FOCUS ON LEGAL ISSUES

Preliminary Reflections Inspired by the Terrorist Attack

by Edwin "Brick" Howe, Jr., CRE

If you haven't already read the fall edition of *Real Estate Issues*, please be sure to do so as soon as you have finished the present column. The fall edition contains, among other things, a compendium of columns concerning the ramifications of the September 11 terrorist attack. It is a remarkable and timely collection of fascinating and informative essays by numerous experts, including Hugh Kelly's retrospective from the viewpoint of mid-2006 (commissioned by Newmark & Company), which gave us the best roadmap I've seen for turning tragedy into triumph.

Interestingly, at this point, there has been relatively little activity on the legal end with respect to September 11 beyond what any faithful reader of *Time* magazine would know. Clearly, an attempt today to "write the book on the law" relating to the issues arising from this ghastly tragedy in any comprehensive, even organized, fashion would be seriously premature. Yet more premature would be an effort to catalogue the potential resolutions to these issues by which humankind will govern its behavior from this point forward. On the other hand, it may be worth reflecting here on a few selected issues, both legal and non-legal, which have arisen from the attack and also on some issues that relate to the attack in the sense that I, for one, would not have taken particular notice of them but for the ruminations inspired by the attack and its aftermath.

WHAT WE KNOW FOR SURE

- Leaving aside military and diplomatic issues, what we know for sure is pretty limited. For months before September 11, we had been asking ourselves, "Are we headed for a recession? Are we already in a recession? Are we beginning to pull out of a V-shaped recession?" The terrorist attack has laid to rest any doubts on this issue—at least as I write this in early January of 2002.
- We also know for sure that many legal documents, including leases and security documents, need to be improved. As a result of our having had a taste of a calamitous series of events that could not have been anticipated by the legal profession or its clients (though some suggest that our federal government might have done a slightly better job in the anticipation sector), it is now it is necessary to turn to the task of prioritizing and taking on these defects.
- A difficulty, of course, is the (seemingly universal) client who complains, "I pay 90 percent of my legal bills for the final 10 percent of the legal protection I get." If the legal profession is going to perform adequately in this sector, the client is will determine the profile of many of the legal consequences resulting from the terrorist attack. Put another way, leaving the money factor out, it is one thing to proclaim, "It seems we have a problem with [say] casualty clauses of our [say] leases." It is quite another to negotiate (even between two parties, much less the multitudes of parties who have come to this realization since September 11) clauses that will make for more just, or simply more businesslike, results.

SOME OF THE THINGS TO THINK ABOUT AND WATCH FOR

Here are some of the key points, which I think should be on the intellectual horizons of lawyers, real estate advisors, and their clients following the terrorist attack:

- The casualty, indemnification, and exculpation clauses of leases and mortgages are, in my experience, one of the stepchildren of the legal side of the real estate industry. In fact, I have found that such clauses are more often a bone of contention in a contract of sale than in a lease, where the parties have many, many other points to cover (such as common area maintenance, escalation, cleaning schedules, you name it) or in a mortgage, where the secured party is interested primarily in the validity and priority of its lien, rather than in the details of the insurance-based portion of its security, and where the mortgagor, who often has to pay the secured party's legal bill, has an interest in minimizing that bill. Of course, many of the risk issues facing mortgagees will be applicable to an unwary ground lessor, as well.

  Factors such as these typically cause the parties to take solace in the "Oh, that'll never happen" school of risk assessment. The parties to documents covering a continuing relationship, rather than a merely transactional relationship, and their counsel really need to think such issues through in a far more mature fashion than has heretofore been the general practice. At the same time, I realize as vividly as you that even considering the advice I have just offered constitutes tinkering with the efficiency of commerce that makes everybody's world go round.

- A subset of the general issue as to casualty and related clauses is differences among such clauses from lease to lease of space within the same facility. Depending upon the relative strength of the tenant and the landlord, the parties may work off the "tenant's standard lease form" (and, having acted primarily as counsel to landlords, I have seen some dillies coming even from sophisticated tenants, including some leases which are incomprehensible in their virtual entirety) or the "landlord's standard lease form." As tenant's counsel, I have seen some bad ones coming from landlords, too, though rarely from sophisticated landlords. (Fortunately, my own lease forms—one for landlord representation and one for tenant representation—are like the Baby Bear's porridge, "just right.")

  But even more troublesome potentially than the problem of incomprehensibility, is that of variety. If a given facility housing 50 tenants is covered by even as few as 15 different lease forms, that means 15 separate disputes when a total casualty occurs, instead of just one. Ideally, the real estate industry would come together to try to control disparities like these. Is this a realistic expectation? Obviously not, as there are hundreds of thousands of leases out there that reflect precisely this shortcoming and that are not about to be renegotiated. Should landlords have this point in mind as they negotiate their leases and mortgagees have it in mind as they approve lease packages for financing? Obviously yes, though the tendency will always be to give in on such "boilerplate issues" in favor of improving the "economic terms." This means that only a few select unhappy landlords and mortgagees will have the opportunity to don sackcloth and ashes when it turns out that the boilerplate is at the heart of the economics of a relationship.

- My sense is that there will be a growing tension between:

  1. landlords and tenants,
  2. landlords and insurers, and
  3. insurers and re-insurers (and presumably between tenants and their own insurers, as well), as to the dispute-resolution process and any lease or policy language covering the same.

  Typically, there will always be at least one party that favors litigation over alternative dispute resolution (ADR). Normally the party favoring litigation will be the one who, absent a dispute, would be the one subject to laying out the cash as a result of a casualty. This is because litigation has become an embarrassingly and artificially lengthy and expensive process in this country that, in most financial cycles, tends to favor the party who has got the cash for the time being and can invest it to cover its legal costs and perhaps something more, leaving the other party without the cash but with the uncertainty as to the litigation's outcome. While ADR—typically arbitration and/or mediation—is hardly

a perfect process, my experience is that it is likely to produce a just result at least as often as litigation and a far more timely result than litigation. It is for this very reason that The Counselors have been in the process, during the last couple of years, of developing their own ADR program for real estate disputes. Perhaps this program, which is on the verge of hitting the market, will provide some opportunities for CREs in the aftermath of the terrorist attack.

- Of course, one needs to be realistic here. Pressure to adopt ADR clauses has to come from the bottom (*i.e.*, the insureds) up. It seems unlikely that such pressure will be exerted at the top or middle of the food-chain (the re-insurers and insurers), and it is they, not the ordinary consumers of insurance services, that have the organized lobbies and pressure groups. Nevertheless, there are others in this picture, as well, including The Counselors and other groups that would like to promote use of their ADR services. And there are also organizations of property owners, operators and mortgagees, such as ULI, ICSC, NCREIF, BOMA, the Real Estate Roundtable and the MBA (and many others) that ought to be interested in taking up these particular cudgels. At the end of this column you will find my e-mail address, and I sincerely invite you to contact me. I would be particularly interested in your suggestions as to how a movement like this could be formed and put into action.
- It occurs to me that a party more likely to suffer than any of the others as a result of some of the negative factors outlined above is the mortgagee whose mortgage does not give him the option to claim insurance proceeds in case of casualty. Such an option was pretty standard fare when I first practiced law in the mid-1960s. Over the years, a great many prospective mortgagors have convinced mortgagees to drop this option. In case of casualty, the absence of this option puts the lender on the sidelines, at least in regard to its practical position as a financial player, when negotiations are undertaken with the borrower's insurer. Notwithstanding the fact that I have normally argued this point on the mortgagor's behalf, the terrorist attack causes me to conclude that the mortgagee who does not insist upon this option is giving up a right far more important than I once thought.
- I think I see a new professional line developing as a result of the attack, which has focused so much attention on insurance issues—a line for which CREs who know something about the insurance business or are willing to bone up on it may be ideally equipped.

  My most frustrating experience of 1999 was representing the owner of multiple shopping centers in three-cornered dealings with the client's insurance broker and with the insurance broker of the company that was to become my client's portfolio and asset manager. I happened to be the only lawyer actively involved, as the manager was doing the legal work in-house. It was many a happy hour I spent in teleconferences with the brokers while they spoke their own private language, arguing over the insurance, exculpation, and indemnification provisions of the draft management contract and the potential insurance-policy clauses that would reflect those provisions, all the while trying to do my best to guide the negotiations in a direction that would be reasonably fair to both parties. Never forget that, if you have an insurance broker who speaks English in a manner understood by laymen, you have a real prize on your hands!

  My client would have been far better served by having on the phone, instead of me, an independent insurance consultant who could speak the lingo and work out appropriate solutions to all these issues and then read the proposed insurance policies to make sure that the issues agreed upon were accurately reflected in them. My client's ability to rely on my real estate background was, if I may say so, a definite plus, but it was *all* I could bring to the table. I believe this state of affairs shortchanged my client, and the asset manager was theoretically even more vulnerable to being shortchanged because it had *no* representative participating in the negotiations who was independent of the commissioned insurance brokerage community.
- In the case just cited, my frustration turned to something like a bad dream when the parent companies of the two brokerages involved in the negotiation merged. The client-oriented imbalance that my presence may have provided initially was, I believe, more than offset by the fact that, within the merged company, the

manager's broker out-ranked the client's. I would not for a moment suggest that the merger gave rise to a conflict of interest, but facts are facts and this particular fact increased the sensitivity of my position by at least 100 percent. It appears that this phenomenon will become ever more prevalent as the wave of consolidations in the insurance industry continues and even accelerates.

A final word of caution concerning the concept of an independent insurance consultant: CREs who are not already reasonably familiar with the insurance industry should not rush out to educate themselves in insurance and then hang out an "Independent Insurance Advisor" shingle. They should do some market research first to ensure that there is a market for such services in a geographical or networking community where they are well known.

Some years ago, one of the large international brokerages spent a lot of money developing an independent advisory group and then found little or no market for the service, which potential clients expected to receive from their lawyers and/or accountants. I tend to think of that as a somewhat special case. I believe a high-profile splashily-advertised advisory service performed by a gigantic, multi-product insurance firm is less likely to be regarded by clients as truly independent than such a service provided by a comparatively specialized and probably relatively small, even one-man, CRE shop or perhaps by a litigation-support group that knows its insurance onions, whether independent or part of a larger organization that does not concentrate on insurance sales.

Whatever a potential client's views on that distinction may be, please do not hesitate to show him the present column as proof-positive that lawyers (and in my view accountants), who are unable to produce credible insurance credentials, *cannot* competently provide these services. You might also mention to the prospective client that the CRE's efforts would not be doubling-up other professionals' efforts. That is to say, *you* would be at the negotiating table *instead* of the client's lawyer or accountant, and, given the several learned professions' fee schedules these days, almost certainly at a fraction of the cost of another professional.

WHAT NOW?

I hope that the above will give the reader a small taste of what we need to reflect upon now that we know that the unthinkable can happen. It will, in my view, be a long, long time before any "standard" responses to these issues can be hammered out and then achieve general acceptance.

Here is an example received from a friend who lives across Lake George from us and who recently retired from one of the large international insurance brokerages. We were discussing how to define "terrorism" in the "terrorism exclusion," a clause that nearly everyone expects to see in future insurance and re-insurance policies. I said, "This is really a tough one. It's no simple task like defining 'pollution.'" He replied, "Brick, it took the industry 30 years to work out a generally accepted definition of 'pollution.'"

I look forward to keeping readers abreast, from time to time, of salient developments on this very new frontier. I look forward equally to readers' input.REI

AUTHOR'S NOTE

The author acknowledges with gratitude the assistance of Philip W. McLaughlin in reviewing a draft of this column and offering a number of valuable suggestions. Mr. McLaughlin was a principal and senior vice president of Johnson & Higgins, both before and after its merger with Marsh & McLennan, and has been acting as an independent insurance consultant since his recent retirement from the combined organization.

ABOUT OUR FEATURED COLUMNIST

Edwin "Brick" Howe, Jr., CRE, *is a lawyer practicing for 36 years in a range of areas, including real estate, shopping center, business, partnership and international law, taxation, and the strategy and tactics of dispute resolution. His law practice is currently conducted principally out of Ticonderoga, NY, which is also the base of his consulting firm, The Roseville Company LLC. In addition, he is senior counsel (by telecommutation and, when required, by airliner) to Howe & Addington LLP, the New York City law firm he founded in 1970, and is executive director of the National Real Estate Forum.* [redacted]