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TRENDS IN REAL ESTATE AND TITLE INSURANCE

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Estoppel Certificates: Deceptively Complex

The long-term consequences may be significant for all parties.

BY JOHN L. OPAR

THE CONCEPT of estoppel appears in the law in various guises. In the law of contract, it appears in the form of a bar or impediment to denial of facts previously affirmed.

But, unlike so many legal concepts rarely seen since the bar exam—"consideration," anyone?—we find the concept of estoppel in virtually every acquisition or financing of leased real property. And, even in respect of unimproved property, the concept may still apply to declarations of covenants and restrictions, easements and other agreements affecting title to real estate.

A real estate acquisition or financing will typically include as a closing condition the delivery of estoppel certificates or letters from tenants or parties to encumbrances. But this is only the end game, which began when the landlord and tenant first entered into lease negotiations or the developer first prepared its declaration of covenants or its condominium declaration. The obligation to deliver estoppel certificates is typically created in these instruments and then tested when the applicable property is transferred or financed.

Whether one represents the landlord as seller or as borrower attempting to procure the certificate, the tenant or declarant delivering the same, or the purchaser or lender relying on it, the stakes can be high and the law surprisingly ill-defined. A review of recent cases discloses relatively few decisions and little uniformity. Essentially, practitioners are left with the clear need to proceed cautiously but with little real guidance as to the extent to which estoppel certificates can in fact be procured or relied upon.

Let's construct a fairly typical scenario involving a tenant estoppel letter. Ordinarily, the landlord will have bargained with the tenant for the tenant's agreement periodically, or in connection with a sale or financing, to deliver an estoppel confirming the terms of its lease. A sophisticated lease may actually attach an agreed form of estoppel. More likely, however, the parties will set out the essential elements of the required estoppel and perhaps an obligation to address such other matters "as may be reasonably requested." Failure to deliver an estoppel within a stated period will most likely be a default under the lease.

Let's assume that the landlord now markets its property for sale. Any purchaser (and its lender) will want the tenant to affirm the terms of its lease as a condition to acquisition or financing.

Why? Simply put, the purchaser and its lender will have priced the acquisition or financing on an Argus or similar model containing assumptions about lease terms—renewal and expansion options, base rent, expense stops and a handful of other elements of the lease. Prior to consummating the transaction, the purchaser and its lender will want to be assured that the economic model reflects reality.

The purchaser and its lender will want the tenant to affirm these matters rather than the landlord. Why? In plain terms, they each believe that they will be able to rely upon the tenant's confirmation for the term of the lease without regard

John L. Opar *is a partner in the property group of Shearman & Sterling.*

to any time or amount limitations the landlord seller may have negotiated to benefit itself.

So the landlord as seller may have little choice but to agree that its sale of the property will be conditioned upon delivery of estoppel letters from key tenants as well as from tenants leasing a specified percentage of the balance of the leased property. How confident can the landlord be of its ability to satisfy this closing condition?

What Landlords Can Do

In my view, the answer comes down largely to the landlord's goodwill with its tenant population. To be sure, the landlord will be able to point to most of its leases and identify an express agreement on the part of the tenant to deliver at least some form of estoppel. But practically, can the landlord enforce this obligation?

In fact, most tenants believe it is beneficial to maintain good relations with their landlords and thus respond timely to requests for estoppels. However, if the tenant refuses to deliver any type of estoppel (or, more likely, attempts to use the estoppel as a bargaining chip with the landlord) or objects to a particular statement not expressly required to be addressed, can the landlord declare the lease in default?

The answer, at least as to non-delivery, is most assuredly yes. But the landlord's ability to enforce its remedies against the tenant is another matter. Would a court actually forfeit a tenant's valuable leasehold interest for refusal to deliver an estoppel?

The landlord would certainly argue that the consequences of non-delivery may be significant and should be sufficient to establish a delivery failure as a material default. However, we are all wary about advising a client that it can terminate a lease for a non-monetary default. But more importantly, the remedy of lease termination is simply inappropriate. The landlord is seeking to sell or finance its cash flow. Terminating the tenant's lease would obviously be self-defeating.

What about specific performance? Most leases will provide that the tenant's covenants are specifically enforceable. But here, the issue is timing. In New York and California, certainly, the courts are unlikely to hear a claim for specific performance in any time frame approaching that required by the landlord to satisfy its closing conditions. Injunctive relief? Most practitioners will argue that injunctive relief is appropriate only as a means of maintaining the status quo, not to force a party to undertake affirmative acts.

Whether in the context of a landlord committing to procure estoppels, a tenant delivering the same or a purchaser or lender relying on the same, estoppels should be judged by a standard other than page count. The long-term consequences may in fact be more significant than those under the lengthier purchase and sale agreement or loan agreement from which they emanate.

From the Tenant's Side

Let's look at matters now from the tenant's perspective. What should a tenant do when requested to deliver an estoppel?

Ideally, the tenant would request that its counsel review the requested delivery against its actual lease obligations. This would represent the best means of assuring that the tenant is only affirming those matters addressed in the relevant lease provisions. However, for many tenants, the estoppel never makes its way to the counsel's desk. It's thought to be too mundane and innocent to require legal review. As a result, too often, an operations person will simply execute what's put in front of him or her.

I am by no means declaiming against generosity as a societal good. Query though whether it belongs in the landlord/tenant relationship.

If the matters affirmed in the signed estoppel are accurate, but beyond what the tenant is required to address, no real harm arises. However, what if the estoppel is inaccurate or negligently completed?

The very concept of estoppel argues that the tenant should be bound by its affirmative statements even if inaccurate or negligently given. Case law is less clear. In two of three recent cases, the tenants appear to have escaped the consequences of their actions in delivering incorrect estoppels.

In a lower court ruling in New York, *Santaro v. Jack of Hearts Carpet Co., Inc.*, 6 Misc.3d 1024(A), 2005 WL 387963 (N.Y.Sup.) (Sup. Ct. Onondaga Cty. 2005), the court ruled that the delivery of an "estoppel certificate" is not sufficient to form the basis of a note or memorandum satisfying the requirements of New York GOL §5-703 (applying the statute of frauds to leases of real property), where the landlord was unable to produce a signed lease. In two California decisions, appellate courts came to contrary results regarding the enforceability against

a tenant of statements made in an estoppel certificate.

In *Plaza Freeway Ltd. Partnership v. First Mountain Bank*, 81 Cal. App. 4th 616 (2000), the appellate court reversed a lower court ruling in favor of a tenant seeking to enforce an extension right, though the notice to extend had been delivered late based on the lease expiration date set out in the estoppel.

In contrast, an appellate court in *Miner v. Tustin Avenue Investors, LLC*, 116 Cal. App. 4th 264 (2004), reversed a lower court decision terminating a tenant's option to extend where the tenant had failed to complete a statement in an estoppel letter requiring that the tenant specify its extension rights. The appellate court refused to treat the tenant's failure to complete the relevant statement as tantamount to denial of the existence of the extension right.

Were these cases properly decided? Well, the *Santaro* court may have been correct in finding that the estoppel certificate itself fell short of the requirements for a writing under GOL §5-703. However, should the tenant have been able to affirm the existence of a lease and then deny the same without consequence?

In *Miner*, the court appears to have put the obligation on the landlord to resolve any ambiguity created by the incomplete certificate. Perhaps this is fair, but it leaves open to question the result if the tenant had written "NA" or "none." The *Plaza Freeway* decision would support a decision in favor of the landlord.

So, we are left with a few disparate decisions where the results are heavily fact-specific and perhaps even result oriented. Two of the three tenants seem to have skated by.

Should that give tenants comfort that estoppels have no legal effect? I submit that a claim involving an inaccurate estoppel given by a sophisticated tenant might well result in a judgment in favor of the landlord or its purchaser. In any event, the stakes are simply too high for tenants to risk loss of significant lease rights by inattention or negligence.

Purchasers and Lenders

What's left is the third side of this triangle—that is, the purchaser or lender relying on the tenant's estoppel.

The *Santaro* and *Miner* decisions call into question the ability of a third party to rely on inaccurate estoppels. There are, however, a few things that a purchaser or lender can do to increase the likelihood that an estoppel can in fact be relied upon.

First, there is the issue of signing authority. Surprisingly few recipients question whether an estoppel has been properly executed. An estoppel signed by a president or vice president of a corporate tenant (or by a corporation as general partner or managing member) should carry apparent authority. Too often, though, estoppels are signed by premises personnel or office managers or, indeed, whoever at the tenant's office the landlord's property manager can charm, cajole or threaten into signing.

Counsel for the purchaser or lender would do well to spend a bit more time reviewing the status of the tenant's signatory, if the same can even be determined. The *Plaza Freeway* court took note, for instance, that the estoppel certificate in that case had been reviewed by the tenant's chief financial officer.

What about incomplete estoppels? Many estoppels contemplate that the tenant will complete factual information before signing the estoppel. Too often, statements are simply left incomplete. *Miner* would place the risk of an incomplete estoppel on the relying party.

This argues for a different approach to preparation of estoppels. Purchasers should require that their sellers prepare and (after purchaser review) deliver estoppels setting out all lease information. The tenant is then simply confirming rather than completing the lease information.

Similarly, estoppel certificates often contemplate that the complete lease and all amendments will be attached to the estoppel. All too frequently, the tenants simply leave this task undone.

A purchaser or lender would well be within its rights to reject an estoppel without the lease attachments. But what if the leases are attached by the landlord after execution and delivery by the tenant, but prior to delivery of the signed estoppel to the purchaser and its lender? Any indication that the lease was attached after the estoppel had been signed and delivered would similarly be grounds for rejection of the estoppel.

In sum, whether in the context of a landlord committing to procure estoppels, a tenant delivering the same or a purchaser or lender relying on the same, estoppels should be judged by a standard other than page count. The long-term consequences may in fact be more significant than those under the lengthier purchase and sale agreement or loan agreement from which they emanate.