

Tri-State Law Bulletin

New York • New Jersey • Connecticut

December 2006

The Smoking Gun: Judge's Decision On Secondhand Smoke May Render Coop/Condo Boards Liable

In a recent New York County Civil Court decision, *Poyck v. Bryant*, the Court held that as a matter of law, secondhand smoke emanating from neighbors can give rise to claims of breach of the implied warranty of habitability and/or constructive eviction. The Court in *Poyck* found that secondhand smoke was just as insidious and invasive as more common conditions such as smoke odors, chemical fumes and excessive noise. Therefore, these claims involve a question of fact as to whether or not the secondhand smoke is so pervasive as to actually breach the implied warranty of habitability and/or cause a constructive eviction.

Background Facts

In *Poyck*, the plaintiff was the owner and lessor of a condominium unit and defendants were the tenants or lessees of the subject unit pursuant to a two-year residential lease. Within three months of the commencement of the lease, new neighbors had moved into the unit next door to defendants. The new neighbors constantly smoked inside their unit and in the hallway outside their unit. The secondhand smoke permeated into the subject unit. Defendants complained to the building's superintendent, plaintiff and plaintiff's attorney-in-fact. However, plaintiff took no action and the condition continued unabated, causing defendants to move out of their unit before the expiration of the lease term.

Meanwhile plaintiff (the owner) maintained that he could not be held liable for the actions of third parties beyond his control. The Court rejected plaintiff's argument and found that New York has long held that the implied warranty of habitability can apply to conditions caused by actions of third-parties beyond a landlord's control. The Court therefore held that there were triable issues of fact as to whether the secondhand smoke in the instant case was so pervasive as to actually breach the implied warranty of habitability and cause a constructive eviction.

Responsibilities of the Co-operative Board of Directors

The warranty of habitability is part of every landlord-tenant relationship. In a co-operative, where a landlord-tenant relationship is created by virtue of the proprietary lease, the co-op board, as landlord, has the duty to take such actions and implement such measures as are necessary to ensure that this warranty is not breached. New York courts have found that the implied warranty of habitability can apply to actions beyond a landlord's control. Good faith is not a defense to a claim for an alleged breach of the warranty of habitability. Therefore, the board should treat secondhand smoke as it would any other invasive condition created by a third-party and act accordingly. In other words, the board should either take such action as is necessary to eliminate the condition or compel the offending shareholder to do so. In the event the situation cannot be resolved between the board and the tenant, the advice of legal counsel should be sought.

Responsibilities of Condominium Unit Owners and Board of Managers

The implied warranty of habitability does not apply to the relationship between the board of managers of a condominium and an individual unit owner, but is invoked in a relationship between a unit owner, as lessor, and a tenant, as the lessee of the unit. Although a tenant may not raise a claim for breach of the warranty of habitability as against the board of managers, the board may still be implicated, as the unit owner may have a cause of action against the board of managers under the provisions of the by-laws. Condominium by-laws typically contain provisions that restrict the use of both units and common areas so as not to unreasonably interfere with the use of other units and common elements by other unit owners. Therefore, just as in the case of cooperative buildings, the board should promptly respond to complaints of secondhand smoke and where warranted, take action to eliminate the condition or compel the offending unit owner to do so. Again, if the situation cannot be amicably resolved, legal counsel should be consulted.

Construction Lending: Deconstructing Construction Contracts

Construction lending is inherently riskier than conventional commercial real estate loans. While conventional commercial real estate loans are supported by real property generating cash flow, construction loans are generally secured by unfinished collateral.

When properly structured (and underwritten, of course) commercial construction lending can bring significant returns to a lender over a relatively short period of time. In order for a proposed project to be successful, lenders must effectively manage a variety of risks. One key set of risks in construction lending is whether a project will be completed lien-free, on-time and within budget.

Managing basic construction risks can begin as early as the planning phase of a construction project with a careful review of the construction documents.

We outline certain general risks associated with a construction project, how these risks can be identified during the project planning phase and ways to address mitigating these risks. Of course, every project is different and entails its own set of issues. The items discussed below, though, include those concerns which commonly arise.

Some of the general risks associated with a construction project include:

Failure to complete the project on schedule.

This can result from material or labor shortages, failure of a major supplier, contractor or subcontractor to deliver goods and services, substandard work that must be redone, contractors or suppliers with competing projects and commitments, casualty or weather-related delays.

Cost overruns. All of the above factors that contribute to unscheduled delays in completing the project can also result in cost overruns. In addition, fast-tracking plans and specifications, change orders, price increases in materials, the need to pay overtime or poor job estimating may cause a project to be over-budget.

Destruction of completed work or work in progress as a result of a casualty.

Filing of liens against the property or failure of contractors to complete the project. Often a result of labor disputes among material suppliers and/or subcontractors and the owner.

Material adverse change in the economic environment. Changes in market demand result in the completed project not achieving anticipated sales or occupancy levels.

Many of the foregoing risks can be identified, and therefore mitigated, through proper review of the construction documents. Among the typical construction documents are the architect's agreement, the general contractor agreement, the construction management agreement (if the project is a large one), the project manual which contains the plans and specifications or drawings and description of the scope of work, the project schedule, the construction subcontracts and the other construction-related agreements.

One of the first elements to evaluate in a construction package is the project manual to determine the type and nature of the project to be constructed and any special features. For example, even seemingly "basic" construction projects, such as multifamily developments, have become increasingly complex with the introduction of the latest in cutting-edge technology and design, such as advanced security and building systems. Unless properly planned and priced, such features can contribute to cost overruns and delays. The unavailability or delay in delivery of very specialized types of materials will very often be the cause of such delays and increased cost.

Next, the particular terms of a contract should be scrutinized. Following is a list of some standard and not-so-standard terms of a construction contract, their significance and how such terms can increase or mitigate certain risks.

Terms affecting the Contract Time. The Contract Time is the time, measured from the date of commencement of a project, in which to achieve substantial completion of the project. Failure to achieve substantial completion by the time specified in the contract can result in overtime charges or other penalties, which, of course, can result in an increase in cost to the owner/borrower. A project that is not completed on time can also void any commitment for permanent take-out financing. Therefore, the reasonableness of the time allotted for substantial completion should be carefully assessed. From a lender's

point of view, there should be a contingency/rent-up period between the completion date set forth in the loan documents and the loan maturity date. Alternatively, structuring a loan to include an option to extend the maturity date can also prevent a loan from going into default before a project is completed (or rented or occupied or otherwise operational). Contracts often include financial disincentives when it comes to schedule delays. To be sure that all the "players" are on the same page, the project architect and the lender's construction consultant need to sign off on the schedule.

Terms affecting the Contract Sum. The Contract Sum is the total cost of a construction project. This amount (which is allocated according to a schedule of values and is broken down into unit prices, cost of alternates, if any, hourly rates, retainage and contingencies) should be evaluated by a knowledgeable consultant or in-house expert as well as by the lender's construction consultant for appropriateness, reasonableness of cost and comprehensiveness. Needless to say, a contract that is not detailed or specific enough to cover the costs for every aspect of a project runs the risk of exceeding the budget, as these costs will have to be negotiated and factored in after construction has begun.

Lenders should also be wary of other pitfalls such as penalties for late payments, and charges for change orders or modifications and "escape" clauses inserted by contractors. Terms such as *per diem* penalties, liquidated and/or consequential damages for time delays which may be triggered when work does not progress as scheduled due to owner-caused delays, all may result in the owner bearing additional costs. Additionally, "front loading", whereby a builder deliberately overstates the cost of work to be completed in the early stages of construction, is not uncommon. If a lender does not evaluate these matters, there may well be insufficient loan funds to complete the project in the event of a default.

A cap on change orders and a cap on the construction sum are devices to ensure that a project does not exceed the construction budget. Retainages (typically 10% of the cost of the work and materials) and contingencies (also 10%) are also effective tools to manage cost overruns and delays and should be required by lenders. Contractors may sometimes negotiate for a termination or gradual reduction in the retainage after 50% of the work has been completed. This is not unreasonable as long as the owner (subject to lender sign-off) retains the discretion to determine whether the work has been progressing to its satisfaction. Payment schedules under the construction contract and subcontracts should be coordinated with one another and with the loan document advance schedule and conditions.

Assignability and ownership of plans. To address a default by the owner/borrower under the construction loan, the lender should take an assignment of the construction contract and thereby have the right to “step into the shoes” of the owner to have the contractor (or a surety) complete the project. (Likewise, if a contractor does not fulfill its obligations under the contract, the owner should be able to retain ownership of the plans, specifications and drawings so that it may retain another contractor to complete the project without incurring the time and additional cost of having new plans drawn). Similar assignments to the lender should be put in place for the agreements with the project architect and engineer(s).

Dispute resolution. The owner and contractor usually have a choice among arbitration, mediation or trial in the event of an unresolved dispute. Although arbitration is favored for small disputes, in general, the larger and more complex the project, the less advantageous arbitration will be. Contracts are more likely to be enforced to the letter in court as opposed to arbitration. In addition, arbitration does not always yield consistent results. Unless all of the contracts among the parties to a dispute include a requirement to proceed to arbitration, not every party may be subject to the arbitration. Furthermore, unless such

contracts also include a clause that the parties consent to a consolidation or joinder of persons or entities to the arbitration where there are common questions of fact and/or issues of law, the risk of inconsistent decisions is even greater. Where there are additional persons or entities that are necessary to achieving a final resolution of the dispute but are not subject to arbitration or cannot be brought into the arbitration by consolidation or joinder, the parties should agree to waive arbitration and have the dispute resolved by a court of competent jurisdiction.

Unforeseen subsurface conditions. One of the biggest causes of delays and cost overruns is the existence of unforeseen or unexpected subsurface conditions. Construction contracts often provide that in the event a contractor encounters subsurface conditions that are materially different from those contemplated in the contract or those that can be reasonably expected, a contractor is entitled to an equitable adjustment in the contract. A full analysis of sub-surface conditions should take place prior to funding of a construction loan or appropriate contingencies should be in place to address the discovery of such conditions.

Responsibilities of architect. Construction contracts should include terms that require architects or their representatives to be present on-site during construction or to make periodic inspections of the work, to ensure that any problems with workmanship or materials are detected in the early stages of construction, and thereby increase the likelihood that modifications can be performed with minimal disruption to the schedule or overall budget. In addition, architects, not owners, should be in direct contact with all the necessary consultants—structural engineer, design professionals, etc. Most architects prefer not to subcontract with all the design consultants for professional liability insurance reasons. However, having the architect as the single point-person reduces the risk that the design of the project will not be properly coordinated.

Guaranty of contractors. Under a performance bond, where one can be obtained, a surety provides conditional assurance that a construction contract will be performed in the event of a contractor default. The cost and difficulty of enforcement of bonds often lead lenders to accept completion guarantees from a sponsor's "deep pockets."

The foregoing is only a broad overview of certain terms found in a construction contract and how such terms distribute the common risks associated with commercial construction projects. Identifying and addressing such risks early in the construction process effectively mitigates resulting costs and helps ensure project and loan viability.

Wage and Hour: Federal Court Rules that Plaintiffs Cannot Maintain State-Law Class Action Alongside FLSA Collective Action

Collective actions under the federal Fair Labor Standards Act (FLSA) can be brought on behalf of only those individuals who affirmatively opt-in to the case, while overtime actions under various state laws usually can be brought as a traditional opt-out class action. Recently, Seyfarth Shaw, on behalf of two different clients, successfully argued before the Chief Judge of the United States District Court for the District of New Jersey that the two types of actions irreconcilably conflict and that a state law overtime class action cannot be maintained alongside an FLSA collective action.

In *Himmelman v. Continental Casualty Co.* (CNA), Case No. 06-166, W. Curtis Himmelman, who worked as a claims analyst, claimed that CNA failed to pay him overtime in violation of the FLSA and New Jersey law. Similarly, in *Herring v. Hewitt Associates, LLC*, Case No. 06-267, Carol Herring, a benefit analyst who administers company benefit plans, alleged she was not paid overtime

in accordance with the FLSA and New Jersey state law.

Himmelman and Herring filed complaints on behalf of themselves and other persons similarly situated asserting both a collective action under the FLSA and a class action under Rule 23 of the Federal Rules of Civil Procedure.

Seyfarth Shaw filed motions to dismiss and/or strike the state-law class allegations on behalf of the respective defendants. The firm argued that a Rule 23 class action is not superior to a Rule 216(b) opt-in collective action under the FLSA because its existence in the same case with an FLSA opt-in collective action is too confusing to putative class members. Due process mandates that putative class members be informed of the existence of their rights under both Rule 23 and the FLSA. Informing putative class members that they must opt-in to the FLSA claim or they may not participate, while at the same time informing them that they must not opt out of the Rule 23 state claims or they may not participate, is inherently confusing.

For example, had plaintiffs moved for and obtained conditional collective action certification under the FLSA before moving for and obtaining Rule 23 certification of the state law claims, putative collective action members would first receive a notice asking whether they wished to affirmatively opt-in to the FLSA claim. They would be told if they did nothing, they *would not* be a part of the case. Thereafter, if a Rule 23 class action is certified, the same putative members would receive a second notice containing the same caption and likely similar language, but this time informing them if they do nothing, they *would* be a part of the case. It is likely that a significant number of class members would regard the second piece of mail to be duplicative of the first, and would throw it out without reading it.

Alternatively, plaintiffs often seek permission to send a single notice of an FLSA collective action and state law class action and combine the two concepts. However, a single notice stating that a putative member will be

excluded from the FLSA claim if he or she does not check a box expressing consent to join the claim and return the notice, while at the same time stating that the member will be part of the class action if he or she does nothing, also is inherently confusing.

In addition, Seyfarth Shaw argued that Rule 23 could never be satisfied because joinder is not impracticable. Under the FLSA, putative plaintiffs can join the suit by simply mailing an opt-in form. Because the named plaintiff must establish that joinder is impracticable in order to maintain a Rule 23 class action, and the mechanism by which a putative plaintiff can join the co-existing FLSA collective action is simple, joinder is not impracticable and a class action cannot be maintained. Finally, maintaining a case with two sets of plaintiffs (a group of opt-in collective action plaintiffs, and a class who declined to opt-out), would present severe case management problems, such as the federal and state claims being tried in more than one proceeding.

Ultimately, the District Court granted the motions. The Court held that the procedures for an opt-in collective action under the FLSA and a Rule 23 opt-out class action are incompatible, mutually exclusive and irreconcilable. Noting the Congressional intent of the FLSA opt-in procedures, the District Court ruled that allowing the plaintiff “to circumvent the opt-in requirement and bring unnamed parties into federal court by calling upon state statutes similar to the FLSA would undermine Congress’s intent to limit these types of claims to collective actions.” In granting the motions, the District Court eliminated plaintiffs’ ability to bring a Rule 23 class action in federal court alleging violations of New Jersey wage and hour laws.

The District Court’s decisions bode favorably for companies facing lawsuits alleging both FLSA collective actions and Rule 23 class actions alleging violations of state wage and hour laws, because the number of plaintiffs who ultimately opt-in to collective actions tends

to be much lower than the number of putative class members in a Rule 23 class action.

Himmelman and *Herring* are the latest in a string of similar victories by Seyfarth Shaw dismissing pendant state law claims.

New York Adopts Unpaid Leave for Spouses of Deployed Servicemembers

New York State now requires that companies provide ten days of unpaid leave to employees whose spouses are military servicemembers and are actively deployed during a period of military conflict. New York Labor Law § 202-i, which became effective in August 2006, applies to employers with more than 20 employees at a given site and to employees (but not independent contractors) who work for an average of 20 or more hours per week. This unpaid leave is to be used only when the employee’s military spouse is “on leave from the armed forces of the United States, national guard or reserves while deployed during a period of military conflict to a combat theater or combat zone of operations.” The statute also prohibits retaliation against any employee who requests or obtains a leave under its provisions.

The statute differs from the Illinois Family Military Leave Act and other well-known family leave laws in certain key respects. First, while the Illinois law provides leave for spouses and parents of deployed servicemembers, the New York law is limited to spouses only. Employers who offer domestic partner benefits or other programs for unmarried employees should consider whether to extend unpaid leave to domestic partners or “significant others” of servicemembers.

In addition, the New York law is all but silent on the mechanics of requesting or granting a leave. Unlike the Illinois leave law, the New York law does not require

employees to provide any advance notice of a need for unpaid leave. New York also does not require employees to provide any documentation of the military spouse's deployment or leave status in order to obtain a leave, whereas Illinois permits employers to request "certification from the proper military authority." Further, while the Illinois statute covers only employees who have been employed by the same employer for at least 12 months and have worked at least 1,250 hours in that time – similar to the federal FMLA – New York does not contain any minimum service requirement beyond limiting the leave benefit to employees who average at least 20 hours of work per week.

Finally, while Illinois provides that employees "shall consult with" employers to schedule leaves to avoid business disruption, the New York statute does not contain any exceptions that enable an employer to deny a leave based on business needs or for any other reason.

While the New York statute does not specify any damages where a leave is denied, its broad anti-retaliation provision essentially cautions employers against denying leaves or imposing any administrative requirement that might be viewed as unduly burdensome. In the short term, employers should proceed carefully, requesting but perhaps not requiring advance notice and documentation of leave where possible. Beyond that, employers should consider amending their employee handbooks and policy manuals to set forth any requirements that they choose to impose on military spousal leave requests.

In Brief: New York Mandates Secure Disposal of Personal Records

In an effort to combat the growing plague of identity theft, New York State now requires businesses to dispose of records containing individuals' "personal identifying information" in a secure fashion. N.Y. Gen. Bus. L. 399-h.

The "Disposal of Personal Records Law," which took effect on December 6, 2006, requires all for-profit entities that have obtained personal identifying information, including Social Security Numbers, driver's license numbers, mother's maiden names, account numbers and ATM access codes, to destroy such information once it is no longer needed, in one of certain specified ways. Businesses may either shred such records, destroy the personal identifying information, modify the records to make the personal identifying information unreadable, or take other "actions consistent with commonly accepted industry practices" to ensure that no unauthorized person will have access to the information. Violations of the statute are punishable by fines up to \$5,000 per violation, as well as injunctive relief.

The new law does not apply to government entities or non-profits, but does cover personal information obtained by for-profit enterprises regardless of the source (e.g. employees, customers or third parties). With the enactment of this statute, New York joins more than 15 other states that have adopted measures to counter identity theft and secure personal data.

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