CADWALADER

The Changing Landscape

August 31, 2020 | Issue No. 15

Table of Contents:

The Commercial Real Estate Landscape in the Post-COVID World

August 31, 2020 | Issue No. 15

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Although the long-term impact of the coronavirus pandemic is not yet clear, the social distancing requirements and health concerns, along with the shift towards remote working, reduced travel, and increased online shopping, will change the landscape of commercial real estate – in particular, offices, hotels and malls, which make up more than half of the mortgages in commercial mortgage-backed securities transactions.

The COVID-19 pandemic had an immediate and profound impact on the commercial real estate sector, and the commercial real estate landscape in the U.S. will likely be dramatically transformed as we emerge from the pandemic. When the pandemic started rapidly moving across the U.S. in March, the spread of the shelter-in-place and work-from-home orders throughout the country – together with the economic turmoil, healthcare challenges, and social distancing – negatively impacted all sectors of the commercial real estate market, although some more than the others. Hotel and retail properties were among the swiftest and hardest-hit categories by the pandemic, as owners were forced to immediately close their properties when cities and counties instituted shelter-in-place orders, while industrial properties and some office properties faced less of a decline. As local economies continue to open up across the country, owners of commercial properties will need to adapt their properties and operations to the post-COVID world.

For retail properties, the pandemic has exacerbated many of the issues that have challenged such properties prior to the pandemic. While some retailers that offer essential goods, such as grocery stores and home improvement stores, have flourished during the pandemic, these stores are typically not located in shopping malls which have been struggling in recent years. Online shopping, which has reduced the need for brick-and-mortar stores, has surged since the pandemic started and will likely continue to grow. In addition, anchor tenants, which had been the lifeblood of malls by attracting visitors, had been vacating large amounts of space prior to the pandemic, and numerous well-known chains, including Neiman Marcus, JCPenney, Lord & Taylor, Pier 1, J.Crew and Brooks Brothers have filed for bankruptcy since the pandemic started.

The pandemic has accelerated the efforts of retail properties to adapt their properties to secure their long-term viability. In recent years, owners of retail properties have been adapting their properties and redeveloping empty anchor space for alternative uses, including turning such space into entertainment complexes, fitness centers, houses of worship, residential properties, and restaurant and dining facilities. But as social distancing requirements will likely keep capacity and foot traffic at a reduced level, mall owners are modifying their business plans for a post-pandemic world. The Related Companies has indicated they plan to redevelop the space that will be left empty by Neiman Marcus at Hudson Yards into office space. Simon Property Group, the largest mall owner in the U.S., is currently under discussions with Amazon to convert empty retail space in malls, particularly those left empty by anchor tenants like Sears and JCPenney, into fulfillment warehouse centers. Simon also joined with Authentic Brands Group to supply financing to Brooks Brothers through its bankruptcy and a sale of Brooks Brothers to Sparc Group, a 50-50 joint venture between the companies for $325 million. This includes a commitment to keep 125 Brooks Brothers stores open, an arrangement that has been approved by the U.S. Bankrutpcy Court of the District of Delaware, with a closing date scheduled for as early as August 31. This isn't the first time a mall owner has acquired a bankrupt retailer. Last year, Simon teamed up with Authentic Brands Group and Brookfield Property Partners to purchase the bankrupt Forever 21. The acquisition was reported as a way for Simon and Brookfield, which were Forever 21's biggest landlords, to keep Forever 21 as an anchor in their properties to avoid triggering any co-tenancy clauses that could result in other tenants being entitled to a right to lower their rent or terminate their leases early.

Hospitality properties are likely to take the longest time to rebound, as travel for business and leisure has dramatically declined and is likely to stay that way for the foreseeable future as multiple states have had to reverse plans to reopen amid surging COVID-19 infections and the current absence of a vaccine. Some reports have indicated that demand for hotel lodging may not return to pre-COVID levels until the third quarter of 2022. While some hotels have chosen to remain closed even as these orders are lifted to save on operational expenses, other hotels have chosen to pivot from their customary operations. In certain jurisdictions, including New York City, hotels have adapted their properties to serve as quarantine housing for individuals who have contacted the virus or to house homeless people during the pandemic. Other owners of hotels are trying to devise new strategies for their properties, including the conversion into office space. The owners of the Bryant Park Hotel in New York City, which had been converted from office space into a hotel in 1998, announced their intent to convert the property back into office space.

The conversion of other properties to office space is likely a result of the outlook for office properties appearing less dire than other sectors. During the height of the pandemic, many office tenants continued to pay rent for their space, even though much of the space was left empty while employees worked remotely. This large-scale and immediate move towards remote work has led many companies to come to the realization that their office employees are productive and can work as effectively remotely, which may lead to a reduced demand for office space. However, the long-term impact on office properties will likely not be evident until tenant leases expire and tenants consider the amount of space needed going forward. In the short term, office owners will need to adapt their properties to consider health and safety concerns of office employees arising from the virus and make changes to their physical spaces and floor plans to comply with the current social distancing and health guidelines. But despite tenants being able to return employees to their offices, most companies have been cautious in bringing back employees on a large scale. Some companies have formulated a staggered work schedule with employees only working 2 to 3 days in the office to reduce the number of employees together in an office at any one time. Many companies have announced that their employees will be permitted to continue to work from home for the foreseeable future, while other companies are considering entering into leases for smaller satellite office space to reduce commute times for their employees on public transportation. Despite the widespread acceptance of employees working remotely as a result of the pandemic, office space – particularly in certain major metropolitan areas, including New York City – should remain necessary. Even after announcing that it will allow most of its employees to continue to work from home until Summer 2021 while others may work from home permanently, Facebook's recent signing of a lease at the Farley Post Office for 730,000 square feet of space, which is in addition to the 1.5 million square feet of space they leased at Hudson Yards last year, is a vote of confidence that office properties will recover in a post-COVID world. There are benefits to employees being together in an office – namely, creativity, collaboration and the presence of a collegial work space. In addition, many employees are likely going to be more willing to return to the office once mass transit safety concerns are addressed and schools are open full time.

While the COVID-19 pandemic will have long-lasting implications on the future of commercial real estate which are difficult to predict, the pandemic has had an unparalleled impact on the way we live and work. These changes have forced property owners to rethink and adapt their properties during the immediate recovery to take into account health concerns, social distancing requirements, safety protocols and mass remote working, all at the same time.

Hotel Financing Series, Part 2: Covenants

August 31, 2020 | Issue No. 15

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In Part 2 of our series on hotel financing in the wake of COVID-19, we take a look at some of the most common covenants in a typical hotel financing transaction, with the understanding that each set of agreed covenants is tailored and specific for each transaction.

Financial covenants

As with all real estate financing, loan-to-value ratio (a measurement of the total loan outstanding against the value of the property) is an essential financial covenant in hotel financing. In addition, the other key financial covenant is the interest cover. Unlike traditional real estate financing, where the historical rent and/or projected rent is used, in hotel financing, the interest cover (or, if applicable, debt service cover) is worked out using the cashflow of the hotel, which is usually a formulation of EBITDA as agreed between the lender and the borrower, against the interest for the same period. In addition, there can be other restrictions, such as an annual limit on capex (unless topped up by the sponsor), or in some instances, where the bank has placed some emphasis on the sponsor's financial backing, a net worth covenant on the sponsor.

General covenants

In addition to the general property covenants, hotel financing usually include a few additional specific covenants, such as:

- maintenance of property to also extend to adhering to brand standards;
- capital expenditure is monitored closely, as hotels often require frequent upgrades and refurbishments. There should be pre-agreed budget and capex expenditure and refurbishment plan as agreed with franchisor each year;
- restriction on amending key hotel documents without lender's prior consent; and
- restriction on terminating and/or appointing new hotel manager without lender's prior consent.

Information covenants

With hotels managed under the franchising model, the franchise agreement usually stipulates a detailed set of ongoing monitoring and inspections conducted by the franchisor on a periodic basis. It is extremely useful for the lender to keep a close eye on these and obtain the results of the periodic inspections via the reporting covenants. Not only are these reports usually quite comprehensive, which includes information such as vacancy rates, average rate yielded for each hotel room, etc., but they are also the first place where lenders can spot any issues or first warnings of deterioration of the business, such as not obtaining a particular star rating on reviews or not meeting the latest upgrade/refurbishment requirement. The lender can then discuss or obtain updates from the borrower as to how these are being addressed with the help of the franchisor.

What is 'Physical Loss'? Court Opens the Door for Policy Holders

August 31, 2020 | Issue No. 15

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In a recent decision by the United States District Court for the Western District of Missouri, Southern Division, the court denied an insurance company defendant's motion to dismiss based on the assertion that COVID-19 does not result in "direct physical loss or direct physical damage"[1] to real property because the same requires an "actual, tangible, permanent, physical alteration of property." Instead, the court agreed with the plaintiff's argument that the term "physical loss" may include the loss of use of such property and the suspension of operations thereon.

In the case, *Studio 417, Inc., et al.* (collectively, "Plaintiff") *v. The Cincinnati Insurance Company* ("Defendant"), Plaintiff, several hair salons and restaurants located in the Springfield and Kansas City metropolitan areas of Missouri brought suit against the Defendant because the Defendant denied coverage under each of the Plaintiff's "all-risk" property insurance policies which included building and personal property coverage and business income coverage (collectively, the "Policies"). The Policies provided that the Defendant would pay for any "accidental [direct] physical loss" or "accidental [direct] physical damage" to the real property (subject to exclusions from coverage set forth in the Policies which Policies in question did not include a specific exclusion to coverage from an illness caused by a virus). The terms "physical loss" and "physical damage" were not defined in the Policies (which is standard).

Plaintiff argued that, during the COVID-19 pandemic, employees and patrons of their respective businesses may have been infected with COVID-19, that such persons could have infected the insured real properties with the virus making the same "unsafe and unusable" and therefore the same resulted in Plaintiff closing or significantly curtailing business at the insured properties. In addition, Plaintiff argued that Plaintiff was required to either close (*e.g.*, the hair salons) or significantly curtail operations at the insured properties (*e.g.*, the restaurants were limited to a take-out business) because of the local government shutdown orders (collectively, the "Shutdown Orders"). Plaintiff alleged that the physical presence of COVID-19 and the Shutdown Orders caused a "physical loss" or "physical damage" to the subject properties because Plaintiff was forced to suspend or reduce business at the insured real properties.

The Defendant responded to Plaintiff's complaint with a motion to dismiss, arguing, in part, that the Policies provide coverage only for the loss of income which is the result of physical damage to the property – tangible, physical loss – not "economic loss caused by governmental or other efforts to protect the public from disease" and, therefore, the loss suffered by Plaintiff based on COVID-19 and the Shutdown Orders were not covered risks under the Policy. Further, Defendant argued that the broad interpretation of the words "physical loss" proposed by Plaintiff (*i.e.*, one that includes a loss of use of the property) would result in "physical loss" being suffered "whenever a business suffers economic harm."

The Court determined that since the terms "physical loss" and "physical damage" were not defined in the Policy, the Court could rely on the plain and ordinary meaning of such words and that the terms "loss" and "damage" are distinct terms with distinct meanings. Further, the Court held that the words "physical loss" are not limited to physical destruction or alteration and that "physical loss" may result when a property is "uninhabitable or unusable for its intended purpose." Therefore, Plaintiff adequately alleged a direct physical loss since COVID-19 is a "physical substance" that is "active on inert physical surfaces" and "emitted into the air" and that the foregoing made the insured properties "unsafe and unusable," resulting in a direct "physical loss" of the insured real properties. The Court also rejected Defendant's argument that if the Plaintiff's interpretation of "physical loss" were accepted, the same would result in "physical loss" being found "whenever a business suffers economic harm" because in this particular case the "physical loss" was specifically caused by COVID-19 and the Shutdown Orders.

Since the start of the COVID-19 pandemic, insurance companies have been receiving and denying claims from commercial policy holders who seek to recover business interruption insurance based on losses due to COVID-19 and various local government shutdowns. The insurance industry has argued that COVID-19 and the resulting government shutdowns are not a covered policy risk because the same does not cause "direct physical loss or damage" to the insured real property and, to date, insurance companies have been largely successful in court. The *Studio 417* case has opened the door for a counter-argument based on the plain meaning of the contract – that "loss" and "damage" are two distinct concepts and that the insured may suffer a "loss" which is not a "tangible physical loss" of real property, and that the same may be a covered risk under the policy. The court in *Studio 417* has not yet ruled on the merits of the case.

In addition, since the Policy in the *Studio 417* case did not have a specific virus exclusion to coverage which is an exclusion in “all risk” policies in many states including New York, Plaintiff was able to avoid an additional and perhaps unsurmountable hurdle for policy holders seeking to recover proceeds of business interruption insurance based on COVID-19 and related government shutdown orders.

Given the ongoing nature of the COVID-19 pandemic and the continued local government shutdowns to avoid the spread of COVID-19, we expect to see many more insurance claims by businesses who have lost all or a substantial portion of their revenue due to the pandemic, denials of coverage by insurance companies based on the “physical loss or damage” policy language, and judicial review of the foregoing.

[1] All quotations in this article are language from the court decision.

COVID-19 Update: Governor Cuomo Extends Tenant Protections, Including Eviction and Foreclosure Moratorium

August 31, 2020 | Issue No. 15

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On August 5, 2020, New York State Governor Andrew Cuomo issued Executive Order 202.55**[1]** (the "New Order") to provide additional relief to renters impacted by the COVID-19 pandemic and extended the time periods for certain other protections that had been previously granted to renters and property owners pursuant to Executive Order 202.8**[2]**, as extended by Executive Order 202.28**[3]** and Executive Order 202.48**[4]** (the "Prior Orders").

The Prior Orders provided for (i) a moratorium on evictions of commercial tenants through August 5, 2020, and residential tenants through July 5, 2020, and (ii) a moratorium on eviction and foreclosure of any residential or commercial tenant or owner through August 20, 2020, if the basis of the eviction or foreclosure is the nonpayment of rent or the mortgage, as applicable, and the tenant or owner, as applicable, is eligible for unemployment insurance or benefits under state or federal law or is otherwise facing financial hardship due to the COVID-19 pandemic.

Executive Order 202.48 previously had removed the restrictions on residential foreclosures and residential evictions, as those have been superseded by legislative action. The Laws of New York 2020, Chapter 112 provides for 180 days of mortgage forbearance for individuals, which period may be extended by the mortgagor for an additional 180 days.**[5]** The Laws of New York 2020, Chapter 127 prohibits evictions of residential tenants that have suffered financial hardship during the COVID-19 pandemic for the non-payment of rent. In each case, the relief granted extends through the period commencing on March 7, 2020, until the date on which "none of the provisions that closed or otherwise restricted public or private businesses or places of public accommodation, or required postponement or cancellation of all non-essential gatherings of individuals of any size" continue to apply.

The New Order extends a number of existing Executive Orders, including the Prior Orders for an additional 30 days, to September 5, 2020, effectively continuing the moratoria on commercial and residential evictions and foreclosures – whether instituted by executive order or passed into law by the legislature – until such date.

[1] Executive Order 202.55, available here.

[2] Executive Order 202.8, available here.

[3] Executive Order 202.28, available here.

[4] Executive Order 202.48, available here.

[5] The Laws of New York 2020, Chapters 112 and 127.

New York State Supreme Court Temporarily Halts UCC Foreclosure of Mezzanine Loan

August 31, 2020 | Issue No. 15

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On August 3, 2020, in *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*,[1] the Supreme Court of the State of New York (the "Court") granted the borrower plaintiffs' motion for a preliminary injunction and prohibited the lender defendant from proceeding with a UCC foreclosure until October 15, 2020. This is the second decision in New York which halted or delayed a UCC foreclosure as a result of the COVID-19 pandemic. While the Court did not expressly refer to the earlier case which granted an injunction to D2Mark LLC on June 23, 2020, temporarily preventing the foreclosure of the indirect equity interests of the owner of the leasehold estate in The Mark Hotel[2], the Court in *Shelbourne* reached a similar conclusion – that a UCC foreclosure may not be commercially reasonable and "that the equities of merely delaying the sale weigh in [the plaintiffs favor]."[3]

Background

The plaintiffs own 100% of the equity interests in Shelbourne Broadway LLC and Shelbourne Albany LLC (the "Property Owners") who, as tenants in common, own property known as 677 Broadway, Albany, New York (the "Property"). The Property Owners took out a mortgage loan secured by the Property (the "Mortgage Loan") and the plaintiffs entered into a mezzanine loan with the defendants secured by 100% of the equity interests in the Property Owners. In May 2020, the Property Owners defaulted on the Mortgage Loan as a result of a missed payment. Shortly thereafter, and as a result of the missed payment of the Mortgage Loan, the defendants notified the plaintiffs that they would be proceeding with a UCC foreclosure sale, via video conference on July 20, 2020.[4]

The Decision

While the plaintiffs brought a number of causes of action regarding the alleged default and the UCC foreclosure, the Court only reached a decision on the plaintiffs' claim that they would suffer irreparable harm if the UCC foreclosure proceeded and declined to address the parties' other arguments and issued a preliminary injunction on that basis.[5] In reaching its decision, the Court noted that "[p]aragraph 7 of Administrative Order of the Chief Administrative Judge of the Courts dated July 23, 2020 (AO/157/20) provides 'no auction or sale of property in any residential or commercial foreclosure matter shall be scheduled to occur prior to October 15, 2020.'"[6] The Court extended that logic of the Administrative Order, which by its terms prohibits only mortgage foreclosure, to cover mezzanine foreclosures on the theory that the "valuation of the equity interests in a company that owns real estate is based on the value of the real estate itself."[7] The Court reasoned that as a result of the COVID-19 pandemic, valuations and consequently the bids received at a UCC foreclosure would be highly uncertain and therefore enjoined the defendants from proceeding with the UCC foreclosure until October 15, 2020. While a mezzanine foreclosure is clearly not a mortgage foreclosure, the Court ignored the legal distinction between a mezzanine loan and a mortgage loan.

Conclusion

While the Court did not provide guidance as to what could make a UCC foreclosure commercially reasonable during the COVID-19 pandemic, given the Court's decision in *Shelbourne BRF LLC* and the June 23 injunction with respect to the mezzanine loan on The Mark Hotel, lenders should exercise caution in attempting to proceed with UCC foreclosures in New York State while the COVID-19 pandemic continues.

[1] *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*, Index No. 652971/2020 (N.Y. Sup. Ct., August 3, 2020).

[2] Cadwalader's memorandum on The Mark Hotel UCC foreclosure is available at https://www.cadwalader.com/resources/clients-friends-memos/the-mark-hotel-borrower-granted-injunction-delaying-mezzanine-lenders-foreclosure-sale.

[3] *Shelbourne BRF LLC*, 652971/2020 at 1.

[4] Verified Complaint, *Shelbourne BRF LLC, Shelbourne 677 LLC v. SR 677 BWAY LLC*, Index No. 652971/2020 at 3-6.

[5] *Shelbourne BRF LLC* at 1, 2.

[6] *Id.* at 1 (*quoting* Administrative Order of the Chief Administrative Judge of the Courts dated July 23, 2020 (AO/157/20)).

[7] *Id.* at 1.

Some Thoughts on Late Charges and Default Rate Interest

August 31, 2020 | Issue No. 15

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In mortgage loan transactions, lenders will customarily charge a fee for late payments and additional (or default) interest upon a default. The late fee is often a percentage (*e.g.*, five percent) of the unpaid installment and is meant to compensate the lender for its administrative costs in handling and processing the delinquent payment and for the loss of the use of such delinquent payment. Default rate interest, on the other hand, is an increase in the interest rate by a specified percentage in the event of a default and is meant to compensate the lender for its increased risk in dealing with a borrower that has defaulted. Default interest is also meant to compensate the lender for any lost opportunity cost in reinvesting the loan proceeds and for its costs in administering a defaulted loan.**[1]** Finally, default interest serves as a deterrent to a borrower from defaulting a loan.

One issue that arises with respect to late charges is whether a late charge may be applied on the payment at maturity. Borrowers routinely object to charging a late charge on the balloon payment. In *Trustco Bank New York v. 37 Clark Street, Inc.*, the mortgage note provided that a late charge of six cents for each dollar overdue could be assessed "for the purpose of defraying the expense incident to handling delinquent payment." The borrower failed to make a payment of the entire amount due under the note at maturity, and following that default, the lender accelerated payment. The lender sought to recover the late charge for the failure to make the balloon payment, and the borrower objected, arguing that the late charges were an "oppressive forfeiture" and impermissible penalty. The Court held that the late charge provision must be construed to apply only to defaults in monthly payments giving rise to collection expenses, not defaults of payments at maturity, such as a balloon payment resulting in acceleration. Such defaults, the Court noted, terminate the borrower's right to correct the default. As a result, late charges did not apply to the balloon payment.**[2]**

In determining the enforceability of both late charges and default rate interest, courts have considered whether the amounts charged have a punitive intent. If charges are so high as to suggest a punitive intent rather than an intent to compensate the lender for its costs, courts have invalidated them. In *Emigrant Funding Corporation v. 7021 LLC*, the contract interest rate was 7.25% and the default rate interest was 24%. The Court reasoned that parties are free to agree that a contract rate of interest will increase upon a default, so long as the interest rate is not usurious or does not constitute a penalty. In this case, the lender charged the borrower both the contract rate of interest and the default rate interest during the periods of time when the borrower defaulted in making timely installment payments. The Court held that the charging of default rate interest in the amount of 24% in addition to the contract rate of interest of 7.25%, which results in a total charge of interest of 31.25%, was criminally usurious. While each case is fact-specific, criminal usury in New York rarely applies to larger loans with sophisticated parties given existing statutory exemptions. However, the Court rejected the borrower's argument that a 24% default rate of interest was a penalty and void as against public policy. The Court held that the default rate interest provision was valid and enforceable, noting that "it is well settled that an agreement to pay interest at a higher rate in the event of default or maturity is an agreement to pay interest and not a penalty."**[3]**

Another consideration for default rate interest is when it should be triggered – upon the occurrence of an event of default or when the lender accelerates the loan. Lenders would prefer the former, while borrowers would prefer the latter. In *In re Crystal Properties, Ltd., L.P.*, the promissory note stated: "Should default be made in any payment provided for in this note, … at the option of the holder hereof and without notice or demand, the entire balance of principal and accrued interest then remaining unpaid shall become immediately due and payable, and thereafter bear interest, until paid in full, at the increased rate of five percent (5%) per annum over and above the rate contracted for herein. No delay or omission on the part of the holder hereof in exercising any right hereunder, … shall operate as a waiver of such right or any other right under this note…" The lender argued that because the note expressly stated that default rate interest is due and payable upon default "without notice or demand," the default rate interest should have accrued at the moment of default. However, the Court disagreed, noting that the language "at the option of the holder" provides that the right to accelerate the unpaid debt is at the lender's option. Further, if the option is exercised, the note will "thereafter" bear interest at the default rate, and that can only mean that the default rate interest does not become effective unless the holder of the note exercises its option to accelerate. Consequently, the Court concluded that the language of the note required the holder to exercise its option to accelerate before the default interest rate is triggered.
[4]

In financing transactions, many borrowers will negotiate default rate interest provisions further to clarify whether the default rate interest accrues from the occurrence of the default or from the occurrence of an event of default. Many times, an event of default may not occur until a significant grace period has elapsed (such as thirty, sixty or ninety days), and many lenders are loath to allow the accrual of default rate interest to be tolled for such an extended period of time. Lenders will argue that if the default never ripens into an event of default, then the default would have been cured and the relevant issue would be rendered moot.

Late charges and default rate interest are monetary issues which should be carefully drafted to ensure that the parties have contracted for what ultimately will be enforceable and what was intended by the parties.

[1] The Law of Real Estate Financing, § 5:106.

[2] Trustco Bank New York v. 37 Clark St., Inc., 157 Misc. 2d 843, 599 N.Y.S.2d 404 (Sup. Ct. 1993).

[3] Emigrant Funding Corp. v. 7021 LLC, 25 Misc. 3d 1220(A), 901 N.Y.S.2d 906 (Sup. Ct. 2009).

[4] In re Crystal Properties, Ltd., L.P., 268 F.3d 743 (9th Cir. 2001).

Taking Notice

August 31, 2020 | Issue No. 15

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A loan document's notice provision is often overlooked as just another boilerplate provision in need of blanks to fill in. However, as technology changes, this section can be a minefield during the life of a 3 to 10 year loan.

At a basic level, a notice provision needs to provide instructions for delivering notice, when notice is deemed delivered, addresses that will be reliable, and a method for the parties to update the addresses in the future.

The surest, if not the easiest, mode of delivery is hand delivery, which is deemed delivered upon delivery. After that, two reliable and frequently permitted methods of delivery are registered or certified mail, return receipt requested, or prepaid overnight delivery with proof of attempted delivery. For overnight delivery, notice is deemed given upon first attempted delivery on a business day and, for certified mail, it is usually deemed given within 3 business days after posting. This is why it is important that all addresses for notice be reliable. You don't want a short notice period to begin after a failed attempt at delivery.

Changing technology has left its mark on notice provisions. One of the few places you will still see a fax number appear is in a legal document's notice provision, with notice deemed given with receipt confirmation. Because fax machines are becoming less common, many agreements only accept facsimile delivery provided one of the other notice methods are also used.

Recently, email addresses are increasingly being added to the notice addresses of parties in legal documents. However, the use of e-mail as a notice method raises a host of issues not previously encountered with other means of providing notice. While there are no federal or state laws prohibiting the use of email for providing notice, parties are often wary of using it as the form of official notice. This is because, as discussed below, email messages often do not provide a reliable way of confirming receipt of delivery. However, if an email address is listed in an agreement without explicit rules around its use, it may be used by the parties and will be accepted as valid by a court. It is therefore important that all parties to an agreement be very clear about the use of email to provide notice and what constitutes effective delivery.

When using registered or certified mail, a proof of delivery or return receipt acknowledges physical delivery to a mailbox. Similarly, a prepaid overnight delivery service provides evidence from an uninterested third party of attempted delivery. These types of delivery ensure that the notice will be received by the intended recipient. An email delivery, on the other hand, does not have the same assurances. Due to email providers' algorithms for sorting emails, sometimes a successfully delivered email may end up in the recipient's spam or junk folder. This is typically the case when the recipient does not have any prior interaction with the sender. In addition, organizations often use an individual's email address for notice, and emails to that address may be lost in the future if that individual leaves the organization.

Generally, courts follow the language of the agreement when determining when a notice becomes effective. While there are federal or state regulations on the use of electronic methods for written contracts, there are no specific restrictions on notice requirements. Thus, parties are free to contract as they wish regarding the notice provision in an agreement. If a notice provision deems notice to be duly given when sent, an email is effective from the moment it is sent, regardless of where the email ended up (such as spam, junk, etc.). In the absence of any language specifying when a notice becomes effective, the law is that mail notice is effective upon posting. However, there is no established law as to when email notice is effective. Therefore, the parties to a contract should be specific about when email notice can be used (for instance, should it be used only for operational matters such as particular required consents rather than formal default notices?) and when it will be deemed to have been delivered. While we have all come to rely on email for our day-to-day communications, it is difficult to determine if and when an email has been received by the intended party. For this reason, parties should proceed with caution with respect to these matters.

Receipt of an email can be shown in many different ways. A “Delivery Receipt” notification will provide the sender an email upon successful delivery of an email to the recipient’s mailbox. This option is not available for all email providers. For example, Microsoft Outlook may provide this service, but other email service providers may not. This method also does not guarantee that the email would be delivered to the recipient’s inbox. The email may be filtered into a spam, junk, or other folder, and the sender would nevertheless receive a successful delivery notification. A read receipt option, on the other hand, only notifies the sender once the recipient opens the email. This notification method ensures actual delivery to the recipient, but is not without its flaws. Although more widespread than the delivery receipt option, the read receipt option is also not a feature found with all email providers. Furthermore, if a sender opted for a read receipt, but the recipient’s email provider lacks the option, or the recipient has turned the function off for privacy reasons, the notification will not be sent upon opening the email. A third option would be to have the recipient send a reply email confirming receipt. This is the most fool-proof method of confirming email delivery. It does not require any features beyond the rudimentary functions all email providers share, and a reply unequivocally shows the email was indeed delivered successfully. This method only works, however, if the recipient voluntarily replies to the notice email. Requiring a receipt as a condition to a notice’s effectiveness would conceivably allow a recipient to extend a notice period by delaying the response to an email.

Many notice provisions in agreements may allow such notice to be delivered by email but may have language that suggests that mere transmission of the email does not create a presumption that the notice was received. This suggests that the clock would begin upon receiving a receipt of email delivery. This receipt may come in the form of a delivery receipt, read receipt, or a reply from recipient. Each of these methods may present situations where the sender never receives a receipt from the recipient. In those instances, if no receipt of delivery is confirmed within a business day, the parties may opt to treat email notice as a first method of communication. The other methods previously discussed could therefore be used as a second method, and notice would be deemed given based only on the corresponding requirements of the secondary notice method.

During the coronavirus pandemic, many counterparties began to introduce email as an acceptable notice method in their agreements. This is understandable given the difficulties with other modes of delivery when people are being asked to work from home. However, regardless of the reasons parties may want to provide for email notification, they should consider the following points before doing so:

- Be sure to provide current email addresses in the agreement, and any email addresses used should be general accounts monitored by multiple people in an organization, rather than an individual’s email address.
- If email addresses are included with the notice addresses, there must be rules around email notices, such as when a notice by email is deemed given or received and when a notice period starts.
- If an agreement deems email notice to be given upon dispatch, a good practice would be to have a test email sent to the email address on the agreement. The recipient can then add the sender as a trusted contact, ensuring future correspondences from the sender will not be filtered to spam or junk mailboxes.
- Finally, best practice would be to require some other physical form of notice to a physical address with official receipt confirmation. Ultimately, this may be the only way to be certain notice has been received by the intended party.

(The authors wish to thank 2020 summer associate Guodong Fu for his contributions to this article.)

Recent Transactions

August 31, 2020 | Issue No. 15

- Representation of noteholder and special servicer in connection with the extension and modification of a mortgage loan secured by student housing located in Morgantown, West Virginia.
- Representation of lender in connection with the origination of a mixed use property located in Amarillo, Texas.
- Represented the junior lender in connection with a $43,000,000 construction loan financing the development of an oceanfront resort located in Mexico.
- Represented ACRES Capital Corp. in its acquisition of Exantas Capital Corp.'s (NYSE: XAN) management agreement from an affiliate of C-III Capital Partners.
- Represented the lenders in connection with a $381 million mortgage and mezzanine loan secured by 78 self-storage facilities in 23 states.
- Represented the lender in connection with an amendment and restructuring of to an existing loan secured by self-storage facilities throughout the country.
- Represented the lender in connection with a loan in the amount of $120 million financing the acquisition of 26 self-storage facilities.