

REAL ESTATE TRANSACTIONS IN A SCARY WORLD

[Heads up!]

Susan R. Fox
Attorney at Law
155 South Madison Street, Suite 326
Denver, CO 80209
303-291-0500
Fax 303-297-1245
sue@foxlegal.net
www.foxlegal.net

As we all know, the world has changed for us since September 11, 2001. The world of commercial real estate is no exception.

A. The Patriot Act

The “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 is commonly known as the, “Patriot Act”. The Patriot Act has extensive requirements dealing with money-laundering which apply to “financial institutions”, and lenders in commercial real estate transactions are (or should be) modifying their loan documents and increasing their due diligence regarding their borrowers accordingly. You can expect that pile of loan documents to grow! One piece of good news is that, so far, the definition of “financial institutions” under the Patriot Act has *not* been interpreted to include real estate brokerage firms.

B. The SDN List

On the other hand, pursuant to Executive Order 13324, *all* “U.S. persons” (entities and individuals, including permanent residents and persons who just happen to be here) must comply with the regulations promulgated and administered by the Treasury Department’s Office of Foreign Assets Control (“OFAC”). These regulations prohibit U.S. persons from engaging in transactions with certain prohibited companies, individuals, nations and residents of certain countries, or persons acting on their behalf, and there are extremely stiff penalties (monetary fines and imprisonment) for non-compliance. Therefore, buyers, sellers, landlords, tenants and property managers should now be ascertaining that the other party to the transaction, and its officers, directors and major equity owners are not on OFAC’s list of “Specially Designated

Nationals and Blocked Persons (“SDN list”). Property owners or managers should be investigating current tenants, as well.

The SDN list, which is updated frequently, can be found at www.treas.gov/offices/eotffc/ofac/sdn/index.html. OFAC also has a hotline, 1-800-540-6322. Experts recommend that due diligence include searching alternative spellings for names being searched, trade names and aliases, and checking for “false positives”. Not surprisingly, entrepreneurial software companies have jumped on this, and there are software programs available which can assist in this task.

Representations or certifications in the transactional documents are advisable (see attachment), but are no substitute for due diligence.

If assets of a person on the SDN list come into the possession of a U.S. person, they must be blocked or frozen, kept in a segregated interest-bearing account, and a report must be filed with OFAC within 10 days and annually thereafter. Earnest money deposits, security deposits or advance rental payments would be examples of such assets.

One can speculate that, since the possibility of a “false positive” is very real, given the similarities in many names, landlords run the risk of liability to a person who is (or whose company is) rejected as a tenant or purchaser because the owner mistakenly (even though in good faith) has determined that the person is on the SDN list. Since many of these people will be ethnic minorities, will lawsuits for discrimination follow? Or what of the landlord who mistakenly determines that an existing tenant, or principal of a corporate tenant is on the SDN list and freezes his security deposit instead of returning it? One of the sample OFAC certifications found in the attachment contains a release of liability as to landlord’s actions taken in a good faith attempt to comply with OFAC obligations, but whether or not a court would honor such a release is an open question.

C. Leasing Issues

Even before 9/11, many leases were beginning to have entire sections devoted to security issues, mostly related to matters such as parking lot security and card-key systems, rather than terrorist attacks. But now, tenants and landlords are also concerned with terrorist issues, and tenants are beginning to want lease provisions to address their concerns. For example, they may want the landlord to make some assurances regarding the security of the building or center (bad idea for the landlord!), and may want the right to install their own,

separate alarm systems or employ their own security guards. They may want to ensure that the landlord will not lease space to “terrorism magnets” such as embassies or consulates, governmental agencies or multi-national companies.

Landlords will want to be sure that amortization of capital expenditures related to anti-terrorism measures, other costs of providing security, and terrorism insurance premiums may be included in operating or common area expenses. They will want a release of liability for acts of terrorists. And they may want the right to impose additional security procedures such as sign-in requirements, security evacuation drills, mail handling requirements and requirements regarding reporting of suspicious activity. Both parties should want *force majeure* clauses to specifically include “acts of terrorism”.

Lenders are likely to begin requiring that their borrowers who are landlords include terrorism-related provisions and certifications by the tenant in their lease forms, and that the borrower-landlords perform due diligence on the SDN status of potential tenants.

D. The Servicemembers' Civil Relief Act

Another recently-enacted federal statute which will have an effect on commercial leases is the “Servicemembers' Civil Relief Act”, which amended the “Soldiers and Sailors Civil Relief Act of 1940”. Among other things, it puts a 6% cap on interest payable by service members; allows for stays of eviction proceedings and permits military personnel or their dependents to terminate leases of real property executed “by or on behalf of” the person called to military service for, “residential, *professional, business, agricultural, or similar purpose*” when the service member receives permanent change-of-station orders or if he or she is deployed with a military unit for 90 days or more. Waivers of the right to terminate a lease are only effective if made in a written agreement executed during or after the period of military service, so a landlord should not put a waiver of the right to terminate in the lease itself. Whether a court will interpret the “by or on behalf of” language to include entities controlled by a service member (for example a limited liability company whose only member is a person called to military service) is anyone's guess, but I would put my money on courts coming down on the side of protecting the service member and his or her limited liability company.

Attachment
to
"Real Estate Transactions in a Scary World"

Sample OFAC Certification / Indemnification Clauses

#1

Tenant represents, warrants and certifies that neither Tenant nor any of its affiliates, nor any of their respective partners, members, shareholders or other equity owners, and none of their respective employees, officers, directors, representatives or agents, is a person or entity with whom U.S. persons or entities are restricted from doing business under regulations of the Office of Foreign Asset Control ("OFAC") of the Department of the Treasury (including those named on OFAC's Specially Designated and Blocked Persons List, "SDN List") or under any statute, executive order (including the September 24, 2001, Executive Order Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism), or other governmental statutes, regulations, orders or directives. Such persons may be referred to as, "Blocked Persons".

Tenant acknowledges and agrees to Landlord's legal obligations (i) not to do business with Blocked Persons and (ii) to freeze any assets of Blocked Persons which may come into Landlord's possession. Tenant releases Landlord from any liability to Tenant for any actions taken by Landlord in good faith efforts to comply with the foregoing obligations.

#2, from the *Commercial Lease Law Insider*, July 2004, p.3.

a. **Certification.** Tenant certifies that:

- (i) It is not acting, directly or indirectly, for or on behalf of any person, group, entity or nation named by any Executive Order or the United States Treasury Department as a terrorist, "Specially Designated National and Blocked Person" or any other banned or blocked person, entity, nation or transaction pursuant to any law, order, rule or regulation that is enforced or administered by the Office of Foreign Assets Control; and
- (ii) It is not engaged in this transaction, directly or indirectly on behalf of, or instigating or facilitating this transaction, directly or indirectly on behalf of, any such person, group, entity or nation.

b. **Indemnification.** Tenant hereby agrees to defend, indemnify and hold harmless Landlord from and against any and all claims, damages, losses, risks, liabilities and expenses (including attorney's fees and costs) arising from or related to any breach of the foregoing certification.

#3

Tenant represents and warrants to Landlord that each individual executing this Lease on behalf of Tenant is authorized to do so on behalf of Tenant and that Tenant is not, and the entities or individuals constituting Tenant or which may own or control Tenant or which may be owned or controlled by Tenant are not, among the individuals or entities identified on any list compiled

pursuant to Executive Order 13224 for the purpose of identifying suspected terrorists. Landlord represents and warrants to Tenant that each individual executing this Lease on behalf of Landlord is authorized to do so on behalf of Landlord and that Landlord is not, and the entities or individuals constituting Tenant or which may own or control Tenant or which may be owned or controlled by Tenant are not, among the individuals or entities identified on any list compiled pursuant to Executive Order 13224 for the purpose of identifying suspected terrorists.