and Tenant Act of 1951, the opinion said.

After the 10-day period in the letters of default had expired, the landlord sent letters of termination to the tenant, explaining the landlord's decision to terminate each of the leases because the tenant was in default of the terms of the leases by failing to make the payment of rent as demanded by

the landlord in the previous letters of default, the opinion said.

The letters of termination also included a “Notice to Quit,” whereby the landlord demanded that the tenant vacate from each of the leased premises 15 days after the date of the letters of termination, the opinion said.

When the tenant failed to appear at the municipal court hearing on the complaints, the court entered a default judgment in favor of the landlord and against the tenant, the opinion said.

After the landlord filed a praecipe for a writ of possession, an alias writ of possession was issued and served.

The landlord ultimately took physical possession of each of the leased premises pursuant to the writs. After the tenant was evicted, its water ice stores were taken over by businesses that began operating the water ice stores under another name.

Shortly thereafter, the tenant filed a petition requesting that the municipal court open the default judgment entered in favor of the landlord and against the tenant.

The municipal court subsequently vacated the default judgment and issued an order for a new monetary judgment and a new judgment for possession in favor of the landlord and against the tenant. The tenant then appealed these newly entered judgments to the Philadelphia County Court of Common Pleas. During the pleading stage of litigation, the tenant filed a suggestion of bankruptcy with the trial court, the opinion said.

A suggestion of bankruptcy is filed to place a court on notice that the defendant in a pending lawsuit has filed a bankruptcy petition. The filing of such a petition operates as an automatic stay of any act to exercise control over property of

the estate. When, prior to the bankruptcy filing, a lease has not been terminated, “the lease is property of the estate subject to the automatic stay.”

In *Ice Treats*, in determining whether the tenant was entitled to the protections of the automatic stay, it was necessary for the bankruptcy court to decide whether the lease was terminated pre-petition. In deciding whether the lease was properly terminated pre-petition, the bankruptcy court examined whether the landlord’s termination of the leases complied with Pennsylvania law.

The bankruptcy court began its analysis by noting that the 3rd U.S. Circuit Court of Appeals has previously held, based upon the Landlord and Tenant Act of 1951, that “a landlord must give a tenant notice in writing before commencing eviction proceedings.”

According to the bankruptcy court, this notice, which the act titles, “Notice to Quit,” allows a tenant time to prepare for eviction once the tenant has failed to respond to the demand for payment. The act requires a landlord seeking eviction to provide the tenant with written notice to vacate from the leased premises due to a failure to pay rent upon demand.

Because the landlord’s notices to vacate here, the letters of termination were not sent to the tenant until after the landlord filed the complaints seeking eviction, the bankruptcy court noted that the landlord failed to comply with the prerequisites for eviction actions under the act.

In doing so, the bankruptcy court found that, because the landlord failed to properly obtain judgment upon the complaints, the writs of possession should never have been issued, and, therefore, the landlord was not entitled to have the tenant evicted from each of the leased premises.

Because the writs of possession should never have been issued, the bankruptcy court concluded that the tenant retained its

interest in each of the leased premises and that the landlord's and the successor tenant's failure to return each of the leased premises to the tenant after notice of the bankruptcy filings was a violation of the automatic stay.

In a warning shot to both the landlord and the successor tenant, the bankruptcy court also pointed out that the issue of whether the violation was willful and, consequently, what damages the landlord should be liable for was to be determined at a later hearing.

LESSON LEARNED

The bankruptcy court's ruling in *Ice Treats* clearly demonstrates the importance of complying with the express terms of a lease. The "Notice to Quit" requirement, in addition to providing the desired notice to tenants, also allows landlords to overcome a major legal hurdle should they bring action to recover possession of leased premises.

In *Ice Treats*, the landlord failed to comply with the notice requirements of the lease and, therefore, was prevented from recovering possession, despite the fact that the tenant did, in fact, default on its rental obligations. Even worse, the landlord may now be liable for damages if its violation of the automatic stay is deemed willful by the bankruptcy court.

Alan Nochumson

Vertical Position 100%

Broker Not Entitled To Commission In Oral Agreement

In a real estate transaction involving the lease or sale of commercial property, a real estate broker will typically play a significant role in the transaction. The broker's compensation for the completed transaction depends upon the type and terms of the agency agreement executed between the broker and the property owner.

One of the most common types of agency agreements is an exclusive listing contract, which generally provides that the broker will receive a commission if the transaction sought is completed within a specified time period. The purpose of such an agreement is to motivate the broker to complete the transaction quickly and for the highest price possible. If the transaction is not completed within the time stated in the contract, the parties can choose either to part ways or to extend the term of the contract for an additional period of time.

A recent decision by the Superior Court of Pennsylvania in *Michael Salove Company v. Enrico Partners L.P.* illustrates the importance of putting into writing the extension of the term of an exclusive listing contract.

Michael Salove Company (MSC), a real estate brokerage firm, and Enrico Partners L.P., a property owner, entered into an exclusive listing contract for the lease of vacant space owned by Enrico in the Main Line suburban area of Philadelphia, the opinion said. MSC had prepared a short form written agreement and after Enrico reduced the duration term of the contract and altered the compensation provisions, the parties executed the written agreement as modified, the opinion said.

When the term of the contract expired, MSC had not yet found a suitable tenant for the vacant space and was not engaged in negotiations with any prospective tenants. MSC alleged that it entered into an oral agreement with Enrico to extend the term of the listing contract prior to its expiration. MSC also claimed that the parties "decided that it wasn't imperative to get … the extension in writing," the opinion said.

According to the opinion, MSC was unable to recollect whether the parties ever discussed the duration of the extension of the term, and MSC admitted it did not send any e-mails or other correspondence to Enrico regarding the conversation. Although MSC claimed that the parties orally agreed to continue operating pursuant to the written exclusive listing contract, Enrico completely denied the existence of any agreement oral or otherwise to extend the duration of the term of the listing contract, the opinion said.

After the original term of the contract had already expired, a prospective tenant reached out to Enrico and expressed interest in leasing the vacant space. Enrico and the prospective tenant exchanged e-mails about the property and the prospective tenant visited the space and, when it did, it saw MSC's sign in the window. Operating under the assumption that MSC was the brokerage firm managing the property, the prospective tenant called MSC and arranged for MSC to accompany the prospective tenant on a tour of the space. After the tour, MSC called the prospective tenant to set up a meeting at the property to discuss with Enrico the logistics of leasing the property.

MSC, Enrico and the prospective tenant met at the space and later exchanged numerous e-mails regarding financial information of the prospective tenant. However, when formal lease negotiations began, MSC did not participate. Soon thereafter, without MSC's involvement, Enrico executed a lease agreement with the prospective tenant for the space.

Because MSC was not paid a brokerage commission as a result of the lease, MSC filed a broker's lien claim against Enrico. MSC thereafter voluntarily agreed to dismiss its lien against the property and, in lieu thereof, proceeded with a claim against Enrico based upon breach of contract, unjust enrichment and quantum meruit.

After discovery, Enrico moved for summary judgment, arguing, in part, that "the claims for commissions were barred by the Real Estate Licensing and Registration Act, RELRA, 63 P.S. 455.101 *et seq.*, because the nature of the services and the fee to be charged were not set forth in a written agreement signed by the consumer."

The trial court granted summary judgment in favor of Enrico, finding "the claim for commissions pursuant to an oral modification extending the term of a written brokerage agreement to be barred under RELRA, and specifically, 63 P.S. 455.606a(b)(1)."

MSC appealed the grant of summary judgment to the Superior Court and only raised the following issue on appeal: "[w]hether 455.606a(b)(1) of the [RELRA] . . . precludes an oral agreement to extend the term of a commercial written real estate broker's agreement, where such written agreement, by operation of law, permits oral modifications of the written agreement."

The Superior Court ultimately found in favor of the property owner, Enrico, rejecting MSC's contention that, prior to the expiration of the term of the exclusive listing agreement, the parties orally agreed to extend the written agreement indefinitely.

Specifically, MSC argued that because the written agreement did not require modifications to be made in writing, the parties were free to orally extend the duration of the agreement. Thus, MSC asserted that the orally extended

agreement was in effect when the prospective tenant expressed interest in the space and at the time the lease was executed, and, as such, MSC was "entitled to a commission as the exclusive listing broker." According to MSC, the "RELRA only requires that the material terms of the parties' contract be in writing."

In agreeing that the RELRA only requires that the material terms of the contract must be in writing, the Superior Court noted that the outcome on appeal hinged upon whether the duration of the term of the agreement was a material term of the agreement.

In resolving this ultimate issue, the Superior Court relied upon the statutory construction of the RELRA, which the legislature amended in 1998 and enacted in 1999 to provide that brokerage agreements must be in writing. In doing so, the Superior Court discussed various relevant sections of the RELRA, in addition to regulations promulgated pursuant thereto.

The Superior Court began its analysis by stating that 63 P.S. 455.606a(b) of the RELRA provides, in pertinent part, that: "[a] licensee may not perform a service for a consumer of real estate services for a fee, commission or other valuable consideration paid by or on behalf of the consumer unless the nature of the service and the fee to be charged are set forth in a written agreement between the broker and the consumer that is signed by the consumer."

The Superior Court continued that the RELRA states a written brokerage contract must contain "[a] statement that the broker's fee and the duration of the contract have been determined as a result of negotiations between the broker and the seller/landlord or buyer/ tenant."

To complete its examination of the statutory construction of RELRA, the Superior Court explained that "[e]xclusive listing

agreements, the type of agreement involved herein, which entitle the listing broker to a commission even if he does not procure the eventual buyer, are governed by 49 Pa. Code 35.332, which provides that exclusive listing contracts 'shall contain, in addition to the requirements in 35.31 . . . the duration of the agreement."

Though the Superior Court "decline[d] to hold that RELRA precludes any oral modification of a written exclusive listing agreement," it did state that "an oral modification of a term of such an agreement, which is required [there]under . . . to be in writing, cannot support a claim for commissions or fees under RELRA."

Since MSC admitted that the parties did not agree in writing or orally, for that matter on the duration of the term of the extended agreement, the Superior Court held that any such oral extension did not comply with the RELRA and MSC's claim to a commission under RELRA is barred.

LESSON LEARNED

The court's ruling in *Michael Salove Company* plainly demonstrates the importance of putting agreements related to real estate transactions into writing. Here, the brokerage firm, MSC, failed to memorialize an alleged oral extension of a prior written agreement and therefore was barred from a claim to a commission that it had worked toward for close to a year.

Alan Nochumson

Lacking Contractual Provision, Landlord Loses Bid For Attorney Fees

Most commercial leases contain a provision allowing for the reimbursement of the landlord's legal fees and costs when the tenant defaults under the terms of the lease. If the tenant does not agree, in writing, to such a reimbursement, the landlord will have a difficult time obtaining a judgment against the tenant inclusive of the reimbursement of the landlord's legal fees and costs.

A recent decision handed down by the U.S. District Court for the Western District of Pennsylvania in *Lewis v. Delp Family Powder Coatings Inc.* portrays a landlord coming to grips with the realization that he cannot obtain the reimbursement of his fees and costs against his tenant in the absence of such a written contractual provision.

In Lewis, the landlord and tenant relationship was established and governed by way of an oral lease arrangement between the parties. For several years, the tenant rented the commercial property based solely upon this oral understanding.

After several years passed, an attorney representing the landlord sent a letter to the tenant demanding payment of rent due by the tenant to the landlord under the oral lease and for the tenant to sign a written lease agreement, the opinion said. In the letter, the property owner's attorney stated that, if the tenant failed to make the payment and execute a written lease agreement with the property owner, the property owner would terminate the oral lease and the tenant would be required to vacate the property.

For several months after receiving the letter, the tenant not only disputed their obligation to pay the property owner for the alleged past due rent owed under the lease but the tenant also refused to execute a written lease agreement with the property owner, all the while continuing to occupy the property and paying rent to the property owner.

The tenant did eventually vacate the property. After that happened, the property owner inspected the property and claimed that the tenant had caused damage to the property, which the tenant disputed.

According to the opinion, because the property owner believed that the cost of repairs to the property was too high to fix, the property owner instead sold the property in "as is" condition at an alleged significant diminished value.

After doing so, the property owner filed suit against the tenant in federal court asserting claims for breach of contract, negligence, and promissory estoppel.

In the complaint, the property owner attached a proposed written lease agreement that the property owner contended the tenant should have executed. Among other things, the written lease agreement contained a provision for the reimbursement of the property owner's legal fees and costs if the tenant defaulted under the terms of the lease.

The tenant moved for summary judgment against the property owner. One of the issues dealt with in the summary judgment motion was whether the property owner could recover his legal fees and costs against the tenant.

In Pennsylvania, courts follow the American Rule in determining whether to award legal fees and costs. According to the federal court in *Lewis*, "The American Rule provides that the parties to litigation are responsible for their own counsel fees, unless otherwise provided by statutory authority, agreement of the parties, or some other recognized

exception."

In the summary judgment motion, the tenant pointed out there was no evidence in the record to show that the tenant expressly contracted to pay the property owner's legal fees and costs and that the property owner's claims of negligence and promissory estoppel did not provide for recovery of such legal fees and costs either.

While acknowledging the limitations of the American Rule, the property owner requested that the federal court deny, or at least defer until time of trial, dismissal of his claim for the reimbursement of his attorney fees.

The property owner first relied upon a statutory basis for the award of legal fees and costs. In particular, the property owner cited to 42 Pa. Cons. Stat. Ann. 2503 and Rule 11 of the Federal Rules of Civil Procedure: "Section 2503 is a Pennsylvania statute authorizing an award of attorney fees . . . as a sanction for dilatory, obdurate or vexatious conduct, and Rule 11 provides for sanctions where Rule 11(b) has been violated."

In rejecting the property owner's argument, the federal court in *Lewis* concluded that the property owner "misse[d] the mark." The federal court noted that "the statutory provision and rule cited by [the property owner] are to be used as a sanction where either counsel or a party is found to have engaged in bad faith or dilatory conduct during the litigation" and "there is simply no allegation or evidence in the record that [the tenant] or their counsel engaged in behavior during this litigation that would justify an award of attorneys' fees under either Section 2503 or Rule 11."

Next, the federal court addressed the property owner's contention that the evidence at trial may result in a finding by the triers of fact that the tenant deliberately evaded a written commercial property lease that would have included a

provision for the reimbursement of his legal fees and costs.

The federal court found the property owner's reliance on the attorney fee provision in the proposed written lease agreement attached to the complaint as misplaced. In doing so, the federal court pointed out that neither side entered into any negotiations with regard to the proposed written lease agreement, that the lease agreement was never executed, and, most importantly, that the property owner did not provide any evidence to show that the lease agreement was the one that the tenant so evaded.

According to the federal court, the property owner never disputed the tenant's assertion that the tenant never saw the proposed written lease agreement before the litigation began.

The property owner also argued that the quantum of his attorney fees represented a consequential damage directly flowing from the tenant's breach of contract. According to the property owner, he would not have incurred attorney fees but for the tenant's breach of the lease and the substantial damage caused by the tenant to the property.

The federal court was not persuaded by the property owner's attempt to recast his attorney fees as consequential damages. In the federal court's opinion, the attempt was "unavailing and nothing more than a pedestrian attempt to circumvent the American Rule," especially in light of "Pennsylvania appellate courts hav[ing] held that attorneys' fees are not recoverable as consequential damages."

Finally, the property owner argued that, because the tenant, did not move for summary judgment on his promissory estoppel claim, under which he seeks to enforce the terms of the written agreement that includes a provision for payment of his attorney fees, the issue of attorney fees can only be addressed at trial.

The federal court determined that the American Rule applied to

the property owner's promissory estoppel claim as it is essentially a claim for breach of contract and, since the property owner failed to show that an exception to the American Rule applies to his promissory estoppel claim, the mere fact that the tenant has not moved for summary judgment on his promissory estoppel claim did not preclude the federal court from granting summary judgment on the property owner's request for attorney fees.

The federal court utilized the same rationale for dismissing the property owner's claim for attorney fees with respect to his negligence claim as well.

LESSONS LEARNED

The federal court's ruling in *Lewis* illustrates the importance, from the landlord's perspective, of having a tenant execute a written lease agreement prior to the tenant gaining possession of the leased premises. By failing to do so, the landlord in *Lewis* lacked legal recourse to obtain the reimbursement of his legal fees and costs he incurred in connection with the tenant's alleged breach of the oral lease.

The cost of doing business as a landlord is expensive enough for some landlords. As part of this calculation, landlords factor in the cost of potential litigation. If the landlord fails to include an attorney fee provision in the lease, the landlord not only forgoes the ability to collect his legal fees and costs if litigation arises, but he also loses his ability to use the potential of this reimbursement as leverage on the tenant to amicably resolve the lease dispute.

In other words, if the tenant knows he may be liable for the landlord's legal fees and costs, the tenant may be more willing to settle the dispute without the necessity of litigation. This is something the landlord cannot afford to overlook.

Reprinted with permission from the July 18, 2011 edition of

Alan Nochumson

Klashtorny Recognized As A Rising Star In Business Litigation

For 2011, Natalie Klyashtorny has been included in the list of Rising Stars – the top-up-and-coming attorneys in the Commonwealth of Pennsylvania – in the field of business litigation.

Each year, only 2.5% of attorneys practicing law in the Commonwealth of Pennsylvania receive the Rising Star honor.

The selections for this list are made by the research team at Super Lawyers, which is a service of the Thomson Reuters, Legal. Each year, the research team at Super Lawyers undertakes a selection process that includes a statewide survey of lawyers, independent evaluation of candidates by the attorney-led research staff, a peer review of candidates by practice area, and a good-standing and disciplinary check.

Vertical Position 14%

Federal Court: Lease Options Are To Be Strictly Exercised

Most commercial tenants who invest, at their cost, significant sums of money in improving their leased premises often insist on including options for them to extend the lease agreement beyond the initial lease term. What most of these tenants fail to realize is that such an option must be properly exercised in strict accordance with the terms of the lease agreement, and, if they fail to do so, they risk forever losing their right to so extend the lease agreement.

In *Warminster Equities LLC v. Warminster Commerce*, the U.S. District Court for the Eastern District of Pennsylvania taught such a devastating lesson to a commercial tenant that failed to properly exercise their option to extend, for all intents and purposes, a 97-year lease agreement.

According to the opinion, the tenant in *Warminster Equities LLC* took over the lease agreement, which had an initial term of 27 years and seven consecutive 10-year options. Under the lease agreement, the tenant could exercise an option by providing the landlord with written notice, via first class mail, of such election to exercise the option no later than 12 months prior to the expiration of the basic term or the then-current extended term.

Prior to the expiration of the initial term, the tenant's predecessor-in-interest properly exercised the first 10-year option. After that happened, the tenant was assigned the leasehold. The tenant financed the purchase of the lease agreement with a loan and subleased the leased premises.

Prior to the expiration of the first lease option, the landlord informed the tenant that it had not received written notice of the tenant's intent to extend the lease agreement

for the second 10-year term in accordance with the terms of the lease agreement and that the leasehold would, therefore, expire upon its own terms, the opinion said.

The tenant then claimed it informed the landlord of its intent to renew prior to the option deadline set forth in the lease agreement, but the landlord maintained its position that the lease agreement had been terminated, the opinion said. According to the opinion, the landlord sent a letter to the bank that financed the tenant's purchase of the lease agreement, explaining that, since the tenant would no longer have an interest in the leased premises upon the expiration of the first option term, the mortgage between the bank and the tenant would expire on that date, and that the bank should satisfy the mortgage immediately after the expiration of the lease agreement.

That same day, the landlord also informed the subtenant that the lease agreement was expiring and that thereafter it should send all rental payments directly to the landlord, the opinion said.

The tenant eventually filed a complaint in federal court seeking, among other things, a declaratory judgment that the lease agreement remained in full force and effect.

The federal court entered summary judgment in favor of the landlord and against the tenant because of what was deemed the tenant's failure to properly extend the leasehold as a result of the tenant's own negligence in not exercising the second option in accordance with the terms of the lease agreement.

According to the federal court, "A lease is a contract and 'is to be interpreted according to contract principles,'" and, with "an option contract, time is always of the essence." The federal court emphasized that "when an option is not exercised until after the prescribed deadline, and the only reason for the delay is the optionee's own negligence, 'equity will not

aid the tardy optionee,'" which "is true even when the option or suffers no prejudice as a result of the delay."

The federal court then noted that the lease agreement required the tenant to exercise the option, in writing, at least 12 months prior to the end of the current term, and by mailing such written notice to the landlord.

Unlike the tenant, the federal court pointed out that the tenant's predecessor-in-interest strictly complied with the lease agreement when exercising the first option.

The tenant did not dispute that it failed to comply with the technical terms of the lease agreement, but rather believed that the written notice requirement should be excused.

First, the tenant argued that the lease agreement was extended by the conduct of the parties. In opposing the summary judgment motion, the tenant claimed that one of its members had multiple conversations with the landlord's manager in which the manager was advised of the tenant's intention to extend the lease agreement.

In rejecting this argument, the federal court stated that the lease agreement unambiguously provided that options could only be exercised by written notice.

Moreover, the federal court discounted the tenant's reliance upon the Supreme Court of Pennsylvania's ruling in *McClelland v. Rush and Matter of Opus One Inc.* The tenant argued that "where a lessee gives oral notice to renew, and the lessor does not timely object to the form thereof, the lessor may be deemed to have waived the right to written notice."

Unlike the landlord in *McCelland*, however, the federal court concluded that the landlord did not "expressly agree" that the tenant may have the leased premises for the second option period.

In *Matter of Opus One Inc.*, a federal court in the Western District during bankruptcy proceedings dealt with a tenant that had notified the landlord in unequivocal language of his intent to extend the lease upon multiple occasions, but the landlord failed to provide the tenant with information such as rental figures under the renewed lease prior to the option deadline.

The federal court in *Matter of Opus One, Inc.* held that enforcing the written notice requirement "would be manifestly unfair, particularly in light of the lessor's repeated refusal to supply information necessary for the lessee's exercise of its option."

In this case, however, the federal court found no evidence that the landlord was responsible in any way for the tenant's failure to provide written notice. Rather, according to the federal court, the only such evidence appears to be the fact that, prior to the option deadline, the landlord's manager failed to remind the tenant of the written notice requirement. Since the lease agreement did not place any obligation upon the landlord to provide such a reminder, the federal court held that the tenant's failure to comply with the technical terms of the lease agreement could not be attributed to any fault on the part of the landlord.

The federal court next summarily rejected the tenant's reliance upon *Land v. Cloister Pure-Spring Water Co.* for the proposition that "where a lessee orally indicates its intent to renew a lease in time, equity may prevent a landlord from rejecting a late written notice where a landlord has not been prejudiced and bears some responsibility for the lateness of the written notice" because the landlord did nothing to cause the tenant's delay in providing written notice under the terms of the lease agreement.

The federal court next addressed whether the landlord waived the written notice requirement as contained in the lease

agreement.

“In Pennsylvania, waiver of a legal right requires a clear, unequivocal and decisive act of the party with knowledge of such right and an evident purpose to surrender it. Waiver may be express or implied. Implied waiver applies only to situations involving circumstances equivalent to an estoppel, and the person claiming the waiver to prevail must show that he was misled and prejudiced thereby.”

As part of its argument, the tenant pointed to conversations between the tenant and the landlord’s manager, during which the tenant communicated the tenant’s interest in buying the property, as evidence that the landlord waived its contractual right to written notice of the tenant’s intent to extend the lease agreement.

During one of these conversations, the tenant claimed it had a lease agreement for a significant period of time, which included the duration of the remaining options.

The federal court believed that this evidence was insufficient to establish waiver because the conversations occurred in the context of the tenant attempting to purchase the property, not to exercise the second option.

Moreover, the federal court noted that, even assuming the landlord’s manager inferred from the tenant’s reference to the potentially long duration of the lease agreement that the tenant intended to renew the lease agreement, the landlord’s manager did not respond with any “clear, unequivocal and decisive act” to indicate that this notice was sufficient and that the landlord would surrender its right to written notice.

Furthermore, the federal court pointed out that the tenant failed to demonstrate that it was misled by the landlord, as is required for a claim of implied waiver.

The federal court also held that the Statute of Frauds

prevented the parties from modifying the requirement that notice of renewal be in writing.

In Pennsylvania, the Statute of Frauds requires that any lease longer than three years must be in writing and "its terms cannot be subsequently orally modified."

As such, even if the conversations between the tenant's member and the landlord's manager demonstrated intent to modify the written notice requirement, which the federal court believed was not the case, the federal court concluded that the tenant's claim that the lease agreement was orally modified is barred by the Statute of Frauds.

LESSONS LEARNED

The federal court's ruling in *Warminster Equities LLC* speaks volumes about the necessity of just following the terms of the contract. All the tenant in *Warminster Equities, LLC* had to do was notify the landlord in advance, in writing, and via first class mail of its election to exercise the second option under the lease agreement. By not complying with these technical requirements of the lease agreement, the tenant lost the ability to continue to lease the property to a subtenant, and, worse, had its loan that financed its purchase of the lease agreement to be called.

When a tenant possesses a lease option, the tenant, thus, must fully understand how to properly exercise the option or risk forever losing that right to extend the lease term.

Alan Nochumson

Nochumson Teaches Attorneys About Title Conveyancing

Alan Nochumson served as a faculty speaker at a Continuing Legal Education (CLE) seminar entitled *Doing Good Deeds . . . And Title Work – Title, Conveyancing, And Ownership* which was sponsored by Pennsylvania Bar Institute.

During the seminar, Nochumson discussed some of the risks, technicalities, and legal considerations one should consider when purchasing real estate.

Vertical Position 100%

Negligence Claim Precluded By Real Estate Service Contract

There are many service providers in the real estate industry, such as real estate agents, architects and contractors. Some of these service providers must obtain certifications and licenses from the state in order to do business, while others are not so required. Either way, most of these service providers are retained by way of written contract. Many times when there is a falling out, there are claims of both breach of contract and negligence.

In *Greenwood Land Co. v. Omnicare Inc.*, the U.S. District Court for the Western District of Pennsylvania recently precluded a tenant from claiming negligence against its real

estate management company under the gist of the action and economic loss doctrines as a result of a contract that existed between the parties.

After the landlord in *Greenwood Land Co.* initiated legal proceedings against the tenant for breach of the lease agreement, the tenant filed a third party complaint against its real estate management company.

In the third party complaint, the tenant, among other things, sought recovery under the real estate service agreement the tenant signed with the real estate management company, as well as for professional negligence committed by the real estate management company in its dealings with the landlord on the tenant's behalf, the opinion said.

The landlord argued that the claim for negligence should be dismissed under either the gist of the action or economic loss doctrines.

In Pennsylvania, the gist of the action doctrine bars tort claims that sound in contract. According to the federal district court, "When a plaintiff alleges that the defendant committed a tort in the course of carrying out a contractual agreement, Pennsylvania courts examine the claim and determine whether the gist or gravamen of it sounds in contract or tort."

The economic loss doctrine is similar, in that "no cause of action exists for negligence that results solely in economic damages unaccompanied by physical injury or property damage."

In its attempt to prevent the dismissal of the negligence claim under the economic loss doctrine, the tenant asserted that damage was, indeed, caused to the landlord's property because of the negligence committed by the real estate management company, the opinion said.

The federal district court was not persuaded by this

assertion, noting that the tenant failed to cite any authority for the proposition that damage to a landlord's property is sufficient to allow a tenant to claim property damage for purposes of circumventing the economic loss doctrine in a suit against a third party.

The federal district court next considered whether the real estate management company should be able to be sued in tort because its conduct fell short of professional property management standards.

Pennsylvania courts have held that claims against at least some professionals can be based both in tort and in contract. Rule 1042.1 of the Pennsylvania Rules of Civil Procedure, which governs professional liability actions, is applicable to certain health care providers, accountants, architects, chiropractors, dentists, engineers and land surveyors, nurses, optometrists, pharmacists, physical therapists, psychologists, veterinarians, attorneys and people or entities holding similar licenses in other states.

Since property management providers are absent from the list of the professionals enumerated in Rule 1042.1, the federal district court openly questioned whether the gist of the action and economic loss doctrines would preclude a claim of negligence made against professionals other than those specified.

In relying upon the rationale employed by the Pennsylvania Court of Common Pleas of Allegheny County in *Rapidigm v. ATM Management Services LLC*, the federal district court emphasized that the "answer depends on whether parties contracting with those service providers should receive the protections of tort law or whether their rights should be governed solely by the terms of their agreement with the service provider."

According to the federal district court, "Where the claims of a party to a contract involve only economic losses, the trend

in the law has been to look solely to contract law to determine the scope of the parties' duties and the remedies for a breach of these duties."

"A party should not be permitted to disrupt the expectations of the parties by supplanting their agreement with a tort action that claims that the party misperformed the agreement," the opinion said.

The federal district court cautioned that "the rationale of the economic loss rule is that tort law is not intended to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement."

In a footnote in its memorandum opinion, the federal district court highlighted that the trial court in *Rapidigm* concluded that "professionals may be sued for malpractice because the higher standards of care imposed on them by their profession and by state licensing requirements engenders trust in them by clients that is not the norm of the marketplace. When no such higher code of ethics binds a person, such trust is unwarranted. Hence, no duties independent of those created by contract or under ordinary tort principles are imposed on them."

The federal district court ultimately determined that a real estate property manager did not fall within the malpractice rule carved out by state courts in Pennsylvania for attorneys, accountants, and other licensed professionals. In doing so, the federal district court concluded that the tenant's claims did not implicate the skill, expertise, or special knowledge that the real estate management company brought to bear on its management of the leased premises, but instead rested upon whether the real estate management company did what it was contractually obligated to do.

Because of the existence of the real estate service agreement, the federal district court also did not believe that the

Pennsylvania Supreme Court's ruling in *Bilt-Rite Contractors Inc. v. The Architectural Studio* saved the negligence claim from dismissal.

In *Bilt-Rite Contractors Inc.*, the Pennsylvania Supreme Court held that a building contractor could maintain a negligent misrepresentation claim against an architect for alleged misrepresentations in the architect's plans for a public construction contract where there was no privity of contract between the architect and the contractor.

In interpreting the Supreme Court's ruling in *Bilt-Rite Contractors Inc.*, the 3rd U.S. Circuit Court of Appeals has only recognized a narrow exception to the doctrine of economic loss allowing an aggrieved party to seek recourse from another party with special expertise where the aggrieved party relied on that expertise, but lacked a contractual relationship.

Relying upon the 3rd Circuit's interpretation of *Bilt-Rite Contractors Inc.*, the federal district court surmised that the gist of the action and economic loss doctrines pre-empted the negligence claim because the tenant had a contractual relationship with the real estate management company and any remedy that the tenant may have lies in an action for breach of contract.

Alan Nochumson

Vertical Position 100%