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# CLIENT ADVISORY

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AUGUST 2010

## COOPERATIVES SHOULD AMEND PROPRIETARY LEASES TO OBTAIN BROAD PROTECTION AGAINST LEGAL EXPENSES

A protracted intra-family litigation involving the disputed ownership of a cooperative unit provides another reminder that cooperatives should seek to ensure that their proprietary leases accord them broad protection against legal fees that they may incur in connection with such disputes.

Ganfer & Shore, LLP represents the cooperative corporation in a building where the rights to one of the units have been disputed for several years following the death of the original tenant-shareholder. The dispute has spawned a series of litigations. Although the litigation involves claims between family members and does not involve claims against the Cooperative, the Cooperative was subpoenaed to produce extensive documents as a non-party. The Cooperative was compelled to retain counsel to protect its interests and to move in court to quash the overbroad subpoena. As a result, the Cooperative incurred significant legal fees.

Many cooperatives have proprietary lease provisions requiring tenant-shareholders to reimburse the cooperative for legal fees and expenses that the cooperative incurs as the result of the tenant-shareholder's breach of the lease. However, as has been discussed in prior issues of this *Client Advisory*, sometimes such a provision may provide the cooperative with only narrow protection. It will entitle the cooperative to reimbursement of its legal fees when it prevails in a dispute involving a tenant-shareholder's *breach* of the lease, but will not necessarily cover fees incurred in other types of disputes, such as this one, where the issue was not whether a tenant-shareholder breached the proprietary lease, but who the tenant-shareholder rightfully is, or in other disputes in which the cooperative incurs legal fees as a non-party.

Fortunately for the other tenant-shareholders of this Cooperative, its proprietary lease contained a broad provision obliging the tenant-shareholder to reimburse the Cooperative for all legal fees and expenses incurred in *any* litigation involving the tenant-shareholder or the unit. Because this provision applied, the Cooperative's legal fees were borne by the parties to the dispute, rather than by its other tenant-shareholders. Cooperatives may wish to review their own forms of proprietary lease to ensure that they too are safeguarded to the fullest extent from substantial legal fees and expenses that may arise from disputes in which they are nothing more than innocent bystanders.

## NEW FEDERAL LEAD PAINT REGULATIONS WILL AFFECT SALES OF RESIDENTIAL PROPERTIES

As previously reported in this *Client Advisory*, effective April 22, 2010, the U.S. Environmental Protection Agency (EPA) substantially expanded the federal regulations governing painting, renovation, or repair work in most housing units built before 1978, as well as other facilities visited regularly by children, to minimize health risks from lead-based paint. The new rule covers "renovation activities" in such housing units – which include even repainting a wall – that disturb more than six square feet of painted surface per interior room or twenty square feet of painted surface on the exterior of a building. Contractors performing such renovation activities must obtain EPA

certification by completing coursework approved by the EPA and must abide by numerous detailed requirements. Penalties for non-compliance can be up to \$37,500 per violation.

The new EPA rule has important implications for all cooperatives and condominiums that were built prior to 1978. Boards must ensure that all contractors performing covered renovation activities, both in individual units and in common areas, have the required certification and training and that they are aware of and comply with the new requirements such as posting notices of the work. In addition, in buildings (including most cooperatives and some condominiums) where board approval is required before a shareholder-tenant or unit owner may undertake alterations in a unit, the building's form of alteration agreement should be amended to make clear that the shareholder-tenant or unit owner is responsible for ensuring compliance with the new rules. In many buildings, the board will expect the managing agent to oversee compliance by shareholder-tenants or unit owners.

The new regulations contain exemptions applying to some work done by a homeowner personally ("do-it-yourself"), or work done in a building where no young children or pregnant women reside. The new regulations also do not apply where a test confirms that the lead paint level on all exposed surfaces is less than 1.0 mg/cm<sup>2</sup>. However, the scope of these exemptions as applied in multi-unit buildings is not entirely clear. In practice, to ensure full compliance with the regulations and ensure that dust potentially containing lead is not released, boards should require that any work done in any portion of a covered building is performed in accordance with the new rules.

This new EPA rule is likely to have an impact on purchases and sales of residences, including both single-family homes and cooperative or condominium units. Purchasers may seek assurance that they will not need to comply with the regulations when they make future alterations, because all painted surfaces are free of lead-based paint or the lead levels are less than the threshold. However, the testing process requires making small borings in the walls, which many sellers may be loath to allow. It may be prudent for buyers to require that sellers make a representation in their purchase agreements, to survive closing, that the property is exempt from the EPA rule, or to make closing contingent on an inspection by a certified inspector confirming that the property is exempt.

### **NEW FEDERAL TAX ON UNEARNED INVESTMENT INCOME WILL AFFECT REAL ESTATE TRANSACTIONS**

Individuals anticipating transactions involving either residential or commercial real estate should be aware of a new federal tax, adopted as part of the health care legislation, that will apply to unearned net investment income effective January 1, 2013. "Unearned net investment income" is defined as including interest, dividends, annuities, royalties, and rents, other than such income derived in the ordinary course of a trade or business, as well as the net gain attributable to dispositions of property. Investment income giving rise to the tax will include a portion of the gain on sale of a principal residence, which has previously been exempted from some other taxes.

The new tax will apply to individuals whose adjusted gross income is more than \$200,000 for single taxpayers, \$250,000 for a married couple filing jointly, and \$125,000 for married taxpayers filing separately. The tax rate will be 3.8%. For sales of a principal residence, the tax will apply only to the portion of a gain that is more than \$250,000 for an individual or \$500,000 for a married couple filing jointly. Sales of other real property, such as a secondary residence or vacation home, are taxable from the first dollar of gain. Individuals who anticipate being a party to future transactions that may be impacted by this tax may wish to consult now with their tax counsel or tax advisors.